

## Rule 17a-3

### Supporting Statement

#### A. Justification

##### 1. Necessity of Information Collection

All brokers and dealers in the ordinary course of their businesses need to maintain certain books and records reflecting, among other things, income and expenses, assets and liabilities, daily trading activity and the status of customer and firm accounts. These books and records are, for the most part, standard and would be kept by any prudent individual engaging in a securities business.

The Commission is statutorily authorized by Sections 17(a)<sup>1</sup> and 23(a)<sup>2</sup> of the Securities Exchange Act of 1934 (“Exchange Act”) to promulgate rules and regulations regarding the maintenance and preservation of books and records of exchange members, brokers and dealers (“broker-dealers”). Exchange Act Section 17(a)(1) provides in pertinent part:

“[all members of a national securities exchange and registered brokers and dealers] shall make and keep for prescribed periods such records...as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the [Exchange Act].”

To standardize recordkeeping practices throughout the industry, the Commission, in 1939, adopted Rule 17a-3,<sup>3</sup> which established minimum standards with respect to business records that broker-dealers must create.<sup>4</sup> Rule 17a-3 requires broker-dealers to make and keep current certain records relating to their financial condition, communications, customer information, and employees.

The Commission adopted certain Amendments to Rule 17a-3 on October 26, 2001 (the “2001 Amendments”),<sup>5</sup> in part as a response to the National Securities Market Improvement Act of 1996 (“NSMIA”).<sup>6</sup> NSMIA prohibits any State from establishing books and records rules for broker-dealers that differ from, or are in addition to, the Commission’s rules, and also requires the Commission to consult periodically with the States concerning the adequacy of the Commission’s books and records rules.<sup>7</sup> The 2001 Amendments expanded the types of records that broker-dealers must create to include additional records necessary for State examiners to review for sales practice violations at office locations, and were designed to assist regulators, particularly State securities regulators, in conducting effective examinations.<sup>8</sup>

<sup>1</sup> 15 U.S.C. § 78q(a).

<sup>2</sup> 15 U.S.C. § 78w(a).

<sup>3</sup> 17 CFR 240.17a-3.

<sup>4</sup> Exchange Act Release No. 2304 (Nov. 13, 1939).

<sup>5</sup> Exchange Act Release No. 44992 (Oct. 26, 2001), 66 FR 55818 (Nov. 2, 2001).

<sup>6</sup> Pub.L.No. 104-290, 110 Stat. 3416 (1996).

<sup>7</sup> Exchange Act Section 15(h), 15 U.S.C. § 78o(h).

<sup>8</sup> Exchange Act Release No. 44992 (Oct. 26, 2001), 66 FR 55818 (Nov. 2, 2001). These rules were proposed in 1996 -- Exchange Act Release No. 37850 (October 22, 1996), 61 FR 55593 (October 28, 1996); and repropounded in 1998 -- Exchange Act Release No. 40518 (Oct. 2, 1998), 63 FR 54404 (Oct. 9, 1998).

In March 2007, the Commission proposed for comment amendments<sup>9</sup> to its net capital, customer protection, books and records, and notification rules for broker-dealers under the Exchange Act. More specifically, the proposed amendments would add a paragraph (a)(23) to Rule 17a-3, which would require certain large broker-dealers to document any implemented internal risk management control designed to assist in analyzing and managing the risks (e.g., market, credit, liquidity, operational) arising from the business activities it engages in, including, for example, securities lending and repo transactions, OTC derivative transactions, proprietary trading and margin lending. The requirement only would apply to broker-dealers that have more than (1) \$1,000,000 in aggregate credit items as computed under the customer reserve formula of Rule 15c3-3, or (2) \$20,000,000 in total capital including debt subordinated in accordance with Appendix D to Rule 15c3-1.<sup>10</sup>

This supporting statement describes the impact of the proposed amendments on the currently approved inventory for this collection of information.<sup>11</sup>

## 2. Purpose of, and Consequences of Not Requiring, the Information Collection

The purpose of requiring broker-dealers to create the records specified in Rule 17a-3 is to enhance regulators' ability to protect investors. These records and the information contained therein will be used by examiners and other representatives of the Commission, State securities regulatory authorities, and the self regulatory organizations (e.g., the Financial Regulatory Authority commonly known as FINRA, the Chicago Board Options Exchange, etc.) ("SROs") to determine whether broker-dealers are in compliance with the Commission's antifraud and anti-manipulation rules, financial responsibility program, and other Commission, SRO, and State laws, rules, and regulations.

If broker-dealers were not required to create these records, Commission, SRO and state examiners would be unable to conduct effective and efficient examinations to determine whether broker-dealers were complying with relevant laws, rules, and regulations.

