

# **PAPERWORK REDUCTION ACT SUBMISSION**

## Rules 17a-3(a)(16)

### Supporting Statement

#### A. Justification

##### 1. Necessity of Information Collection

The Commission is statutorily authorized by Sections 17(a) and 23(a) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> to promulgate rules and regulations regarding the maintenance and preservation of books and records of brokers and 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 protections of investors, or otherwise in furtherance of the purposes of the [Act].”

Virtually all brokers and dealers in the ordinary course of their businesses 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 broker-dealer engaging in a securities business.

In an attempt to standardize bookkeeping practices throughout the industry, in 1940 the Commission adopted Rules 17a-3 and 17a-4, which codified and specified minimum standards with respect to business records made by brokers and dealers. Rule 17a-3, in effect, requires exchange members, brokers and dealers to make and keep current certain records relating to the broker-dealers’ financial condition as well as records reflecting certain employee and principal information. Rule 17a-4 requires exchange members, brokers and dealers to preserve for prescribed periods of time certain records required to be made by Rule 17a-3. In addition, Rule 17a-4 requires the preservation of records required to be made by other Commission rules and other kinds of records which firms make or receive in the ordinary course of business. These include, but are not limited to, bank statements, canceled checks, bills receivable and payable, originals of communications, and descriptions of various transactions.

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<sup>1</sup> 15 U.S.C. 78 et seq.

In December 1998, the Commission eliminated Rule 17a-23 and transferred the recordkeeping and preservation requirements to Rules 17a-3(a)(16) and 17a-4(b)(10). Rule 17a-4(b)(10) was subsequently renumbered 17a-4(b)(11). Rule 17a-3(a)(16) requires certain records to be kept in conjunction with the operation of an internal broker-dealer system. The Commission believes that these recordkeeping requirements continue to be valuable for the oversight and inspections of internal broker-dealer systems by the Commission and the National Association of Securities Dealers (“NASD”).

To a significant degree, Rule 17a-3(a)(16) represents a codification of standard recordkeeping practices of broker-dealers. Rule 17a-3(a)(16) identifies the records that broker-dealers operating internal broker-dealer systems are required to make.

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

The information contained in the records required to be preserved by the rule would be used by examiners and other representatives of the Commission, state securities regulatory authorities and the self-regulatory organizations (“SROs”) to enable the Commission to carry out its statutory obligations by ensuring that broker-dealers are in compliance with the Commission’s requirements for operation of trading systems and to improve the protection of investors.

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

The Commission believes that improvements in automation and data processing technology may reduce any burdens that result from the rule. The Commission is not aware of any technical or legal obstacles to reducing the burden through the use of improved information technology.

4. Efforts to Identify Duplication

Not applicable; there is no duplication of information.

5. Effects on Small Entities

The recordkeeping and preservation requirements of Rule 17a-3 would apply equally to all registered broker-dealers operating internal broker-dealer systems. Therefore, the Rules could apply to small businesses. Pursuant to

17 CFR 240.0-10(c), the term “small business” or “small organization” when used in reference to a broker-dealer means a broker-dealer that has total capital (net worth plus subordinated liabilities) of less than \$500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to 17 CFR 240.17a-5(d) or, if not required to file such statements, a broker-dealer that had total capital of less than \$500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business, if shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization as defined in 17 CFR 240.0-10. The Commission staff has estimated that nine broker-dealers are small entities as defined by the Act.

#### 6. Consequences of Less Frequent Collection

If the required collections of information were to be conducted less frequently, the Commission would be unable to comply with its statutory obligations and protections afforded to the public would be lessened through the decreased ability of the Commission, state securities authorities and the SROs to examine such broker-dealers.

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

This information collection is not conducted in a manner that is inconsistent with 5 CFR 1320.5(d)(2).

#### 8. Consultations Outside the Agency

Before adoption, Commission rules are published for notice and comment.

#### 9. Payment or Gift to Respondents

Not applicable.

#### 10. Assurances of Confidentiality

The records required by the proposed amendments would be available only to the examination of the Commission staff, state securities authorities and the SROs. Subject to the provisions of the Freedom of Information Act, 5 U.S.C. § 522 (“FOIA”), and the Commission’s rules thereunder (17 CFR 200.80(b)(4)(iii)), the Commission does not generally publish or make available information contained in any 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. No issues of a sensitive nature are involved.

12. Estimate of Respondent Reporting Burden

By using past data to determine the proportional relationship between record making and record preservation, the Commission estimates that 27 hours need be allotted to recordkeeping under Rule 17a-3(a)(16).<sup>2</sup>

13. Estimate of Total Annualized Cost Burden

Not applicable; (a) it is not anticipated that respondents will have to incur any capital and start up cost to comply with the rule; (b) it is not anticipated that the respondents will have to incur any additional operational or maintenance cost to comply with the rule.

14. Estimate of Cost to the Federal Government

There will be no additional costs to the Federal Government.

15. Explanation of Changes in Burden

The Commission previously stated that 27 hours needed be allotted to recordkeeping under Rule 17a-3(a)(16), and that each respondent would spend an average of approximately 27 hours complying with Rule 17a-3(a)(16) making the required records. These statements were misleading because they appeared to identify two separate hourly burdens (one for recordkeeping versus one for record-

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<sup>2</sup> The Commission estimates that an employee of a broker-dealer charged to ensure compliance with Commission regulations receives annual compensation of \$464,400. This compensation is the equivalent of \$258 per hour (\$464,400 divided by 1,800 payroll hours per year). The Commission estimates that the average estimated cost for each respondent would be \$6,966. This estimated average cost is broken down as follows:

$$\text{Rule 17a-3(a)(16) Recordkeeping requirements } 27 \text{ hours at } \$258/\text{hr}^2 = \$6,966$$

The total annual obligation for each broker-dealer required to comply with proposed Rule 17a-3(a)(16) would be \$6,966.00.

making). The estimate in Section 12 above was restated to clarify that there is only one hourly burden of 27 hours allotted to Rule 17a-3(a)(16).

The Commission previously calculated the cost of the hourly burden as the estimate of the total annualized cost burden in Section 13. This was incorrect, because the calculation did not address either (a) capital and start up costs, or (b) a total operation and maintenance and purchase of services cost to comply with the rule. The estimate in Section 13 above was restated to correctly address these types of costs.

16. Information Collections Planned for Statistical Purposes

Not applicable. The information is not published for statistical use.

17. Explanation as to Why Expiration Date Will Not be Displayed

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

18. Exceptions to Certification

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

B. Collection of Information Employing Statistical Methods

Not applicable. The collection of information does not employ statistical methods.