SJK

December 16. 1998

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, DC 20549

Re: Books and Records Requirements for Brokers and Dealers Under the Securities Exchange Act of 1934; Securities Exchange Act Release No. 34-40518

Dear Mr. Katz:

On behalf of the Securities Industry Association ("SIA")[1] and The Bond Market Association (the "Association")[2] (collectively the "Associations"), we appreciate the opportunity to comment on the reproposed amendments[3] to the books and records requirements set out in Rules 17a-3 and 17a-4 under the Securities Exchange Act of 1934.[4] According to the Release, the reproposed amendments are designed to clarify and expand recordkeeping requirements with respect to, among other things, purchase and sale documents, customer records, associated person records, and customer complaints. The reproposed amendments also specify the books and records that broker-dealers would have to make available at local offices. The stated intent of the amendments is to assist securities regulators when conducting sales practice examinations.

---

[1] The Securities Industry Association ("SIA") brings together the shared interests of nearly 800 securities firms, employing more than 380,000 individuals, to accomplish common goals. SIA members—including investment banks, broker-dealers, and mutual fund companies—are active in all markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift, and pension plans, and accounts for $270 billion of revenues in the U.S. economy. This and other recent comment letters can be found on the SIA's website at www.sia.com.

[2] The Bond Market Association represents securities firms and banks that underwrite, trade and sell debt securities, both domestically and internationally. The Association's member firms account for in excess of 95% of all primary issuance and secondary trading activity in the domestic debt capital markets. More information about the Association can be obtained from our website at www.bondmarkets.com.

[3] Securities Exchange Act Release No. 34-40518 (October 2, 1998), 63 FR 54404 ("Release No. 40518").

[4] 17 CFR 240.17a-3 and 240.17a-4.

Securities Industry Association 120 Broadway, 35th Floor, New York, NY 10271-0080 212.608.1500 Fax 212.587.3988 http://www.sia.com
Washington Office: 1401 Eye Street, NW, Washington, DC 20005-2225 202.296.9410 Fax 202.296.9775
The Bond Market Association 40 Broad Street, New York, NY 10004-2373 212.440.9400 Fax 212.440.5260 http://www.bondmarkets.com
Washington Office: 1445 New York Avenue, NW, Washington, DC 20005-2158 202.434.8400 Fax 202.434.8456

I. Executive Summary

The Associations support Securities and Exchange Commission ("SEC" or "Commission") efforts to achieve the highest level of investor protection. We believe that public trust and confidence in the markets must be the industry's highest priority. In general, the Associations believe that the reproposing release reflects a somewhat more balanced approach to books and records requirements than its predecessor. In several key areas, however, this is not the case. The release would impose vastly disproportionate costs and administrative burdens on the securities industry for advancements in sales practice oversight that are either of questionable or marginal benefit, or that can be more effectively addressed by other means. Consistent with these overall concerns, this letter offers more specific comments on the issues below. Additionally, in light of the Year 2000 remediation efforts currently underway, firms will need a considerable amount of time to do the systems reprogramming necessitated by the changes. The Associations strongly believe that the moratorium on rules requiring systems modifications should apply to any new books and records rules.

- Local office recordkeeping. Each broker-dealer currently maintains extensive books and records relating to all of its operations—including those of local offices—either centrally or through the designation of an Office of Supervisory Jurisdiction ("OSJ") in locations where business is conducted. The Associations believe that the current proposal for recordkeeping and retention at local offices, which would be defined in relation to an arbitrary number of associated persons working in a particular location, would contribute little or nothing to customer protection, but would impose significant new costs and substantially disrupt long-established business practices. Neither the state securities regulators nor the SEC has met the burden of demonstrating the need for the proposed "local office" recordkeeping regime, particularly in light of the significant new costs and burdens it would impose.

- Customer account information. Proposed Rule 17a-3(a)(16) would require broker-dealers to seek out and record customer account information that, in certain situations, is either unnecessary in light of the regulatory objective, or which may be impossible to obtain. Broker-dealers provide a diverse range of financial intermediation services, including full service, unsolicited and non-recommended order taking, and clearing brokerage. Depending on the particular role the broker-dealer plays in a given arrangement, the Associations do not believe that the same account information

should be required in all cases. In addition, the Associations suggest a number of practical improvements to proposed rule changes regarding updates to customer account information.

- Exception reports. Broker-dealers often generate various reports to monitor trading and other activity within firms. This self-regulatory process can involve hundreds of different reports, many of which are designed to exist for only a few seconds as part of an overall surveillance process. If forced to retain or to maintain a facility for recreating each individual report, many broker-dealers may be faced with a disincentive to generate the number and range of reports used in internal monitoring due to the massive burden such a requirement would impose.

