

**SUPPORTING STATEMENT**  
**For the Paperwork Reduction Act Information Collection Submission for Proposed**  
**Rule 15l-2**

**A. JUSTIFICATION**

**1. Necessity for the Information Collection**

Proposed new rule 15l-2 under the Securities Exchange Act of 1934 (17 CFR 240.15l-2 (the “Exchange Act”) would impose burdens on broker-dealers registered with the Commission (“broker-dealers”) relating to investments in “leveraged/inverse investment vehicles” by their retail customers.<sup>1</sup> Under the proposed rule, the term “leveraged/inverse investment vehicle” means a registered investment company, or exchange-listed commodity- or currency-based trust or fund, that seeks, directly or indirectly, to provide investment returns that correspond to the performance of a market index by a specified multiple, or to provide investment returns that have an inverse relationship to the performance of a market index, over a predetermined period of time. The proposed rule is designed to address investor protection concerns related to leveraged/inverse investment vehicles by helping to ensure that retail investors in those products are capable of evaluating their characteristics and the unique risks they present.

Under the proposed rule, before accepting an order from a customer that is a natural person (or the legal representative of a natural person) to buy or sell shares of a leveraged/inverse investment vehicle, the broker-dealer must approve the customer’s account to engage in those transactions in accordance with the proposed rule. To make

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<sup>1</sup> See Use of Derivatives by Registered Investment Companies and Business Development Companies; Required Due Diligence by Broker-Dealers and Registered Investment Advisers Regarding Retail Customers’ Transactions in Certain Leveraged/Inverse Investment Vehicles, Investment Company Act Release No. 33704 (Nov. 25, 2019).

this approval determination, the proposed rule would require a broker-dealer (or any associated person of the broker-dealer) to exercise due diligence to ascertain certain essential facts about the customer. Specifically, the broker-dealer would have to seek to obtain certain information about the retail investor as described in the proposed rule. A broker-dealer could approve the retail investor's account to buy or sell shares of leveraged/inverse investment vehicles only if, based on the information obtained, the broker-dealer had a reasonable basis to believe that the investor is capable of evaluating the risks associated with leveraged/inverse investment vehicles. Proposed rule 15l-2 also would require broker-dealers to adopt and implement policies and procedures reasonably designed to achieve compliance with the proposed rule's provisions. Finally, proposed rule 15l-2 includes related recordkeeping provisions.

The proposed rule contains "collections of information" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").<sup>2</sup> The information collections are integral to the framework of proposed rule 15l-2 and therefore necessary to help further the proposed rule's aforementioned goals. The information collections also would assist the Commission's examination staff in assessing investment advisers' compliance with the requirements of proposed rule 15l-2.

## **2. Purpose and Use of the Information Collection**

The collection of information under proposed rule 15l-2 is integral to the framework of the proposed rule and therefore necessary to further the proposed rule's goal of helping to ensure that retail investors who invest in leveraged/inverse investment vehicles are capable of evaluating the unique risks of those products. The information

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<sup>2</sup> See 44 U.S.C. 3501 through 3521.

collection also would assist the Commission's examination staff in assessing broker-dealers' compliance with the requirements of the proposed rule. The respondents to proposed rule 15l-2 would be broker-dealers registered with the Commission that place orders for retail customers to invest in leveraged/inverse investment vehicles.

### **3. Consideration Given to Information Technology**

Proposed rule 15l-2 would not require the reporting of any information or the filing of any documents with the Commission. The Electronic Signatures in Global and National Commerce Act<sup>3</sup> and rule 17a-4(f) under the Securities Exchange Act of 1934 permit broker-dealers to maintain records electronically.

### **4. Duplication**

The Commission periodically evaluates rule-based reporting and recordkeeping requirements for duplication and reevaluates them whenever it proposes a rule or a change in a rule. Broker-dealers are subject to other disclosure and recordkeeping requirements under the federal securities laws and agency rules, which may require broker-dealers to seek to obtain similar information about retail investors and to retain related records. Proposed rule 15l-2, however, has the distinct purpose of helping to ensure that retail investors that invest in leveraged/inverse investment vehicles are capable of understanding the risks of those products.

### **5. Effect on Small Entities**

We recognize that the collections of information required by proposed rule 15l-2 may require different amounts of time or external assistance for different broker-dealers. The Commission believes, however, that imposing different requirements on smaller

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<sup>3</sup> P.L. 106-229, 114 Stat. 464 (June 30, 2000).

broker-dealers would not be consistent with the investor protection purposes of proposed rule 15l-2. The Commission reviews all rules periodically, as required by the Regulatory Flexibility Act, to identify methods to minimize recordkeeping or reporting requirements affecting small businesses.

