

## SEC Updates Broker-Dealer Record-Keeping Rules

On October 12, 2022, the SEC issued a [final rule](#) modernizing electronic record-keeping requirements for broker-dealers, security-based swaps dealers (SBSDs), and major security-based swaps participants (MSBSPs). For broker-dealers, the compliance date is six months after **Federal Register** publication. SBSDs and MSBSPs<sup>1</sup> will be allowed 12 months after **Federal Register** publication for compliance. This article focuses on only the broker-dealer requirements.

### Background

The broker-dealer electronic record-keeping rule, adopted in 1997, required broker-dealers to preserve electronic records exclusively in a non-rewriteable, non-erasable format (known as a write-once, read-many (WORM) format). After two decades of technological advancements, these amendments modernize electronic retention requirements, including more technology-neutral language to accommodate new advancements.

### Scope

The amendments update the following sections of the *Securities Exchange Act of 1934* (Exchange Act):

- Rules 17a-4(f) and (j) – Broker-dealer electronic record-keeping and prompt production of records requirements
- Rules 18a-6(e) and (g) – SBSD and MSBSP electronic record-keeping and prompt production of records requirements
- Rules 17a-4(i) and 18a-6(f) – Undertaking requirements for third parties that prepare or maintain the records of a broker-dealer, SBSD, or MSBSP

### Key Changes

The amendments modernize existing requirements as follows:

- Updates language – Terms like “electronic storage media” and “electronic storage system” have been replaced with “electronic record keeping system,” which is defined as a system that preserves records in a digital format that requires a computer to access the records
- Eliminates a requirement that a broker-dealer notify its designated examining authority (DEA) before employing an electronic record-keeping system
- Adds an audit-trail alternative to the existing requirement that broker-dealers preserve electronic records exclusively in WORM format (see details below)
- Requires that broker-dealers produce electronic records in a reasonably usable electronic format to allow securities regulators to search and sort information on the records (see details below)
- Creates an alternative to the existing requirement that a broker-dealer hire a third party to provide the firm’s electronic records to securities regulators if the firm fails or is unable to do so. Under the final rule, a firm’s designated executive officer (DEO) can undertake this responsibility (see details below)

<sup>1</sup> As of April 30, 2022, there are 48 entities that are SEC-registered SBSDs, and no entities have registered as MSBSPs.

- Adds an alternative approach to the undertaking that must be obtained from a third party that holds electronic records for a broker-dealer to accommodate the practice of using a record-keeping service, including a cloud service provider (see details below)

### Summary of Electronic Record-Keeping Changes

Provision	Rule 17a-4		Rule 18a-6	
	Current	As Amended	Current	As Amended
<b>DEA Notification</b>	Required	No longer required	Not required	Not required
<b>WORM</b>	Required	WORM or audit-trail required	Not required	WORM or audit-trail required for nonbank SBS Entities
<b>3<sup>rd</sup> Party Undertaking Regarding Electronic Records</b>	Required	3 <sup>rd</sup> Party or executive officer undertaking required	Not required	3 <sup>rd</sup> Party or executive officer undertaking required
<b>Produce Electronic Records in a Reasonably Useable Format</b>	Not required	Required	Not required	Required
<b>Alternative Undertaking for Cloud Service Providers</b>	Not permitted	Permitted	Not Permitted	Permitted

## Audit Trail Alternative

The final rule adds an audit-trail alternative to the existing WORM requirement. Under this option, a broker-dealer will need to use an electronic record-keeping system that maintains and preserves electronic records in a manner that permits the recreation of an original record if it is modified or deleted. The objective of the audit-trail requirement was to provide an alternative to broker-dealers that permits them to preserve Broker-Dealer Regulatory Records on the same electronic record-keeping system used for business purposes if the system has the capacity to recreate an original record if it is modified or deleted. To meet the audit-trail requirement, the electronic record-keeping system would need to maintain and preserve the records for the duration of their applicable retention periods in a manner that maintains a complete time-stamped audit trail that includes:

- All modifications to and deletions of a record or any part thereof
- The date and time of actions that create, modify, or delete the record
- The individual(s) creating, modifying, or deleting the record, if applicable. This can be a unique identifier rather than a name

