

INFORMATIONAL

**Books And
Records Rules**

**Amendments To
Broker/Dealer Books
And Records Rules
Under The Securities
Exchange Act Of 1934****SUGGESTED ROUTING**

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

- Executive Representatives
- Legal & Compliance
- Operations
- Senior Management

KEY TOPICS

- Books and Records
- Exchange Act Rule 17a-3
- Exchange Act Rule 17a-4

Executive Summary

On October 25, 2001, the Securities and Exchange Commission (SEC or Commission) adopted amendments to Rules 17a-3 and 17a-4 of 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. 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. The *Federal Register* version of the SEC final rule release is provided in Attachment A. For a more complete description of the amendments, members should review the attached SEC final rule release.

Questions/Further Information

Questions concerning this *Notice* may be directed to Emily Gordy, Acting Director, Office of Regulation Policy, Department of Member Regulation, NASD Regulation, Inc. (NASD Regulation), at (202) 728-8070, or Grace Yeh, Assistant General Counsel, Office of General Counsel, NASD Regulation, at (202) 728-6939.

Discussion And Background

In general, Rules 17a-3 and 17a-4 of the Exchange Act establish minimum requirements for records that broker/dealers must prepare and periods during which such records must be maintained.

On October 11, 1996, the National Securities Market Improvement Act of 1996 (NSMIA) was enacted, prohibiting states from establishing books and records rules that differ from, or are more burdensome than those established by the Commission's rules. NSMIA also requires that the SEC periodically consult with states concerning the adequacy of the Commission's books and records rules. The SEC originally proposed amendments to its books and records rules in 1996 (the 1996 Amendments) in response to NSMIA and to concerns expressed by the members of the North American Securities Administrator's Association that the existing Commission's books and records rules do not require firms to make and retain records that would facilitate sales practice examinations and enforcement activities in individual broker/dealer offices by state regulators. Based on comments received on the proposed 1996 Amendments, the SEC substantially revised the amendments and re-proposed them in 1998 (the 1998 Amendments). The final rule amendments incorporate many of the suggestions raised in the approximately 115 comment letters and a letter from the Office of Management Budget that the Commission received in response to the proposed 1998 Amendments.

Highlights Of Amendments

The Commission believes that the final amendments balance the interests of securities regulators to obtain information in a time-efficient manner with the concerns expressed by many industry representatives that costs of complying with the proposed requirements, particularly the

customer account record and rules that require records to be maintained at offices, will be unduly burdensome. The Commission further believes that since broker/dealers presently maintain a significant portion of the records required under the adopted amendments in order to comply with federal or self-regulatory organization (SRO) requirements or in the normal course of business, the new requirements should not present considerable additional burdens for most broker/dealers.

Some of the more significant changes to the books and records rules are discussed below.

1. Office – The amended rules define “office” as locations where one or more associated persons regularly conduct a securities business. The definition of office is significant because firms are required to create and maintain certain records at offices for two years. The final rules provide that instead of maintaining records at a particular office, a broker/dealer may choose to produce records promptly upon request at the office to which the records relate or at another place as agreed to by the regulator. In its final rule release, the Commission states that the word “promptly” has deliberately not been defined in the rule, and suggests that in general, records that are readily available at an office should be produced on the day of the request while the time frame for filling large or complex requests should be discussed between the firm and the regulator.

A broker/dealer is not required to maintain records at an office that is a private residence if only one associated person (or multiple associated persons if members of the same immediate family) regularly conducts 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 the office. Instead, records pertaining to private residence offices may either be maintained at another location within the state of the office at the broker/dealer’s choosing or be produced promptly at an agreed upon location.

The records that broker/dealers must create as to each office include 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 record keeping compliance procedures.

