

SUPPORTING STATEMENT
for the Paperwork Reduction Act Information Collection Submission for
“Rule 17a-13”

A. JUSTIFICATION

1. Necessity of Information Collection

In the period between 1967 and 1970, the securities industry was in the midst of a prolonged and severe operational crisis. An increase in trading volume clogged the inadequate machinery for the control and delivery of securities. As a result, many broker-dealers were unable to locate securities belonging to customers. Others found themselves with substantial quantities of securities in their possession without knowing to whom they belonged. The chaotic state of affairs in many back offices of broker-dealers created the climate for the theft of securities by back office personnel.

In response, on November 8, 1971, the Securities and Exchange Commission (the “Commission”) adopted Rule 17a-13 under the Securities Exchange Act of 1934 (15 U.S.C. 78o and 78q) (“Exchange Act”). Rule 17a-13 generally requires that at least once each calendar quarter, all registered broker-dealers physically examine and count all securities held and account for all other securities not in their possession, but subject to the broker-dealer’s control or direction. Any discrepancies between the broker-dealer’s securities count and the firm’s records must be noted and, within seven days, the unaccounted for difference must be recorded in the firm’s records. Rule 17a-13 provides that under specified conditions, the securities count, examination, and verification of a broker-dealer’s entire list of securities may be conducted on a cyclical basis rather than on a certain date. Although Rule 17a-13 does not require a broker-dealer to file a report with the Commission, discrepancies between a broker-dealer’s records and its securities count may be required to be reported, for example, as a loss on Form X-17A-5, which must be filed with the Commission under Exchange Act Rule 17a-5. Rule 17a-13 exempts broker-dealers that limit their business to the sale and redemption of securities of registered investment companies or interests or participation in an insurance company separate account and those who solicit accounts for federally insured savings and loan associations, provided that such persons promptly transmit all funds and securities and hold no customer funds and securities. Rule 17a-13 also does not apply to certain broker-dealers required to register only because they effect transactions in securities futures products.

Rule 17a-13 requires the recording of only those differences in the broker-dealer’s records that remain unresolved seven business days after the date of the examination, count, and verification. The Commission or the self-regulatory organization (“SRO”) designated as the broker-dealer’s examining authority may examine these recorded discrepancies in a broker-dealer’s records to determine whether they are the result of the firm’s inability to maintain control of its business.

The Commission is statutorily authorized to promulgate Rule 17a-13 by virtue of Exchange Act Sections 15(c)(3) and 17(a). These sections authorize the Commission to provide safeguards with respect to the financial responsibility and related practices of broker-dealers,

including the acceptance of custody and the use of customer securities. These sections also authorize the Commission to require the making and preservation of such records as the Commission deems appropriate for the protection of investors and in the public interest. Further statutory authority is found in Exchange Act Section 23(a) (15 U.S.C. 78w).

2. Purpose and Use of the Information Collection

The information is used as an inventory control device to monitor a broker-dealer's ability to account for all securities held in transfer, in transit, pledged, loaned, borrowed, deposited, or otherwise subject to the firm's control or direction. Any discrepancies between the security count and the broker-dealer's records alert the Commission and the SROs to those firms experiencing back-office operational issues. Without Rule 17a-13, the Commission and applicable SROs would lose this important warning device to inform them when a broker-dealer might be having problems accounting for the securities for which it is responsible.

3. Consideration Given to Information Technology

Since Rule 17a-13 provides that firms must reconcile their books and records with their physical inventory and inventory in transit, improved information technology would not reduce the burden.

4. Duplication

Some SROs, of which a broker-dealer may be a member, require the broker-dealer to make similar counts of securities in the firm's possession or control. These counts, however, are used for different purposes.

5. Effect on Small Entities

To the extent that broker-dealers covered by Rule 17a-13 are small entities, these entities would be impacted. The impact would, however, be mitigated because most small entities do not hold securities.

6. Consequences of Not Conducting Collection

If the security counts were conducted less frequently, investors would not have the protection that the federal securities laws require. As discussed above, between 1967 and 1970, a number of broker-dealers became insolvent because of their inability to account for the securities that their records showed they possessed or controlled.

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

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

8. Consultations Outside the Agency

The required Federal Register notice with a 60-day comment period soliciting comments on this collection of information was published. No public comments were received.

9. Payment or Gift

No payments or gifts were provided to respondents.

10. Confidentiality

The records required to be made by Rule 17a-13 are available only to Commission examination staff, state securities authorities, and applicable SROs. Subject to the provisions of the Freedom of Information Act, 5 U.S.C. § 522, and the Commission's rules thereunder (17 CFR 200.80(b)(4)(iii)), the Commission does not generally publish or make available information contained in any 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. The information collection does not collect any Personally Identifiable Information ("PII").

12. Burden of Information Collection

Currently, there are approximately 4,462 broker-dealers registered with the Commission. However, given the variability in their businesses, it is difficult to quantify how many hours per year each broker-dealer spends complying with Rule 17a-13. As noted, Rule 17a-13 requires a broker-dealer to account for all securities in its possession or subject to its control or direction. Many broker-dealers hold few, if any, securities, while others hold large quantities. Therefore, the time burden of complying with Rule 17a-13 will depend on respondent-specific factors, including size, number of customers, and proprietary trading activity. The staff estimates that the average time spent per respondent is 100 hours per year on an ongoing basis to maintain the records required under Rule 17a-13. This estimate takes into account the fact that more than half of the 4,462 respondents – according to financial reports filed with the Commission – may spend little or no time complying with Rule 17a-13, given that they do not do a public securities business or do not hold inventories of securities. For these reasons, the staff estimates that the total recordkeeping burden per year is 446,200 hours (4,462 respondents x 100 hours/respondent).

13. Costs to Respondents

Not applicable: (a) it is not anticipated that respondents will have to incur any capital and start-up cost to comply with Rule 17a-13; and (b) it is not anticipated that respondents will have to incur any additional operational or maintenance cost (other than provided for in Item 12) to comply with Rule 17a-13.

14. Costs to Federal Government

The staff estimates that the total time spent examining broker-dealers is approximately 268,741 hours per year and that, of that time, 1%, or 2,687 hours, is devoted to examining for compliance with Rule 17a-13. The staff estimates that the hourly cost of these reviews is \$47.25.¹ Therefore, the estimated cost to the Commission of Rule 17a-13 is approximately \$127,000. There are no costs to the Federal Government apart from these labor costs.

15. Changes in Burden

The change in the recordkeeping burden is due to the change in the estimated number of broker-dealers subject to Rule 17a-13. The estimated number of broker-dealers decreased from 5,030 to 4,462. Therefore, the compliance burden decreased from 503,000 hours (5,030 respondents x 100 hours/respondent) to 446,200 hours (4,462 respondents x 100 hours/respondent).

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 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.

¹ GSA, Guide to Estimating Reporting Costs (1973) (which sets the value of one hour of staff time at \$35.00 + 35% overhead).