

Rule 15g-9

Supporting Statement

A. Justification

1. Necessity of Information Collection

The Commission adopted Rule 15g-9 (17 CFR 240.15g-9) in 1989 pursuant to Section 15(c)(2) of the Securities Exchange Act of 1934, which authorizes the Commission to promulgate rules that prescribe means reasonably designed to prevent fraudulent, deceptive, or manipulative practices in connection with over-the-counter. Rule 15g-9 requires broker-dealers to produce a written suitability determination for, and to obtain a written customer agreement to, certain recommended transactions in low-priced stocks that are not registered on a national securities exchange or authorized for trading on NASDAQ, and whose issuers do not meet certain minimum financial standards. The Rule is necessary to prevent the indiscriminate use by broker-dealers of fraudulent, high pressure telephone sales campaigns to sell low-priced securities to unsophisticated customers.

The scope of the Rule is limited in order to exclude transactions that are less likely to be subject to abusive, high-pressure sales practices. Application of the Rule is limited to transactions in penny stocks, which are generally defined as non-NASDAQ OTC equity securities whose issuers do not meet certain financial standards described below. In addition, exemptions are provided for (1) transactions in which the price of the security is five dollars or more; (2) transactions in which the purchaser is an accredited investor or an established customer of the broker-dealer; (3) transactions that are not recommended by the broker-dealer; and (4) transactions by a broker-dealer who is not a market maker in the penny stock that is the subject of the transaction, and whose sales-related revenue from transactions in penny stocks does not exceed five percent of its total sales-related revenue from transactions in securities.

2. Purpose of, and Consequences of Not Requiring, the Information Collection

The Commission realizes that only comprehensive action will successfully reduce fraud in the sale of low-priced securities, and therefore has undertaken a broad-based program in this area that includes expanded enforcement efforts, a public education program, and regulatory initiatives. In adopting what is now Rule 15g-9, the Commission sought to combat the unscrupulous, high-pressure sales tactics of certain broker-dealers by imposing objective and readily reviewable requirements that discipline the process by which new customers are induced to purchase low-priced stocks. The requirements were intended to assist investors in protecting themselves from fraudulent sales practices, and also to reinforce a broker-dealer's suitability obligations, which are long-standing obligations under self-regulatory organization ("SRO") rules.

An essential aspect of high-pressure “boiler-room” operations is the constant solicitation of new, and often unsophisticated, customers. The Rule disciplines this process by establishing account opening procedures that must be followed before penny stocks are recommended to unsophisticated new customers. The procedures were intended to increase the likelihood that the broker-dealer will make an appropriate suitability determination by requiring the broker-dealer to obtain sufficient information concerning the customer, and to consider the customer's previous investment experience, investment objectives, and financial situation.

In addition, the Rule protects investors from fraudulent sales practices in penny stocks in two ways. First, the requirement that the customer agree to purchases in writing provides the customer with an opportunity to make an investment decision outside of a pressured telephone conversation with a salesperson. Second, the account opening procedures require the broker-dealer to provide a copy of the broker-dealer's suitability determination to the customer prior to the customer's commitment to purchase a penny stock. As a result, the customer has an opportunity to review the determination and decide whether the broker-dealer has made a good faith attempt to consider the customer's financial situation, investment experience and investment objectives.

The consequences of not requiring the information specified in the Rule would be a substantial weakening of the Rule's effectiveness. The Commission believes that certain broker-dealers engaging in abusive sales practices in connection with penny stocks may choose to ignore the requirements of the Rule. The Rule therefore requires records to be kept that indicate their compliance with each of its provisions. This documentation enables regulatory authorities to review a broker-dealer's compliance with the Rule, and provides the basis for simple and direct enforcement actions against broker-dealers that fail to comply.

3. Role of Improved Information Technology and Obstacles to Reducing Burden

Not applicable.

4. Efforts to Identify Duplication

Broker-dealers are not otherwise required to obtain the written agreement to purchases required by the Rule. As discussed in item (5), however, responsible broker-dealers currently obtain information of substantially the same type that is required by the Rule to comply with SRO suitability rules. Although the information currently obtained by responsible broker-dealers also can be used to satisfy the Rule's requirements, the Rule does not duplicate these SRO rules because the Rule contains an enhanced suitability determination and allows for direct Commission enforcement actions in cases of non-compliance. Nor does the Rule duplicate the requirements of the penny stock Rules. The penny stock Rules mandate that broker-dealers disclose certain information about the market for penny stocks and the particular penny stock transaction to customers with whom they do business in penny stocks, while the Rule requires broker-dealers who

do such business to obtain certain information from customers, and to make a suitability determination on the basis thereof.

5. Effects on Small Entities

The statements requested are not extensive, and therefore the collection of information is not unduly burdensome for small entities.

6. Consequences of Less Frequent Collection

These statements are required only upon the occurrence of a single event. Therefore, collection could be no less frequent.

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

Not applicable. The Rule is not inconsistent with 5 CFR 1320.5(d)(2).

8. Consultations Outside the Agency

Not applicable. Consultations outside the Commission are not conducted with regard to this rule.

9. Payment of Gift to Respondents

Not applicable.

10. Assurance of Confidentiality

Not applicable.