## 3. Role of Improved Information Technology and Obstacles to Reducing Burden

The Commission believes that improvements in telecommunications and data processing technology may reduce any burdens that result from Rule 17a-3. Broker-dealers are not prevented by Rule 17a-3 from using computers or other mechanical devices to generate the records required under the Rule.

## 4. Efforts to Identify Duplication

Rule 17a-3 was drafted and amended to codify SRO record-keeping requirements and the record-keeping practices of prudent broker-dealers. Because most broker-dealers already create many of the records required by Rule 17a-3 either voluntarily or pursuant to SRO requirements, no duplication of such information is apparent.

<sup>9</sup> Exchange Act Release No. 55341 (Feb. 23, 2007), 72 FR 12862 (Mar. 19, 2007).

<sup>10</sup> See proposed Rule 17a-3(a)(23) in the 2007 proposing release.

<sup>11</sup> See *supra* note 9. The 2007 proposals also would add a paragraph (e)(9) to Rule 17a-4, which would require a broker-dealer to maintain these records for three years after the date the broker-dealer ceases to use the system of controls.

5. Effects on Small Entities

The books and records required under Rule 17a-3 are normally created by small broker-dealers. Since small broker-dealers utilize processes that are more manual in nature, while large broker-dealers use more automated processes, the Commission has estimated some of the time factors for small broker-dealers to be higher, as described below.

The proposed amendments to Rule 17a-3 would not effect small broker-dealers because requirement only would apply to broker-dealers that have more than (1) \$1,000,000 in aggregate credit items as computed under the customer reserve formula of Rule 15c3-3, or (2) \$20,000,000 in total capital including debt subordinated in accordance with Appendix D to Rule 15c3-1.<sup>12</sup>

6. Consequences of Less Frequent Collection

The information required to be collected and recorded under Rule 17a-3 allows the Commission, State securities regulatory authorities, and the SROs to determine whether broker-dealers are in compliance with Commission, State, and SRO anti-fraud and anti-manipulation rules, financial responsibility rules, and other rules and regulations. If a broker-dealer does not make these records, or it makes these records less frequently, the level of investor protection will be reduced. The records a broker-dealer is required to make under Rule 17a-3 are, for the most part, essential to the successful operation of a securities firm, and failure to make the records on a current basis would likely cause the broker-dealer to experience operational difficulties.

7. Inconsistencies with Guidelines in 5 CFR 1320.5(d)(2)

Not applicable because the collection is not required in a manner inconsistent with 5 CFR 1320.5(d)(2).

8. Consultations Outside the Agency

The staff of the Commission regularly communicates with and requests the views of staff of the Securities Industry Association, State securities administrators, the New York Stock Exchange, and the National Association of Securities Dealers, Inc. concerning the principal requirements of Rule 17a-3. The Commission staff also communicates with broker-dealers on a continuous basis. None of these organizations have raised any concerns regarding Rule 17a-3.

Further, all Commission rule proposals are published in the *Federal Register* for public comment. The comment period for the 2007 proposing release that discusses the proposed amendments to Rule 17a-3 was 60 days.<sup>13</sup> This comment period afforded the public an opportunity to respond to the proposal. No PRA comments were received in response to this request.

9. Payment or Gift to Respondents

No gifts or payments will be given to respondents.

---

<sup>12</sup> Exchange Act Release No. 55341 (Feb. 23, 2007), 72 FR 12862 (Mar. 19, 2007); see proposed Rule 17a-3(a)(23).

<sup>13</sup> Exchange Act Release No. 55341 (Feb. 23, 2007), 72 FR 12862 (Mar. 19, 2007).

10. Assurance of Confidentiality

The records required by Rule 17a-3 are available only to the examination staffs of the Commission, State regulatory authorities, and the SROs. Subject to the provisions of the Freedom of Information Act, 5 U.S.C. § 552 (“FOIA”) and the Commission’s rules thereunder (17 CFR 200.80(b)(4)(iii)), the Commission generally does not publish or make available information contained in reports, summaries, analyses, letters, or memoranda arising out of, in anticipation of, or in connection with an examination or inspection of the books and records of any person or any other investigation.

11. Sensitive Questions

No questions of a sensitive nature are asked.

