

SUPPORTING STATEMENT

for the Paperwork Reduction Act New Information Collection Submission for

Rule 17a-3

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”). 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-3,³ which established minimum standards with respect to business records that broker-dealers must create.⁴ 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 25, 2001 (the “2001 Amendments”), in part as a response to the National Securities Market Improvement Act of 1996 (“NSMIA”).⁵ 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.⁶ The 2001 Amendments expanded the types of records that broker-dealers must create to include additional records necessary for State examiners to

¹ 15 U.S.C. § 78q(a).

² 15 U.S.C. § 78w(a).

³ 17 CFR 240.17a-3.

⁴ Exchange Act Release No. 2304 (Nov. 13, 1939).

⁵ Pub.L.No. 104-290, 110 Stat. 3416 (1996).

⁶ Exchange Act Section 15(h), 15 U.S.C. § 78o(h).

review for sales practice violations at office locations, and were designed to assist regulators, particularly State securities regulators, in conducting effective examinations.⁷

2. Purpose and Use of 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 and are used by examiners and other representatives of the Commission, State securities regulatory authorities, and the self regulatory organizations (e.g., FINRA, CBOE, 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. Consideration Given to Information Technology

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. 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.

5. Effect 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.

6. Consequences of Not Conducting 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

⁷ See Exchange Act Release No. 37850 (October 22, 1996), 61 FR 55593 (October 28, 1996) ("Proposing Release").

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 1320.8(d)

There are no special circumstances. This collection is consistent with the guidelines in with 5 CFR 1320.8(d).

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. The Federal Register notice with a 60-day comment period soliciting comments on this collection of information was published on January 20, 2011 (76 FR 3680). No comments were received.

9. Payment or Gift

No gifts or payments will be given to respondents.

10. 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. Burden of Information Collection

All registered broker-dealers are subject to Rule 17a-3. As of October 1, 2010, there were 5,057 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 1,259,193 hours per year.⁸ These hours are recordkeeping burdens.

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.⁹ The Commission estimates that each broker-dealer spends, on 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 2,529 hours.¹⁰ These hours are recordkeeping burdens.

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,¹¹ 2) listing persons who can explain the broker-dealer's records,¹² and that

⁸ 5,057 (the number of broker-dealers as of October 1, 2010) multiplied by 1 hour per day multiplied by 249 working days equals 1,259,193 hours.

⁹ 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)).

¹⁰ (5,057 broker-dealers x 30 minutes) / 60 minutes.

¹¹ 17 CFR 240.17a-3(a)(20). A similar requirement was also added in paragraph (a)(17)(iii).

¹² 17 CFR 240.17a-3(a)(21).

list principals responsible for establishing compliance policies and procedures.¹³ 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 843 hours.¹⁴ These are recordkeeping burdens.

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 2009, 5,252 broker-dealers that filed the FOCUS Schedule I Reports on December 31, 2009 reported that they maintained a total of 109,506,556 customer accounts. Fifty 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 5,202 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 107,881,659 customer accounts (or 99% of the total customer accounts reported), and the Small Broker-dealers reported that they held the remaining 1,624,897 customer accounts (or 1% of the total customer accounts reported). The Commission estimates that approximately 27.7% of the 109,506,556 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.¹⁵ Accordingly, the total number of active customer accounts regarding which broker-dealers would need to provide customers with account information is approximately 79,173,240 (78,381,508 held by Large Broker-dealers and 791,732 held by Small Broker-dealers).

The Commission estimates that broker-dealers will be required to provide customer account information to approximately 26,391,080 customers per year to comply with paragraph (a)(17)(i)(B)(I).¹⁶ Further, the Commission estimates that this will take Large Broker-dealers an average of 1½ minutes per account, or 653,179 hours per year,¹⁷ and that it will take Small Broker-dealers an average of 7 minutes per account, or 30,790 hours per year.¹⁸ Thus, the estimated total burden on the industry to comply with the paragraph (a)(17)(i)(B)(I) requirement provide account information to customers when an account is opened and periodically thereafter

¹³ 17 CFR 240.17a-3(a)(22).

¹⁴ (5,057 broker-dealers x 10 minutes) / 60 minutes.

¹⁵ 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.

¹⁶ (79,173,240 x (1 every 3 years)).

¹⁷ (26,391,080 account records x 99% x 1.5 minutes / 60 minutes) = 653,179 hours per year.

¹⁸ (26,391,080 account records x 1% x 7 minutes / 60 minutes) = 30,790 hours per year.

is 683,969 hours per year.¹⁹ These hours are recordkeeping and third party disclosure burdens, with an assumption that the burden is split evenly between the two burden types.

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.²⁰ The Commission estimates that approximately 20%²¹ of the customers from whom information is requested will update their account records, resulting in 5,278,216 updated account records each year.²² In addition, the Commission estimates that 5% of active customer accounts, or 3,958,662,²³ 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 minutes²⁴ for small broker-dealers to update each account, resulting in an additional burden of 777,436 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).²⁵ These hours are recordkeeping and third party disclosure burdens, with an assumption that the burden is split evenly between the two burden types.

