

SUPPORTING STATEMENT
for the Paperwork Reduction Act New Information Collection Submission for
Rule 17a-3 – Records to be Made by Certain Exchange Members, Brokers and Dealers

A. JUSTIFICATION

1. Necessity of Information Collection

In the ordinary course of their business, all broker-dealers must 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 and broker-dealers. Section 17(a)(1) provides that all national securities exchange members and registered broker-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].”

In 1940, the Commission, to standardize recordkeeping practices throughout the industry, adopted Rules 17a-3 and 17a-4, which codified and specified minimum standards with respect to business records that a broker-dealer must create and maintain.³ Rule 17a-3 requires exchange members and broker-dealers to make and keep current certain records relating to an exchange member’s or broker-dealer’s financial condition and operations. Rule 17a-3 was subsequently amended in 2001 to: (1) expand the types of records that broker-dealers must create to include additional records necessary for state examiners to review for sales practice violations at office locations; and (2) to assist regulators, particularly state securities regulators, in conducting effective examinations.⁴

On July 30, 2013, the Commission adopted amendments to Rule 17a-3 in conjunction with the amendments to the broker-dealer financial responsibility rules.⁵ Specifically, the amendments to Rules 17a-3 and 17a-4 require certain large broker-dealers to make and keep current a record documenting credit, market, and liquidity risk management controls established and maintained by the broker-dealer to assist it in analyzing and managing the risks associated with its business activities. The amendment apply only to broker-dealers that have more than (1)

¹ 15 U.S.C. 78q(a).

² 15 U.S.C. 78w(a).

³ 17 CFR 240.17a-3; 17 CFR 240.17a-4.

⁴ See Exchange Act Release No. 44992 (Oct. 26, 2001), 66 FR 55818 (Nov. 2, 2001).

⁵ Financial Responsibility Rules for Broker-Dealers, Exchange Act Release No. 70072 (July 30, 2013), 78 FR 51824 (Aug. 21, 2013).

\$1,000,000 in aggregate credit items as computed under the customer reserve formula of Rule 15c3-3, or (2) \$20,000,000 in capital.

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 used by examiners and other representatives of the Commission, the self-regulatory organizations (e.g., FINRA, CBOE, etc.) ("SROs"), and state securities regulatory authorities to determine whether broker-dealers are in compliance with the Commission's anti-fraud 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 from using computers or other mechanical devices to generate the records required under Rule 17a-3.

4. Duplication

Rule 17a-3 was drafted and amended to codify SRO record-keeping requirements and the record-keeping practices of 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. Based on FOCUS Report data, as of December 31, 2011, the Commission estimates that there are approximately 2,506 broker-dealers that are small entities. Because small broker-dealers utilize processes that are more manual in nature than the automated processes used by large broker-dealers, the Commission estimates that some of the hour burdens related to complying with Rule 17a-3 will be higher for small broker-dealers.

The amendment to Rule 17a-3 will not affect any small entities since the requirements only apply to certain large broker-dealers.

6. Consequences of Not Conducting Collection

The information required to be collected and recorded under Rule 17a-3 allows the Commission, SROs, and state securities regulatory authorities to determine whether broker-dealers are in compliance with Commission, SRO, and state 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 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 1320.5(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 in the proposing release on the included Paperwork Reduction Act (“PRA”) analysis in March 2007.⁶ The Commission re-opened the comment period in May 2012.⁷ 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.”⁸ 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 of the adopting release.

With respect to the amendment to Rule 17a-3, the amendment, as proposed, would have required a broker-dealer to create a record documenting its “internal risk management controls.”⁹ The Commission modified the rule text in the adopting release, so that the final rule required certain broker-dealers to document risk management controls established to manage market, credit, and liquidity risk, rather than all of its “internal risk management controls.” In light of the

⁶ See Financial Responsibility Rules for Broker-Dealers, Exchange Act Release No. 55431 (Mar. 9, 2007), 72 FR 12862 (Mar. 19, 2007).

⁷ See Financial Responsibility Rules for Broker-Dealers, Exchange Act Release No. 66910 (May 3, 2012), 77 FR 27150 (May 9, 2012).

⁸ 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>.

⁹ Financial Responsibility Rules for Broker-Dealers, 72 FR at 12899.

change in the final rule text to require the documentation of controls established to manage market, credit, and liquidity risk, rather than all of its “internal risk management controls,” the Commission reduced the final PRA estimate for Rule 17a-3 because the final rule narrowed the scope of internal risk management controls the broker-dealer is required to document. Consequently, the change to the final rule should result in a reduction in the one-time hour burden originally estimated in the proposing release.