#### **6. Consequences of Not Conducting Collection**

The collection of information under proposed rule 15l-2 is integral to the framework of proposed rule 15l-2 and therefore necessary to help further the proposed rule's goal of helping to ensure that retail investors in leveraged/inverse investment vehicles are capable of evaluating the characteristics and unique risks those products present. Thus, not requiring this collection of information would be incompatible with the goals of proposed rule 15l-2.

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

Proposed rule 15l-2 would require a broker-dealer to maintain a written record of the information that it obtained under the rule 15l-2 due diligence requirement and its written approval of the customer's account for buying or selling shares of leveraged/inverse investment vehicles, as well as the broker-dealer's policies and procedures under the proposed rule, for a period of not less than six years (the first two years in an easily accessible place) after the date of the closing of the customer's account. Although this six-year period exceeds the three-year guideline for most kinds of records under 5 CFR 1320.5(d)(2), the Commission believes that this is warranted because the rule contributes to the effectiveness of the Commission's examination and inspection program. Because the period between examinations may be as long as six years, it is

important that the Commission have access to records that cover the entire period between examinations.

#### **8. Consultation Outside the Agency**

Before adopting proposed rule 15l-2, the Commission will receive and evaluate public comments on the proposal and its collection of information requirements. Moreover, the Commission and the staff of the Division of Investment Management and the Division of Trading and Markets participate in an ongoing dialogue with representatives of the investment company and broker-dealer industries through public conferences, meetings, and information exchanges. These various forums provide the Commission and staff with a means of ascertaining and acting upon the paperwork burdens confronting the industry.

#### **9. Payment or Gift**

No payment or gift to respondents was provided.

#### **10. Confidentiality**

Responses provided to the Commission in connection with staff examinations or investigations would be kept confidential subject to the provisions of applicable law. If information collected pursuant to proposed rule 15l-2 is reviewed by the Commission's examination staff, it will be accorded the same level of confidentiality accorded to other responses provided to the Commission in the context of its examination and oversight program.

#### **11. Sensitive Questions**

No information of a sensitive nature, including social security numbers, or personally identifiable information (PII) would be required under this collection of

information. The agency has determined that a system of records notice (SORN) and privacy impact assessment (PIA) are not required in connection with the collection of information.

## **12. Estimate of Hour Burden**

The following estimates of average burden hours and costs are made solely for purposes of the Paperwork Reduction Act and are not derived from a comprehensive or even representative survey or study of the cost of Commission rules and forms.<sup>4</sup>

The respondents to the proposed rule would be broker-dealers registered under the Exchange Act with retail customers that transact in leveraged/inverse investment vehicles. Compliance with proposed rule 15l-2 would be mandatory for all such broker-dealers. To the extent that records required to be created and maintained by broker-dealers under the proposed rule are provided to the Commission in connection with examinations or investigations, such information would be kept confidential subject to the provisions of applicable law.

We estimate that, as of December 31, 2018, there were approximately 2,766 broker-dealers registered with the Commission that reported some sales to retail customer investors.<sup>5</sup> We further estimate that 700 of those broker dealers with retail customer

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<sup>4</sup> The Commission's estimates of the relevant wage rates in the tables below are based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association's Office Salaries in the Securities Industry 2013. The estimated wage figures are modified by Commission staff to account for an 1,800-hour work-year and multiplied by 2.93 to account for bonuses, firm size, employee benefits, overhead, and adjusted to account for the effects of inflation. *See* Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013 ("SIFMA Report").

<sup>5</sup> Our estimates relating to retail sales by broker-dealers are based on data obtained from Form BD and Form BR.

accounts (approximately 25%) have retail customer accounts that invest in leveraged/inverse investment vehicles.

#### **A. Due Diligence and Account Approval**

Under proposed rule 15l-2, before accepting an order from a customer that is a natural person (or the legal representative of a natural person) to buy or sell shares of a leveraged/inverse investment vehicle, the broker-dealer must approve the customer's account to engage in those transactions in accordance with the proposed rule. To make this determination, the broker-dealer must exercise due diligence to ascertain certain facts about the customer, his or her financial situation, and investment objectives. To comply with this due diligence requirement, the broker-dealer must seek to obtain certain information described in the proposed rule. This proposed rule is modeled, in large part, after the FINRA rule requiring due diligence and account approval for retail investors to trade in options.<sup>6</sup> Based on our understanding of how broker-dealers comply with the FINRA options account requirements, we believe that a common way for broker-dealers to comply with this due diligence obligation would be to utilize in-house legal and compliance counsel, as well as in-house computer and website specialists, to create an online form for customers to provide the required information for approval of their accounts to trade in leveraged/inverse investment vehicles. We also believe that a portion of the due diligence would be performed by individuals associated with a broker-dealer or by telephone or in-person meetings with investors.

