

Rule 17a-4

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)¹ and 23(a)² 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”). 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 1940, adopted Rules 17a-3 and 17a-4 (one of the “Books and Records Rules”),³ which codified and specified minimum standards with respect to business records that broker-dealers must create and maintain. Rule 17a-3 requires exchange members, brokers and dealers to make and keep current certain records relating to a broker’s or dealer’s financial condition and operations. Rule 17a-4 requires broker-dealers to preserve, for prescribed periods of time, certain records required to be created under Rule 17a-3 and certain other Commission rules. In addition, Rule 17a-4 requires broker-dealers to preserve other records that may be created or received by the broker-dealer in the ordinary course of its business for prescribed periods of time.

In March 2007, the Commission proposed for comment amendments⁴ 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 make and maintain records documenting internal controls that assist in analyzing and managing risks.⁵ The proposed requirement would apply to broker-dealers that have more than \$1,000,000 in customer credits or

¹ 15 U.S.C. § 78q(a).

² 15 U.S.C. § 78w(a).

³ 17 CFR 240.17a-3 and 17 CFR 240.17a-4.

⁴ Exchange Act Release No. 55341 (Feb. 23, 2007), 72 FR 12862 (Mar. 19, 2007).

⁵ See proposed Rule 17a-3(a)(23).

\$20,000,000 in capital.⁶ The 2007 proposals also would add a paragraph (e)(9) to Rule 17a-4, which would require a broker-dealer to maintain these records proposed under Rule 17a-3(a)(23) for three years after the date the broker-dealer ceases to use the system of controls.

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

The purpose of requiring that broker-dealers maintain the records specified in the Rule 17a-4 is to help ensure that examiners and other representatives of the Commission, State securities regulatory authorities, and the SROs have access to the information and documents necessary 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. Without Rule 17a-4, it would be impossible for the Commission to determine whether a broker-dealer that chose not to preserve records was in compliance with these rules. Such a situation would not be in the public interest and would be detrimental to investors and the financial community as a whole.

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

Rule 17a-4 specifically allows brokers and dealers to use electronic storage media to comply with the record-keeping requirements under the Securities and Exchange Act of 1934. In fact, because it simply sets minimum standards for the electronic storage media employed, Rule 17a-4 does not limit broker-dealers to using forms of electronic storage which may become obsolete as new technology is developed. The Commission believes that improvements in telecommunications and data processing technology may reduce any burdens that result from Rule 17a-4.

4. Efforts to Identify Duplication

Not applicable. There is no duplication.

5. Effects on Small Entities

The number and complexity of records required to be preserved by Rule 17a-4 vary proportionately with the volume and complexity of the broker-dealer's business. Further, broker-dealers may choose which media (hard-copy, microfiche, electronic storage, etc.) is most appropriate given their size and the type of business they do. The books and records required under Rule 17a-4 are normally retained by small broker-dealers.

The proposed amendments to Rule 17a-4 would not effect small broker-dealers because requirement to preserve the record in proposed Rule 17a-3(a)(23) 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 15c3-1.⁷

⁶ See proposed Rule 17a-3(a)(23) in the 2007 proposing release.

6. Consequences of Less Frequent Collection

Not applicable. Rule 17a-4 is a record preservation rule.

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

Certain provisions of Rule 17a-4 require respondents to retain records for more than three years. Specifically, Rule 17a-4(a) requires broker-dealers to preserve for a period of not less than six years:

1. Purchase and sales blotters, securities and cash receipts, and disbursements blotters;
2. Ledgers of a broker-dealer's assets, liabilities, income and expense, and capital accounts;
3. Customer account ledgers;
4. Securities position reports;
5. Lists of office employees able to explain records to examiners; and
6. A record of persons responsible for establishing policies and procedures designed to ensure that the broker-dealer is compliant with applicable rules and regulations.

After the closing of any customer's account, broker-dealers must preserve for at least six years any account cards or records which relate to the terms and conditions of opening and maintaining the account. Broker-dealers are required to maintain and preserve in an easily accessible place:

1. Employment records of associated persons until at least three years after the employment has terminated;
2. Processed fingerprint cards and other related information until at least three years after the termination of employment or association;
3. All records required pursuant to paragraph (a)(15) of Rule 17a-3 for the life of the enterprise;
4. All account record information required pursuant to Rule 17a-3(a)(17) until at least six years after the earlier of the date the account was closed or the date on which the information was replaced or updated; and
5. Each compliance, supervisory, and procedures manual, including any updates, modifications, and revisions to the manual, describing the policies and practices of the member, broker or dealer with respect to compliance with applicable laws and rules, and supervision of the activities of each natural person associated with the member, broker or dealer until three years after the termination of the use of the manual.

