August 26, 2011

Ms. Elizabeth M. Murphy
Secretary
U.S.Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File Number S7-23-11, *Broker-Dealer Reports*

Dear Ms Murphy:

We appreciate the opportunity to respond to the Securities and Exchange Commission's ("the Commission's") Release No. 34-64676 entitled "Broker-Dealer Reports" (the "Proposal").

PricewaterhouseCoopers LLP ("PwC") is the U.S. member of the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity. PwC provides a broad range of professional services to the financial services industry, including accounting and auditing, regulatory compliance and risk management to the broker-dealer sector.

Overall, we support the Proposal as we believe that the proposed amendments to Exchange Act Rule 17a-5 (the "Rule") will help to clarify the requirements for reporting on a broker-dealer's compliance with the Rule. While supportive of the Commission's overall Proposal, we believe further consideration of the following areas will improve the Proposal. In the remainder of our letter, we have organized our observations into the following topical areas:

- The definition and application of material non-compliance and related notification requirements
- Interaction of internal control over financial reporting and compliance and internal control over compliance
- Interaction with the work performed and reporting required under other regulations
- Implementation of Transition Period

We have also responded to certain of the specific questions posed in the Commission's Proposing Release in an appendix to this letter.

The Definition and Application of Material Non-Compliance and Related Notification Requirements

We agree with the Commission's identification of certain relevant factors that should be considered in order to determine whether an instance of non-compliance is material and those matters that would necessarily constitute instances of material non-compliance. However, we believe that additional guidance is needed in identifying an appropriate framework for evaluating the materiality of such instances, including any quantitative measures that may be appropriate in order to achieve consistent

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guidance is needed in identifying an appropriate framework for evaluating the materiality of such instances, including any quantitative measures that may be appropriate in order to achieve consistent application. For example, the following examples illustrate circumstances where such a framework would be helpful:

- *Elements of the Rule which are not quantitative in nature (e.g., the possession or control requirement under Exchange Act Rule 15c3-3, or the account statement requirement).* Applying a materiality threshold is more challenging in these areas where instances of non-compliance cannot be measured in terms of a relationship to financial statement materiality levels. Therefore, a framework involving qualitative considerations would be helpful in order to ensure consistent application between broker-dealers, between broker-dealers and their auditors, and between auditing firms.

- *Whether an adjustment that exceeds the financial statement materiality levels made to the broker-dealer's regulatory computations would necessarily be considered an instance of material non-compliance, even if no Rule violation resulted from the error.* For example, if a broker-dealer misapplied the guidance related to (i) a computation under Rule 15c3-1 or (ii) the reserve requirements Rule 15c3-3, resulting in a quantitatively material adjustment to the broker-dealer's net capital or reserve requirement, would these adjustments be considered an instance of material non-compliance even if the broker-dealer's excess net capital or reserve bank account was adequate to cover the revised computations?

In addition, we agree with the Commission that timely and effective notification of a broker-dealer's material non-compliance with the Financial Responsibility Rules enables the Commission to react timely in protecting investors and others. However, we believe compliance with the existing process for notification under Rules 17a-5(h)(2) and 17a-11 satisfies the objective of timely notification. Under Rule 17a-11, when a broker-dealer discovers, or is informed by an independent public accountant pursuant to Rule 17a-5(h)(2), of the existence of a "material inadequacy," the broker-dealer is required (within 24 hours) to inform the Commission and the applicable designated examining authority. The broker-dealer is also required to furnish the independent public accountant a copy of the notification to the regulators within this same 24-hour period. If the independent public accountant fails to receive such notice from the broker-dealer within this 24-hour period, or if the independent public accountant disagrees with the statements contained in the notice of the broker-dealer, the independent public accountant then has the responsibility to notify the SEC and the designated examining authority within 24 hours thereafter, as set forth in Rule 17a-5(h)(2).

Fundamentally, we believe that the management of the broker-dealer is responsible for the assertions being made in its "Compliance Report" and, accordingly, has the primary responsibility for determination and notification of material non-compliance. The Commission in its proposed amendment to Rule 17a-5 noted that it expects the independent public accountant's examination engagement to be performed under PCAOB Attestation Standards. These standards clearly provide that management is responsible for the subject matter to which it is asserting, and not the independent public accountant. [1]

We are concerned that by imposing on independent public accountants the *primary* responsibility of notifying the Commission of a broker-dealer's material non-compliance, the Commission may be shifting responsibility it had established under Rule 17a-11 from the broker-dealer to the independent auditor.