12. Estimates of Respondent Reporting Burden

All registered broker-dealers are subject to Rule 17a-3. As of July 30, 2007 there were 5,850 broker-dealers registered with the Commission. Recordkeeping requirements will vary depending on the size and complexity of the broker-dealer. Prior to the 2001 Amendments, the Commission estimated that one hour a day was the average amount of time needed by a broker-dealer to comply with the requirements of Rule 17a-3. The number of working days per year is 249, so the total estimated burden for broker-dealers would be 1,456,650 hours per year.<sup>14</sup>

In addition, the 2001 Amendments added additional paperwork burdens, including 1) an amendment to paragraph (a)(12) and the addition of paragraph (a)(19) to require broker-dealers to create certain additional records regarding their associated persons, 2) the addition of paragraphs (a)(20) to (a)(22) to require broker-dealers to make additional records regarding their compliance with applicable regulations and create lists of those personnel responsible for establishing compliance policies and procedures and able to explain the information in the broker-dealer’s records, and 3) the addition of new paragraph (a)(17) which requires that a broker-dealer provide each customer with a copy of the account information on record relating to his or her account and periodically update customer account information (so that the customer can verify that the account information is correct), and send notices to customers when the account information is changed.

As stated previously, the amendment to paragraph (a)(12) and the addition of paragraph (a)(19) contained in the 2001 Amendments require that a broker-dealer create certain records regarding its associated persons.<sup>15</sup> The Commission estimates that each broker-dealer spends, on

---

<sup>14</sup> 5,850 (the number of broker-dealers as of July 30, 2007) x 1 hour per day x 249 working days = 1,456,650 hours.

<sup>15</sup> These records include; 1) all agreements pertaining to the associated person’s relationship with the broker-dealer and a summary of each associated person’s compensation arrangement (17 CFR 240.17a-3(a)(19)(ii)), 2) a record delineating all identification numbers relating to each associated person (17 CFR 240.17a-3(a)(12)(ii)), 3) a record of the office at which each associated person regularly conducts business (17 CFR 240.17a-3(a)(12)(iii)), and 4) a record as to each associated person listing transactions for which that person will be compensated (17 CFR 240.17a-3(a)(19)(i)).

average, approximately 30 minutes each year to ensure that it is in compliance with these amendments, resulting in a total annual compliance burden of about 2,925 hours.<sup>16</sup>

The addition of paragraphs (a)(20) to (a)(22) contained in the 2001 Amendments require that a broker-dealer make records 1) indicating that it has either complied with or adopted procedures designed to establish compliance with applicable regulations of certain securities regulatory authorities,<sup>17</sup> 2) listing persons who can explain the broker-dealer's records,<sup>18</sup> and that list principals responsible for establishing compliance policies and procedures.<sup>19</sup> The Commission estimates that, on average, each broker-dealer will spend 10 minutes each year to ensure compliance with these requirements, yielding a total burden of about 975 hours.<sup>20</sup>

Estimating the paperwork burden associated with paragraph (a)(17) requires a more complicated formula to calculate the compliance burden because it is based on the number of customer accounts for which a broker-dealer must collect this information as opposed to the number of broker-dealers. In addition, the Commission understands that large broker-dealers have more automated processes to collect and create these records than smaller broker-dealers, and has factored this into its estimates.

As of the end of 2006, 5,754 broker-dealers that filed the FOCUS Schedule I Reports on December 31, 2006 (a report that all registered broker-dealers are required to file with the Commission) reported that they maintained a total of 111,773,638 customer accounts. Forty eight of those broker-dealers reported that they maintained over 100,000 accounts each (for purposes of this Supporting Statement, the "Large Broker-dealers"), and the remaining 5,706 broker-dealers maintained less than 100,000 customer accounts each (for purposes of this Supporting Statement, the "Small Broker-dealers"). The Large Broker-dealers reported that they held a total of 109,529,017 customer accounts (or 98% of the total customer accounts reported), and the Small Broker-dealers reported that they held the remaining 2,244,621 customer accounts (or 2% of the total customer accounts reported). The Commission estimates that approximately 27.7% of the 111,773,638 total customer accounts would be excluded from the provisions of 17a-3(a)(17) because the accounts are either (i) not accounts of natural persons, (ii) inactive, or (iii) accounts for which the broker-dealer does not have a suitability requirement.<sup>21</sup> Accordingly, the total number of active customer accounts regarding which broker-dealers would need to provide customers with account information is approximately 80,812,340 (79,196,093 held by Large Broker-dealers and 1,616,247 held by Small Broker-dealers).

The Commission estimates that broker-dealers will be required to provide customer account information to approximately 26,937,447 customers per year to comply with paragraph (a)(17)(i)(B)(1).<sup>22</sup> Further, the Commission estimates that this will take Large Broker-dealers an

---

<sup>16</sup> (5,850 broker-dealers x 30 minutes) / 60 minutes.

<sup>17</sup> 17 CFR 240.17a-3(a)(20). A similar requirement was also added in paragraph (a)(17)(iii).

