

SUPPORTING STATEMENT
for the Paperwork Reduction Act Information Collection Submission for
Rule 17a-5 Reports to be Made by Certain Brokers and Dealers

A. Justification

1. Necessity of Information Collection

Section 17(a)(1) of the Securities Exchange Act of 1934 (“Exchange Act”) provides that broker-dealers must make and keep records, furnish copies of the records, and make and disseminate reports as the Securities and Exchange Commission (“Commission”), by rule, prescribes. Section 17(e)(1)(A) of the Exchange Act requires every broker-dealer registered with the Commission to annually file with the Commission: a balance sheet and income statement “certified by an independent public accounting firm, or by a registered public accounting firm if the firm is required to be registered under the Sarbanes-Oxley Act of 2002” and such other financial statements (which shall, as the Commission specifies, be certified) and information concerning its financial condition as the Commission, by rule, may prescribe. A registered public accounting firm means a public accounting firm registered with the Public Company Accounting Oversight Board (“PCAOB”).¹ Section 17(e)(2) provides that the Commission, by rule, may prescribe the form and content of the financial statements and the accounting principles and standards used in their preparation.

The Commission has adopted Rule 17a-5, which is the reporting rule for broker-dealers.² Rule 17a-5(a) requires the filing of Form X-17A-5 (17 CFR 249.617), the Financial and Operational Combined Uniform Single Report (“FOCUS Report”). Rule 17a-5(b) requires that a report be filed when a broker-dealer holding a membership in a national securities exchange or registered national securities association ceases to be a member in good standing of the exchange or association. Rule 17a-5(c) requires broker-dealers to furnish certain financial information to customers.³ Rule 17a-5(d) requires broker-dealers to file annual reports, which generally must be audited by an independent public accountant. Rule 17a-5(e) prescribes the nature and form of the reports filed under Rule 17a-5(d). Rule 17a-5(f) pertains to the qualifications of accountants. Rule 17a-5(g) contains audit objectives. Rule 17a-5(h) addresses the extent and timing of audit procedures. Rule 17a-5(i) contains general provisions relating to accountant’s reports. Rule 17a-5(j) addresses the accountant’s report on material inadequacies. Rule 17a-5(k) pertains to supplemental reports. Rule 17a-5(l) pertains to the use of certain statements filed with the Commission. Rule 17a-5(m) addresses extensions and exemptions. Rule 17a-5(n) pertains to notifications of changes in fiscal year. Rule 17a-5(o) contains filing requirements. Rule 17a-5(p) pertains to OTC derivatives dealers.

The FOCUS Report was designed to eliminate the overlapping regulatory reports required by various self-regulatory organizations and the Commission and to reduce reporting

¹ Section 2(a)(12) of the Sarbanes-Oxley Act of 2002 (Pub. L. No. 107-204).

² The OMB Control Number for Rule 17a-5 is 3235-0123.

³ Rule 17a-5(c) is subject to a separate Paperwork Reduction Act filing (OMB Control Number 3235-0199).

burdens. The FOCUS Report consists of: (1) Part I which is a monthly report that must be filed by every broker-dealer that clears transactions or carries customer accounts; (2) one of three alternative quarterly reports: a comprehensive Part II which must be filed by every broker-dealer that clears transactions or carries customer accounts, a less detailed Part IIA which must be filed by broker-dealers that do not clear transactions or carry customer accounts, or a Part IIB that is filed only by specialized broker-dealers registered with the Commission as OTC Derivatives Dealers;⁴ (3) Supplemental Schedules which must be filed annually; and (4) a Facing Page which must be filed with the annual audited report of financial statements.

Section 982 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”),⁵ enacted on July 21, 2010, among other things, amended the Sarbanes-Oxley Act of 2002 to provide the PCAOB with authority to establish, subject to Commission approval, an inspection program and auditing and attestation, quality control, ethics, and independence standards to be used by registered public accounting firms that audit broker-dealers.