9. Payment or Gift

No payment or gift is provided to respondents.

10. Confidentiality

The records required by Rule 17a-3 are available only to the examination staffs of the Commission, SROs, and state regulatory authorities. 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 entity.

11. Sensitive Questions

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

12. Burden of Information Collection

All registered broker-dealers are subject to Rule 17a-3. As of December 31, 2011, there were 4,709 broker-dealers registered with the Commission. While recordkeeping requirements will vary based on the size and complexity of the broker-dealer, the Commission estimates that one hour a day is the average amount of time needed by a broker-dealer to comply with the overall requirements of Rule 17a-3, in addition to the burdens described below. The number of working days per year is approximately 249, so the total annual recordkeeping burden for broker-dealers is approximately 1,172,541 hours, with an average per firm recordkeeping burden of 249 hours per year.¹⁰

Additionally, paragraphs (a)(12) and (a)(19) of Rule 17a-3 require broker-dealers to create certain additional records regarding their associated persons.¹¹ The Commission estimates that each broker-dealer will spend, on average, approximately 30 minutes each year to ensure

¹⁰ 4,709 x 1 hour x 249 working days = 1,172,541 hours.

¹¹ 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)).

that it is in compliance with these paragraphs, resulting in a total annual recordkeeping burden of approximately 2,355 hours.¹²

Paragraphs (a)(20)–(22) of Rule 17a-3 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 those able to explain the information in the broker-dealer’s records.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 annual recordkeeping burden of approximately 785 hours.¹⁴

Paragraph (a)(17) to Rule 17a-3 requires that a broker-dealer: (1) provide each customer with a copy of the account information on record relating to his or her account; (2) periodically update customer account information (so that the customer can verify that the account information is correct); and (3) send notices to customers when the account information is changed. Estimating the paperwork burden associated with paragraph (a)(17) of Rule 17a-3 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 consideration into its estimates.

As of 2011 year end, 4,728 broker-dealers reported in their Financial and Operational Combined Uniform Single Report (“FOCUS Report”) Schedule I filings that they maintained a total of 111,274,166 customer accounts. Forty-seven of the broker-dealers reported that they maintained over 100,000 accounts each, and the remaining 4,681 broker-dealers maintained less than 100,000 customer accounts each. The 47 broker-dealers that maintained over 100,000 customer accounts reported that they held a total of 109,227,394 customer accounts (or 98% of the total customer accounts reported). The 4,681 broker-dealers that maintained less than 100,000 customer accounts reported that they held the remaining 2,046,772 customer accounts (or 2% of the total customer accounts reported). The Commission estimates that approximately 30,833,944 customer accounts (27.7% of the 111,274,166 total customer accounts) would be excluded from the provisions of paragraph (a)(17) of 17a-3 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 80,440,222.¹⁶

¹² (4,709 broker-dealers x 30 minutes) / 60 minutes = 2,355 hours.

¹³ Specifically, paragraphs (a)(20)–(22) of Rule 17a-3 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 (17 CFR 240.17a-3(a)(20)); (2) listing persons who can explain the broker-dealer’s records (17 CFR 240.17a-3(a)(21)); and (3) that list principals responsible for establishing compliance policies and procedures (17 CFR 240.17a-3(a)(22)).

¹⁴ (4,709 broker-dealers x 10 minutes) / 60 minutes = 785 hours.

¹⁵ See 17 CFR 240.17a-3(a)(17)(i)(D).

¹⁶ 78,831,418 + 1,608,804 = 80,440,222.

