



FREQUENTLY ASKED QUESTIONS ABOUT THE AMENDMENTS TO BROKER/DEALER BOOKS AND RECORDS RULES UNDER THE SECURITIES EXCHANGE ACT OF 1934

Executive Summary

On October 25, 2001, the Securities and Exchange Commission (“SEC” or “Commission”) adopted amendments to Rules 17a-3 and 17a-4 under the Securities Exchange Act of 1934 (“Exchange Act”) to clarify and expand record keeping requirements in connection with purchase and sale documents, customer records, associated person records, customer complaint records, and certain other matters.¹ The amendments also require broker/dealers to maintain or promptly produce certain records at each office to which those records relate. The amendments become effective on May 2, 2003.

Since the issuance of the SEC’s Release (the “Adopting Release”) concerning the amendments, many questions have been raised. The purpose of this Notice is to address some frequently asked questions about the new SEC requirements.

The answers expressed below are staff opinions only and have not been reviewed or endorsed by NASD’s Board, nor have they been approved by the SEC.

Frequently Asked Questions

Order Tickets

Question 1: What are the new requirements for order tickets?

Answer: The final rules require that a brokerage order ticket:

- Show the terms and conditions of the order or instructions, and any modification or cancellation thereof;
- Identify the account for which the order is entered;
- Identify the associated person, if any, responsible for the account and any other person who entered or accepted the order on behalf of the customer, or if a customer entered the order on an electronic system, a notation of that entry;
- Describe whether the order was entered subject to discretionary authority;
- Include, to the extent feasible, the time of execution or cancellation;² and
- Identify the time the order was received, the time of entry, and the price at which it was executed.³

Question 2: What is meant by the “time of entry”?

Answer: The term “time of entry” means the time when the member, broker or dealer transmits the order or instruction for execution.⁴

Question 3: If the time of entry is simultaneous or nearly simultaneous with the time that the order is received, does the firm have to create a separate entry for each time?

Answer: In its Adopting Release, the SEC stated that in such situations, it must be clear from the order ticket that the time of receipt was the same as the time of entry. The Commission further stated that the time recorded must be accurate and this should not be construed as an exception to allow firms to use an approximate time for one or both entries.⁵

Question 4: What must a firm put on the order ticket if an associated person is not assigned to an account?

Answer: Firms that do not assign associated persons to an account do not have to include the identity of an associated person on the order ticket.⁶

Question 5: Must a firm create an order ticket record when a customer purchases mutual funds or variable annuities?

Answer: The amended rule states that a memorandum does not need to be made regarding a purchase, sale or redemption of a security on a “subscription-way basis” directly from or to the issuer (such as mutual funds or variable annuities), if the member, broker or dealer maintains a copy of the subscription agreement regarding a purchase, or a copy of any other document required by the issuer regarding a sale or redemption, instead of making a separate record as to transactions.⁷

In these instances, customers fill out applications or subscription agreements that the broker/dealer forwards to an issuer. These documents generally include information that is important for, and specific to, a particular type of transaction.⁸ In its Adopting Release, the Commission also notes that automatic dividend reinvestments are similar to the purchases of mutual funds and variable annuities and should be treated in a similar fashion.⁹

Question 6: When an associated person responsible for the account is identified on the order ticket, must the associated person be identified by name?

Answer: If a firm assigns identification numbers or codes to persons entering customer orders, the broker/dealer may enter the identification code or number on the order ticket instead of the associated person’s name. If a firm chooses this option, it must, if requested by a representative of a securities regulatory authority, provide the actual identity of the person who entered the order. This requirement may be satisfied by a companion record to the order ticket.¹⁰

Associated Persons Records

Question 7: What records must a firm maintain concerning its associated persons?

Answer: Rule 17a-3(a)(12) requires a firm to make records concerning its associated persons, including information regarding their employment and disciplinary histories. The amendment to (a)(12), requires that firms create a record listing all of their associated persons that shows, for each associated person, every office where the associated person regularly conducts a securities business, and listing all internal identification numbers or codes and the CRD number assigned to each associated person.¹¹

Question 8: How is “associated person” defined?

