

# CLIENT ALERT

## SEC PROPOSES AMENDMENTS TO ELECTRONIC RECORDKEEPING REQUIREMENTS FOR BROKER-DEALERS AND SECURITY-BASED SWAP ENTITIES

### BACKGROUND

On November 18, 2021, the SEC proposed to amend Rules 17a-4 and 18a-6 under the Securities Exchange Act of 1934<sup>1</sup> to modify the electronic recordkeeping requirements for broker-dealers, security-based swap dealers, and major security-based swap participants (the “Proposed Amendment”).<sup>2</sup> The Proposed Amendment would:

- Create an “audit trail” alternative to the current requirement that electronic records be preserved exclusively in a non-rewritable, non-erasable format;
- Eliminate the requirement that a broker-dealer provide its designated examining authority with advance notice prior to employing electronic storage media and representations that the electronic storage media meets certain specified conditions in Rule 17a-4; and
- Replace the requirement that a third party with the ability to access the firm’s electronic records undertake to provide the records to securities regulators if the firm refuses to do so with a requirement that a senior officer undertake this responsibility.<sup>3</sup>

Comments are due 30 days after publication in the Federal Register.

### DISCUSSION

The current electronic recordkeeping requirements for broker-dealers, set forth in paragraph (f) of Rule 17a-4, were adopted in 1997. The current rule requires that a broker-dealer’s electronic recordkeeping system preserve the records exclusively in a “non-rewriteable, non-erasable” (also known as a “write once, read many” or “WORM”) format. The WORM requirement is intended to prevent the alteration, over-writing, or erasure of the records. In addition, current Rule 17a-4 requires broker-dealers to notify FINRA prior to employing electronic storage media and requires a representation from broker-dealers (or third-party service providers) of compliance with 17a-4(f).<sup>4</sup> Broker-dealers using electronic storage media for recordkeeping also must designate with FINRA at least one third party who has access to the

<sup>1</sup> 17 CFR 240.17a-4; 17 CFR 240.18a-6.

<sup>2</sup> See SEC Release Number 34-93614, “*Electronic Recordkeeping Requirements for Broker-Dealers, Security-Based Swap Dealers, and Major Security-Based Swap Participants*” (“Proposing Release”), available at [https://www.sec.gov/rules/proposed/2021/34-93614.pdf?utm\\_medium=email&utm\\_source=govdelivery](https://www.sec.gov/rules/proposed/2021/34-93614.pdf?utm_medium=email&utm_source=govdelivery).

<sup>3</sup> Rule 18a-6, which sets forth the record preservation requirements for security-based swap dealers and major security-based swap participants, is modelled after Rule 17a-4. See Proposing Release at page 3.

<sup>4</sup> See 17 CFR 240.17a-4(f).

# MURPHY & CGONIGLE

For more information, contact:



**MARK ATTAR**  
[mattar@mmlawus.com](mailto:mattar@mmlawus.com)



**LARRY BERGMANN**  
[lbergmann@mmlawus.com](mailto:lbergmann@mmlawus.com)



**MATTHEW COMSTOCK**  
[mcomstock@mmlawus.com](mailto:mcomstock@mmlawus.com)



**MICHAEL McDONALD**  
[mmcdonald@mmlawus.com](mailto:mmcdonald@mmlawus.com)

broker-dealer's electronic storage media so that the third party may furnish records of the broker-dealer to regulators on reasonable request when the broker-dealer refuses to do so.<sup>5</sup>

Current Rule 18a-6 does not contain either an audit trail or a WORM alternative for electronic storage of books and records. The Proposed Amendment would require a standalone security-based swap dealer that does not have a prudential regulator (a nonbank security-based swap dealer) or a major security-based swap participant to choose one of the two preceding storage standards for books and records maintained electronically. The proposed electronic storage standards would apply to records created as of the date the Proposed Amendment becomes effective; they would not apply to records created before that date.