<sup>18</sup> 17 CFR 240.17a-3(a)(21)

<sup>19</sup> 17 CFR 240.17a-3(a)(22)

<sup>20</sup> (5,850 broker-dealers x 10 minutes) / 60 minutes.

<sup>21</sup> See Rule 17 CFR 240.17a-3(a)(17)(i)(D). The Commission arrived at this number using estimates provided by the firms (in their comment letters and otherwise) as to how many of their accounts would fit in to one or more of these categories.

<sup>22</sup> (80,812,340 x (1 every 3 years)).

average of 1½ minutes per account, or 659,967 hours per year,<sup>23</sup> and that it will take Small Broker-dealers an average of 7 minutes per account, or 62,854 hours per year.<sup>24</sup> Thus, the estimated total burden on the industry to comply with the paragraph (a)(17)(i)(B)(1) requirement provide account information to customers when an account is opened and periodically thereafter is 722,821 hours per year.<sup>25</sup>

If a customer provides a broker-dealer with updated account record information, the broker-dealer must, pursuant to paragraphs (a)(17)(i)(B)(2) and (3), update the customer's account information and send the revised account information to the customer to verify its accuracy.<sup>26</sup> The Commission estimates that approximately 20%<sup>27</sup> of the customers from whom information is requested will update their account records, resulting in 5,387,489 updated account records each year.<sup>28</sup> In addition, the Commission estimates that 5% of active customer accounts, or 4,040,617,<sup>29</sup> will initiate changes to their account records on a yearly basis, just as they do now, with no prompting from any account record mailing. The Commission estimates that it would take, on average, 5 minutes for large broker-dealers to update each account and 10 minutes<sup>30</sup> for small broker-dealers to update each account, resulting in an additional burden of 801,389 hours per year to update account record information and provide the new account information to customers as required by paragraphs (a)(17)(i)(B)(2) and (3).<sup>31</sup>

Thus, the total number of hours attributable to the 2001 Amendments is 1,528,110 hours per year.<sup>32</sup> When added to the annual hour burden for the rest of 17a-3 (of 1,456,650 hours), the resulting estimated total yearly hour burden to comply with current Rule 17a-3 is approximately 2,984,760 hours.<sup>33</sup>

The proposed amendments to Rule 17a-3 described in the 2007 proposing release would require certain large broker-dealers to make and maintain records documenting internal controls

---

<sup>23</sup> (26,937,447 account records x 98% x 1.5 minutes / 60 minutes) = 659,967 hours per year.

<sup>24</sup> (26,937,447 account records x 2% x 7 minutes / 60 minutes) = 62,854 hours per year.

<sup>25</sup> (659,967 hours + 62,854 hours) = 722,821 hours.

<sup>26</sup> 17 CFR 240.17a-3(a)(17)(B)(2) and (3).

<sup>27</sup> This estimate was suggested by the comment letter Merrill Lynch provided in response to the reproposing release.

<sup>28</sup> (26,937,447 x 20%) = 5,387,489.

<sup>29</sup> (80,812,340 x 5%) = 4,040,617.

<sup>30</sup> This estimate takes into account the 1½ and 7 minutes it would take large and small broker-dealers, respectively, to provide this updated account information to customers, and the 3.5 minutes and 3 minutes it would take large and small broker-dealers, respectively, to receive the returned data and input any changes into the account record. The estimated total minutes for updating and providing this information to customers of 5 minutes for large broker-dealers and 10 minutes for small broker-dealers were taken from a comment letter to the 2001 Amendments.

<sup>31</sup> (((5,387,489 account records + 4,040,617 account records) x 98%) x (5 minutes / 60 minutes)) + (((5,387,489 account records + 4,040,617 account records) x 2%) x (10 minutes / 60 minutes)) = 801,389.

<sup>32</sup> 2,925 hours (attributable to the amendment to paragraph (a)(12) and the addition of paragraph (a)(19)) + 975 hours (attributable to the addition of paragraphs (a)(20) to (a)(22)) + 722,821 hours (attributable to providing customers with account information) + 801,389 (hours to update and send revised account information to customers) = 1,528,110 hours.

<sup>33</sup> 2,984,760 = (1,528,110 + 1,456,650).

that assist in analyzing and managing risks.<sup>34</sup> The proposed requirement would apply to broker-dealers that have more than \$1,000,000 in customer credits or \$20,000,000 in capital. The Commission estimates that this requirement would result in a one-time burden to the industry.