- Technical modifications. The Associations recommend a series of technical changes to the proposed rule amendments regarding identification of personnel entering customer orders, time of order entry, identification of local office personnel, recording of non-monetary compensation, limiting the "local office" definition to domestic locations, and records of oral complaints.

II. Introduction and Background

The original proposal was issued in 1996 in response to certain concerns raised by members of the North American Securities Administrators Association ("NASAA") about the adequacy of the Commission's books and records rules as they relate to sales practices, and the accessibility of those records.[5] In particular, the original proposal would have obligated broker-dealers to create and retain a wide range of additional records that state securities regulators claimed they might find valuable during examination and enforcement proceedings. Notably, there had been no evidence of widespread abuse, merely anecdotal information provided by state regulators indicating that examinations have been hindered by the absence of key records in branch offices or by delays in the production of those records.[6] In fact, the genesis for the proposal appeared to be problems that state regulators had encountered with one limited portion of the securities industry—firms that deal in microcap stocks.

As you know, the original proposal provoked widespread and uniform industry criticism. The industry opposed such sweeping changes because, in its view, the costs

[5] Securities Exchange Act Release No. 37850 (October 22, 1996), 61 FR 55593 ("Release No. 37850").

[6] Release No. 37850 at 4 and Release No. 40518 at 6.

and burdens associated with the proposals far outweighed any potential increase in investor protection. The concerns of state regulators, the industry believed, would be more appropriately addressed by rules targeting microcap fraud, rather than by imposing burdensome new regulatory requirements on the entire securities industry.

After the close of the comment period on the original proposal, representatives of the broker-dealer community held a number of meetings and discussions with staff of the SEC and officials from NASAA in an effort to address state regulators' fundamental concerns, without creating the massive new costs, inefficiencies, and needless disruptions to long-established business practices that the original proposal would have entailed. We commend NASAA and the SEC for working cooperatively with the industry in that process. As a result of those discussions, we believe that common ground has been reached on many important issues, and we identified a number of situations in which reasonable policy justifications exist for revising current books and records requirements. Conversely, those same discussions produced agreement that a number of other provisions contained in the original proposal were either unnecessary or unjustified in light of the costs and burdens they would impose, or that there were other, more effective and less disruptive means of achieving the same underlying policy objectives. Subsequently, and prior to publication of the reproposal, we submitted to the SEC suggested language for implementing changes in those areas where general agreement had been reached.[7] We appreciate that many of the industry's suggestions are reflected in this proposal.

Despite the considerable progress that has been made, however, there are several key provisions that we continue to believe are unjustified and unnecessary, particularly when the potential investor protection benefits are weighed against the cost and administrative burden associated with their implementation. Specifically, the Associations continue to believe that it is illogical to define local office in relation to an arbitrary number of associated persons working in a particular location, and to require the maintenance of extensive records at that location. We do not believe that either state securities regulators or the SEC have demonstrated the need for such a requirement, particularly in light of the significant new costs and burdens that it would impose.[8]

---

[7] *See* letter to Michael Macchiaroli, SEC, from Judith Poppalardo, SIA, dated December 1, 1997.

[8] Section 3(f) of the Exchange Act requires the Commission, whenever it is required to consider the public interest in its rulemakings, to "consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation." 15 U.S.C. 78c(f). The instant proposals, to the extent that they impose unnecessary costs and burdens on the industry, actually will impede these goals.

As discussed more fully below, there are other provisions also that, while much improved, still require modification. Specifically, the provision regarding customer account information is broader than necessary to achieve the stated objective of the proposal. The provision does not take into account the wide diversity of services provided by broker-dealers and imposes undue burdens by expanding substantive requirements. Also, we believe more flexibility is required in the provision dealing with the retention of exception reports. Finally, we suggest several technical modifications. With these changes, we believe the reproposal represents reasonable enhancements to Rules 17a-3 and 17a-4 that most firms in the industry could accept.

III. Effective Date

As a threshold matter, in whatever form they are adopted, the rules will require an implementation schedule that is commensurate with the specific revisions that are enacted. Given the extensive revisions that are likely to be required in firms' records creation and retention procedures, and the corresponding need for extensive programming and systems modifications to give effect to these new requirements, the Associations urge the Commission to establish a reasonable and workable implementation schedule. Consideration should be given to an implementation date, for those provisions that the Commission determines to adopt, that extends well into 2000.