Currently, there are 105 leveraged/inverse mutual funds, 164 leveraged/inverse ETFs, and 17 exchange-listed commodity- or currency-based trusts or funds that meet the

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<sup>6</sup> See, e.g., FINRA rule 2360(b)(16), (17) (requiring firm approval, diligence, and recordkeeping for options accounts).

definition of “leveraged/inverse investment vehicle” under the proposed rule.

Accordingly, there are 286 leveraged/inverse investment vehicles in total for which a broker-dealer would be required to approve a retail customer’s account before the customer could transact in the shares of those vehicles. Based on our experience with broker-dealers and leveraged/inverse investment vehicles, we estimate that each of these leveraged/inverse investment vehicles is held by approximately 2,500 separate retail investor accounts held by registered broker-dealers, for a total of 715,000 existing accounts requiring approval to trade in leveraged/inverse investment vehicles. We further estimate that approximately 10,000 new retail accounts will be opened each year requiring approval to trade in leveraged/inverse investment vehicles.

Table 1 below summarizes our initial and ongoing PRA burden estimates associated with the due diligence and account approval requirements in proposed rule 15l-2. Based on our understanding of current broker-dealer practices, we do not estimate that there will be any initial or ongoing external costs associated with the proposed due diligence and account approval requirements.



**Table 1: Proposed Rule 15l-2 Due Diligence and Account Approval PRA Estimates**

	Internal initial burden hours	Internal annual burden hours <sup>1</sup>		Wage rate <sup>2</sup>	Internal time costs	Initial external cost burden	Annual external cost burden
<b>PROPOSED ESTIMATES</b>							
Development and implementation of customer due diligence	6 hours	2 hours	×	\$365 (compliance attorney)	\$730		
	9 hours	3 hours	×	\$284 (senior systems analyst)	\$852	\$0	\$0
	12 hours	4 hours	×	\$331 (senior programmer)	\$1324		
Annual burden per broker-dealer		9 hours			\$2906		
Estimated number of affected broker-dealers		700			700		
<b>Total burden (I)</b>		<b>6300 hours</b>			<b>\$2,034,200</b>		
Customer due diligence	3 hours	1 hour	×	\$365 (compliance attorney)	\$365		
	3 hours	1 hour	×	\$70 (compliance clerk)	\$70		
Evaluation of customer information for account approval/disapproval	1 hour	.33 hours	×	\$309 (compliance manager)	\$101.97		
Total annual burden per customer account	7 hours	2.33 hours			\$536.97		
Estimated number of affected customer accounts		× 248,333.33 <sup>3</sup>			× 248,333.33	× 248,333.33	× 248,333.33
<b>Total burden (II)</b>		<b>578,616.66 hours</b>			<b>\$133,347,548</b>		
<b>Total annual burden (I+II)</b>		<b>584,916.66 hours</b>			<b>\$135,381,748</b>	<b>\$0</b>	<b>\$0</b>

**Notes:**

1. Includes initial burden estimates annualized over a three-year period.

2. See *supra* footnote 3.

3. We estimate that 715,000 existing customer accounts with broker-dealers would require the proposed rule 15l-2 account approval for trading in leveraged/inverse investment vehicles, and that 10,000 new customer accounts opened each year would require such approval. Accordingly, we believe that over a three-year period, a total of 745,000 accounts will require approval, which when annualized over a three-year period, equals 248,333.33 accounts per year.

## **B. Policies and Procedures**

Proposed rule 15l-2 would require broker-dealers to adopt and implement policies and procedures reasonably designed to achieve compliance with the proposed rule's provisions. We believe that broker-dealers likely would establish these policies and procedures by adjusting their current systems for implementing and enforcing compliance policies and procedures. While broker-dealers already have policies and procedures in place to address compliance with other Commission rules (among other obligations), they would need to update their existing policies and procedures to account for rule 15l-2. To comply with this obligation, we believe that broker-dealers would use in-house legal and compliance counsel to update their existing policies and procedures to account for the requirements of rule 15l-2. For purposes of these PRA estimates, we assume that broker-dealers would review the policies and procedures that they would adopt under proposed rule 15l-2 annually (for example, to assess whether the policies and procedures continue to be "reasonably designed" to achieve compliance with the proposed rule). We therefore have estimated initial and ongoing burdens associated with the proposed policies and procedures requirement. As discussed above, we estimate that approximately 700 broker dealers have retail customer accounts that invest in leveraged/inverse investment vehicles. We do not estimate that there will be any initial or ongoing external costs associated with the proposed policies and procedures requirement.

Table 2 below summarizes our initial and ongoing annual PRA burden estimates associated with the policies and procedures requirement in proposed rule 15l-2.