Interaction of Internal Control over Financial Reporting and Compliance and Internal Control over Compliance

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[1] Attest Engagement Section 101 ("AT 101") provides that, "the practitioner's role in an attest engagement is that of an attester, the practitioner should not take on the role of the responsible party." (AT 101.13) AT 101 further states: "The party wishing to engage the practitioner is responsible for the subject matter, or has a reasonable basis for providing a written assertion about the subject matter." (AT 101.13.a)

As noted in the Proposing Release, the Commission is *not* requiring that the broker-dealer assess the effectiveness of internal control over financial reporting, as issuers are required to do in connection with the requirements of the Sarbanes-Oxley Act of 2002. Instead, the Proposal would require the Compliance Report to include a statement as to whether the broker-dealer has established and maintained a system of internal control to provide the broker-dealer with reasonable assurance that any instances of material non-compliance with the Financial Responsibility Rules will be prevented or detected on a timely basis. However, we note that many aspects of the 15c3-1 and 15c3-3 computations are derived in part from the financial reporting process. For example, the accuracy of a specific security haircut charge in the Rule 15c3-1 computation depends, in part, on whether the fair value of that security is appropriately measured. Because of these interactions with the financial reporting process, we believe it would be helpful if the Commission would provide additional guidance or clarify its expectations related to the assessment of internal controls over financial reporting considered necessary to evaluate whether internal control over compliance is effective.

We also request further guidance around the evaluation of the severity of deficiencies in internal control over compliance when material weaknesses are identified in connection with the financial statement audit; specifically, whether the Commission believes that all material weaknesses identified during the financial statement audit, should necessarily be a material weakness in internal control over compliance with the Financial Responsibility Rules. Auditors are required to consider internal control deficiencies identified as part of the audit in accordance with AU 325, "Communications about Control Deficiencies in an Audit of Financial Statements". In connection with this evaluation, a material weakness may be identified. For example, the auditor may identify a material misstatement in a non-allowable asset during the performance of its financial statement audit. However, as the asset is not an allowable asset for regulatory purposes, the adjustment would have no impact on the broker-dealer's computation of net capital under 15c3-1. Would this adjustment be considered a material weakness in internal control over compliance with the Financial Responsibility Rules? Additionally, would the Commission expect that all instances of material non-compliance would necessarily be considered material weaknesses?

The Proposal provides that the broker-dealer's assertions related to the effectiveness of internal control over compliance with the Financial Responsibility Rules would cover the entire fiscal year (except for during the transition period). This is in contrast to an issuer's statement related to internal control over financial reporting, which is "as of" year-end. While we agree that the proposed time period is consistent with the Investment Advisor Custody Rule, we believe additional guidance regarding how the proposed time period would affect management's assertion as to the effectiveness of its internal controls for the Financial Responsibility Rules. The Proposal indicates that a material weakness identified at any point during the period would preclude management from asserting that its internal controls over compliance was effective, even if the material weakness was remediated during the period. We believe that the broker-dealer should have an opportunity to remediate the material weakness during the period and conclude whether or not its internal control over compliance with the Financial Responsibility Rules was effective as of year-end. The Commission could consider a dual-report approach that would provide for an assessment of the broker-dealer's compliance with, and internal controls over specified rules as of the year-end date and an assessment as to internal control over compliance with the Financial Responsibility Rules for the period under audit. This approach would meet the objectives of having the examination be for the same period as the Investor Custody Rule, disclose material weaknesses identified during the year, and allow for management to have an opportunity to remediate the material weakness and conclude their internal control over compliance with the Financial Responsibility Rules is effective as of year-end.

The Interaction with the Work Performed and Reporting Required Under Other Regulations

Rule 206(4)-2 of the Investment Advisers Act of 1940 ('Rule 206')

Certain dually-registered broker-dealers are required to perform a surprise count under Rule 206. The Commission has previously stated that an auditor performing the surprise count can place reliance on the controls report when determining the amount of confirmations with the depositories. Since the

Compliance Report and Compliance Examination Report under Rule 17a-5 will satisfy the control report requirements under Rule 206, we would appreciate the Commission clarifying its expectation related to whether an auditor performing a custody examination would be able to place reliance on the attestation examination of the broker-dealer's compliance with Rule 206 on an ongoing basis. If, as we presume, the Commission does expect such reliance, what factors should the auditor consider, given that the attestation report related to controls over compliance with the Proposal is not required to be completed until 60-days after the broker dealer's fiscal year end, while the surprise examination may occur at any time during the year?

CFTC Rule 1.16

Auditors of certain broker-dealers who are also registered as Futures Commission Merchants ("FCMs") with the CFTC are required to file a report under CFTC Rule 1.16, related to their review of the broker-dealer's practices and procedures in complying with CFTC Rule 1.16. As compliance with CFTC Rule 1.16 is not in the scope of the Commission's proposal, certain broker-dealers will be required to provide both the management assertion and related auditor attestation required by this Proposal, as well as the existing report by the auditor as to the broker-dealer's compliance with CFTC Rule 1.16. These requirements may be duplicative. We request that the Commission direct its staff to work with the CFTC so that management's assertion and the related auditor attestation will cover all regulatory rules required of a broker-dealer that is also registered as an FCM.