Answer: The current (or pre-amendment) Rule 17a-3(a)(12)(ii), defined “associated person” for purposes of (a)(12) as: “a partner, officer, director, salesman, trader, manager, or other employee handling funds or securities or soliciting transactions or accounts for such member, broker or dealer.” The amendment to Rule 17a-3 changes the definition of “associated person.”

The new definition is much broader. It has been modified to incorporate the definitions set forth in Exchange Act Sections 3(a)(18) and 3(a)(21). An associated person includes any partner, officer, director, or branch manager of a broker/dealer (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with a broker/dealer, or any employee of a broker/dealer. This includes order-takers. In the Adopting Release, the Commission notes that the term “associated person” includes any independent contractor, consultant, franchisee, or other person providing services to a broker/dealer equivalent to those services provided by persons specifically referenced in the Exchange Act.¹² Excluded from the definition are persons whose functions are solely clerical or ministerial.¹³

Customer Account Records

Question 9: What account records must be kept regarding a customer?

Answer: The amendment to Rule 17a-3 created new subsection Rule 17a-3(a)(17), which requires broker/dealers to create an account record for each customer or owner that is a natural person with certain minimum information regarding each customer or owner. The required information includes: the customer’s or owner’s name, tax identification number, address, telephone number, date of birth, employment status (including occupation and whether the customer is an associated person of a broker or dealer), annual income, net worth (excluding the value of a primary residence), and the account’s investment objectives.¹⁴

It is also important to point out that the rule states that a broker/dealer is not required to include the customer’s tax identification number and date of birth with the information provided to the customer. The Adopting Release notes that several commenters suggested that unauthorized access to such information could facilitate the perpetration of fraud against the customer.¹⁵

Question 10: What kind of information must be maintained if an account has more than one owner?

Answer: If an account has more than one owner, the record must include personal information for each owner of the account who is a natural person. However, as the Adopting Release explains, it is acceptable for firms to combine joint owners’ financial information rather than obtaining and maintaining such information separately for each owner. The Adopting Release also notes that the record should reflect the investment objectives for the account and not the individual investment objectives for each joint owner named on the account.¹⁶

This release explains that, although a broker/dealer must create a single record for each account, that record may consist of more than one document, such as two or more account applications.¹⁷

Question 11: What information must a firm obtain from a customer with a discretionary account?

Answer: In addition to the aforementioned required information (listed in Question 9), for discretionary accounts, firms must obtain the dated signature of each customer granting the discretionary authority and the dated signature of each natural person to whom discretionary authority was granted.¹⁸

Question 12: What other information must be contained in the customer account records?

Answer: The account record must indicate whether it has been signed by the associated person responsible for the account, if any, and approved or accepted by a principal of the firm.¹⁹

Question 13: What if no one is assigned to the account?

Answer: In the Adopting Release, the SEC recognized that firms do not always assign an associated person to each account. Accordingly, the SEC added the phrase “if any” to the requirement that the account record state whether it had been signed by an associated person. Even if no associated person is assigned to an account, the account record must indicate whether a principal has approved it.²⁰

Question 14: Does the amended rule require firms to furnish customers with account record information?

Answer: Rule 17a-3(a)(17) requires that broker/dealers periodically furnish each customer or owner with a copy of the account record (or an alternate document containing all of the required information), generally within 30 days of opening the account and at least every 36 months thereafter and when certain information is changed.²¹ For accounts in existence before May 2, 2003, broker/dealers have three years from May 2, 2003, to obtain and furnish customers with the account record information.

The rule also requires that the firm include with the account record or alternate document an explanation of any terms regarding investment objectives.²² In addition, the account record or alternate document should include or be accompanied by prominent statements that the customer or owner should mark any corrections and return the account record or alternate document to the firm and that the customer or owner should notify the firm of any future changes to the information contained in the account record.²³

Question 15: What triggers this requirement?