2. Customer Account Records – New Rule 17a-3(a)(17) requires broker/dealers to create an account record for each customer. Broker/dealers must make a good faith effort to collect certain information including basic identification and background information on the customer and the account’s investment objectives. Broker/dealers are required to furnish each customer with the information periodically, generally within 30 days of opening the account and at least every 36 months thereafter and when certain information is changed. Broker/dealers have three years from May 2, 2003 to obtain and furnish customers with the account record information for accounts in existence on May 2, 2003.

Since the purpose of the customer account records is primarily to enable regulators to review for

compliance with suitability rules, accounts that are not subject to SRO suitability requirements, including NASD Conduct Rules 2310 and 2860(b)(16)(B),¹ are exempt from the account record requirements.² Accounts that have been inactive for 36 months are also exempt from the customer account requirements.

Broker/dealers should be aware that even if Rule 17a-3(a)(17) does not require them to create a customer account record for certain accounts, they must still comply with federal laws and SRO rules to collect or update information regarding customer accounts.³

3. Order Tickets – To help securities regulators more efficiently determine whether certain individuals are engaged in sales practice violations, Rules 17a-3(a)(6) and 17a-3(a)(7) were amended to require that order tickets identify the time the order was received, even if subsequently executed, the identity of each associated person responsible for the account, if any, and any other person who entered or accepted the order on behalf of the customer, or, if applicable, a notation that a customer entered the order on an electronic system.⁴ Broker/dealers are not required to create a record of sales or purchase transactions entered into on a subscription basis directly from or to the issuer so long as the broker/dealer maintains a copy of the subscription agreement.

4. Associated Persons Records – Rule 17a-3(a)(12) identifies the records and information that must be maintained with respect to each associated person. To help regulators identify associated persons and where they work, amendments to Rule 17a-3(a)(12) require broker/dealers to create

records of all offices at which each associated person regularly conducts business as well as of all identification numbers assigned to the associated person.

The final amendments specify new associated person records requirements, including records of every written complaint received by the broker/dealer against each associated person (or alternatively, firms have the option to keep a copy of the written complaint along with records of the disposition of the complaint),⁵ records of all agreements pertaining to the associated person's relationship with the broker/dealer and a summary of each associated person's compensation arrangement and records listing transactions for which each associated person will be compensated.

5. Communications With Public – Under new Rule 17a-3(a)(20), broker/dealers are required to make records that demonstrate compliance with applicable federal regulations and SRO rules on communications with the public that require principal approval.⁶

6. Record Maintenance –

Amendments to Rule 17a-4 clarify the periods of time that records described in Rule 17a-3 must be maintained. The amended rules also require that broker/dealers maintain other information, including the following:

- for the life of the entity, copies of Forms BD and all amendments thereto;
- for three years after the date of the report, all reports which a securities regulatory authority has requested or required a firm to create and each examination report;
- for three years after the termination of use, all manuals describing the firm's policies and practices with respect to compliance and supervision; and
- for 18 months after the date the report was generated, reports created to review unusual activity in customer accounts.

Endnotes

- 1 NASD Conduct Rules 2310 and 2860(b)(16)(B) require that members use reasonable efforts and exercise diligence to collect customer information, including a customer's investment objective in connection with making investment recommendations or prior to opening up an options trading account for the customer, respectively.
- 2 Firms that do not make investment recommendations are excluded from the customer account requirements.
- 3 Members are required under NASD Conduct Rule 3110(c) maintain certain customer information.
- 4 If the broker/dealer uses an electronic system to generate the order ticket, and such system does not have a field to enter the name of any person, other than the associated person responsible for the account, who accepted the order, the broker/dealer may produce upon request by a regulator a separate record to identify the person rather than identify the person on the order ticket.
- 5 NASD Conduct Rule 2860(b)(17) and IM-3110(d) require each member to keep records of complaints.
- 6 NASD Conduct Rule 2210(b) requires that a principal of the member must approve all items of advertising and sales literature.

©2001 National Association of Securities Dealers, Inc. (NASD). All rights reserved. Notices to Members attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.