The Commission is proposing amendments to Rule 17a-5.⁶ These amendments were proposed, in part, as a result of Section 982 of the Dodd-Frank Act. The amendments to Rule 17a-5(a) would require a broker-dealer to file proposed Form Custody with its designated examining authority.⁷ Form Custody would elicit information about whether and how a broker-dealer maintains custody of customer assets. The amendments to Rule 17a-5(d) would require a broker-dealer to file either a compliance report or an exemption report as part of its annual report. The compliance report would contain, among other things, assertions by the broker-dealer with respect to Exchange Act Rules 15c3-1, 15c3-3, and 17a-13 (the “financial responsibility rules”). The exemption report would be filed by a broker-dealer that is exempt from Exchange Act Rule 15c3-3. Broker-dealers generally would be required to file a report by an independent public accountant addressing the assertions in the compliance report or exemption report and would be required to file copies of the annual reports and accountants’ reports with the Securities Investors Protection Corporation (“SIPC”). The amendments to Rule 17a-5(f) would require: (1) that the independent public accountant be registered with the PCAOB if required by the Sarbanes-Oxley Act of 2002; (2) broker-dealers to include in their notice designating an accountant that the engagement of the accountant included the undertakings of Rule 17g-5(g); and (3) broker-dealers that clear transactions or carry customer accounts to agree to allow representatives of the Commission and its designated examining authority to review the documentation associated with the reports of the independent public accountant and to agree to permit the independent public accountant to discuss with representatives of the Commission the findings associated with the reports of the independent public accountant, if requested for purposes of an examination of the broker-dealer. The amendments to Rule 17a-5(g) would require that the independent public accountant, as part of

⁴ Part IIB of Form X-17A-5 is required to be filed by OTC derivatives dealers under Rule 17a-12 and is subject to a separate Paperwork Reduction Act filing (OMB Control Number 3235-0498).

⁵ Pub. L. No. 111-203.

⁶ Broker-Dealer Reports, Exchange Act Release No. 64676 (June 15, 2011), 76 FR 37572 (June 27, 2011).

⁷ Form Custody is subject to a separate Paperwork Reduction Act filing.

the engagement, undertake to prepare its reports based on an examination of the financial report and an examination of the compliance report or a review of the exemption report of the broker-dealer in accordance with standards of the PCAOB.

2. Purpose and Use of the Information Collection

Reports required to be made under Rule 17a-5 are used, among other things, to monitor the financial and operational condition of a broker-dealer by the self-regulatory organization that is the broker-dealer's designated examining authority and by the Commission staff. The FOCUS Report and the annual reports are the primary means of ensuring compliance with the Commission's financial responsibility rules. A firm's failure to comply with these rules would severely impair the Commission's and the self-regulatory organizations' ability to protect customers.

FOCUS Report information is used in preparation for broker-dealer examinations and inspections. The completed forms also are used to determine which firms are engaged in various securities-related activities, the extent to which they are engaged in those activities, and how economic events and government policies might affect various segments of the securities industry.

3. Consideration Given to Information Technology

The data required in the FOCUS Report are tailored to the complexity of the broker-dealer's business. The burden is therefore commensurate with the type of business in which the firm engages. As of December 31, 2008, approximately 82% of FOCUS Reports were filed electronically. Annual reports, however, are filed with the Commission in paper form.

4. Duplication

The Commission designed Rule 17a-5 to eliminate duplicative reporting requirements among the various securities regulatory agencies. Therefore, any duplication of the information requested is minimal.

5. Effect on Small Entities

Broker-dealers must file one of three alternative quarterly reports on Form X-17A-5: a comprehensive Part II of Form X-17A-5, which must be filed by every broker-dealer that clears transactions or carries customer accounts; a less detailed Part IIA which must be filed by broker-dealers that do not clear transactions or carry customer accounts; or a Part IIB that is filed only by specialized broker-dealers registered with the Commission as OTC Derivatives Dealers. The majority of small broker-dealers file Part IIA of Form X-17A-5 because they do not clear transactions or carry customer accounts. Part IIA is shorter and requires less time to complete than Part II. Out of 530 firms that must file Part II, only 16 are small firms. It would be inappropriate to provide these small firms with an exemption from this Rule because the report provides critical financial information from the firms responsible for the safekeeping and disposition of customer funds and securities.

With respect to the proposal, the Commission believes that the burden associated with the proposal would generally be substantially smaller on smaller broker-dealers. Based on FOCUS Report data, there are currently 871 broker-dealers that, under paragraph (c) of Rule 0-10 (17 CFR 240.0-10(c)), the Commission would classify as “small” businesses or organizations for purposes of the Regulatory Flexibility Act (5 U.S.C. 601 *et. seq.*). There are relatively few small broker-dealers that clear transactions or carry customer accounts. A broker-dealer that does not clear transactions or carry customer accounts would generally not need to enter detailed information on the Form. A compliance report would be required to be filed only by a broker-dealer that is not exempt from Rule 15c3-3. Further, only broker-dealers that clear transactions or carry customer accounts would be required to agree to allow representatives of the Commission and their designated examining authority, if requested for purposes of an examination of the broker-dealer, to review the documentation associated with the reports of the independent public accountant and to agree to permit the independent public accountant to discuss with representatives of the Commission the findings associated with those reports.

6. Consequences of Not Conducting Collection

If the required reports were not made, it would impair the Commission’s and the self-regulatory organizations’ ability to protect customers. Further, if the required collections were conducted less frequently, the information in the reports would become outdated.