- 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

Broker-dealers will now have the flexibility to preserve all of their electronic Broker-Dealer Regulatory Records either by:

- Using an electronic record-keeping system that meets either the audit-trail requirement or the WORM requirement
- Preserving some electronic records using an electronic record-keeping system that meets the audit-trail requirement and preserving other electronic records using an electronic record-keeping system that meets the WORM requirement

## Electronic Record-Keeping Systems Requirement

The final rule includes additional requirements for a broker-dealer's electronic record-keeping system:

- **Verification**— The electronic record-keeping system must automatically verify the completeness and accuracy of the processes for storing and retaining records electronically.
- **Serialization** – This only applies if optical disks are used to meet the WORM requirement. The system should serialize the original and duplicate units of storage media, and time-date the required period of retention for the information placed on such electronic storage media.
- **Download and transfer** – The electronic record-keeping system must have the capacity to readily download and transfer copies of a record and its audit trail (if applicable) in both a human readable format and a reasonably usable electronic format, and to readily download and transfer the information needed to locate the electronic record, as required by the SEC staff and other relevant securities regulators.
- **Backup** – A broker-dealer would need to have either redundancy capabilities equal to the level achieved through using a backup record-keeping system or a second electronic record-keeping system that preserves a second set of records if the original record-keeping system is temporarily or permanently inaccessible that can be accessed and examined if the primary electronic record-keeping system storing the primary set of records is disrupted, malfunctions, or otherwise becomes inaccessible.

## Broker-Dealer Requirements for Using an Electronic Record-Keeping System

The final rule imposes obligations on a broker-dealer's use of an electronic record-keeping system to ensure that the SEC staff and other relevant securities regulators can access and examine the records.

- **Facilities to produce records** – Broker-dealers and security-based swaps entities would be required to have at all times available—for examination by the SEC staff and other relevant securities regulators—facilities for immediate production of records preserved by means of the electronic record-keeping system and for producing copies of those records.
- **Ability to provide records stored electronically** – The broker-dealer must be ready at all times to provide records stored on an electronic record-keeping system and related information.
- **Accountability on inputting records** – For WORM systems only, a broker-dealer must have in place an auditable system of controls<sup>2</sup> that records, among other things:
  - Each input, alteration, or deletion of a record
  - The names of individuals inputting, altering, or deleting a record

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<sup>2</sup> A system of controls that is documented and can be audited by internal or external examiners to determine whether the controls are operating as required

- The date and time such individuals input, altered, or deleted the record
- Information to access and locate records – A broker-dealer must organize, maintain, keep current, and provide promptly upon request by the SEC staff or other relevant securities regulators all information necessary to access and locate records preserved by means of the electronic record-keeping system.

## Designated Executive Officer or Third Party

Previous guidance required that a broker-dealer exclusively using electronic storage media for some—or all—of its record preservation must have at least one third party to access and download information from the broker-dealer's electronic storage media to any acceptable medium. The third party must file with the broker-dealer's DEA for the following undertakings:

- To furnish promptly to the SEC, the broker-dealer's self-regulatory organization(s), and state securities regulators, upon reasonable request, such information as is deemed necessary by the securities regulators to download information kept on the broker-dealer's electronic storage media to any medium acceptable
- To take reasonable steps to provide access to information contained on the broker-dealer's electronic storage media, including, as appropriate, arrangements for the downloading of any record required to be maintained and preserved by the broker-dealer in a format acceptable to the securities regulators. These arrangements must provide specifically that in the event of a failure on the part of a broker-dealer to download the record into a readable format and after reasonable notice to the broker-dealer, upon being provided with the appropriate electronic storage medium, the third party will undertake to do so, as the securities regulators may request

To address concerns raised that having a third party for these responsibilities could expose a broker-dealer to data leakage and cybersecurity threats, the final rule gives a broker-dealer the option to use a DEO to make the above undertakings instead of a third party.