Implementation of Transition Period

The Commission has proposed that the amendments contained in the Proposal be effective for annual reports filed with the Commission for fiscal years ending on or after December 15, 2011, with a provision for a transition period for annual reports filed between December 15, 2011 and September 15, 2012. We are concerned that these implementation dates may not be practicable as broker-dealers will need time for effective and efficient preparation, including training, to ensure quality working practices around identification, evaluation, and remediation of potential instances of non-compliance. In addition, we note that, for the auditors, engagement planning and interim testing procedures for most December 31, 2011 audit engagements are already underway, and believe audit firms should be provided additional time to incorporate the changes into our audit methodology and to complete related training programs prior to the beginning of the year in which the proposal would apply.

We also note that the Commission must still consider public comment before adopting any final rules, which makes these dates even more unfeasible. Additionally, under the current timing, the proposal will become effective prior to the proposed effective date of the related PCAOB standards, under which the audits of broker-dealers will be performed. Therefore, we believe that the effective date should be delayed to apply to annual reports filed on or after September 15, 2012, with 2012 being a transition year where compliance is assessed at year-end for a point in time, rather than for the full year.

Additionally, we would appreciate clarity as to the interaction of the transition provision allowing broker/dealers to make a point-in-time assertion in its initial Compliance Report as to the adequacy of its controls with Advisers Act custody requirements. To the extent that an affiliated broker-dealer serves as a qualified custodian for an investment adviser, a point-in-time report appears to render that adviser unable to comply with the Advisers Act Rule 206(4)-2(a)(6), which requires "an opinion of an independent public accountant as to whether controls have been placed in operation as of a specific date, and are suitably designed and operating effectively to meet control objectives relating to custodial services..... during the year". How would the ability of a broker-dealer that is also an investment advisor to rely on the examination of its initial Compliance Report be affected by a transition period allowing for a point in time assertion?

We appreciate the opportunity to express our views and would be pleased to discuss our comments or answer any questions that the Commission or its staff may have. Please contact Brian R. Richson (973-236-5615) or Derrick T. Stiebler (973-236-4904) regarding our submission.

Sincerely,

PricewaterhouseCoopers LLP

cc:

SEC
Chairman Mary L. Schapiro
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James R. Doty, Chairman
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Steven B. Harris, Board Member
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Martin F. Baumann, Chief Auditor

Appendix

File Number S7-23-11, *Broker-Dealer Reports*

This appendix provides PwC's responses to certain of the specific questions posed by the Proposing Release.

Compliance Reports

Question: Are there any practical issues the Commission should consider with respect to the proposal to assert compliance with the Financial Responsibility Rules?

> Response: The Commission should consider clarifying the expectations for the documentation to be maintained by management in support of their assertions. While the auditor will not be required to report on the process management undertakes in order to make their assertion, we expect that broker-dealers would need to maintain certain documentation in order to support their assertion. Without further guidance, we expect that working practices in this area may vary widely.

Question: Is the proposed definition of the term "material non-compliance" understandable in the context of broker-dealer audits? What alternative definition could be used? Why would any alternative definition be more appropriate?

> Response: Please see the body of our response letter under 'The Definition and Application of Material Non-Compliance and Related Notification Requirements.'

Question: Are the examples of material non-compliance described above appropriate? What other examples of material non-compliance should be specifically identified, if any? Should the Commission include examples of material non-compliance in the text of the rule?

> Response: As noted in the body of our response letter, we would appreciate additional guidance related to evaluating materiality of material non-compliance, especially related to the aspects of the Rule which are not quantitative in nature. Rather than including examples in the text of the rule, the Commission might consider releasing companion interpretive guidance, similar to the "Q&As" issued in conjunction with the Custody Rule. This would have the additional advantage of being able to expand or revise the guidance as needed without the need for a formal amendment to the rule.

Question: Is the proposed definition of the term "material weakness" understandable in the context of Rule 17a-5? What alternative definition could be used? Why would any alternative definition be more appropriate?

> Response: We believe that the definition of material weakness is appropriate, however, as discussed in the body of our response letter, we would appreciate additional guidance to assist in determining when instances of material non compliance raise to the level of a material weakness.

Compliance Examination and Examination Report

Question: Should the independent public accountant provide an opinion with regard to the process that the broker-dealer used to arrive at its assertions?

Response: We believe that, similar to the requirements for the auditor in connection with an audit of internal control over financial reporting, independent public accountants should report only on broker-dealers' assertion and not the process used to arrive at the assertion.

Notification Requirements

Question: Would an alternative means to notify the Commission of an instance of material non-compliance be appropriate? If so, what alternative and why?

Response: Please see the section entitled 'The Definition and Application of Material Non-Compliance and Related Notification Requirements'.