7. Inconsistencies with Guidelines in 5 CFR 1320.8(d)

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

8. Consultations Outside the Agency

Form X-17A-5 was approved after years of study and comment by representatives of the securities industry through advisory committees and through the normal rule proposal method.

With respect to the proposal, all Commission rule proposals are published in the Federal Register for public comment. The comment period for the proposing release is 60 days. This comment period affords the public an opportunity to respond to the proposal. The proposing release solicits comment on the new “collection of information” requirements and associated paperwork burdens. A copy of the release is attached. Comments on Commission releases are generally received from registrants, investors, and other market participants. In addition, the Commission and staff participate in ongoing dialogue with representatives of various market participants through public conferences, meetings and informal exchanges. Any comments received on this proposed rulemaking will be posted on the Commission’s public website, and made available through <http://www.sec.gov/rules/proposed.shtml>. Several commenters stated that they believed that the Commission had underestimated the costs associated

with the proposal. Although the comment period has closed, the Commission will consider all comments received prior to publishing the final rule, and will explain in any adopting release how the final rule responds to such comments, in accordance with 5 C.F.R. 1320.11(f).

9. Payment or Gift

No payments or gifts were provided to respondents.

10. Confidentiality

Reports filed pursuant to Rule 17a-5(a) are deemed to be confidential pursuant to Rule 17a-5(a)(3). Pursuant to Rule 17a-5(e)(3), the statements filed pursuant to Rule 17a-5(d) are public, but if the statement of financial condition is bound separately, the balance of the audited financial statements will be deemed confidential.

11. Sensitive Questions

Not applicable. No inquiries of a sensitive nature are made.

12. Burden of Information Collection

The variation in the size and complexity of broker-dealers subject to Rule 17a-5 make it difficult to calculate the burden of the information collection. However, the Commission estimated, on average, that each report required to be filed under Rule 17a-5 will require approximately 12 hours. At year-end 2008, the Commission estimated that there were approximately 5,190 broker-dealers registered with the Commission, and that of those firms there were approximately 530 broker-dealers that clear transactions or carry customer accounts. The Commission estimated that approximately 530 firms filed monthly reports, approximately 4,400 firms filed quarterly reports, and approximately 220 firms filed annual reports on Form X-17A-5. In addition, approximately 5,190 firms filed annual audited reports. As a result, there were approximately 29,370 total annual responses $((530 \times 12) + (4,400 \times 4) + 220 + 5,190 = 29,370)$. This resulted in an estimated annual reporting burden of 354,360 hours $(29,370 \text{ annual responses} \times 12 \text{ hours} = 352,440 \text{ hours})$.

In addition, the Commission estimated that approximately 11 broker-dealers will elect to use Appendix E to Rule 15c3-1 to compute certain of their capital charges (as of October 2009, seven brokers or dealers have elected to use Appendix E). The Commission estimates that the average amount of time necessary to prepare and file the additional monthly reports that must be filed by these firms is approximately 4 hours per month, or approximately 48 hours per year; the average amount of time necessary to prepare and file the additional quarterly reports is about 8 hours per quarter, or approximately 32 hours per year; and the average amount of time necessary to prepare and file the additional supplemental reports with the annual audit required is approximately 40 hours per year. Consequently, the Commission estimates that the total additional annual reporting burden for these 11 broker-dealers is approximately 1,320 hours $((48 + 32 + 40) \times 11 = 1,320)$.

The Commission therefore estimated that the total annual reporting burden under Rule 17a-5 is approximately 353,760 hours ($352,440 + 1,320 = 353,760$).

In connection with the proposal, the Commission now estimates that as of December 31, 2009 there are approximately 5,063 broker-dealers registered with the Commission. The Commission estimates that 305 broker-dealers maintain custody of customer assets and are required to comply with the customer protection provisions of Rule 15c3-3. As of December 31, 2009, 4,752 broker-dealers claimed exemptions to Rule 15c3-3.⁸ The Commission estimates that 528 broker-dealers clear transactions or carry customer accounts.

Adjusted for these new estimates, the total annual reporting burden under Rule 17a-5 would be approximately 351,948 hours ($(528 \times 12) + (4,400 \times 4) + 220 + 5,063 = 29,219$). $29,219 \times 12 = 350,628$. $350,628 + 1,320 = 351,948$).

With regard to the proposed amendments, the Commission estimates that it would take broker-dealers that are required to comply with Rule 15c3-3 approximately 60 hours to prepare the compliance report, for an annual industry-wide reporting burden of approximately 18,300 hours (305 respondents times 60 hours = 18,300 hours). The Commission estimates that it would take broker-dealers claiming an exemption from Rule 15c3-3 approximately 5 hours to complete the exemption report, for an annual industry-wide reporting burden of approximately 23,760 hours (5 hours times 4,752 respondents = 23,760 hours).