Answer: The following events require the firm to provide the account record information to the customer:

- (1) The opening of a new account -- the broker/dealer must furnish the account record information within 30 days of the opening of the account;
- (2) The periodic updating of an account – the broker/dealer must furnish the account record information at least once every 36 months; and
- (3) A change in the account’s investment objectives – the broker/dealer must furnish to each customer or owner, and associated person, if any, responsible for the account a copy of the updated account record information within 30 days after receiving notice of the change.²⁴

Also, if there is a change in name or address of the customer or owner, the broker/dealer must send the notification of the change to the customer's old address, or to each joint owner, and to the associated person, if any, responsible for the account, within thirty days after receiving notice of the change.

Question 16: Is a firm required to make a separate mailing when providing customers with the account record information?

Answer: The new rule does not require a separate mailing. In its Adopting Release, the Commission notes that this mailing may be combined with other mailings.²⁵ The Commission explains that account record information may be printed, for example, on a customer's account statement. In addition, a firm may mail the customer a copy of the customer's complete account record reflecting any change of other account record information on or before the 30th day after the date the firm received notice of any change. The firm may also choose to send this notification with the next statement scheduled to be mailed to the customer.²⁶

Question 17: Is there an exemption from the account record information requirements?

Answer: The Adopting Release notes that many firms argued for an exemption contending that the rule was intended to allow examiners to review for suitability, but that firms are not subject to SRO suitability requirements for all of their accounts. The SEC decided to create an exemption for certain accounts. The rule states that the account record and furnishing requirements of Rule 17a-3(a)(17) will only apply to accounts for which a firm is, or has within the past 36 months been, required to make a suitability determination under the federal securities laws or under the requirements of a self-regulatory organization of which it is a member.

The Adopting Release emphasizes, however, that the obligation to collect and record suitability information may arise under SRO rules and interpretations. If, after the account is opened, the firm or its associated persons engage in conduct that would subject the firm to suitability requirements, the firm must obtain the information before making such a recommendation. The firm would also have to comply thereafter with the requirement to furnish customers with a copy of their account records for verification, under the Rule, but the account could re-qualify for the exemption if suitability determinations were no longer required of the firm.

Firms should look at NASD Rules 2310 and 2860(b)(16)(B), which deal with, respectively, making recommendations to customers and member's suitability obligations, and with diligence in opening customer accounts for options trading, where due diligence must be exercised in ascertaining essential facts about a customer, his or her financial status and investment objectives. Firms should also be aware of other SRO rules such as NYSE Rule 723, Chicago Board Options Exchange Rule 9.9 and the MSRB Rule G-19. In addition, it is important to note that the term "suitability determination" in this context should be interpreted broadly. A firm may have an obligation to perform a suitability determination under the Exchange Act (like in Sections 10(b) and 15(c)), Commission Rules (such as Rules 10b-5 and 15c1-2, 15g-1-15g-9), SRO Rules or common law.²⁷

Question 18: Must firms create account records under Rule 17a-3(a)(17) for all accounts?

Answer: Rule 17a-3(a) (17) requires firms to create an account record for both new and existing accounts. For accounts opened on or after May 2, 2003, the firm must obtain the account record information required under Rule 17a-3(a) (17) (i) (A) when the account is opened.²⁸

For accounts existing before May 2, 2003, firms will have 36 months to obtain the required information for the account record. A new 36-month furnishing cycle under Rule 17a-3(a) (17) will begin when the firm obtains the account record information within the initial 36-month grace period.²⁹

Question 19: Must firms provide customers with copies of written agreements?

Answer: The release states that each broker/dealer is required to create a record for each account indicating that each customer was furnished with a copy of any written agreement entered into on or after the effective date of the rule pertaining to that account, and that if requested by the customer or owner, the customer or owner was furnished with a fully executed copy of each agreement. This will enable customers to review the terms of agreements to which they are subject, and to better understand their rights and responsibilities under these agreements.³⁰

Question 20: What if a customer refuses, neglects, or is unable to provide the required information to the broker/dealer?

