

Rule 15g-2

SUPPORTING STATEMENT

A. Justification

1. Necessity for Information Collection

Section 15(c)(2) of the Securities Exchange Act of 1934 (“Exchange Act”) authorizes the Commission to promulgate rules that prescribe means reasonably designed to prevent fraudulent, deceptive, or manipulative acts or practices in connection with over-the-counter securities (“OTC”) transactions. Pursuant to this authority, on July 7, 2005, the Commission amended Exchange Act Rule 15g-2 (the “Rule”) to provide an explicit “cooling-off period” to replace the implicit period that customers traditionally have had when the disclosure documents required by the penny stock rules are provided by postal mail rather than electronically.

Rule 15g-2(a) prohibits a broker-dealer from effecting a transaction in a penny stock with or for the account of a customer unless the broker-dealer distributes to the customer, prior to effecting a transaction in a penny stock, a disclosure document, as set forth in Schedule 15G, and receives a signed and dated acknowledgement of receipt of that document from the customer in tangible form. The document (“penny stock disclosure document”), which must contain the information set forth in Schedule 15G, gives several important warnings to investors concerning the penny stock market, and cautions investors against making a hurried investment decision. Rule 15g-2 requires broker-dealers to provide their customers with a penny stock disclosure document, as set forth in Schedule 15G under the Exchange Act, prior to each customer's first non-exempt transaction in a penny stock.

The 2005 amendments to Rule 15g-2(b) impose a uniform waiting period of two business days that can be satisfied by waiting two days after sending the penny stock disclosure document required by the rule electronically or by mail or some other paper-based means. As amended, the rule prohibit a broker-dealer from effecting a transaction in a penny stock for or with the account of a customer unless, prior to effecting the transaction, the broker-dealer distributes to the customer a penny stock disclosure document, and has obtained from the customer a signed and dated acknowledgement of receipt of that document. The amendments to Rule 15g-2 were designed to preserve parity between electronic and paper communications in the context of the disclosure requirements of the penny stock rules.

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

In adopting Rule 15g-2, 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 penny stock disclosure document gives several important warnings to investors concerning the penny stock market, and cautions investors against making a hurried investment decision. Among other things, the penny stock disclosure document points out that salespersons are not impartial advisors, that investors should compare information from the salesperson with other information on the penny stock, and that investors in penny stocks should be prepared for the possibility of losing their whole investment. As a result of these procedures, 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. 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 acknowledging receipt of the penny stock disclosure documents.

5. Effect on Small Entities

The Commission believes that the changes incorporated in the Rule substantially reduce the Rule’s effect on legitimate broker-dealers and issuers. The Commission also believes that the significant potential for sales practice abuse and manipulation in connection with the transactions covered by the Rule justifies the Rule.

6. Consequences of Less Frequent Collection

As stated at Section 2 above, the Rule disciplines the “boiler room” process by establishing account opening procedures that must be followed before Penny Stocks are recommended to unsophisticated new customers. The penny stock disclosure document gives several important warnings to investors concerning the penny stock market, and cautions investors against making a hurried investment decision. As a result of these procedures, 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 requiring such disclosure less frequently would be a substantial weakening of the Rule's effectiveness because each new customer would not receive the required warning. Furthermore, any less frequent recordkeeping would jeopardize the ability of the Commission and the SROs to monitor compliance with the requirements of the Rule.

7. Inconsistencies With Guidelines In 5 CFR 1320.5(d)(2)

This collection is not inconsistent with 5 CFR 1320.5(d)(2).

8. Consultations Outside the Agency

Not applicable.

9. Payment of Gift to Respondents

Not applicable.

10. Assurances of Confidentiality

The information is not confidential. In fact, this information is subject to inspection by the Commission and the various SROs.

11. Sensitive Questions

No questions of a sensitive nature are asked.

