

NASD NOTICE TO MEMBERS 97-43

SEC Amends Broker/Dealer Record Retention Rule

Suggested Routing

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Executive Summary

On February 5, 1997, in Release No. 34-38245 (Release), the Securities and Exchange Commission (SEC) amended its broker/dealer record retention rule to allow broker/dealers to employ, under certain conditions, electronic storage media to maintain records required to be retained. These 17a-4 amendments reflect a recognition of technological developments that will provide economic as well as time-saving advantages for broker/dealers by expanding the scope of recordkeeping options while, at the same time, continuing to require broker/dealers to maintain records in a manner that preserves their integrity. The SEC has also issued an interpretation, through the Release, of its record retention rule relating to the treatment of electronically generated communications.

This rule change codifies two SEC staff no-action positions issued on November 3, 1979, and June 18, 1993, respectively (described below), that allowed broker/dealers to utilize microfiche and optical storage technology (OST) under the same conditions as referenced in the Release. These conditions are further outlined in *NASD Notice to Members 93-47* as well as the rule itself (see changes to rule below). The new amendments now allow for the retention of required records, pursuant to SEC Rules 17a-3 and 17a-4, to be stored and maintained using OST, including confirmations and order tickets. However, the recordkeeping requirements pursuant to Securities Exchange Act of 1934 (Exchange Act) Rules 15g-2 and 15g-9 are not to be met by use of electronic storage media. Specifically, Rules 15g-2 and 15g-9 require broker/dealers to obtain from a customer prior to effecting transactions in penny stocks: (i) a manually signed acknowledgement of the receipt of a risk disclosure document; (ii) a written agreement to transactions involv-

ing penny stocks; and (iii) a manually signed and dated copy of a written suitability statement. As a result of the SEC not permitting the use of electronic media to satisfy the requirements of Rules 15g-2 and 15g-9 as outlined in the May 1996 Interpretive Release, the staff of the Division of Market Regulation (Division) believes it would not be appropriate to permit the storage of records required by such rules using electronic storage media. The record retention requirements under these rules require maintenance in paper format for the prescribed time period.

The rule amendment is also calling for the following arrangements: (i) audit systems for certain records; (ii) escrow agents; (iii) third-party download providers; and (iv) indexing of optical disks. These arrangements are summarized immediately below and discussed in detail within the Release.

Audit Systems: Requires the implementation and use of an audit system where required records pursuant to Rule 17a-4 are being entered or when any additions to existing records are made. No audit records will be required for records that can be accessed but not altered by the reader.

Escrow Agents: Broker/dealers who use outside service bureaus to preserve records could place in escrow and keep current a copy of the information necessary to access the format (i.e., the logical layout) of the optical disks and to download records stored on optical disks.

Third-Party Download Provider: Requires broker/dealers that use OST exclusively to have arrangements with at least one third party that has the ability to download information from the broker/dealer's electronic storage system to another acceptable medium. The provider must submit an agreement to the member firm's

designated examining authority (DEA) which will permit the SEC and appropriate DEA to access the members records when needed. Any notices and representation(s) required by SEC Rule 17a-4(f)(2)(i) and 17a-4(f)(3)(vii) should be directed to:

NASD Regulation, Inc.
Compliance Department
1735 K Street, NW
Washington, DC 20006-1500

or facsimile to:
(202) 728-8341.

Indexing of Optical Disks: Requires broker/dealers to keep or escrow all information necessary to download records and indices stored on optical disks.

Background

SEC Rules 17a-3 and 17a-4 specify minimum requirements with respect to the business records that must be kept and maintained by broker/dealers as well as the specific periods during which such records and other docu-

ments relating to the broker/dealer's business must be preserved. Generally, records preserved pursuant to these Rules must be kept for up to six years, the first two in an easily accessible place. Some records, however, must be preserved for three years, and records concerning the legal existence of the broker/dealer (e.g., partnership articles, minute books, stock certificate books) must be preserved during the life of the broker/dealer and its successors.

Until 1970, paper was the sole medium for the preservation of the records required under Rules 17a-3 and 17a-4. In 1970, Rule 17a-4 was amended to permit records to be immediately produced on microfilm for recordkeeping purposes. This amendment allowed for the use of microfilm for record preservation purposes provided that the conditions set forth in paragraph (f) of Rule 17a-4 were met. In 1979, SEC staff interpreted Rule 17a-4 to include microfiche as well as microfilm for recordkeeping purposes, provided that the requirements of Rule 17a-4(f) were satisfied.

Moreover, on June 18, 1993, the SEC issued a no-action letter in response to a May 19, 1992, letter from the Securities Industry Association's Ad Hoc Record Retention Committee allowing for further expansion in the manner records may be preserved under 17a-3 and 17a-4. Specifically, the Committee was granted no-action relief by the Division to allow broker/dealers to maintain the required records on optical disk storage.

The SEC Release that follows this *Notice* contains details regarding the specific requirements to be met if OST is to be utilized, among other things. Members planning to use OST should review the Release in its entirety.

Questions concerning this *Notice* should be directed to Robert Broughton, District Coordinator, NASD Regulation, Inc., at (202) 728-8361; or Susan DeMando, District Coordinator, NASD Regulation, Inc., at (202) 728-8411.

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