Answer: If a customer refuses, neglects or is unable to provide or update any account record information required under Rule 17a-3(a)(17)(i)(A), the broker/dealer is excused from obtaining the required information.³¹ In its Adopting Release, the Commission notes the rule, as adopted, does not require that the broker/dealer include an explanation of the customer's neglect, refusal or inability to provide the information. The Commission, however, states that the broker/dealer is required to make a good faith effort to collect the information and would bear the burden of explaining why the information is not available.³²

Firms should also be aware, however, that this provision is limited to the (a)(17) account record requirement and does not apply to any other federal or SRO rules requiring the collection of information.³³

Complaints

Question 21: Must a firm create a record of customer complaints it receives concerning associated persons?

Answer: New Rule 17a-3(a)(18)(i) requires firms to make a record of every written customer complaint they receive about an associated person. This requirement extends to complaints received electronically from customers. The record must include the following information:

- The complainant's name, address, and account number;
- The date the complaint was received;
- The name of each associated person identified in the complaint;
- A description of the nature of the complaint; and
- The disposition of the complaint.³⁴

Because firms are already required to keep originals of incoming written complaints, firms have the option to comply with this rule by keeping the original complaint along with a record of the disposition of the complaint, if kept by name of the associated person.³⁵

Question 22: What kind of record is a firm required to create regarding notification to customers of where to file complaints?

Answer: Under 17a-3(a)(18)(ii), firms are required to make a record indicating that each customer has been provided with a notice of the address and telephone number of the department of the firm to which complaints may be directed.³⁶

Compensation

Question 23: Must firms maintain records regarding an associated person's compensation?

Answer: New Rule 17a-3(a)(19)(i) requires firms to make a record concerning each associated person, listing each purchase and sale of a security attributable, for compensation purposes, to that associated person. The record must include the amount of compensation (if monetary) and a description of the compensation (if non-monetary).³⁷

Under this requirement, firms must make records of all commissions, concessions, overrides, and other compensation to the extent they are earned or accrued for transactions. In addition, if the compensation is non-monetary, that description should include an estimate of its value.³⁸

Question 24: How is "non-monetary compensation" defined?

Answer: The term "non-monetary compensation" includes compensation such as sales incentives, gifts, or trips that would be provided to associated persons if certain sales goals were achieved. Such non-monetary compensation should be recorded if directly related to sales. Non-monetary compensation does not include items of little value distributed by the firm.

Question 25: Must firms maintain records of their agreements with associated persons under the amended rules?

Answer: Firms must maintain a record of all agreements pertaining to the relationship between each associated person and the broker/dealer, including a summary of each associated person's compensation arrangement or plan.³⁹ In addition, to the extent that compensation is based on factors other than remuneration on a per trade basis, the firm must make a record that describes the method by which compensation is to be determined.⁴⁰ This requirement includes verbal agreements and records, such as commission schedules, which may change on a periodic basis.⁴¹

Compliance with Requirements for Communications with the Public

Question 26: What records must the firm keep regarding communications with the public?

Answer: New Rule 17a-3(a)(20) requires each firm to make a record documenting that the firm has complied with, or adopted policies and procedures reasonably designed to establish compliance with, applicable federal regulations and SRO rules, which require that a principal approve any advertisements, sales literature, or other communications with the public.⁴²

Persons to Explain Records and their Content

Question 27: What records are required to be maintained regarding the identification of firm personnel that can explain customer records?

Answer: The amendments to Rule 17a-3 added a requirement that broker/dealer firms create a record that lists, by name or title, all personnel at an office who can, without delay, explain the

types of records that the firm maintains at that office.⁴³ In its Adopting Release, the Commission stated that the individuals must be able to promptly explain how the firm makes, keeps and titles its records. The Commission noted that firms may identify more than one person and list the records each person is able to explain.⁴⁴

Record Listing Principals of the Firm

Question 28: Is there a requirement for a record listing the principals of the firm?