Comparison to the IA Custody Rule

Question: Should the Commission add additional elements to the scope of the proposed Examination Report? Commenters should identify any such elements and discuss the feasibility, benefits and costs of including them as elements in the scope of the proposed Compliance Examination.

Response: Please see the section entitled 'The Interaction with the Work Performed and Reporting Required Under Other Regulations'.

Changes in Applicable Auditing Standards

Question: Should the requirement to be audited in accordance with PCAOB standards be phased in for non-carrying broker-dealers? Why or why not? If so, what time-table should the Commission adopt?

Response: We do not believe that a phase-in period is necessary for audits of non-carrying broker-dealers. Rather, we believe that confusion could result in performing broker-dealer audits under two different sets of auditing standards.

Compliance Date and Transition Period

Question: Will the proposed compliance date and transition period for the Annual Reporting Amendments provide sufficient time for broker-dealers to prepare the additional reports and for independent public accountants to comply with PCAOB standards? Will it provide sufficient time to plan and perform Compliance Examination procedures? If not, what are the impediments and what would be a more appropriate time frame for implementation?

Response: Please see the body of our letter in the section titled ' Implementation of the Transition Period.'

Access to Audit Documentation

Question: Would any limitations on the ability of examiners to have access to audit documentation or to discuss the findings of the independent public accountant be appropriate? If so, what are those restrictions, why would they be appropriate, and what effect would they have on broker-dealer examinations?

Response: We believe that the proposed rule requiring each clearing broker-dealer to consent to permitting its independent public accountant to allow the Commission and DEA examination staff to review the documentation associated with its annual audit reports required under Rule 17a-5, and to discuss findings related to the audit reports with the Commission and DEA staff, [2] is too broad. the Proposing Release states that the Commission "preliminarily intends that examiners generally would use any information obtained ... to establish the scope and focus of a pending examination ... [to] enhance and improve the efficiency and effectiveness of Commission and DEA examination,"[3] However, the proposed rule itself is not limited as to the possible other uses of the information. The relationship between the broker-dealer and its auditors requires frank conversations that would potentially be inhibited by allowing unrestricted use of the information obtained from reviewing the documentation of and having discussions with the independent public accountant. . We believe that the Commission should clarify that any information obtained from the independent public accountant may not be used for any purpose other than, as suggested in the Release, "in connection with conducting a regulatory examination of the clearing broker-dealer."

We also request that the Commission confirm that any access to individuals for discussions or audit documentation for review granted by the independent public accountant for these purposes does not shift any responsibility for the scoping or conduct of regulatory examinations of broker-dealers to those independent public accountants, and that the ultimate authority and responsibility for the planning and execution of those examinations remains entirely with the Commission and the DEA.

Finally, we request that the Commission confirm that any information derived from communications with the independent public accounting firms will be exempt from public disclosure under Exemption 8 of the Freedom of Information Act.

Question: Should the Commission require a broker-dealer to submit a statement consenting to provide access to its independent public accountant and the audit documentation ("statement of consent") only when it files the "Notice pursuant to Rule 17a-5(f)(2)"?

Response: Yes, we believe that the filing of the statement of consent should be performed in connection with the "Notice pursuant to Rule 17a-5(f)(2)."

Question: How often should the statement of consent be filed (e.g., on an annual or more frequent basis)?

Response: We believe that the filing of a single evergreen statement of consent is sufficient, only to be updated if the broker-dealer replaces its auditor.

SIPC

Question: Rather than filing the annual reports directly with SIPC, should the Commission propose that the broker-dealers make the reports available to SIPC upon request? If so, why? If no, why not?

Response: The "clean up" amendments section of the Release includes a proposal to require broker-dealers to file their annual reports with the Securities Investor Protection Corporation ("SIPC"). This proposed amendment does not appear to relate to the stated purpose of the "clean up" amendments, namely to "modernize the rule and delete unnecessary or outdated provisions." Nor does the proposed amendment serve in any way the purposes of the broker-dealer reporting amendments generally as described in the Release.

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[2] See Proposing Release, at p. 1 and 3.
[3] See Proposing Release, at p. 42.

Rather, far from being a "clean up" amendment, the Commission's stated purpose for the amendment is to attempt to override existing legal limitations on the ability of SIPC to assert claims for monetary damages against independent public accountants based on their reports for broker-dealers. Federal courts, including the Supreme Court, have been clear that SIPC may not bring claims against independent public accountants under federal law. As the release acknowledges, state courts have reached similar conclusions under state law. Release at 77, note 163. We believe that this rulemaking is not the appropriate vehicle for addressing important issues relating to SIPC's ability to assert legal claims against third parties. We suggest that if SIPC's ability to assert such claims is to be revisited, it should be done through a full analysis with careful consideration of the relevant federal policies and limitations, as well as the costs and benefits of any such proposal.