

SUPPORTING STATEMENT
For the Paperwork Reduction Act Information Collection Submission for
Rule 17a-11 – Notification Provisions for Brokers and Dealers

A. JUSTIFICATION

1. Necessity of Information Collection

In response to an operational crisis in the securities industry between 1967 and 1970, the Securities and Exchange Commission (“Commission”) adopted Rule 17a-11 (17 CFR 240.17a-11) under the Securities Exchange Act of 1934 (“Exchange Act”).¹ Rule 17a-11 requires broker-dealers that are experiencing financial or operational difficulties to provide notice to the Commission, the broker-dealer’s designated examining authority (“DEA”), and the Commodity Futures Trading Commission (“CFTC”) if the broker-dealer is registered with the CFTC as a futures commission merchant. Rule 17a-11 is an integral part of the Commission’s financial responsibility program, which enables the Commission, a broker-dealer’s DEA, and, if applicable, the CFTC, to increase surveillance of a broker-dealer experiencing difficulties and to obtain any additional information necessary to gauge the broker-dealer’s financial or operational condition.

Rule 17a-11 requires a broker-dealer to give notice if its net capital declines below certain levels or of certain other occurrences related to its net capital. Rule 17a-11 also requires over-the-counter (“OTC”) derivatives dealers and broker-dealers that are permitted to compute net capital pursuant to Appendix E to Exchange Act Rule 15c3-1 (17 CFR 240.15c3-1e) to give notice when their tentative net capital drops below certain levels. A broker-dealer must also provide notice if it has failed to make and keep certain books and records and when it discovers or is notified by an independent public accountant of the existence of a material inadequacy. OTC derivatives dealers must also provide notice of the back testing of exceptions identified pursuant to Appendix F to Rule 15c3-1 (17 CFR 240.15c3-1f).

On July 30, 2013, the Commission adopted amendments to Rule 17a-11 in conjunction with its amendments to the financial responsibility rules.² Specifically, the Commission added new paragraph (c)(5) to Rule 17a-11 to help identify broker-dealers with highly leveraged non-government securities lending and borrowing and repurchase operations.³ The Commission also adopted an amendment to the first sentence of paragraph (b)(1) of Rule 17a-11 to require that a broker-dealer meeting the definition of insolvent must provide immediate notice to the Commission, the firm’s DEA and, if applicable, the CFTC.⁴

¹ See Exchange Act Release No. 9268 (July 30, 1971). The Office of Management and Budget (“OMB”) Control Number is 3235-0085.

² Financial Responsibility Rules for Broker-Dealers, Exchange Act Release No. 70072 (July 30, 2013), 78 FR 51824 (Aug. 21, 2013).

³ See paragraph (c)(5) of Rule 17a-11, as adopted.

⁴ See paragraph (b)(1) of Rule 17a-11, as adopted.

2. Purpose and Use of the Information Collection

The information obtained under Rule 17a-11 is used to monitor the financial and operational condition of a broker-dealer by the Commission staff, by the broker-dealer's DEA, and, if applicable, by the CFTC. This information alerts the Commission, the DEA, and, if applicable, the CFTC, of the need to increase surveillance of the broker-dealer's financial and operational condition and to assist the broker-dealer in complying with the Commission's rules. No similar information is already available to use or modify for purposes of complying with Rule 17a-11 because the disclosures required by the rule are unobtainable until the early warning mechanisms are triggered. Only the most up-to-date information will help the Commission, DEAs, and the CFTC to monitor broker-dealers experiencing financial or operational difficulties.

The monthly report related to the broker-dealer's securities borrowed and loan or securities repurchase/reverse repurchase activity may be filed by a broker-dealer in lieu of the filing of the required notice under Rule 17a-11(c)(5). The monthly report is designed to enhance the monitoring of these securities activities by securities regulators.

3. Consideration Given to Information Technology

Broker-dealers that are required to provide notice under Rule 17a-11 may give or transmit such notice by telegraphic notice or facsimile transmission. Reports required by Rule 17a-11 may be transmitted by overnight delivery. Certain DEAs have developed systems that enable them to receive these notices electronically.

