

**SUPPORTING STATEMENT
for the Paperwork Reduction Act
Information Collection Submission for
“Rule 15g-9”**

A. Justification

1. Necessity of Information Collection

The Commission adopted Rule 15g-9 (17 CFR 240.15g-9) (“the Rule”) in 1989 pursuant to Section 15(c)(2) of the Securities Exchange Act of 1934 (“Exchange Act”), 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 (“OTC”) transactions. 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 penny stocks as that term is defined in Section 3(a)(51) of the Exchange Act and Rule 3a51-1 thereunder. The Rule is necessary to prevent the indiscriminate use by broker-dealers of fraudulent, high pressure telephone sales campaigns to sell penny stocks 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 generally refer to non-exchange listed 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 and Use of the Information Collection

The Commission recognizes that only comprehensive action will successfully reduce fraud in the sale penny stocks, 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 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 penny 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 reigns in this process by establishing account opening procedures that must be followed before penny stocks are recommended to unsophisticated new customers. The procedures are 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 in writing to penny stock purchases 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. Consideration Given to Information Technology

No consideration was given to using information technology to reduce this burden.

4. 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 rule requirements because the Rule contains an enhanced suitability determination and allows for direct Commission enforcement actions in cases of non-compliance. In addition, the Rule does not duplicate any of the requirements of other rules adopted pursuant to Section 15(g) of the Exchange Act. The other rules adopted pursuant to Section 15(g) mandate that broker-dealers disclose certain

information to customer about the penny stock market in general and about the particular penny stock transaction to customers with whom they do business. In contrast, the Rule requires that broker-dealers who engaged in penny stock transactions with customers 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 Not Conducting 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 1320.8(d)

There are no special circumstances. The collection is consistent with the guidelines in 5 CFR 1320.8(d).

8. Consultations with Outside Agencies

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 are provided to any respondents.

10. Confidentiality

Not applicable.

11. Sensitive Questions

There are no questions of a sensitive nature asked.

12. Burden of Information Collection

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 broker-dealers whose questionable sales practice activities correspond directly to the sale of penny stocks (*i.e.* boiler-room broker-dealers), the primary type of security that the Rule addresses. The Rule is intended to reign in questionable penny stock sales practices

by establishing procedures that broker-dealers follow 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 for penny stock purchases.

The burden on the other broker-dealers, however, is 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 approximately five percent of registered broker-dealers, or 253 broker-dealers, are subject to the Rule (5% x approximately 5,063 registered broker-dealers = 253 broker-dealers). 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 253 broker-dealer respondents, that the current annual burden of Rule 15g-9 is 19,734 hours (253 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 approximately 253 respondents, the annual burden for customer responses is 394,680 minutes (1,560 customer minutes per each of the 253 respondents) or 6,578 hours.

In addition, we estimate that, if tangible means of communications alone are used, broker-dealers could incur a burden under Rule 15g-9 of approximately two minutes per response. Since there are approximately 253 broker-dealer respondents and each respondent would have approximately 156 responses annually, respondents would incur an aggregate burden of 78,936 minutes (253 respondents x 156 responses x 2 minutes per response), or 1,315 hours. Accordingly, the aggregate annual hour burden associated with

Rule 15g-9 is 27,627 hours (19,734 hours to prepare the suitability statement and agreement + 6,578 hours for customer review + 1,315 hours for processing).

We recognize that the Rule's 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). Because there are approximately 253 respondents, the annual customer respondent burden, if electronic communications were used by all customers, would be approximately 355,9212 minutes (253 respondents x 1,404 minutes per each respondent), or 5,920 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, the 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 26,969 hours (19,734 hours to prepare the suitability statement and agreement + 5,920 hours for customer review + 1,315 hours for processing).

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, the total aggregate hour burden would be 27,297 burden hours ((27,627 aggregate burden hours for documents and signatures in tangible form x 0.50 of the respondents = 13,813 hours) + (26,969 aggregate burden hours for electronically signed and transmitted documents x 0.50 of the respondents = 13,484 hours). We estimate that 50% of the burden associated with Rule 15g-9 is a recordkeeping type of burden, and the remaining 50% of the burden is a third party disclosure type of burden.

13. 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. Costs to Federal Government

There are no costs to the Federal Government apart from internal labor costs. 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. Changes in Burden

There was a slight increase in the number of respondents affected by the rule, which impacted agency estimates. This increase was caused by an increase in the number of registered broker-dealers.

16. Information Collection Planned for Statistical Purposes

This collection does not involve statistical methods.

17. Exceptions to Certification for Paperwork Reduction Act Submissions

The Commission is not seeking approval to not display the expiration date for OMB approval.

B. Collection of Information Employing Statistical Methods.

Rule 15g-9 does not employ statistical methods.