11. Sensitive Questions

There are no questions of a sensitive nature asked

12. Estimate of Respondent Reporting Burden

The burden of the collection of information varies widely depending on the activity and size of the broker-dealer. In this regard, the burden is the greatest on those boiler-room broker-dealers whose sales practices activity is the primary problem to which the Rule is addressed. The Rule is intended to discipline this process by establishing procedures that must be followed before recommending penny stocks to unsophisticated customers. The burden of the Rule's information requirements therefore is triggered by the solicitation of new customers, and the greatest burden is imposed on broker-dealers who are constantly soliciting new customers in low-priced non-NASDAQ OTC securities.

The burden on the other broker-dealers, however, are much lower. These broker-dealers tend to concentrate on servicing existing customers. Consequently, the additional information burden for these broker-dealers is not nearly as great as for boiler-room broker-dealers, and the Rule imposes the greatest burden on those broker-dealers who employ sales practices that are the direct target of the prophylactic requirements of the Rule.

The Commission staff estimates that there are approximately 240 broker-dealers subject to the Rule. As indicated above, the burden of the Rule on a respondent varies widely depending on the frequency with which new customers are solicited. On the average for all respondents, the staff has estimated that respondents process three new customers per week, or approximately 156 new customer suitability determinations per year. We also estimate that a broker-dealer would expend approximately one-half hour per new customer in obtaining, reviewing, and processing (including transmitting to the customer) the information required by Rule 15g-9, and each respondent would consequently spend 78 hours annually (156 customers x .5 hours) obtaining the information required in the rule. We determined, based on the estimate of 240 broker-dealer respondents, that the current annual burden of Rule 15g-9 is 18,720 hours (240 respondents x 78 hours).

In addition, we estimate that if tangible communications alone are used to transmit the documents required by Rule 15g-9, each customer should take: (1) no more than eight minutes to review, sign and return the suitability determination document; and (2) no more than two minutes to either read and return or produce the customer agreement for a particular recommended transaction in penny stocks, listing the issuer and number of shares of the particular penny stock to be purchased, and send it to the broker-dealer. Thus, the total current customer respondent burden is approximately 10 minutes per response, for an aggregate total of 1,560 minutes for each broker-dealer respondent. Since there are 240 respondents, the annual burden for customer responses is 374,400 minutes (1,560 customer minutes per each of the 240 respondents) or 6,240 hours.

In addition, we estimate that, if tangible means of communications alone are used, broker-dealers could incur a recordkeeping burden under Rule 15g-9 of approximately two minutes per response. Since there are approximately 240 broker-dealer respondents and each respondent would have approximately 156 responses annually, respondents would incur an aggregate recordkeeping burden of 74,880 minutes (240 respondents x 156 responses x 2 minutes per response), or 1,248 hours. Accordingly, the aggregate annual hour burden associated with Rule 15g-9 is 26,208 hours (18,720 hours to prepare the suitability statement and agreement + 6,240 hours for customer review + 1,248 recordkeeping hours).

We recognize that under the amendments to Rule 15g-9, the burden hours may be slightly reduced if the transaction agreement required under the rule is provided through electronic means such as e-mail from the customer to the broker-dealer (e.g., the customer may take only one minute, instead of the two minutes estimated above, to

provide the transaction agreement by e-mail rather than regular mail). If each of the customer respondents estimated above communicates with his or her broker-dealer electronically, the total burden hours on the customers would be reduced from 10 minutes to 9 minutes per response, or an aggregate total of 1,404 minutes per respondent (156 customers x 9 minutes for each customer). Since there are 240 respondents, the annual customer respondent burden, if electronic communications were used by all customers, would be approximately 336,960 minutes (240 respondents x 1,404 minutes per each respondent), or 5,616 hours. We do not believe the hour burden on broker-dealers in obtaining, reviewing, and processing the suitability determination would change through use of electronic communications. In addition, we do not believe that, based on information currently available to us, recordkeeping burdens under Rule 15g-9 would change where the required documents were sent or received through means of electronic communication. Thus, if all broker-dealer respondents obtain and send the documents required under the rule electronically, the aggregate annual hour burden associated with Rule 15g-9 would be 25,584 hours (18,720 hours to prepare the suitability statement and agreement + 5,616 hours for customer review + 1,248 recordkeeping hours).

We cannot estimate how many broker-dealers and customers will choose to communicate electronically. If we assume that 50 percent of respondents would continue to provide documents and obtain signatures in tangible form, and 50 percent would choose to communicate electronically in satisfaction of the requirements of Rule 15g-9, the total aggregate hour burden would be 25,896 burden hours ((26,208 aggregate burden hours for documents and signatures in tangible form x 0.50 of the respondents = 13,104 hours) + (25,584 aggregate burden hours for electronically signed and transmitted documents x 0.50 of the respondents = 12,792 hours).

13. Estimate of Cost to Respondents

There is no cost to respondents other than the internal cost of the hours per respondent per year obtaining the information required by the rule.

14. Estimate of Cost to the Federal Government

Cost to the federal government result from appropriate regulatory agency staff time and related overhead cost devoted to analyzing the data reported by broker-dealers. Commission staff estimates that approximately 50 hours of staff time per year are devoted to analysis of the data at a cost of \$2500 per year.

15. Explanation of Changes in Burden

Not applicable. There is no change in the burden.

16. Information Collections Planned for Statistical Purpose

Not applicable. There is no intention to publish the information for any purpose.

17. Explanation as to Why Expiration Date Will Not be Displayed

Not applicable.

18. Exceptions to Certification

Not applicable.

B. Collection of Information Employing Statistical Methods.

Rule 15g-9 does not employ statistical methods.