4. Duplication

Duplication of information is not a concern because the reporting requirements are only applicable to those broker-dealers triggering the early warning mechanisms of Rule 17a-11.

5. Effect on Small Entities

To the extent that some broker-dealers that are required to give notice under this rule are small entities, Rule 17a-11 will impact these entities. However, information is collected from small registered broker-dealers only when they are required to provide notice under Rule 17a-11.

The amendments to paragraph (c)(5) of Rule 17a-11, related to providing notice or reporting monthly regarding a broker-dealer's securities lending or repurchase activity, will not affect any small entities because, based on FOCUS Report data, as of December 31, 2011, the Commission estimates that none of the broker-dealers that engage in securities lending and borrowing or securities repurchase and reverse repurchase activity are small entities. The amendment to paragraph (b)(1) of Rule 17a-11, requiring a broker-dealer to give notice if it is insolvent, will only apply to small entities to the extent they become insolvent and are required to give notice.

6. Consequences of Not Conducting Collection

In the absence of the rule, the Commission, DEAs, and, if applicable, the CFTC, would likely not be promptly alerted to a broker-dealer's financial or operational problems.

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

There are no special circumstances. This collection is consistent with the guidelines in 5 CFR 1320.5(d)(2).

8. Consultations Outside the Agency

The Commission requested comment on the Paperwork Reduction Act ("PRA") analysis in the proposing release in March 2007.⁵ The Commission re-opened the comment period in May 2012.⁶ The Commission received one comment addressing the PRA generally.

The commenter specifically stated that the estimates the Commission provided utilized only the number of broker-dealers that the Commission "justifiably considers to be affected by the proposals."⁷ The commenter, however, believed that most, if not all, broker-dealers will spend over 90 hours each analyzing the effects of the rules as implemented, will spend many more than 90 hours each in implementing procedures and modifying their written supervisory procedures to comply with the new rules, will spend in excess of 240 hours each in the monitoring of such rules, and will spend in excess of \$15,000 each for outside counsel and auditor opinions or work product. This commenter did not provide additional detail about the basis for its view that the Commission's estimates were too low. The Commission agreed with the commenter that broker-dealers directly affected by the rule amendments may be required to implement procedures or modify their written supervisory procedures in order to comply with the rule amendments. In cases where the final rule amendments required a broker-dealer to implement or document certain policies and procedures, these hour burdens were included in the final PRA hour estimates discussed in the adopting release. Consequently, the Commission addressed the commenter's concerns that directly relate to the collections of information in the PRA section of the adopting release.

9. Payment or Gift

No payment or gift is provided to respondents.

10. Confidentiality

⁵ See Amendments to Financial Responsibility Rules for Broker-Dealers, Exchange Act Release No. 55431 (Mar. 9, 2007), 72 FR 12862 (Mar. 19, 2007). The Commission re-opened the public comment period on May 3, 2012.

⁶ See Amendments to Financial Responsibility Rules for Broker-Dealers, Exchange Act Release No. 66910 (May 3, 2012), 77 FR 27150 (May 9, 2012).

⁷ See letter from Michael Scillia, National Investment Banking Association, to Securities and Exchange Commission (July 12, 2012), <http://www.sec.gov/comments/s7-08-07/s70807-102.pdf>.

The Commission will generally not publish or make available to any person notices or reports received pursuant to Rule 17a-11. The Commission believes that information obtained under Rule 17a-11 relates to a condition report prepared for the use of the Commission, other federal governmental authorities, and securities industry DEAs responsible for the regulation or supervision of financial institutions.

11. Sensitive Questions

Not applicable. No information of a sensitive nature is required.

12. Burden of Information Collection

Broker-dealers whose net capital declines below certain specified levels or who are otherwise experiencing financial or operational problems have a reporting burden under Rule 17a-11. In 2011, the Commission received approximately 465 notices under Rule 17a-11. The Commission estimated that each broker-dealer reporting pursuant to Rule 17a-11 will spend approximately one hour preparing and transmitting the notice required by Rule 17a-11, resulting in a total estimated annual reporting burden of 465 hours.