12. Estimate of Respondent Reporting Burden

There are approximately 240 broker-dealers that could potentially be subject to current Rule 15g-2, and that each one of these firms processes an average of three new customers for penny stocks per week. Thus, each respondent processes approximately 156 penny stock disclosure documents per year. If communications in tangible form alone are used to satisfy the requirements of Rule 15g-2, then (a) the copying and mailing of the penny stock disclosure document takes no more than two minutes per customer, and (b) each customer takes no more

than eight minutes to review, sign and return the penny stock disclosure document. Thus, the total existing respondent burden is approximately 10 minutes per response, or an aggregate total of 1,560 minutes per respondent. Since there are 240 respondents, the current annual burden is 374,400 minutes (1,560 minutes per each of the 240 respondents) or 6,240 hours. In addition, broker-dealers incur a recordkeeping burden of approximately two minutes per response. Since there are approximately 156 responses for each respondent, the respondents incur an aggregate recordkeeping burden of 74,880 minutes (240 respondents x 156 responses for each x 2 minutes per response) or 1,248 hours, under Rule 15g-2. Accordingly, the current aggregate annual hour burden associated with Rule 15g-2 (that is, assuming that all respondents provide tangible copies of the required documents) is approximately 7,488 hours (6,240 response hours + 1,248 recordkeeping hours).

The burden hours associated with Rule 15g-2 may be slightly reduced when the penny stock disclosure document required under the rule is provided through electronic means such as e-mail from the broker-dealer (e.g., the broker-dealer respondent may take only one minute, instead of the two minutes estimated above, to provide the penny stock disclosure document by e-mail to its customer) and return e-mail from the customer (the customer may take only seven minutes, to review, electronically sign and electronically return the penny stock disclosure document). In this regard, if each of the customer respondents estimated above communicates with his or her broker-dealer electronically, the total ongoing respondent burden is approximately 8 minutes per response, or an aggregate total of 1,248 minutes (156 customers x 8 minutes per respondent). Assuming 240 respondents, the annual burden, if electronic communications were used by all customers, is 299,520 minutes (1,248 minutes per each of the 240 respondents) or 4,992 hours. Under Rule 15g-2, the recordkeeping burden is 1,248 hours. Thus, if all broker-dealer respondents obtain and send the documents required under the rules electronically, the aggregate annual hour burden associated with Rule 15g-2 is 6,240 (1,248 hours + 4,992 hours).

In addition, if the penny stock customer requests a paper copy of the information on the Commission's Web site regarding microcap securities, including penny stocks, from his or her broker-dealer, the printing and mailing of the document containing this information takes no more than two minutes per customer. Because many investors have access to the Commission's Web site via computers located in their homes, or in easily accessible public places such as libraries, then, at most, a quarter of customers who are required to receive the Rule 15g-2 disclosure document request that their broker-dealer provide them with the additional microcap and penny stock information posted on the Commission's Web site. Thus, each broker-dealer respondent processes approximately 39 requests for paper copies of this information per year or an aggregate total of 78 minutes per respondent (2 minutes per customer x 39 requests per respondent). Since there are 240 respondents, the estimated annual burden is 18,720 minutes (78 minutes per each of the 240 respondents) or 312 hours.

We have no way of knowing how many broker-dealers and customers will choose to communicate electronically. Assuming that 50 percent of respondents continue to provide documents and obtain signatures in tangible form and 50 percent choose to communicate

electronically to satisfy the requirements of Rule 15g-2, the total aggregate burden hours is 7,176 ((aggregate burden hours for documents and signatures in tangible form x 0.50 of the respondents = 3,744 hours) + (aggregate burden hours for electronically signed and transmitted documents x 0.50 of the respondents = 3,120 hours) + (312 burden hours for those customers making requests for a copy of the information on the Commission's Web site)).

13. Estimate of Total Annualized Cost Burden

A broker-dealer's copying, sending, and recordkeeping hour burden under the rule, as noted above, is four minutes (1/15th of an hour). Assuming an average of \$ 24.10 for recordkeeping staff time, broker-dealer time, therefore, costs approximately \$ 1.61 for each Schedule 15G provided to its customer under the rule. Thus, the total paperwork cost burden for broker-dealer time to comply with Rule 15g-2 is approximately \$ 60,278 (240 respondents x 156 new customers annually x \$ 1.61 for each document).

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.

16. Information Collected Planned For Statistical Purposes

Not applicable.

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

Not applicable. The collection of information pursuant to the Rule does not employ statistical methods.