

**MEMO# 11182**

August 12, 1999

## **SEC ADOPTS TEMPORARY Y2K OPERATIONAL CAPABILITY RULES FOR REGISTERED BROKER-DEALERS AND NON-BANK TRANSFER AGENTS**

1 Year 2000 Operational Capability Requirements for Registered Broker-Dealers and Transfer Agents, Rel. No. 34-41661 (July 27, 1999); 64 Fed. Reg. 42012 (August 3, 1999). The Commission had proposed a series of rules that would have imposed permanent operational capability standards for broker-dealers and non-bank transfer agents outside of a Y2K context, but at the urging of the Institute and others, decided to table that proposal for the time being. See Letter from Barry E. Simmons, Assistant Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission, dated April 12, 1999. 2 See Memorandum to Accounting/Treasurers Committee No. 7-99, Closed-End Investment Company Committee No. 11-99, Compliance Advisory Committee No. 9-99, Electronic Commerce Advisory Committee No. 2-99, Internal Audit Advisory Committee No. 1-99, Operations Committee No. 9-99, SEC Rules Committee No. 19-99, Transfer Agent Advisory Committee No. 21-99, and Unit Investment Trust Committee No. 7-99, dated March 15, 1999. 1 [11182] August 12, 1999 TO: ACCOUNTING/TREASURERS COMMITTEE No. 26-99 CLOSED-END INVESTMENT COMPANY COMMITTEE No. 24-99 ELECTRONIC COMMERCE ADVISORY COMMITTEE No. 12-99 INTERNAL AUDIT ADVISORY COMMITTEE No. 2-99 OPERATIONS COMMITTEE No. 31-99 SEC RULES COMMITTEE No. 61-99 TRANSFER AGENT ADVISORY COMMITTEE No. 52-99 UNIT INVESTMENT TRUST COMMITTEE No. 18-99 RE: SEC ADOPTS TEMPORARY Y2K OPERATIONAL CAPABILITY RULES FOR REGISTERED BROKER-DEALERS AND NON-BANK TRANSFER AGENTS

The SEC recently adopted a series of temporary rules under the Securities Exchange Act of 1934 ("Exchange Act") that establish Y2K operational capability standards for registered broker-dealers and transfer agents.<sup>1</sup> The rules were adopted largely as proposed.<sup>2</sup> Specifically, Exchange Act Rules 15b7-3T and 17a-9T, for broker-dealers, and 17Ad-21T, for non-bank transfer agents, require such entities to ensure their mission critical computer systems are Y2K compliant by August 31, 1999, or to certify that any material Y2K problems in their mission critical systems will be remediated no later than November 15, 1999, or else cease operating their business by December 1, 1999. The temporary rules also impose special recordkeeping requirements. The adopted rules are attached and are summarized below. The temporary rules become effective August 30, 1999. Definition of "Material Y2K Problem" 3 A broker-dealer or transfer agent will not be presumed to have a material Y2K problem if its written procedures or internal testing do not cover mission critical systems under the control of third parties. But control over a mission critical system would occur if

the entity operates and maintains that system. 4 In that case, the firm would also have to submit a second signed certificate stating either that the firm has remediated its Y2K problem or that it intends to cease operations. In addition, after August 31, 1999, if the firm discovers a new material Y2K problem, it must promptly notify the SEC (and applicable DEA) and submit a certificate in accordance with the rule. 5 The broker-dealers affected under this rule include only those broker-dealers that are required to maintain as of December 29, December 30, and December 31, 1999, minimum net capital of \$250,000. 6 Per Exchange Act Rule 240.17a-4(f), this would include storage via micrographic media or electronic storage media. 2 Under the adopted rules, a broker-dealer or transfer agent would be presumed to have a "material Y2K problem" if, at any time on or after August 31, 1999, it (1) does not have written procedures reasonably designed to identify, assess, and remediate any Y2K problems in mission critical systems under its control; (2) has not verified its Y2K remediation efforts through reasonable internal testing of its mission critical systems under its control and reasonable testing of external links under its control; (3) has not remediated all exceptions related to its mission critical systems contained in any independent public accountant's report prepared on behalf of the broker-dealer or transfer agent pursuant to Exchange Act Rules 17a-(5)(e)(5)(vi) and 17Ad-18(f), respectively; and (4) for broker-dealers, has not verified its Y2K remediation efforts by satisfying Y2K testing requirements imposed by its SRO. Prohibition on Non-Compliant Broker-Dealers and Transfer Agents and Certification The adopted rules require a registered broker-dealer or non-bank transfer agent that has, or is presumed to have, a material Y2K problem after August 31, 1999, to notify the Commission, and in the case of a broker-dealer, its designated examining authority (DEA), and cease operations. The rules permit the entity to continue operating until December 1, 1999, however, if its chief executive officer (or an individual with similar authority) certifies and demonstrates that it will fix the problem by November 15, 1999.4 Any broker-dealer or transfer agent that continues to have a material Y2K problem after November 15th will be required to cease operations by December 1, 1999. The adopting release adds that these notices and certifications will be made available to the public. Recordkeeping Requirements The adopted rules impose special recordkeeping requirements for broker-dealers and non-bank transfer agents. For broker-dealers, temporary Exchange Act Rule 17a-9T requires certain broker-dealers to make a separate copy of their trade blotter and their securities record or ledger for the last three business days of 1999.5 These records must be stored in an easily accessible place for at least one year, but may be preserved in any format that is acceptable and in compliance with the Exchange Act recordkeeping rules.6 Similarly, for transfer agents, temporary Exchange Act Rule 17Ad-21T requires every non-bank transfer agent, beginning on August 31, 1999, and ending on March 31, 2000, to maintain daily segregated backup records for all master securityholder files, which must be preserved for a rolling five business day period in a manner that will allow for the transfer and conversion of the records to a 7 If the transfer agent has a material Y2K problem, it must preserve for at least one year the five day backup records immediately preceding the day the problem was discovered. 3 successor transfer agent.7 From December 27 through December 31, 1999, the transfer agent must make a backup copy for all master security holder files and preserve these records for at least one year. Barry E. Simmons Assistant Counsel Attachment