

SUPPORTING STATEMENT
for the Paperwork Reduction Act Information Collection Submission for
Rule 8c-1 – Hypothecation of Customers’ Securities

A. JUSTIFICATION

1. Necessity of Information Collection

Sections 8(a) and (b) of the Securities Exchange Act of 1934 (“Exchange Act”) (15 U.S.C. 78h) authorize the Securities and Exchange Commission (“Commission”) to prescribe rules and regulations prohibiting, under certain circumstances, the hypothecation, or the arranging for the hypothecation, of any securities carried for the account of any customer.¹ Exchange Act Rule 8c-1² was adopted in 1940 to furnish added protection to customers against losses incurred as a result of the pledging of customers’ securities as collateral by members of national securities exchanges and other broker-dealers. Prior to the adoption of Rule 8c-1, most customer agreements did not prohibit a broker-dealer from commingling customer securities with its own securities as collateral for loans used by the firm in its business as a broker-dealer or trader for its own account. In addition, most customer agreements did not prohibit a broker-dealer from borrowing more on their customers’ securities than was owed them by the customers. The risk of loss to a customer whose securities were so used by a broker-dealer that failed was greatly increased.³

Rule 8c-1 generally prohibits a broker-dealer from using its customers’ securities as collateral to finance its own trading, speculating, or underwriting transactions. More specifically, Rule 8c-1 states three main principles: (1) a broker-dealer is prohibited from commingling the securities of different customers as collateral for a loan without the consent of each customer; (2) a broker-dealer cannot commingle customers’ securities with its own securities under the same pledge; and (3) a broker-dealer can only pledge its customers’ securities to the extent that customers are in debt to the broker-dealer.⁴

2. Purpose and Use of the Information Collection

The information required by Rule 8c-1 is necessary for the execution of the Commission’s mandate under the Exchange Act to prevent broker-dealers from hypothecating or arranging for the hypothecation of any securities carried for the account of any customer under certain circumstances. In addition, the information required by Rule 8c-1 provides important investor protections.

¹ Further statutory authority is found in Section 23(a) of the Exchange Act, 15 USC 78w.

² 17 CFR 240.8c-1.

³ See Securities Exchange Act Release No. 2690 (November 15, 1940).

⁴ See Securities Exchange Act Release No. 2690 (November 15, 1940); Securities Exchange Act Release No. 9428 (December 29, 1971).

3. Consideration Given to Information Technology

The compilation of this information must be done on an individual basis for each potential customer. Thus, improved information technology would not reduce the burden.

4. Duplication

Not applicable. Although Exchange Act Rule 15c2-1 requires similar information, combining the notices and consents under Rules 8c-1 and 15c2-1 in the same documents is not prohibited.

5. Effect on Small Entities

The requirements under Rule 8c-1 are not unduly burdensome on smaller broker-dealers. Moreover, the requirements prescribed by Rule 8c-1 are those that a prudent businessperson would keep in the ordinary course of business.

6. Consequences of Not Conducting Collection

The information collected pursuant to Rule 8c-1 occurs based on individual transactions. Consequently, there is no way to require less frequent collection without undermining the purposes of Rule 8c-1.

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

There are no special circumstances. This collection is consistent with the guidelines in 5 CFR 1320.5(d)(2).

8. Consultations Outside the Agency

The required Federal Register notice with a 60-day comment period soliciting comments on this information collection was published. No public comments were received.

9. Payment or Gift

No payments or gifts were provided to respondents.

10. Confidentiality

No assurances of confidentiality are provided in the statute or the rule.

11. Sensitive Questions

No questions of a sensitive nature are asked. The information collection does not collect any Personally Identifiable Information (PII).

12. Burden of Information Collection

The amount of time required to comply with the rule will vary depending on the amount of customer securities hypothecated by the broker-dealer. Commission staff estimates that for each hypothecation, compliance time will take approximately 10 minutes to create and send notice of hypothecation to the pledgee in accordance with the rule and approximately 20 minutes to request and process consents from customers to permit commingling of customer accounts under the same lien.

There are approximately 60 respondents as of year-end 2015 (i.e., broker-dealers that conducted business with the public, filed Part II of the FOCUS Report, did not claim an exemption from the Reserve Formula computation, and reported that they had a bank loan during at least one quarter of the current year). Each respondent makes an estimated 45 annual responses, for an aggregate total of 2,700 responses per year.⁵ Each response takes approximately 0.5 hours to complete. Thus, the total compliance burden per year is 1,350 burden hours.⁶

13. Costs to Respondents

Respondents will not incur any capital, start-up, operational, or maintenance costs. In addition, respondents should not need to purchase any services with regard to the reporting requirements.

14. Costs to Federal Government

Not applicable. Broker-dealers maintain the required records under this rule.

15. Changes in Burden

Changes in burden are reflective of the most recent data regarding the number of responses and time required for response. While the response time did not change, the number of respondents decreased, resulting in the aggregate annual burden being reduced.

16. Information Collection Planned for Statistical Purposes

Not applicable. The information collected is not used for statistical purposes.

17. Approval to Omit OMB Expiration Date

The Commission is not seeking approval to omit the expiration date.

⁵ 60 respondents x 45 annual responses = 2,700 aggregate total of annual responses.

⁶ 2,700 responses x 0.5 hours = 1,350 hours.

18. Exceptions to Certification for Paperwork Reduction Act Submissions

This collection complies with the requirements in 5 CFR 1320.9.

B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS

This collection does not involve statistical methods.