Thus, the total number of hours attributable to the 2001 Amendments is 1,464,777 hours per year.²⁶ When added to the annual hour burden for the rest of 17a-3 (of 1,259,193 hours), the resulting estimated total yearly hour burden to comply with Rule 17a-3 is approximately 2,723,970 hours.²⁷

¹⁹ (653,179 hours + 30,790 hours) = 683,969 hours.

²⁰ 17 CFR 240.17a-3(a)(17)(B)(2) and (3).

²¹ This estimate was suggested by the comment letter Merrill Lynch provided in response to the reproposing release.

²² (26,391,080 x 20%) = 5,278,216.

²³ (79,173,240 x 5%) = 3,958,662.

²⁴ 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.

²⁵ (((5,278,216 account records + 3,958,662 account records) x 99%) x (5 minutes / 60 minutes)) + (((5,278,216 account records + 3,958,662 account records) x 1%) x (10 minutes / 60 minutes)) = 777,436.

²⁶ 2,529 hours (attributable to the amendment to paragraph (a)(12) and the addition of paragraph (a)(19)) + 843 hours (attributable to the addition of paragraphs (a)(20) to (a)(22)) + 683,969 hours (attributable to providing customers with account information) + 777,436 (hours to update and send revised account information to customers) = 1,464,777 hours.

²⁷ 2,723,970 = (1,259,193 + 1,464,777).

The Commission believes that a broker-dealer would have a compliance department employee, at \$273 per hour;²⁸ ensure that the firm is compliant with those portions of Rule 17a-3 that were in effect prior to the 2001 Amendments, as well as the amendments to paragraph (a)(12) and new paragraphs (a)(19), (a)(20), (a)(21) and (a)(22) that were added by the 2001 Amendments. Therefore, the estimated annualized cost to respondents to ensure compliance with those portions of Rule 17a-3 that were in effect prior to the 2001 Amendments, as well as the amendments to paragraph (a)(12) and new paragraphs (a)(19), (a)(20), (a)(21) and (a)(22) that were added by the 2001 Amendments is approximately \$344,680,245.²⁹

With respect to paragraph (a)(17), the Commission believes that broker-dealers would generally have i) a senior registered retail sales assistant provide customers with account record information and ii) a senior data entry clerk update customer account information when a customer provides the broker-dealer with new account information. According to SIFMA's Office Salaries in the Securities Industry 2010, the hourly wage of a senior retail sales assistant is approximately \$68 per hour,³⁰ and the hourly wage of a senior data entry clerk is approximately \$61 per hour.³¹ Thus the aggregate cost of the burden hours associated with paragraph (a)(17) of Rule 17a-3 is about \$95,609,211 ((923,358 hours³² attributable to providing customers with a copy of account record information x \$68) + (538,047 hours³³ attributable to updating customer account information x \$61)).

²⁸ This figure (\$273/hour) is the salary given for a Compliance Manager in SIFMA's Management & Professional Earnings in the Securities Industry 2010, modified by Commission staff to account for an 1,800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

²⁹ 1,259,193 hours + 2,529 hours + 843 hours) x \$273 = \$344,680,245.

³⁰ This figure is based on SIFMA's Office Salaries in the Securities Industry 2010, modified by Commission staff to account for an 1,800-hour work year and multiplied by 2.93 to account for bonuses, firms size, employee benefits and overhead.

³¹ This figure is based on SIFMA's Office Salaries In the Securities Industry 2010, as modified by Commission staff for a 1800-hour work year, and multiplied by 2.93 to account for bonus, firm size, employee benefits and overhead.

³² First, there are 683,969 hours associated with compliance with paragraph (a)(17)(i)(B)(1). Second, (((5,278,216 account records + 3,958,662 account records) x 99%) x (1.5 minutes / 60 minutes)) = 228,613 hours for large broker-dealers to provide customers with updated account information associated with compliance with paragraphs (a)(17)(i)(B)(2) and (3). Third, (((5,278,216 account records + 3,958,662 account records) x 1%) x (7 minutes / 60 minutes))) = 10,776 hours for small broker-dealers to provide customers with updated account information associated with compliance with paragraphs (a)(17)(i)(B)(2) and (3). Consequently, the total hours to provide customers with account information is (683,969 hours + 228,613 hours + 10,776 hours) = 923,358 hours. *See supra*, footnote 24.

³³ The hour burden for large broker-dealers to update account record information is approximately 3½ minutes, and the hour burden for small broker-dealers to update account record information is about 3 minutes. *See supra*, footnote 24. Consequently, it would take large broker-dealers approximately 533,429 hours (or (((5,278,216 account

Therefore total cost of the hourly burden associated with ongoing compliance with Rule 17a-3 is \$344,680,245 + \$95,609,211 = \$440,289,456.