Answer: Rule 17a-3(a)(22) requires firms to make a record listing each principal of the firm responsible for establishing policies and procedures that are reasonably designed to ensure compliance with any applicable federal requirements or rules of a SRO of which the firm is a member that require acceptance or approval of a record by a principal.⁴⁵

Office Records

Question 29: Many of the new requirements are geared towards creating records that relate to each office of a broker/dealer and maintaining those records at each office. How is “office” defined?

Answer: The amended rules define “office” as any location where an associated person regularly conducts business. However, an office would *not* include a customer's office that an associated person visits on a regular basis.⁴⁶

A broker/dealer is not required to produce records at an office that is a private residence, provided that:

- only one associated person, or multiple associated persons who reside at that location and are members of the same immediate family, regularly conduct business at the office;
- the office is not held out to the public as an office; and
- neither customer funds nor securities are handled at that office.⁴⁷

Instead, records pertaining to private residences may either be maintained at some other location within the same state as that office as the broker/dealer chooses, or be promptly produced at an agreed upon location.⁴⁸

Question 30: What records must be created and kept current as to each office?

Answer: New Rule 17a-3(g) requires firms to make and keep current, separately for each office, certain books and records that reflect the activities of the office.⁴⁹ This includes blotters, order tickets, customer account records, records with respect to associated persons, customer complaints, records evidencing compliance with SRO rules with regard to communications with the public, records of persons who can explain the information in the broker/dealer's records, and records of each principal responsible for establishing recordkeeping compliance procedures.⁵⁰

Question 31: How long must firms maintain records at office locations?

Answer: The requirement to maintain certain records at office locations is two years. The amended rules also provide that, if a broker/dealer does not maintain records at an office, but instead chooses to produce the records upon request, the broker/dealer must produce the records “promptly.”⁵¹

Question 32: How is “promptly” defined?

Answer: In the Adopting Release, the Commission states that the word “promptly” has deliberately not been defined in the rule.⁵² The Commission states that, in general, requests for records that are readily available at the office (either on-site or electronically) should be filled on the day the request is made. If a request is unusually large or complex, then the firm should discuss with the regulator a mutually agreeable time frame for production.⁵³

Question 33: What if the firm has a foreign office?

Answer: The Commission states in the Adopting Release, that, while the broker/dealer must make certain records for its foreign office, it is not required to maintain or produce those records at the foreign office. Instead, those records would be maintained at the broker/dealer's main office.⁵⁴

General Record Retention Requirements

Question 34: What records must be retained under the amendments?

Answer: The amended rules require that broker/dealers do, among other things, the following:

- Retain originals of all communications received and copies of all communications sent (and any approvals thereof) by the firm (including interoffice memoranda and communications) relating to its business including all communications which are subject to the rules of a self regulatory organization of which the firm is a member regarding communications with the public. (Note that the term “communication” includes sales scripts.)
- Preserve for a period of not less than 6 years after the closing of any customer’s account, any account cards or records which relate to the terms and conditions with respect to the opening and maintenance of the account.
- Retain copies of certain organizational documents for the life of the entity such as partnership articles or articles of incorporation or charter books. Each firm is also required to maintain copies of all of its Forms BD, Forms BDW, and all amendments thereto and all licenses or other documents showing the registration of the firm with any securities regulatory authority.
- Maintain, for three years after the date of the report, all reports which a securities regulatory authority has requested or required a firm to make and furnish to it pursuant to an order or settlement, and each securities regulatory authority examination report.
- Maintain, for three years after the termination of use, all compliance, supervisory, and procedure manuals (including any updates, modifications, and revisions to the manual) describing the firm's policies and practices with respect to compliance and supervision.
- Maintain, for 18 months after the date the report was generated, all reports created to review unusual activity in customer accounts.⁵⁵

¹ See SEC Exchange Act Release 34-44992 (Oct. 26, 2001); *see also* 66 Fed. Reg. 55,818 (November 2, 2001).

² Most broker/dealers are required to record the time the order was received from a customer under NASD Order Audit Trail System (OATS) rules. *See* NASD Rules 6954(b)(16) and 3110(h).

³ *See* 66 Fed. Reg. 55,818, 55,819 & 55,838.