In practice, many broker-dealers use WORM-compliant electronic recordkeeping systems solely to meet the requirements of Rule 17a-4 while maintaining separate, duplicative recordkeeping systems to access their records in the ordinary course of business. To address this issue, the Proposed Amendment would offer broker-dealers the option to employ an "electronic recordkeeping system"<sup>6</sup> that meets the proposed "audit-trail" requirements as an alternative to the existing WORM requirement.<sup>7</sup>

Under the audit-trail alternative, the electronic recordkeeping system would need to preserve the records for the duration of their applicable retention periods in a manner that maintains a complete time-stamped audit trail that includes: (1) all modifications to and deletions of a record or any part thereof; (2) the date and time of operator entries and actions that create, modify, or delete the record; (3) the identity of individual(s) creating, modifying, or deleting the record; and (4) any other information needed to maintain an audit trail of each distinct record in a way that maintains security, signatures, and data to ensure the authenticity and reliability of the record and will permit re-creation of the original record and interim iterations of the record.<sup>8</sup>

The audit-trail alternative would require broker-dealers, security-based swap dealers and major security-based swap dealers to maintain electronic recordkeeping systems that ensure that if an original record is altered, over-written, or erased, it can be re-created in a reasonably usable electronic format for the retention period applicable to the original record. The audit trail alternative should give broker-dealers the opportunity to eliminate duplicative recordkeeping done solely for Rule 17a-4 purposes in favor of maintaining one set of records that can be recreated under the audit trail requirements.

The Proposed Amendment also would eliminate the notice and representation requirements from Rule 17a-4. Under the current rule, broker-dealers must notify FINRA prior to employing electronic storage media, which includes a 90-day notice if the broker-dealer intends to employ electronic storage media other than optical disk technology.<sup>9</sup> Furthermore, the rule also requires a representation from the broker-dealer or third party service provider that the selected electronic storage medium meets the conditions of Rule 17a-4 compliance.<sup>10</sup> The SEC has determined that both requirements are no longer necessary and would be eliminated under the Proposed Amendment.

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<sup>5</sup> See 17 CFR 240.17a-4(f)(3)(vii).

<sup>6</sup> Proposed Rule 17a-4(f)(1)(ii) and Proposed Rule 18a-6(e)(2) would define the term "electronic recordkeeping system" to mean "a system that preserves records in a digital format and that requires a computer to access the records."

<sup>7</sup> See Proposing Release at page 11.

<sup>8</sup> Id at page 23.

<sup>9</sup> See 17 CFR 240.17a-4(f)(2)(i).

<sup>10</sup> See 17 CFR 240.17a-4(f)(2)(i).

To address the cyber-security concerns raised by broker-dealers in production, the Proposed Amendment would replace the third-party production requirement with a requirement that a senior officer undertake the responsibility to furnish the broker-dealer's records in the event the broker-dealer refuses.<sup>11</sup> This change is intended to limit access by third-parties while creating an obligation on the senior officer to produce records in circumstances where employees or other officers of the broker-dealer are either unwilling or unable to access and download a requested record or its audit trail. The Proposed Amendment would likewise impose a senior officer requirement on nonbank security-based swap dealers and major security-based swap participants under Rule 18a-6.

The SEC states that the Proposed Amendment is designed to be technology neutral and relevant to current industry practices. If finalized, the addition of the audit trail alternative should provide broker-dealers flexibility in their recordkeeping practices and remove any duplicative recordkeeping being done solely for Rule 17a-4 compliance. In addition, the elimination of the notice and representation requirements should also ease the burden of Rule 17a-4 compliance on broker-dealers because it will eliminate a practice the SEC themselves considers unnecessary. Replacing the third-party production requirement by placing the responsibility on a senior officer would create an additional responsibility on firms but provide the benefit of minimizing third-party access to the firm's books and records. If finalized, broker-dealers should take the Proposed Amendment as an opportunity to examine their recordkeeping compliance programs to determine if they can be more efficient by taking advantage of the audit trail alternative.

				
<b>NEW YORK</b>	<b>WASHINGTON DC</b>	<b>VIRGINIA</b>	<b>CHICAGO</b>	<b>SAN FRANCISCO</b>
1185 Ave. of the Americas 21 <sup>st</sup> Floor New York, NY 10036	1001 G Street NW Seventh Floor Washington, DC 20001	4870 Sadler Road Suite 301 Glen Allen, VA 23060	300 N. LaSalle Street Suite 2200 Chicago, IL 60654	44 Montgomery Street Suite 3750 San Francisco, CA 94104

<sup>11</sup> See 17 CFR 240.17a-4(f)(3)(vii).