Based on FOCUS Report filings, the Commission estimates there are approximately 517 broker-dealers that meet the applicability threshold of this proposed amendment (\$1,000,000 in credits or \$20,000,000 in capital). Based on staff experience, the Commission estimates that these larger broker-dealers generally already have documented the procedures and controls they have established to manage the risks arising from their business activities. Moreover, among these firms, the time per firm likely would vary depending on the size and complexity of the firm. For some firms, the burden may be close to 0 hours and for others it may be hundreds of hours. Taking this into account, the Commission estimates that a broker-dealer would spend, on average, approximately 120 hours of employee resources augmenting its documented procedures to come into compliance with this proposed amendment. Therefore, the Commission estimates the total one-time burden to the industry resulting from the proposed amendments to Rule 17a-3 would be approximately 62,040 hours.<sup>35</sup>

### 13. Estimates of Total Cost Burden

Ongoing operation and maintenance costs include the cost of postage to provide customers with account information, and costs for equipment and systems development. The Commission estimates that under Rule 17a-3(a)(17), approximately 36,365,553 customers (26,937,447 account records<sup>36</sup> + 5,387,489 updated account records<sup>37</sup> + 4,040,617 updated account records<sup>38</sup>) will need to be provided with information regarding their account on a yearly basis. Firms may include this information with other communications sent to customers, for instance in customer account statements. In response to requests for comment relating to the 2001 Amendments, those firms that provided estimates of postage costs indicated that postage costs to provide customers with account record information would be about \$0.244 per item mailed.<sup>39</sup> However postage costs may have increased since 2001. Consequently, the Commission estimates that the postage costs associated with providing 36,365,553 customers with copies of their account record information would be approximately \$8,176,435 per year (28,390,400 x \$0.288<sup>40</sup>).

At the time of the 2001 Amendments large broker-dealers that provided cost information estimated that their ongoing, yearly costs for equipment and systems development resulting from

---

<sup>34</sup> See proposed Rule 17a-3(a)(23).

<sup>35</sup> 517 broker-dealers x 120 hours = 62,040 hours.

<sup>36</sup> This figure is based on the number of active customer accounts (80,812,340) divided by 3 since the broker-dealer must send each customer a copy of his or her account record information once every three years.

<sup>37</sup> This figure is based on the number of active customer accounts that receive their account record (26,937,447) times .20, since the Commission estimates that 20% of customers that receive their account record will update their account record information.

<sup>38</sup> This figure is based on the number of active customer accounts (74,061,915) times 0.05, since 5% of customers update their account record information each year.

<sup>39</sup> See Morgan Stanley Dean Witter comment letter submitted by J.Higgins in response to the 2001 Amendments; See Merrill Lynch comment letter to the 2001 Amendments.

<sup>40</sup> The CPI has increased by about 18% since the end of 2001. (\$0.244 x 1.18) = \$0.288.

Rule 17a-3 would be approximately \$0.25 per customer account. The Commission believes that the additional cost for smaller broker-dealers is included in the increased hourly burden costs delineated above.<sup>41</sup> However costs for equipment and systems development may have increased since 2001. Consequently, the Commission believes that the total ongoing equipment and systems development costs relating to Rule 17a-3 for the industry would be about \$23,362,847 per year (79,196,093 active customer accounts held by Large Broker-dealers x \$0.295<sup>42</sup>).

Consequently, the total cost burden associated with Rule 17a-3 is approximately \$31,539,282 per year.<sup>43</sup>

14. Estimated Cost to the Federal Government

There will be no additional costs to the Federal Government.

15. Explanation of Changes in Burden

The Commission increased the estimated annual hour burden by 31 hours to correct a data entry error made in the last submission. The Commission also increased the one-time reporting burden as a result of the proposed amendments to paragraph (a)(23) to Rule 17a-3.<sup>44</sup>

16. Information Collection Planned for Statistical Purposes

No plans for publication of the records and information required exist at this time, nor does the Commission expect to require the publication of these records in the future.

17. Explanation of Why Expiration Date Will Not be Displayed

The Commission is not seeking approval to not display the expiration date for OMB approval.

18. Exceptions to Certification

The Commission is not seeking an exception to the certification statement.

B. Collections of Information Employing Statistical Methods

Not applicable.

---

<sup>41</sup> Smaller broker-dealers are not as automated, and their processes tend to be more manual in nature. In addition, no smaller broker-dealers provided information regarding any increased equipment or systems development costs at the time of the 2001 Amendments.

<sup>42</sup> The CPI has increased by about 18% since the end of 2001. ( $\$0.25 \times 1.18$ ) = \$0.295.

<sup>43</sup> This includes annual postage costs of \$8,176,435 and ongoing equipment and systems development costs of \$23,362,847 per year.

<sup>44</sup> See *supra* note 9.