⁴ *See* Rule 17a-3(a)(6)(i); 66 Fed. Reg. 55,818, 55,838.

⁵ 66 Fed. Reg. 55,818, 55,819.

⁶ *Id.*

⁷ 66 Fed. Reg. 55,818, 55,838.

⁸ 66 Fed. Reg. 55,818, 55,819.

⁹ *Id.*

¹⁰ 17a-3(a)(12)(ii); 66 Fed. Reg. 55,818, 55,819.

¹¹ 66 Fed. Reg. 55,818, 55,819-55,820, 55,838.

¹² 66 Fed. Reg. 55,818, 55,820, 55,840.

¹³ *Id.*

¹⁴ *Id.* at 55,820-55,821, 55,838. Most firms already collect this information to assist them in assessing customers' suitability or to comply with other rules.

¹⁵ *Id.* at 55,821.

¹⁶ 66 Fed. Reg. 55,818, 55,820-21, 55,838.

¹⁷ *Id.* at 55,821.

¹⁸ Rule 17a-3(a)(17)(i)(A); 66 Fed. Reg. 55,818, 55,820, 55,838; *See also* NASD Rule 2510(b).

¹⁹ Rule 17a-3(a)(17)(i)(A); 66 Fed. Reg. 55,818, 55,820, 55,838; *See* NASD Rule 3110(c)(1)(C).

²⁰ 66 Fed. Reg. 55,818, 55,820-821.

²¹ *Id.* at 55,838.

²² 66 Fed. Reg. 55,818, 55,820.

²³ *Id.* at 55,838-55,839.

²⁴ *Id.* at 55,838-55,839.

²⁵ *Id.* at 55,821.

²⁶ *Id.*

²⁷ *See* 66 Fed. Reg. 55,818, 55,822 and fn. 37. Please note that the Adopting Release does not address this issue with regard to single stock futures or appropriate determinations under day trading rules.

²⁸ *Id.*

²⁹ *Id.*

³⁰ *Id.* at 55,822, 55,839.

³¹ 17a-3(a)(17)(i)(C); 66 Fed. Reg. 55,818, 55,821-55,822.

³² 66 Fed. Reg. 55,818, 55,821.

³³ Recognition of this limitation will be particularly important after the final rule is issued pursuant to Section 326 of the USA PATRIOT Act, and firms are required to identify and verify the identity of customers.

³⁴ 66 Fed. Reg. 55,818, 55,822-23.

³⁵ *Id.*; *See* NASD IM-3110(d).

³⁶ 66 Fed. Reg. 55,818, 55,822-55,823. Questions have been asked about which firm should serve as a contact for customer complaints in an introducing/clearing relationship. The Commission's release indicates that, to the extent not otherwise required, this should be a matter of negotiation between the introducing firm and the clearing firm. If contact information is provided for both firms, the notification should clearly indicate which firm the customer should contact and for what purposes. The Commission also indicated that firms have flexibility to determine how this notice can be delivered to the customers—and inserting the notice on a customer statement is one option. *See also* NASD Rule 3230.

³⁷ 66 Fed. Reg. 55,818, 55,823, 55,839.

³⁸ *Id.* at 55,823.

³⁹ The term "relationship," as used in paragraph (a)(19) of Rule 17a-3, refers solely to the employment or contractual relationship between the associated person and the broker/dealer. It would not relate to personal relationships unrelated to the firm's business. *See* 66 Fed. Reg. 55,818, 55,823.

⁴⁰ *See* 66 Fed. Reg. 55,818, 55,823.

⁴¹ *Id.*

⁴² *Id.* at 55,823-824; *See* NASD Rule 2210(b).

⁴³ Rule 17a-3(a)(21).

⁴⁴ 66 Fed. Reg. 55,818, 55,823.

⁴⁵ *Id.* at 55,824.

⁴⁶ Rules 17a-3(h)(1) and 17a-4(k); *See* 66 Fed. Reg. 55,818, 55,825.

⁴⁷ 66 Fed. Reg. 55,818, 55,825.

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ *Id.*

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.* at 55,825-826, 55,840.