

MEMO# 10124

July 14, 1998

SEC ADOPTS TRANSFER AGENT AND BROKER-DEALER YEAR 2000 READINESS RULES; SEEKS FURTHER COMMENTS ON ATTESTATION REQUIREMENTS

1 Year 2000 Readiness Reports To Be Made by Certain Transfer Agents, SEC Release No. 34-40163; File No. S7-8-98 (July 2, 1998); and Reports To Be Made by Certain Brokers and Dealers, SEC Release No. 34-40162; File No. S7-7-98 (July 2, 1998) (the "Releases"). 2 See Memorandum to Accounting/Treasurers Committee No. 13-98, Compliance Advisory Committee No. 8-98, Independent Accountants Advisory Committee No. 3-98, Internal Audit Committee No. 2-98, Investment Advisers Committee No. 10-98, Operations Committee No. 13-98, SEC Rules Committee No. 23-98, Transfer Agent Advisory Committee No. 14-98, Unit Investment Trust Committee No. 9-98, and Electronic Commerce Working Group, dated March 10, 1998. [10124] July 14, 1998 TO: ACCOUNTING/TREASURERS MEMBERS No. 18-98 COMPLIANCE ADVISORY COMMITTEE No. 19-98 INDEPENDENT ACCOUNTANTS ADVISORY COMMITTEE No. 8-98 INTERNAL AUDIT COMMITTEE No. 7-98 INVESTMENT ADVISERS COMMITTEE No. 26-98 OPERATIONS COMMITTEE No. 27-98 SEC RULES COMMITTEE No. 73-98 TRANSFER AGENT ADVISORY COMMITTEE No. 41-98 UNIT INVESTMENT TRUST COMMITTEE No. 22-98 RE: SEC ADOPTS TRANSFER AGENT AND BROKER-DEALER YEAR 2000 READINESS RULES; SEEKS FURTHER COMMENTS ON ATTESTATION REQUIREMENTS

The Securities and Exchange Commission recently adopted a temporary rule and temporary rule amendments that would require non-bank transfer agents and certain broker-dealers, respectively, to file progress reports regarding their Year 2000 readiness.¹ New temporary Rule 17Ad-18 under the Securities Exchange Act of 1934 (the "Act") requires non-bank transfer agents to file two reports with the Commission (instead of three, as proposed), and temporary amendments to Rule 17a-5 under the Act requires broker-dealers with a minimum net capital requirement of \$5,000 (instead of \$100,000, as proposed) or greater to file two reports. The first report for each registrant is due by August 31, 1998, and should reflect the status of Year 2000 efforts as of July 15, 1998. The second report is due by April 30, 1999, reflecting remediation efforts as of March 15, 1999. The Releases are attached, and a discussion of significant differences between the proposals² and the final rules follow. Attestation Requirement The Commission had proposed to require that each follow-up report be accompanied by an independent public accountant's attestation affirming certain assertions made by management regarding its Year 2000 remediation efforts. The Commission decided, however, to defer consideration of this requirement due, in part, to concerns raised by the American Institute of Certified Public Accountants³ See Memorandum to Accounting/Treasurers Committee No. 18-98, Compliance Advisory

