

SUPPORTING STATEMENT
for the Paperwork Reduction Act Information Collection Submission for
Rule 15c2-5 – Disclosure and other requirements when extending or arranging credit in certain transactions

A. JUSTIFICATION

1. Necessity of Information Collection

The Securities and Exchange Commission (“Commission”) adopted Rule 15c2-5¹ under the Securities Exchange Act of 1934 (“Exchange Act”) to counter abuses in transactions known as “equity funding” programs. In these transactions, a broker-dealer sells securities to a customer and the securities act as collateral for loans. The proceeds of the loans are used to fund the premiums on a life insurance policy which is sold to the customer. Prior to the adoption of Rule 15c2-5, some broker-dealers offered such programs without determining and documenting their suitability for customers. In addition, customers were sometimes inadequately informed of the nature and extent of their obligations under the program, the charges to be incurred, and the risks assumed. Furthermore, a substantial portion of the payments would go to the broker-dealer.² Although Rule 15c2-5 was prompted by the abuses associated with equity funding programs, the rule encompasses other transactions that share the same characteristics as these programs.

Rule 15c2-5 prohibits a broker-dealer from arranging or extending certain loans to persons in connection with the offer or sale of securities unless, before any element of the transaction is entered into, the broker-dealer: (1) delivers to the person a written statement containing the exact nature and extent of the person’s obligations under the loan arrangement; the risks and disadvantages of the loan arrangement; and all commissions, discounts, and other remuneration received and to be received in connection with the transaction by the broker-dealer or certain related persons (unless the person receives certain materials from the lender or broker-dealer which contain the required information); and (2) obtains from the person information on the person’s financial situation and needs, reasonably determines that the transaction is suitable for the person, and retains on file and makes available to the person on request a written statement setting forth the broker-dealer’s basis for determining that the transaction was suitable.

The Commission is statutorily authorized by Section 15(c)(2) of the Exchange Act to adopt rules and regulations that define and prescribe means reasonably designed to prevent acts and practices that are fraudulent, deceptive or manipulative.³ Further statutory authority is in Section 23(a) of the Exchange Act.⁴

¹ See 17 CFR 240.15c2-5.

² See Exchange Act Release Nos. 34-6809 (May 22, 1962), 27 FR 5204, 5205 (June 2, 1962) (proposing release); see also 34-6851 (July 17, 1962), 27 FR 7091 (July 26, 1962) (adopting release).

³ See 15 U.S.C. 78o(c)(2).

⁴ See 15 U.S.C. 78w.

2. Purpose and Use of the Information Collection

The information required by Rule 15c2-5 is necessary to execute the Commission's mandate under the Exchange Act of preventing fraudulent, manipulative, and deceptive acts and practices by broker-dealers. In addition, the information required by Rule 15c2-5 provides the broker-dealer must reasonably determine that the transaction is suitable for the customer and deliver to the customer a written statement setting forth the basis upon which this determination was made.

3. Consideration Given to Information Technology

The collection of information is done on an individual transactional basis. Thus, improved technology would not reduce the burden.

4. Duplication

The requirements of Rule 15c2-5 are not duplicated elsewhere. In certain circumstances, information specified in the rule must also be produced when complying with other regulatory requirements, such as those of the Commission or the self-regulatory organizations. Rule 15c2-5 requirements generally conform to obligations imposed by other statutory or regulatory provisions.

5. Effect on Small Entities

To the extent that some broker-dealers covered by Rule 15c-5⁵ are small entities, the rule would impact these entities. The impact would, however, be mitigated by the lower number of Rule 15c2-5 transactions these firms execute. Moreover, a prudent businessperson would comply with the rule in the ordinary course of business.

6. Consequences of Not Conducting Collection

The information is collected as each transaction warrants, and therefore the collection cannot be less frequent without undermining the purpose of the rule.

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).

8. Consultations Outside the Agency

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.

⁵ See 17 CFR 240.15c-5.

9. Payment or Gift

No payments or gifts have been provided to respondents.

10. Confidentiality

No assurances of confidentiality are provided in Section 15(c)(2) or Rule 15c2-5. The records required by Rule 15c2-5 would be available only to the Commission staff, state securities authorities, and self-regulatory organizations. Subject to the provisions of the Freedom of Information Act, 5 U.S.C. 552, and the Commission's rules thereunder,⁶ the Commission does not generally publish or make available information contained in any reports, summaries, analyses, letters, or memoranda arising out of, in anticipation of, or in connection with an examination or inspection of the books and records of any person or any other investigation.

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 Commission estimates that there are approximately 50 respondents that require an aggregate total of 600 hours to comply with Rule 15c2-5.⁷ Each of these approximately 50 registered broker-dealers makes an estimated six annual responses, for an aggregate total of 300 responses per year.⁸ Each response takes approximately two hours to complete. Thus, the total compliance burden per year is 600 burden hours.⁹ The approximate internal compliance cost per hour is \$57.00 for clerical labor, resulting in a total internal compliance cost of \$34,200.¹⁰ These reflect internal labor costs; there are no external labor, capital, or start-up costs.

13. Costs to Respondents

Respondents will not incur any capital, start-up, operational or maintenance costs to comply with the rule.

14. Costs to Federal Government

Not applicable.

⁶ See 17 CFR 200.80(b)(4)(iii).

⁷ 50 respondents x 6 responses per year x 2 hours per response = 600 hours per year.

⁸ 50 respondents x 6 responses per year = 300 responses per year.

⁹ 300 responses per year x 2 hours per response = 600 hours per year.

¹⁰ 600 hours per year x \$57.00 per hour = \$34,200 per year.

15. Changes in Burden

None.

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.

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.