

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 broker-dealer 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 backtesting exceptions identified pursuant to Appendix F to Rule 15c3-1 (17 CFR 240.15c3-1f).

Additionally, paragraph (b)(1) of Rule 17a-11 requires notice when a broker-dealer becomes subject to certain insolvency events. 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 the broker-dealer’s tentative net capital; or, alternatively, (2) report monthly their securities lending and repurchase activities to their DEA in a form acceptable to their DEA.

On July 30, 2013, the Commission adopted conforming and technical amendments to paragraph (e) of Rule 17a-11 in conjunction with its amendments to Rule 17a-5 (“2013

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

Amendments”).² Prior to the 2013 Amendments, paragraph (e) of Rule 17a-11 provided that whenever a broker-dealer discovered, or was notified by an independent public accountant, pursuant to paragraph (h)(2) of Rule 17a-5 or paragraph (f)(2) of Rule 17a-12³ of the existence of any material inadequacy as defined in paragraph (g) of Rule 17a-5 or paragraph (e)(2) of Rule 17a-12, the broker-dealer was required to give notice to the Commission, its DEA, and, if applicable, the CFTC, within 24 hours of the discovery or notification and transmit a report to the Commission, its DEA, and if applicable, the CFTC, within 48 hours of the notice stating what the broker-dealer has done or was doing to correct the situation. The 2013 Amendments substitute the term “material weakness” as defined in paragraph (d)(3)(iii) of Rule 17a-5 for the term “material inadequacy” with respect to Rule 17a-5 and replace the reference to paragraph (h)(2) of Rule 17a-5 with a reference to paragraph (h) of Rule 17a-5. Specifically, the final rule provides that whenever a broker-dealer discovers, or is notified by its accountant under paragraph (h) of Rule 17a-5 of the existence of any material weakness, the broker-dealer must: (1) give notice of the material weakness in accordance with paragraph (g) of Rule 17a-11 within 24 hours of the discovery or notification; and (2) transmit a report within 48 hours of the notice in accordance with paragraph (g) of Rule 17a-11 stating what the broker-dealer has done or is doing to correct the situation.⁴ The rule retains a reference to material inadequacy as defined in paragraph (h)(2) of Rule 17a-12, but the 2013 Amendments correct citations to that rule.

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. 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, self-regulatory organizations, 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 paragraph (c)(5) of Rule 17a-11. The monthly report is designed to enhance the monitoring of these securities activities by securities regulators.

² See Broker-Dealer Reports, Exchange Act Release No. 70073 (July 30, 2013), 78 FR 51910 (Aug. 21, 2013).

³ Rule 17-12, a reporting rule for OTC derivatives dealers, was not amended.

⁴ Paragraph (g) of Rule 17a-11 states: “Every notice or report required to be given or transmitted by this section shall be given or transmitted to the principal office of the Commission in Washington, D.C., the regional office of the Commission for the region in which the broker or dealer has its principal place of business, the designated examining authority of which such broker or dealer is a member, and the Commodity Futures Trading Commission if the broker or dealer is registered as a futures commission merchant with such Commission.” 17 CFR 240.17a-11(g).

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 self-regulatory organizations have developed systems that enable broker-dealers to transmit 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.

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.⁵ The Commission did not receive comments on the analysis.

9. Payment or Gift

No payments or gifts were provided to respondents.

10. Confidentiality

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

⁵ See Broker-Dealer Reports, Exchange Act Release No. 64676 (June 15, 2011), 76 FR 37572 (June 27, 2011).

federal governmental authorities, and securities industry DEAs responsible for the regulation or supervision of broker-dealers.

11. Sensitive Questions

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

12. Burden of Information Collection

Only 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.

Paragraph (b)(1) of Rule 17a-11 requires notice when a broker-dealer becomes subject to certain insolvency events. 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 will be approximately 20 minutes.⁶

With respect to the reporting requirements of paragraph (c)(5) of Rule 17a-11, the Commission estimates that approximately one stock loan/borrow notice will be sent per year. The Commission further estimates 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.⁷

The Commission also estimates that, annually, six broker-dealers will submit the monthly stock loan/borrow report under paragraph (c)(5) of Rule 17a-11. 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.⁸ 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

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

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

⁸ 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).

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.⁹

Therefore, the total annual reporting burden associated with Rule 17a-11 is approximately 738.¹⁰

With respect to the 2013 Amendments, the Commission does not expect any change in the number of notices filed per year as a result of the final amendments because, as referenced above, the material inadequacy notification requirement is being replaced by a material weakness notification requirement. Therefore, the final amendments to Rule 17a-11 should not result in a change in the current burden for Rule 17a-11.

13. Costs to Respondents

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

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 U.S. General Services Administration, Guide to Estimating Report Costs (1986).

15. Changes in Burden

The Commission does not believe that the burden associated with Rule 17a-11 would change as a result of the 2013 Amendments.

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 from OMB to omit the expiration date for this information collection.

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

¹⁰ 465 + 0.333 + 0.167 + 200 + 72 = 737.5 hours, rounded to 738.

18. Exceptions to Certification for PRA 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.