Committee No. 12-98, Independent Accountants Advisory Committee No. 4-98, Internal Audit Committee No. 3-98, Investment Advisers Committee No. 13-98, Operations Committee No. 22-98, SEC Rules Committee No. 30-98, Transfer Agent Advisory Committee No. 23-98, Unit Investment Trust Committee No. 12-98, and Electronic Commerce Working Group, dated April 14, 1998. 4 See Proposed Rule: Year 2000 Readiness Reports To Be Made by Certain Transfer Agents, Release No. 34-40165; File No. S7-8-98 (July 2, 1998); and Proposed Rule: Reports To Be Made by Certain Brokers and Dealers, Release No. 34-40164; File No. S7-7-98 (July 2, 1998) (copies attached). In these releases, the Commission also requests comment on the feasibility and desirability of an agreed-upon procedures engagement. 5 Specifically, the Commission took the position that allowing the public, particularly transfer agents and broker-dealers, to have access to the information would enable interested persons, including other transfer agents and broker-dealers, to assess the Year 2000 readiness of those entities with which they are doing business. Such parties could then request additional information or assurances, or take other appropriate steps as necessary to ensure Year 2000 compliance. ("AICPA"). The AICPA recommended against the proposed attestation requirement because of the lack of established criteria against which to measure a registrant's remediation efforts, and a concern that the purpose and conclusions of the attestation report could be misunderstood and that uninformed users of the reports would place undue reliance on them. As an alternative, the AICPA suggested that independent accountants could perform an "agreed-upon procedures" engagement, which, among other things, would eliminate the variability of examination procedures performed by independent public accountants, and thus increase reporting consistency. The Releases note that the Commission will consider such a requirement if the accounting industry recommends a standard that can be used by public accountants in connection with the follow-up reports. In light of the AICPA's concerns (and similar concerns raised by the Institute³ and others), the Commission has issued companion releases in which it has re-opened the comment period regarding the attestation requirement.⁴ Comments on the attestation requirement proposal are due by Wednesday, August 12, 1998. If there are issues you would like the Institute to address in its comment letter, please contact Greg Smith by telephone at (202) 326-5851, fax at (202) 326-5853, or e-mail at Smith@ici.org; or Barry Simmons by telephone at (202) 326-5923, fax at (202) 326-5839, or e-mail at simmonbe@ici.org, by Friday, July 24, 1998. Public Availability Under the final rules, each report filed by a non-bank transfer agent or a broker-dealer will be publicly available. The Release recognized the concerns expressed by the Institute and other commenters regarding this requirement, but expressed the Commission's belief that the public's interest is best served by requiring full and open disclosure.⁵ Reporting Requirements The proposed rules would have required, among other things, detailed descriptions of Year 2000 staffing efforts and the work performed (including time estimates) by management personnel and other Year 2000 dedicated staff. The final rules were revised to require only a summary of the efforts of Year 2000 dedicated individuals or groups of individuals. In addition, neither non-bank transfer agents nor broker-dealers will have to provide an estimate of the time that management has spent on Year 2000 efforts. The adopted rules leave largely intact the proposed requirement that registrants disclose the number and provide a description of exceptions identified during the internal and external testing of software that are unresolved as of the report date. The final rules specify, however, that only "material" 6 Copies of Form TA-Y2K (Parts I & II) and Form BD-Y2K (Parts I & II) are attached. 3 exceptions must be disclosed. The determination of what constitutes a "material" exception is left up to the registrant's judgment. Report Format As proposed, each non-bank transfer agent and broker-dealer would have had to discuss, in narrative format, its efforts to address Year 2000 problems. The Commission adopted in part an NASD recommendation that the reports be in an objective, check-the-box

questionnaire format. Although recognizing that this format would be a more efficient way of collecting certain information, the Commission determined that under this format, the largest, most significant non-bank transfer agents, and the broker-dealers that pose the greatest risk to customers and the market, would not provide it sufficient information to effectively assess Year 2000 problems. Therefore, new temporary Rule 17Ad-18 requires all non-bank transfer agents to file Part I of Form TA-Y2K (a check-the-box style report), and all non-bank transfer agents that do not qualify for an exemption under Rule 17Ad-13(d) (i.e., the exemption for small transfer agents or issuer transfer agents that typically handle few issues), to supplement Part I by completing Part II of the form (a narrative format). Similarly, the temporary amendments to Rule 17a-5 require each broker-dealer with a minimum net capital requirement of \$5,000 or greater to file with the Commission Part I of new Form BD-Y2K (a check-the-box style report), and each broker-dealer with a minimum net capital requirement of \$100,000 or greater also to file Part II of the form (a narrative format).⁶ Barry E. Simmons Assistant Counsel Attachments

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