The amendment to paragraph (b)(1) of Rule 17a-11, requiring notice when a broker-dealer becomes subject to certain insolvency events, will result in irregular filings from a small number of broker-dealers. The Securities Investor Protection Corporation's 2012 annual report indicates that the average annual number of broker-dealers which have become subject to a liquidation proceeding under the Securities Investor Protection Act of 1970 over the last ten years is two. Using this figure as a basis, the Commission estimates that approximately two insolvency notices will be sent per year and that a broker-dealer will spend, on average, approximately ten minutes of employee resources to prepare and send the notice. Therefore, the Commission estimates that the total annual reporting burden to broker-dealers arising from this amendment will be approximately 20 minutes.⁸

The amendment to paragraph (c)(5) of Rule 17a-11 requires broker-dealers engaged in securities lending or repurchase activities to either: (1) file a notice with the Commission and their DEA whenever the total money payable against all securities loaned, subject to a reverse repurchase agreement or the contract value of all securities borrowed or subject to a repurchase agreement, exceeds 2,500% of tentative net capital; or, alternatively, (2) report monthly their securities lending and repurchase activities to their DEA in a form acceptable to their DEA.

As of December 31, 2011, the Commission estimated that approximately one stock loan/borrow notice would be sent per year. The Commission further estimated that a broker-dealer will spend, on average, approximately ten minutes of employee resources to prepare and send the notice. Therefore, the Commission estimates that the total annual reporting burden to broker-dealers arising from this amendment will be approximately ten minutes.⁹

⁸ 2 notices x 10 minutes per notice = 20 minutes or .333 hours.

⁹ 1 notice x 10 minutes per notice = 10 minutes or .167 hours.

The Commission estimates that, annually, six broker-dealers will submit the monthly stock loan/borrow report. Each firm will spend, on average, approximately 100 hours of employee resources updating its systems to generate the information required in the monthly report. Therefore, the Commission estimates that the total one-time reporting burden to broker-dealers arising from this requirement will be approximately 600 hours.¹⁰ The Commission estimates each firm will spend, on average, approximately one hour per month (or twelve hours per year) of employee resources to prepare and send the report or to prepare the information for the FOCUS report (as required by the firm's DEA, if applicable). Therefore, the Commission estimates the total annual reporting burden arising from this section of the amendment will be approximately 72 hours.¹¹

Therefore, the total additional annual reporting burden resulting from the amendments is approximately 273.¹² The total annual reporting burden associated with Rule 17a-11 is approximately 738.¹³

13. Cost to Respondents

Rule 17a-11 does not impose any costs other than internal labor costs that are associated with the hour burdens described in Item 12.

14. Costs to Federal Government

The annual operational costs incurred by the federal government in enforcing compliance and reviewing the notices required by Rule 17a-11 amount to approximately \$9,118. This amount is based upon the calculation of the value of approximately 193 hours of staff time devoted to these activities, plus the related overhead expenses. These estimates have been computed based on the GSA, Guide to Estimating Report Costs (1986).

15. Changes in Burden

The change in the reporting burden is due to an increase in the annual and one-time hour burdens, due to the amendments adopted to paragraphs (b)(1) and (c)(5) to Rule 17a-11, as described in paragraph 12 above.

16. Information Collection Planned for Statistical Purposes

Not applicable. The information collection is not used for statistical purposes.

¹⁰ 6 broker-dealers x 100 hours per firm = 600 hours. The three-year annualized number for this one-time burden is 200 hours (600 hours/3 years).

¹¹ 6 broker-dealers x 12 hours per year = 72 hours.

¹² .333 + .167 + 200 + 72 = 272.5

¹³ 465 + 273.

17. Approval to Omit OMB Expiration

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

18. Exceptions to Certification for Paperwork Reduction Act Submissions

This collection complies with the requirements in 5 CFR 1320.9.

B. COLLECTION OF INFORMATION EMPLOYING STATISTICAL METHODS

This collection does not involve statistical methods.