

17a-3(a)(9) requires broker-dealers to obtain, with respect to each margin and cash account, the name and address of each beneficial owner, provided that the broker-dealer need only obtain such information from the persons authorized to transact business for the account if it is a joint or corporation account.¹⁵³

Further, broker-dealers are already required, pursuant to NASD Rule 3110, to obtain certain identifying information with respect to each account.¹⁵⁴ For example, if the customer is a natural person, the rule requires the broker-dealer to obtain the customer's name and address.¹⁵⁵ In addition, the broker-dealer must determine whether the customer is of legal age, and, if the customer purchases more than just open-end investment company shares or is solicited to purchase such shares, the broker-dealer must obtain the customer's tax identification or social security number.¹⁵⁶ If the customer is a corporation, partnership, or other legal entity, the broker-dealer must obtain its name, residence, and the names of any persons authorized to transact business on behalf of the entity.¹⁵⁷ If the account is a discretionary account, the broker-dealer must obtain the signature of each person authorized to exercise discretion over the account.¹⁵⁸ Finally, the broker-dealer must maintain all of this information as a record of the firm.

In addition, NYSE Rule 405 requires broker-dealers to "[u]se due diligence to

dealers obtain certain identifying information from customers at the commencement of the business relationship, including, for natural persons: name, address, date of birth, investment experience and objectives, social security number or taxpayer identification number, net worth, annual income, occupation, employer's address, and the names of any persons authorized to effect transactions in the account. For non-resident aliens, the SIA Committee recommended that the broker-dealer obtain, in addition to the information above, a passport number or other valid government identification number. The SIA Committee also made a number of recommendations with respect to customers that are not natural persons.

¹⁵³ 17 CFR 240.17a-3(a)(9).

¹⁵⁴ Section 15(b)(8) of the Exchange Act (15 U.S.C. 78o(b)(8)) requires each broker-dealer to become a member of a securities association registered pursuant to section 15A of the Exchange Act (15 U.S.C. 78o-3) unless the broker-dealer effects transactions solely on a national securities exchange of which it is a member. The NASD is the only securities association registered pursuant to section 15A. Exchange Act Rule 15b9-1 (17 CFR 240.15b9-1) exempts broker-dealers from this requirement to register with the NASD if they (1) are an exchange member, (2) carry no customer accounts, and (3) derive gross annual income from purchases and sales of securities other than on a national securities exchange of not greater than \$1,000. Generally then, most broker-dealers that carry customer accounts are members of the NASD and subject to Rule 3110.

¹⁵⁵ NASD Rule 3110(c)(1).

¹⁵⁶ NASD Rule 3110(c)(2).

¹⁵⁷ NASD Rule 3110(c)(1).

¹⁵⁸ NASD Rule 3110(c)(3).

learn the essential facts relative to every customer, every order, every cash or margin account accepted or carried by such organization and every person holding power of attorney over any account accepted or carried by such organization."¹⁵⁹

While broker-dealers currently are required to obtain most of this information, the Commission estimates that there will be some new costs for broker-dealers because some may not be obtaining all the required information. The Commission estimates that the total cost to the industry to obtain the minimum identifying information will be \$1,598,458 in 2003, \$7,037,000 in 2004 and \$7,761,508 in 2005.¹⁶⁰

3. Verifying Identifying Information

The final rule gives broker-dealers substantial flexibility in establishing how they will independently verify the information obtained from customers. For example, customers that open accounts on a broker-dealer's premises can provide a driver's license or passport, or if the customer is not a natural person, it can provide a copy of any documents showing its existence as a legal entity (e.g., articles of incorporation, business licenses, partnership agreements or trust instruments). There are also a number of options for customers opening accounts via the telephone or Internet. In these cases, broker-dealers may obtain a financial statement from the customer, check the customer's name against a credit bureau or database, or check the customer's references with other financial institutions.

The documentary and non-documentary verification methods set forth in the rule are not meant to be an exclusive list of the appropriate means

¹⁵⁹ NYSE Rule 405(1).

¹⁶⁰ The Commission estimates that obtaining the required minimum identifying information will take broker-dealers approximately one minute per account. This takes into consideration the fact that approximately 97% of customer accounts are held at the 70 largest broker-dealers. These firms likely already obtain the required identifying information from their customers. Therefore, requiring that each piece of identifying information be obtained should not impose a significant additional burden. The average hourly cost of the person who would be obtaining this information is \$22.70 per hour (per the SIA Earnings Report, Table 082 (Retail Sales Assistant, Registered) and including 35% in overhead charges). Therefore, the costs to the industry would be: (number of new accounts per year) \times (1/60 of an hour) \times (\$22.70). As indicated previously, the Commission estimates that the number of new accounts in the upcoming years will be: 16,900,000 in 2003, 18,600,000 in 2004 and 20,515,000 in 2005. The final rule will be effective only for the last quarter of 2003. Therefore, while the total cost for a twelve-month effective period would be \$6,393,833, the actual cost being allocated to the rule for 2003 is \$1,598,458 (or $\frac{1}{4}$ of \$6,393,833).

of verification. Other reasonable methods may be available now or in the future. The purpose of making the rule flexible is to allow broker-dealers to select verification methods that are, as section 326 requires, reasonable and practicable. Methods that are appropriate for a smaller broker-dealer with a fairly localized customer base may not be sufficient for a larger firm with customers from many different countries. The proposed rule recognizes this fact and, therefore, allows broker-dealers to employ such verification methods as would be suitable for a given firm to form a reasonable belief that it knows the true identities of its customers.

The Commission estimates identity verification could result in costs for broker-dealers because some firms currently may not use verification methods. The Commission estimates that the total cost to the industry to verify the identifying information will be \$13,343,958 in 2003, \$58,745,000 in 2004 and \$64,793,208 in 2005.¹⁶¹

4. Determining Whether Customers Appear on a Federal Government List

The Commission believes that broker-dealers that receive federal government lists, chiefly clearing firms, already have procedures for checking customers against them. First, there are substantive legal requirements associated with the lists circulated by Treasury's Office of Foreign Asset Control of the U.S. Treasury (OFAC). The failure of a firm to comply with these requirements could result in criminal and civil penalties. The Commission believes that, given the events of September 11, 2001, most broker-dealers that receive lists from the federal government have implemented procedures for checking their customers against them.

The Commission estimates that this requirement could result in some additional costs for broker-dealers because some may not already check such lists. The Commission estimates

¹⁶¹ The Commission estimates that the processing costs associated with verification methods will be approximately \$1.00 per account. The Commission further estimates that the average time spent verifying an account will be five minutes. The hourly cost of the person who would undertake the verification is \$25.90 per hour (per the SIA Earnings Report, Table 086 (Data Entry Clerk, Senior) and including 35% in overhead charges). Therefore, the costs to the industry reported above are: (number of new accounts per year) \times (\$1.00) + (number of new accounts per year) \times (1/12 of an hour) \times (\$25.90). The Commission estimates that the number of new accounts in the upcoming years will be: 16,900,000 in 2003, 18,600,000 in 2004 and 20,515,000 in 2005. The final rule will be effective only for the last quarter of 2003. Therefore, while the total cost for a twelve-month effective period would be \$53,375,833, the actual cost being allocated to the rule for 2003 is \$13,343,958 (or $\frac{1}{4}$ of \$53,375,833).