13. Costs to Respondents

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 35,627,958 customers (26,391,080 account records³⁴ + 5,278,216 updated account records³⁵ + 3,958,662 updated account records³⁶) 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.³⁷ However, postage costs have increased since that time. The current estimate for postage costs is \$0.288, and postage costs have continued to rise.³⁸ Consequently, the Commission estimates that the postage costs associated with providing 35,627,958 customers with copies of their account record information would be approximately \$10,688,387 per year (35,627,958 x \$0.30). These costs are recordkeeping and third party disclosure burdens, with an assumption that the burden is split evenly between the two burden types.

At the time of the 2001 Amendments large broker-dealers that provided cost information³⁹ estimated that their ongoing, yearly costs for equipment and systems development resulting from 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

records + 3,958,662 account records) x 99%) x (3.5 minutes / 60 minutes))) to update customer account information in compliance with paragraphs (a)(17)(i)(B)(2) and (3). In addition, it would take small broker-dealers approximately 4,618 hours (or (((5,278,216 account records + 3,958,662 account records) x 1%) x (3 minutes / 60 minutes))) to update customer account information in compliance with paragraphs (a)(17)(i)(B)(2) and (3). Therefore, the total hours to update customer account information is (533,429 hours + 4,618 hours) = 538,047 hours.

³⁴ This figure is based on the number of active customer accounts (79,173,240) divided by 3 since the broker-dealer must send each customer a copy of his or her account record information once every three years.

³⁵ This figure is based on the number of active customer accounts that receive their account record (26,391,080) times .20, since the Commission estimates that 20% of customers that receive their account record will update their account record information.

³⁶ This figure is based on the number of active customer accounts (79,173,240) times 0.05, since 5% of customers update their account record information each year.

³⁷ 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. The CPI has increased by about 21% since the end of 2001. (\$0.244 x 1.21) = \$0.2954. In addition, postage costs have increased. Therefore, the Commission is increasing the estimate to \$0.30.

³⁹ See *supra*, footnote 37.

increased hourly burden costs delineated above.⁴⁰ However costs for equipment and systems development 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 \$23,514,452 per year (78,381,507 active customer accounts held by Large Broker-dealers x \$0.30⁴¹). This cost is a recordkeeping burden.

The total cost burden associated with Rule 17a-3 is approximately \$34,202,837 per year.⁴²

14. Costs to Federal Government

There will be no additional costs to the Federal Government.

15. Changes in Burden

The annual hour burden of 2,723,970 hours reflects a 260,759 decrease over the current OMB inventory of 2,984,729 hours. This change incorporates both a decrease in the number of respondents of 793, from 5,850 to 5,057, and a decrease in the number of customer accounts held by broker-dealers of 2,267,082, from 111,773,638 to 109,506,556.

The annual cost burden of \$34,202,837 is \$2,663,556 greater than the current OMB inventory of \$31,539,281. This increase reflects the additional costs created by increased cost estimates due to inflation and increases in postage costs.

Due to the facts that 1) certain of the paperwork burdens are derived based on the number of broker-dealers and others are derived based on the number of customers, 2) certain records a broker-dealer must create pursuant to Rule 17a-3 must be created daily, others weekly, others monthly, others annually, and still others periodically, and 3) certain time frames are estimated based on the relative size of the broker-dealers, this rule is not easily described. Consequently, the staff divided the total annual hour burdens by 5,057, the number of respondents to reach the average number of hours per year that each respondent would be required to spend to comply with Rule 17a-3. For the 683,969 and 777,436 annual hours related to complying with Rule 17a-3(a)(17)(B)(1) and Rule 17a-3(a)(17)(B)(2) and (3), respectively, we have assumed that 50% of the annual hours relate to recordkeeping and 50% relate to third party disclosure. These assumptions result in an annual hour breakdown for recordkeeping and third party disclosure as follows:

Recordkeeping	$[(683,969 + 777,436)/2] + 1,259,193 + 2,529 + 843] / 5,057 = 394.16$
Third party disclosure	$[(683,969 + 777,436)/2] / 5,057 = 144.4933$

⁴⁰ 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.

⁴¹ The CPI has increased by about 21% since the end of 2001. $(\$0.25 \times 1.18) = \0.3025 .

⁴² This includes annual postage costs of \$10,688,387 and ongoing equipment and systems development costs of \$23,514,452 per year.

Similarly, for the annual cost burden, the staff divided the annual cost burdens (described above in more detail in Section 13) by the number of respondents (5,057) to reach the average cost per year for each respondent to comply with Rule 17a-3. For the \$10,688,387 annual costs to send customers copies of their account record information, we have assumed that 50% of the annual costs relate to recordkeeping and 50% relate to third party disclosure. These assumptions result in an annual cost burden breakdown for recordkeeping and third party disclosure as follows:

Recordkeeping	$[(\$10,688,387/2) + \$23,514,452]/5,057 = \$5,706.673$
Third party disclosure	$(\$10,688,387/2)/5,057 = \$1,056.791$

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. Display of OMB Approval Date

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

18. Exceptions to Certification for Paperwork Reduction Act Submissions

This collection complies with the requirements in 5 CFR 1320.9.

B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS

This collection does not involve statistical methods.