

**MEMO# 13533**

May 21, 2001

## **SEC INTERPRETIVE GUIDANCE ON OPERATION OF BROKER-DEALER RECORDKEEPING RULE UNDER E-SIGN**

[13533] May 21, 2001 TO: BROKER/DEALER ADVISORY COMMITTEE No. 13-01 ELECTRONIC COMMERCE ADVISORY COMMITTEE No. 11-01 OPERATIONS MEMBERS No. 12-01 SEC RULES MEMBERS No. 44-01 SMALL FUNDS MEMBERS No. 15-01 TECHNOLOGY ADVISORY COMMITTEE No. 5-01 TRANSFER AGENT ADVISORY COMMITTEE No. 37-01 RE: SEC INTERPRETIVE GUIDANCE ON OPERATION OF BROKER-DEALER RECORDKEEPING RULE UNDER E-SIGN The Securities and Exchange Commission has issued a release providing interpretive guidance on Rule 17a-4(f) under the Securities Exchange Act of 1934 ("Exchange Act").<sup>1</sup> The purpose of the Release is to explain how the electronic storage requirements of the Rule satisfy the Electronic Signatures in Global and National Commerce Act of 2000 ("E-SIGN"). The attached Release details the Commission's analysis and findings underlying its conclusion that the electronic storage requirements of the Rule meet and are consistent with the requirements of E-SIGN. Accordingly, with this Release, the Commission has determined not to adopt any substantive changes in its electronic recordkeeping rules for broker-dealers.<sup>2</sup> At the outset, the Release notes that Rule 17a-4(f) currently permits broker-dealers to maintain required records using micrographic media or electronic storage media provided certain conditions are met.<sup>3</sup> The Release asserts that the Rule satisfies the requirements of 1 See SEC Rel. No. 34-44238 (May 1, 2000); 66 Fed. Reg. 22916 (May 7, 2000) ("Release"). 2 Under E-SIGN, the Commission has until June 1, 2001 to adopt amendments to its recordkeeping rules in order for them to be given effect under E-SIGN. The Commission's interpretive guidance is in anticipation of that deadline and thus represents the extent of its regulatory actions in this area. In contrast, the SEC's Division of Market Regulation, earlier this month, adopted amendments to certain recordkeeping rules under the Exchange Act to allow registered transfer agents to use electronic or micrographic storage media to maintain and preserve required records. See SEC Rel. No. 34-44227 (April 27, 2001). Also, in March, the SEC's Division of Investment Management proposed, but has not yet adopted, 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 registered 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. Nos. IC-24890; IA-1932 (March 13, 2001). 3 One of those conditions is the requirement that if an electronic storage medium is used it must preserve the records exclusively in a non-rewriteable, non-erasable format (so-called write once, read many, or "WORM"). 2Section 101(d) of E-SIGN that electronic records be stored in a manner that ensures they are accurate, accessible and capable of accurate reproduction for later reference. The Release adds that Rule

17a-4(f) not only allows for the retention of documents in electronic form, but it does so in a much broader manner than E-SIGN. Rather than limiting its applicability to contracts or other records that relate to transactions in or affecting interstate or foreign commerce, the Rule permits the electronic retention of all records that broker-dealers are required to retain under the Rule. The Release discusses the requisite findings the Commission made in further determining that the Rule is consistent with E-SIGN. First, the Commission found that there is substantial justification for its interpretation. The Release explains that the electronic storage requirements of Rule 17a-4(f) are justified by the need to protect investors, ensure the soundness of the securities markets, enable appropriate regulatory oversight, and keep up with the complexities of the securities business. Second, the Commission found that the electronic storage requirements of Rule 17a-4(f) are substantially equivalent to the requirements imposed on non-electronic records. The Release points to the various conditions underlying the use of electronic storage, such as the index requirement, the availability of retrieval facilities, and the WORM provision, and notes that these requirements are analogous to the storage requirements imposed on non-electronic records, all of which are intended to ensure the prompt production of legible, true and complete records, regardless of their form. Third, the Commission found that the electronic storage requirements of Rule 17a-4(f) do not impose unreasonable costs on the acceptance and use of electronic records. The Release explains that most of the conditions imposed under the Rule have been in place since 1993, adding that since then, broker-dealers have had the option of storing records electronically on optical disk, and since 1997, have had the option of utilizing any electronic media. Finally, the Commission found that Rule 17a-4(f) does not require the implementation of a specific technology. Rather, the Release clarifies that because optical tape, CD-ROM and certain other methods of electronic storage are available in WORM and can provide the same safeguards against data manipulation and erasure that optical disk provides, broker-dealers are permitted to employ any electronic storage media that meet the conditions set out in the Rule.<sup>4</sup> Barry E. Simmons Associate Counsel Attachment Note: Not all recipients receive the attachment. To obtain a copy of the attachment to which this memo refers, please call the ICI Library at (202) 326-8304 and request the attachment for memo 13533. ICI Members may retrieve this memo and its attachment from ICINet (<http://members.ici.org>). <sup>4</sup> Despite the Commission's analyses and findings, the Release notes that even if the electronic storage requirements of Rule 17a-4(f) afforded greater legal status to the implementation or application of a specific technology or technical specification, the requirements would still be permissible under E-SIGN because they serve an important governmental interest and are substantially related to the achievement of that interest. <sup>3</sup> Attachment (in .pdf format)