The Commission estimates that broker-dealers will be required to provide customer account information to approximately 26,813,407 customers per year to comply with paragraph (a)(17)(i)(B)(1).¹⁷ Further, the Commission estimates that this will take the 47 broker-dealers that maintained over 100,000 customer accounts an average of 1½ minutes per account, or 656,928 hours per year.¹⁸ It will take the 4,681 broker-dealers that maintained less than 100,000 customer accounts an average of 7 minutes per account, or 62,565 hours per year.¹⁹ Thus, the estimated total annual recordkeeping and disclosure burden on the industry to comply with the paragraph (a)(17)(i)(B)(1) is 719,493 hours.²⁰ These hours are recordkeeping and 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)–(3), update the customer’s account information and send the revised account information to the customer to verify its accuracy.²¹ The Commission estimates that approximately 20% of the customers from whom information is requested will update their account records, resulting in 5,362,681 updated account records each year.²² In addition, the Commission estimates that 4,022,011 customer accounts (5% of active customer accounts) will initiate changes to their account records on a yearly basis, just as they do now, with no prompting from any account record mailing.²³ The Commission estimates that it would take, on average, 5 minutes for the 47 broker-dealers that maintain over 100,000 customer accounts to update each account and 10 minutes for the 4,681 broker-dealers that maintain less than 100,000 customer accounts to update each account, resulting in an additional annual burden of 797,699 hours to update account record information and provide the new account information to customers as required by paragraphs (a)(17)(i)(B)(2) and (3).²⁴ These hours are recordkeeping and disclosure burdens, with an assumption that the burden is split evenly between the two burden types.²⁵

¹⁷ $80,440,222 / 3 \text{ years} = 26,813,407.$

¹⁸ $(26,813,407 \text{ account records} \times 98\% \times 1.5 \text{ minutes}) / 60 \text{ minutes} = 656,928 \text{ hours per year.}$

¹⁹ $(26,813,407 \text{ account records} \times 2\% \times 7 \text{ minutes}) / 60 \text{ minutes} = 62,565 \text{ hours per year.}$

²⁰ $656,928 + 62,565 = 719,493 \text{ hours.}$

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

²² $(26,813,407 \times 20\%) = 5,362,681.$

²³ $(80,440,222 \times 5\%) = 4,022,011.$

²⁴ $((5,362,681 \text{ account records} + 4,022,011 \text{ account records}) \times 98\%) \times (5 \text{ minutes} / 60 \text{ minutes}) + ((5,362,681 \text{ account records} + 4,022,011 \text{ account records}) \times 2\%) \times (10 \text{ minutes} / 60 \text{ minutes}) = 797,699.$ This estimate includes the amount of time it would take the broker-dealers to provide updated account information to customers (1.5 and 7 minutes) and to receive the returned data and input changes into the account record (3.5 and 3 minutes).

²⁵ For purposes of this supporting statement, as stated above, the total annual hour burden related to complying with Rule 17a-3(a)(17)(B)(1)-(3) of 1,517,192 hours (719,493 hours + 797,699 hours) would be evenly split between recordkeeping and third party disclosure. Therefore, a total of 758,596 (1,517,192/2) total hours would attributed to each recordkeeping and third party disclosure, with an average of 160.4475 hours per 4,728 respondents for each of recordkeeping and third party disclosure burdens.

Thus, the total annual burden attributable to paragraphs (a)(12), (17), (19), and (20)–(22) is approximately 1,520,332 hours.²⁶ Therefore, the total annual burden to comply with Rule 17a-3, prior to the adoption of new paragraph (a)(23), is approximately 2,686,873 hours.²⁷

With respect to the adoption of paragraph (a)(23) of Rule 17a-3, the Commission estimates that a broker-dealer will spend, on average, approximately 100 hours of employee resources to comply with this amendment to ensure its market, credit, and liquidity risk controls are documented. Based on FOCUS Report data, as of December 31, 2011, the Commission estimates there are approximately 490 broker-dealers that would be subject to the final rule amendment.²⁸ Therefore, the Commission estimates that the total one-time recordkeeping burden to broker-dealers will be approximately 49,000 hours.²⁹

In addition to the one-time hour burden, based on similar collections of information requiring the documentation of risk management controls, broker-dealers required to comply with this amendment likely will incur annual hour burdens.³⁰ The Commission estimates that a broker-dealer would spend approximately 45 hours per year to ensure its compliance with the amendment to Rule 17a-3, for an annual recordkeeping burden on the industry of 22,050 hours.³¹

Therefore, the total annual burden to comply with Rule 17a-3, including new paragraph (a)(23), is approximately 2,731,257 hours.³²

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 36,198,099 customers (26,813,407 account records³³ + 5,362,681 updated account records³⁴ + 4,022,011 updated

²⁶ 2,355 hours + 785 hours + 719,493 hours + 797,699 hours = 1,520,332 hours.

²⁷ 1,172,541 + 1,520,332 = 2,692,873.

²⁸ This estimate is based on the number of firms that have \$1,000,000 in credits or \$20,000,000 in capital.