**Table 2: Proposed Rule 15l-2 Policies and Procedures PRA Estimates**

	Internal initial burden hours	Internal annual burden hours <sup>1</sup>		Wage rate <sup>2</sup>	Internal time costs
<b>PROPOSED ESTIMATES</b>					
Establishing and implementing rule 15l-2 policies and procedures	3 hours	1 hour	×	\$309 (compliance manager)	\$309.00
	1 hours	0.33 hours	×	\$365 (compliance attorney)	\$120.45
	1 hour	0.33 hours	×	\$530 (chief compliance officer)	\$174.90
Reviewing and updating rule 15l-2 policies and procedures		1 hour	×	\$309 (compliance manager)	\$309.00
		1 hour	×	\$365 (compliance attorney)	\$365.00
		1 hour	×	\$530 (chief compliance officer)	\$530.00
Total annual burden per broker-dealer		4.66 hours			\$1,808.35
Number of affected broker- dealers		× 700			× 700
<b>Total annual burden</b>		<b>3,262 hours</b>			<b>\$1,265,845</b>

**Notes:**

1. Includes initial burden estimates annualized over a three-year period.
2. See *supra* footnote 3.

### C. Recordkeeping

Under proposed rule 15l-2, a broker-dealer would have to maintain a written record of the information that it obtained under the rule 15l-2 due diligence requirement and its written approval of the customer’s account, as well as the firm’s policies and procedures, for a period of not less than six years (the first two years in an easily accessible place) after the date of the closing of the customer’s account. To comply with this obligation, we believe that broker-dealers would use in-house personnel to compile and maintain the relevant records. We do not estimate that there will be any initial or ongoing external costs associated with this requirement.

Table 3 below summarizes our PRA initial and ongoing annual burden estimates associated with the recordkeeping requirement in proposed rule 15l-2.

**Table 3: Proposed Rule 211(h)-1 Recordkeeping PRA Estimates**

	Internal initial burden hours	Internal annual burden hours		Wage rate <sup>1</sup>	Internal time costs
<b>PROPOSED ESTIMATES</b>					
Recordkeeping	0 hours	1 hour	×	\$62 (general clerk)	\$62
	0 hours	1 hour	×	\$95 (senior computer operator)	\$95
Total annual burden per broker-dealer	0 hours	2 hours			\$157
Number of affected broker-dealers	× 700	× 700			× 700
<b>Total annual burden</b>	<b>0 hours</b>	<b>1,400 hours</b>			<b>\$109,900</b>

**Notes:**

1. See *supra* footnote 3.

**D. Proposed Rule 15l-2 Total Estimated Burdens**

As summarized in Table 4 below, we estimate that the total hour burdens and time costs associated with proposed rule 15l-2, including the burden associated with the due diligence and account approval requirement, the policies and procedures requirement, and the recordkeeping requirement, would result in an average aggregate annual burden of 589,578.66 hours and an average aggregate time cost of \$136,757,493. Therefore, each broker-dealer would incur an annual burden of approximately 842.26 hours, at an average time cost of approximately \$195,367.85, to comply with proposed rule 15l-2.

**Table 4: Proposed Rule 15l-2 Total Estimated PRA Burden**

	Internal initial burden hours	Internal burden time cost	External cost burden
Due diligence and account approval	584,916.66 hours	\$135,381,748	\$0
Policies and procedures	3,262 hours	\$1,265,845	\$0
Recordkeeping	1,400 hours	\$109,900	\$0
<b>Total annual burden</b>	<b>589,578.66 hours</b>	<b>\$136,757,493</b>	<b>\$0</b>
Number of affected broker-dealers	÷ 700	÷ 700	÷ 700
<b>Average annual burden per affected broker-dealer</b>	<b>842.26 hours</b>	<b>\$195,367.85</b>	<b>\$0</b>

### **13. Cost to Respondents**

As discussed in Item 12, we estimate that proposed rule 15l-2's costs related to the customer due diligence and account approval, recordkeeping, and policies and procedures requirements are fully captured as internal hour burdens in Item 12.

### **14. Costs to Federal Government**

Proposed rule 15l-2 does not impose a cost to the federal government. Commission staff may, however, review records produced pursuant to the rule in order to assist the Commission in carrying out its examination and oversight program.

### **15. Changes in Burden**

This is the first request for approval of the collection of information for this rule.

### **16. Information Collection Planned for Statistical Purposes**

Not applicable.

### **17. Approval to Omit OMB Expiration Date**

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

### **18. Exceptions to Certification for Paperwork Reduction Act Submissions**

The Commission is not seeking an exception to the certification statement.

**B. COLLECTIONS OF INFORMATION EMPLOYING STATISTICAL METHODS**

The collection of information will not employ statistical methods.