In addition, the Commission estimates that it would take broker-dealers approximately 30 minutes to file the annual reports with SIPC, for an industry-wide annual third-party disclosure burden of 2,529 hours per year ($1/2$ hour times 5,057 broker-dealers = 2,529 hours).

The Commission estimates that it would take a broker-dealer approximately 2 hours to amend and file a new notice designating an accountant under the proposed amendments, for a one-time industry-wide reporting burden of approximately 10,114 hours (5,057 broker-dealers times 2 hours = 10,114 hours). Annualized over a three-year period, the annual reporting burden would be approximately 3,371 hours per year ($10,114 / 3 = 3,371$).

SIPC would be required to file a proposed and final rule with the Commission to require broker-dealers to file the SIPC forms with SIPC. The Commission estimates that it would take 100 hours on a one-time basis for SIPC to prepare the necessary filings. Annualized over a three-year period, the annual reporting burden would be approximately 33 hours per year ($100 / 3 = 33$).

Therefore, the total additional annual reporting burden resulting from the proposal would be approximately 47,993 hours ($18,300 + 23,760 + 2,529 + 3,371 + 33 = 47,993$). The total annual reporting burden associated with Rule 17a-5 would therefore be approximately 399,941 hours ($351,948 + 47,993 = 399,941$).

⁸ There is a discrepancy of 6 broker-dealers in the estimates: $305 + 4,752 = 5,057$, which the Commission used in certain estimates below; $5,063 - 5,067 = 6$.

13. Costs to Respondents

The Commission previously estimated that there were no annualized costs associated with Rule 17a-5. However, the cost associated with the independent accountant's examination of the financial statements broker-dealers file with the Commission should have been included in prior submissions.

Based on staff experience, the Commission estimates that the average annual cost associated with the examination would be approximately \$30,000 for a non-carrying broker-dealer and approximately \$300,000 for a carrying broker-dealer, for an average annual reporting cost per broker-dealer of approximately \$46,300 ($\$300,00 \times 305$ carrying broker-dealers = \$91,500,000; $\$30,000 \times 4,752$ non-carrying broker-dealers = \$142,560,000; $\$91,500,000 + \$142,560,000 = \$234,060,000$; $234,060,000 / 5,057 = \$46,284$, rounded to \$46,300).

In connection with the proposed amendments, the Commission estimates that the cost associated with the independent accountant's examination of the proposed compliance report would be approximately \$150,000 per carrying broker-dealer per year, for an industry-wide annual reporting cost of approximately \$45,750,000 per year ($\$150,000 \times 305$ carrying broker-dealers = \$45,750,000). The Commission estimates that the cost associated with the independent public accountant's review of the proposed exemption report would be approximately \$3,000 per non-carrying broker-dealer per year, for a total industry-wide annual reporting cost of approximately \$14,256,000 ($4,752$ non-carrying broker-dealers times \$3,000 = \$14,256,000) per year.

14. Costs to Federal Government

There are no costs to the Federal government associated with the information collections required under Rule 17a-5.

15. Changes in Burden

With respect to the proposal, the change in burden would be due to a change in the estimate of the number of respondents, resulting in a decrease of 1,812 hours ($353,760 - 351,948 = 1,812$) and the additional burden due to the proposed amendments, resulting in an increase of 47,993 hours, for a net increase of 46,181 hours ($47,993 - 1,812 = 46,181$). The change in external cost due to the proposed amendments would be approximately \$60,006,000 per year ($\$45,750,000 + \$14,256,000 = \$60,006,000$).

In addition, the cost associated with the independent accountant's examination of the financial statements broker-dealers file with the Commission should have been included in prior submissions. The Commission estimates that the total industry-wide annual reporting cost associated with the examination of the financial statements is approximately \$234,000,000 per year ($\$46,300 \times 5,063 = \$234,416,900$, rounded to \$234,000,000).

16. Information Collection Planned for Statistical Purposes

Not applicable. The information collected is not used for tabulation, statistical analysis or publication.

17. Display of OMB Approval Date

The Commission requests authorization to omit the expiration date on the electronic version of Form X-17A-5, although the OMB control number will be displayed. Including the expiration date on the electronic version of the form will result in increased costs, because the need to make changes to the form may not follow the application's scheduled version release dates.

18. Exceptions to Certification for Paperwork Reduction Act Submissions

Not applicable. This collection complies with the requirements in 5 CFR 1320.9.

B. Collections of Information Employing Statistical Methods

Not applicable. This collection does not involve statistical methods.