²⁹ 490 broker-dealers x 100 hours = 49,000 hours. For purposes of this supporting statement, the one-time burden annualized over the three year approval period is 16,334 (rounded from 16,333.33 or 49,000/3), with an average hour burden per firm of 33.334 hours (16,334/490 firms).

³⁰ See Risk Management Controls for Brokers or Dealers with Market Access; Final Rule, Exchange Act Release No. 63241 (Nov. 3, 2010), 75 FR 69792, 69815 (Nov. 15, 2010). See also Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers, Exchange Act Release 68071, 77 FR at 70295 and 70297.

³¹ 490 broker-dealers x 45 hours = 22,050 hours. The 45 per hour annual estimate is based on a similar collection of information. See Risk Management Controls for Brokers or Dealers with Market Access; Final Rule, Exchange Act Release No. 63241 (Nov. 3, 2010), 75 FR 69792, 69815 (Nov. 15, 2010).

³² 1,172,541 + 1,520,332 + 16,334 + 22,050 = 2,731,257.

³³ This figure is based on the number of active customer accounts (80,440,222) divided by 3 since the broker-dealer must send each customer a copy of his or her account record information once every three years.

account records³⁵) 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, such as customer account statements. The current estimate for postage costs is \$0.46. Consequently, the Commission estimates that the postage costs associated with providing 36,198,099 customers with copies of their account record information would be approximately \$16,651,126 per year.³⁶ These costs are recordkeeping and disclosure burdens, with an assumption that the burden is split evenly between the two burden types.

With respect to the amendment to paragraph (a)(23) to Rule 17a-3, a broker-dealer is required to document its liquidity, credit, and market risk management controls, if it has established such controls. These broker-dealers may incur one-time startup costs to hire outside counsel to review the documented controls to ensure the broker-dealer is meeting the requirements of the rule. Based on staff experience with similar reviews, the Commission estimates that 490 broker-dealers would incur \$2,000 in legal costs,³⁷ or \$980,000, in the aggregate, initial one-time recordkeeping burden to review and comment on the documented risk management controls.³⁸ For purposes of this supporting statement, the one-time cost of \$980,000 annualized over the three-year approval period is \$326,667,³⁹ with an average cost per respondent of \$666.667.⁴⁰

The total annualized cost burden associated with Rule 17a-3 is approximately \$16,977,793 per year.⁴¹

14. Costs to Federal Government

The federal government does not incur a cost for this collection of information since it relates to a recordkeeping burden for the respondents.

15. Changes in Burden

Overall, the one-time and annual recordkeeping hour burdens have generally increased due to the adoption of new paragraph (a)(23) to Rule 17a-3 as described in paragraph 12 above.

³⁴ This figure is based on the number of active customer accounts that receive their account record (26,813,407) times 20%, since the Commission estimates that 20% of customers that receive their account record will update their account record information.

³⁵ This figure is based on the number of active customer accounts (80,440,222) times 5%, since 5% of customers update their account record information each year.

³⁶ $36,198,099 \times \$0.46 = \$16,651,126$. Therefore, for purposes of this supporting statement, the total annual hour burden will be \$8,325,563 each for recordkeeping and third party disclosure, with an average per respondent of \$1,760.9058 per respondent. $\$8,325,563 / 4,728$ broker-dealers = 1,760.9058.

³⁷ The Commission staff estimates that the review of the documented controls would require 5 hours of outside counsel time at a cost of \$400 per hour.

³⁸ $\$2,000 \times 490$ broker-dealers = \$980,000.

³⁹ $\$980,000 / 3$ years = \$326,666.66 (rounded to \$326,667).

⁴⁰ $\$326,666.66 / 490$ firms = \$666.667.

⁴¹ $\$16,651,126 + \$326,667 = 16,977,793$.

The annual disclosure burdens have decreased due to a decreased in the number of registered broker-dealers. Changes in overall hour burden estimates also have resulted from changes in the number of broker-dealers registered with the Commission, as well as other estimates derived from more recently available FOCUS data (*e.g.*, estimates related to customer account information).

While costs burdens increased due to the adoption of new paragraph (a)(23) to Rule 17a-3 and increases in postage rates, the overall cost burdens for this collection of information have decreased due to the deletion of equipment and systems development costs related to amendments to Rule 17a-3 adopted in 2001 because a broker-dealer will no longer incur this type of cost. These costs would have been incurred in the several years following the adoption of the amendments to Rule 17a-3 in 2001.

16. Information Collection Planned for Statistical Purposes

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

17. Approval to Omit OMB Expiration Date

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

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.