The DEO must be a member of the broker-dealer's senior management who has the knowledge, credentials, and information necessary to access and provide the records without having to rely on other individuals at the firm or have appointed in writing up to three designated specialists who have such knowledge, credentials, and information and are direct or indirect reports to the officer. A designated specialist must be a broker-dealer employee who has access to and the ability to provide records maintained and preserved on the electronic record-keeping system. The DEO also could appoint—in writing—up to two employees to assist the DEO in fulfilling these duties. A designated officer must be a broker-dealer employee who reports directly or indirectly to the DEO and has access to and the ability to provide records maintained and preserved on the electronic record-keeping system either directly or through a designated specialist who reports directly or indirectly to the designated officer.

The DEO's appointment of—or reliance on—a designated officer or designated specialist does not relieve the DEO of the undertaking obligations. The DEO is at all times responsible for fulfilling these obligations either directly or through a designated officer or specialist regardless of any actions taken by a designated officer or designated specialist in response to a request of the SEC or other relevant securities regulator.

**A broker-dealer can continue to use a third party to meet these requirements instead of a DEO; however, because of changes in the obligations required under the final rule, an updating undertaking would need to be filed with the DEA.**

## Third-Party Requirements – Alternative Undertaking

Previous guidance required a third party that prepares or maintains Broker-Dealer Regulatory Records (in either paper or electronic form) to file a written undertaking—traditional undertaking—with the SEC signed by a duly authorized person whereby the third party agrees—among other things—to permit examination of the records by the SEC’s representatives or designees, as well as to promptly furnish to the SEC or its designee true, correct, complete, and current hard copies of any or all or any part of such books and records. Currently, cloud service providers do not have the ability to assume these undertaking requirements because files stored in the cloud are encrypted and only accessible by the broker-dealer; therefore, cloud vendors cannot meet the undertaking requirement to produce records in an electronic form.

The final rule permits a cloud service provider to make an alternative undertaking better tailored to how cloud service providers maintain broker-dealers records but still accommodate the record accessibility to the SEC and other securities regulators. Alternative undertaking requirements include:

- The third party must acknowledge that the records are the broker-dealer’s property.
- The third party must acknowledge, *i.e.*, in an addendum to the existing service contract, that the broker-dealer has made the following representations to the third party:
  - The broker-dealer is subject to SEC rules governing the maintenance and preservation of certain records.
  - The broker-dealer has independent access to the records maintained by the third party. It is the responsibility of the broker-dealer (not the third party) to ensure that its access to the records maintained by the third party meets the definition of independent access.
  - The broker-dealer consents to the third party fulfilling the alternative undertaking obligations.
- The third party must undertake to facilitate—within its ability<sup>3</sup>—and not impede or prevent the examination, access, download, or transfer of the records by an SEC representative or designee or a trustee appointed under the Securities Investor Protection Act (SIPA) to liquidate the broker-dealer.

### **This alternative undertaking does not apply when the third party maintains Broker-Dealer Regulatory Records in paper format or on micrographic media.**

To use the alternative, the broker-dealer must have independent access to the records held by the third party. The broker-dealer must be able to regularly access the records without the need of any intervention by the third party and can unilaterally access the records held by the third party as contemplated by the traditional undertaking. The broker-dealer must be able to permit examination of the books and records at any time or from time to time during business hours by SEC representatives or designees and to promptly furnish to the SEC or its designee a true, correct, complete, and current hard copy of any or all or any part of such records.

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<sup>3</sup>This means that the third party undertakes to provide to the SEC representative or designee or SIPA trustee the same type of technical support with respect to records access that it would provide to the broker-dealer in the normal course. This does not mean that the third party must produce a hard copy of the records or take the other actions that are agreed to in the traditional undertaking.

Any contractual provisions between a broker-dealer and a third-party service provider that would allow the latter to withhold, delete, or discard records—electronic or otherwise—in the event of a broker-dealer’s nonpayment are inconsistent with existing retention requirements. If a third party deletes or discards a broker-dealer’s records in a manner that is not consistent with the retention requirements, such action would constitute a primary violation of the rule by the broker-dealer and may subject the service provider to secondary liability for causing or aiding and abetting the violation.

## Conclusion

If you have questions, reach out to a professional at **FORVIS** or submit the Contact Us form below.

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