

MEMO# 13500

May 14, 2001

SEC ADOPTS FINAL RULES GOVERNING ELECTRONIC RECORDKEEPING FOR TRANSFER AGENTS

[13500] May 14, 2001 TO: ELECTRONIC COMMERCE ADVISORY COMMITTEE No. 10-01 OPERATIONS MEMBERS No. 9-01 SEC RULES MEMBERS No. 39-01 SMALL FUNDS MEMBERS No. 13-01 TECHNOLOGY ADVISORY COMMITTEE No. 4-01 TRANSFER AGENT ADVISORY COMMITTEE No. 33-01 RE: SEC ADOPTS FINAL RULES GOVERNING ELECTRONIC RECORDKEEPING FOR TRANSFER AGENTS The Securities and Exchange Commission has adopted amendments to Rule 17Ad-7 under the Securities Exchange Act of 1934 to allow registered transfer agents to use electronic or micrographic storage media to maintain their records.¹ As you may recall, the Commission had originally proposed amendments to Rule 17Ad-7 in 1999.² As adopted, the final rule (attached) has been modified to reflect comments received from the Institute and other industry participants. The final rule becomes effective May 31, 2001. Briefly summarized, amended Rule 17Ad-7 requires transfer agents that choose to maintain their records using electronic or micrographic storage media³ to -- use storage mechanisms that are designed to ensure the accessibility, security, and integrity of the records, detect attempts to alter or remove the records, and provide means to recover altered, damaged, or lost records; create an index of the records that are electronically or micrographically stored and store the index with the underlying records; keep a duplicate of all records and indexes that are stored using electronic or micrographic storage media; 1 See SEC Rel. No. 34-44227 (April 27, 2001) ("Adopting Release"). 2 See SEC Rel. No. 34-41442 (May 25, 1999). 3 The new provisions of Rule 17Ad-7 define the term "micrographic media" to mean microfilm or microfiche or any similar medium, and the term "electronic storage media" to mean any digital storage medium or system. 2 be able to promptly download electronically or micrographically stored records to an alternate medium such as paper, microfilm, or microfiche; and keep in escrow an updated copy of the software or other information that is necessary to access and download electronically stored records. As part of these conditions, the final rule also imposes obligations on transfer agents to have available at all times for examination by Commission examiners and the transfer agent's appropriate regulatory agency ("ARA") the stored records, the related index, and facilities to project or produce easily readable images of the stored records.⁴ Record Integrity Standards Amended Rule 17Ad-7 imposes record integrity standards to deter the alteration of stored records. The Commission had proposed to require transfer agents that maintained their records electronically to do so in a non-rewriteable, non-erasable format (also known as "WORM" or write once, read many). In the final rule, however, the Commission eliminated this requirement, in part due to the low incidence of altered transfer agent records, and the paucity of enforcement actions brought against transfer agents in this area. Instead, amended Rule 17Ad-7 adopts a goals oriented

approach and permits a transfer agent to use an electronic storage system so long as it is designed to: (1) ensure the security and integrity of the records by means of manual and automated controls; (2) detect attempts to alter or remove the records; and (3) provide means to recover altered, damaged or lost records.

Third Party Access Requirement The proposed amendments to Rule Ad-7 contained certain conditions on the use of electronic storage media that were designed to provide access to information stored on such media if a transfer agent is no longer operating, refuses to cooperate with the Commission or its ARA, or has not properly or fully indexed electronically stored records. Specifically, before a transfer agent could use electronic storage media, it would have had to have an independent third party file an undertaking with the Commission stating that it had the ability to download information from the transfer agent's electronic storage system and that it would do so at the request of either the Commission or the transfer agent's ARA. The Adopting Release discusses the concerns expressed by industry commenters that the proposed requirement raises security and confidentiality risks as it would require that undertakings be filed by a third party that has direct access to the transfer agent's records. In consideration of such concerns, the Adopting Release clarifies that the third party is not required to have a continuous or unlimited right to use or have access to the records. Rather, the final rule requires a transfer agent to place in escrow with an independent third party⁵ its records management software that will enable the Commission or the transfer agent's ARA to

4 The Adopting Release clarifies that Rule 17Ad-7, as amended, does not specify the type of medium on which the index should be stored. The Release also clarifies that the requirement to maintain duplicates of records stored on micrographic or electronic storage media is not a requirement to maintain backup storage systems. 5 For this purpose, the final rule defines "independent" third party as a third party that does not control, is not controlled by, and is not under common control with, the transfer agent.

3access records and indexes. The Adopting Release makes clear that the escrow agent will only have in its possession the records management software but will not have access to the underlying records. The escrow agent will be required under the final rule to file an undertaking with the Commission and the transfer agent's ARA that it will make such software available to them promptly upon request. In response to the Institute's request for clarification regarding the third party access undertakings requirement and the electronic storage media already in use by transfer agents, the Adopting Release clarifies that Rule 17Ad-7, as amended, supersedes all previously issued no-action letters.

6 E-SIGN and Related Rulemaking Initiatives The Adopting Release refers to the Electronic Signatures in Global and National Commerce Act ("E-SIGN") that became effective last fall, and reports that the adopted amendments are consistent with the requirements of E-SIGN. The Adopting Release explains that E-SIGN's recordkeeping provisions with respect to SEC rules would have become effective on March 1, 2001, but since the Commission announced several pending rulemaking activities regarding its recordkeeping requirements⁷ prior to the March 1st deadline for doing so, the timeframe was extended until June 1, 2001. At that time any such rulemaking initiative must be completed in order to be given effect under E-SIGN.⁸ As noted above, the amendments to Rule 17Ad-7 become effective on May 31, 2001, which coincides with the June 1st deadline.

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6 See DST Systems, Inc. (February 2, 1993) (permitting transfer agents, investment advisers, and investment companies to retain their records using optical disk storage technology); Securities Exchange Act Rel. No. 38245 (Feb. 5, 1997) (permitting transfer agents to fulfill their recordkeeping requirements by complying with the provisions of Rule 17a-4 under the

Securities Exchange Act of 1934). 7 See SEC Rel. No. 34-44014 (February 28, 2001). 8 Consistent with this rulemaking initiative, in March, the SEC's Division of Investment Management proposed amendments to its recordkeeping rules under the Investment Company Act of 1940 and the Investment Advisers Act of 1940 to expand the circumstances under which investment companies and investment advisers may use electronic storage media to maintain and preserve required records. See Electronic Recordkeeping by Investment Companies and Investment Advisers, SEC Rel. No. IC-24890; IA-1932 (March 13, 2001). In a related matter, the Institute understands that the Division of Market Regulation has decided to forego any changes to its electronic record retention requirements for broker-dealers after determining that its current rules are in conformance with E-SIGN. Under those rules, a broker-dealer is not required to use an electronic format, but if it does choose to maintain records electronically, it must do so using WORM technology.

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