In addition, Rule 17a-4(d) requires that a broker-dealer maintain specified organizational documents for the life of the enterprise and any successor enterprise.

These extended retention periods are necessary with respect to the records itemized above in order to provide regulators with sufficient time to conduct comprehensive inspections and investigations. Due to budget constraints, regulators only examine broker-dealers and office

⁷ Exchange Act Release No. 55341 (Feb. 23, 2007), 72 FR 12862 (Mar. 19, 2007); see proposed Rule 17a-3(a)(23) and 17a-4(e)(9).

locations periodically. Further, certain of these documents do not become obsolete (*e.g.*, organizational documents).

8. Consultations Outside the Agency

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-4 was 60 days.⁸ 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

Not applicable.

10. Assurance of Confidentiality

The records required by Rule 17a-4 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

Not applicable.

12. Estimates of Respondent Reporting Burden

The Commission estimates that, on average, each broker-dealer spends 254 hours each year to ensure that it is in compliance with Rule 17a-4 and to produce required records promptly at an office when so required. Therefore, the Commission estimates that compliance with current Rule 17a-4 requires 1,305,814 hours each year (5,141 broker-dealers x 254 hours).

The proposed amendment to Rule 17a-4(e)(9) discussed in the 2007 proposing release would require a broker-dealer to maintain the records made under proposed Rule 17a-3(a)(23) for three years after the date the broker-dealer ceases to use the system of controls.⁹ The Commission believes that the current estimated annual hours for Rule 17a-4 would not change as a result of proposed Rule 17a-4(e)(9) because the paperwork burden associated with this proposed rule derives from the substance of the proposed amendments to Rule 17a-3(a)(23).¹⁰

⁸ Exchange Act Release No. 55341 (Feb. 23, 2007), 72 FR 12862 (Mar. 19, 2007).

⁹ See *supra* note 4. The 2007 proposed amendments would add a paragraph (a)(23) to Rule 17a-3 which would require certain large broker-dealers to make and maintain records documenting internal controls that assist in analyzing and managing risks. The proposed requirement would apply to broker-dealers that have more than \$1,000,000 in customer credits or \$20,000,000 in capital.

13. Estimates of Total Cost Burden

Based on conversations with members of the securities industry and based on the Commission's experience in the area, we estimate that the average broker-dealer spends approximately \$5,000 each year to store documents required to be retained under Rule 17a-4. Costs include the cost of physical space, computer hardware and software, etc., which vary widely depending on the size of the broker-dealer and the type of storage media employed. The Commission estimates that the annual reporting and record-keeping cost burden is \$25,705,000. This cost is calculated by the number of active, registered broker-dealers multiplied by the reporting and record-keeping cost for each respondent (5,141 active, registered broker-dealers x \$5,000)).

14. Estimated Cost to the Federal Government

Not applicable.

15. Explanation of Changes in Burden

The changes in the annual hour burden are a result of a data entry error made in the previous submission, as well as a reduction in the number of respondents due to a decrease in the number of broker-dealers to 5,141. The decrease in the number of broker-dealers results in a decrease in both the total annual hour burden and the total annual cost burden.

The Commission notes that there will be no changes in the reporting burden as a result of the proposed amendment to paragraph (e)(9) to Rule 17a-4. The reporting burdens are included in the proposed amendment to Rule 17a-3(a)(23) in the 2007 proposing release.¹¹

16. Information Collection Planned for Statistical Purposes

Not applicable.

17. Explanation of Why Expiration Date Will Not be Displayed

Not applicable.

18. Exceptions to Certification

Not applicable.

B. Collection of Information Employing Statistical Methods

Not applicable.

¹⁰ The Commission has revised the estimated PRA for Rule 17a-3 resulting from the proposed amendments to Rule 17a-3(a)(23); *see supra* note 4, at 72 FR 12862, 12878.

¹¹ *Id.*