In this regard, it is important to recognize that these amendments are likely to involve significant computer systems modifications for firms at a time when most available resources are being directed at the Year 2000 remediation effort.[9] The Commission has acknowledged the critical nature of the remediation effort by announcing a moratorium on the implementation of new Commission rules that require major reprogramming of computer systems by SEC-regulated entities between June 1, 1999 and March 31, 2000.[10] The Associations respectfully request that the Commission make clear in the adopting release that the moratorium will apply to these proposed amendments.

---

[9] In addition to the Year 2000 effort, firms also must contend with systems modifications necessitated by the conversion in January 1999 to a single European currency, the new Order Audit Trail System ("OATS") requirements imposed by the National Association of Securities Dealers, and the conversion to a decimal-based pricing system.

[10] Policy Statement: Regulatory Moratorium to Facilitate the Year 2000 Conversion, Securities and Exchange Commission, August 27, 1998.

IV. Definition of Local Office

The revised proposals would require broker-dealers to maintain or provide ready access to a wide range of specified books and records in each local office of the broker-dealer. "Local office" for this purpose would be defined to include any location where two or more associated persons regularly conduct a securities business. The required records would not need to be maintained at the local office if the local office could produce printed copies on the same day that a request is made, or within a reasonable time under certain unusual circumstances. The basic rationale for changing the status quo is to provide regulators with more convenient and immediate access to broker-dealer books and records than is provided under the current system, in which many firms centralize such books and records at one or more specified locations.

The Associations strongly believe that this proposed change is unnecessarily burdensome in light of its purpose, costs and prospective benefits.[1] Importantly, neither state securities regulators nor the SEC has demonstrated pervasive or systematic abuses by the industry in failing to provide prompt access to required records. Even if the premise is accepted that there are instances in which the storage of records in "distant" locations has impeded the speed or efficiency of regulatory inspections or investigations, the desire for more convenient access to such records does not justify a proposed solution of this magnitude. The local office proposal must be balanced against the significant additional recordkeeping obligations that would be imposed on broker-dealers, and the elimination of much-needed discretion of a broker-dealer to bring to the public small, minimally-staffed offices (especially in areas outside of major population centers) without unnecessarily burdensome record retention and maintenance requirements, as is the case under the present regulatory structure.

1. Proposed Local Office Definition Will Defeat the Benefits of Current Recordkeeping Practices

As noted above the reproposed amendments would modify the definition of "local office" in paragraph (g)(1) of Rule 17a-3 to include locations where two or more associated persons regularly conduct a securities business. The Commission asks whether a higher number of associated persons would be appropriate for the definition of

---

[1] For example, the provision regarding local offices would require broker-dealers to maintain the required records at each local office purportedly to facilitate sales practice examinations by state regulators. However, the proposal imposes these additional record-keeping burdens on all broker-dealers, including those (such as broker-dealers whose customer base is purely institutional or that engage only in non-recommended order taking) whose businesses generally do not raise sales practice concerns and are therefore rarely subject to sales practice examinations.

local office. The Associations believe that numbers of employees are irrelevant for this purpose. Indeed, given advances in technology, it is not inconceivable that, within the next several years, some firms may conduct at least part of their business out of "virtual offices" with no defined geographic location. While the two-person definition assures that the rule does not apply to individuals who work from home or have a minimal presence in an office such as a bank branch, it continues to be crafted too narrowly and in complete disregard of the supervisory scheme established in part to protect the integrity of documents for which retention is required. There is a well-established framework, *i.e.*, the OSJ, that was implemented to facilitate supervision of remote, geographically dispersed offices where such records already can be produced.

Many firms consolidate their records at one or more central locations while other firms house them at OSJs. Among other reasons, consolidation and centralization of records is desirable to conserve space, efficiently allocate staff resources, and facilitate internal control. Under the current proposal, recordkeeping would have to be decentralized or records would have to be duplicated for multiple locations. The threat of mishandling of originals in local offices and lack of centralized controls would dissuade many firms from implementing a policy in which the retention of original versions of documents would be decentralized. Consequently, we expect most firms would duplicate all of the required records for all locations. We recognize that the proposal would add a provision in Section 17a-4 that the capability to make documents stored in a form other than hard copy available at a local office within a specified period of time will satisfy the local office record maintenance requirements. While many firms have this capability to a greater or lesser extent, use of such technology is not universal within the securities industry and many broker-dealers, particularly smaller broker-dealers, will not be able to rely on this provision.

In response to comments on the original proposal, the Commission created a single-person office exception to accommodate those individuals who work from home or who have only a minimal presence in another location. The Associations believe the same rationale would support an exception for all offices that are not OSJs. As discussed below, the costs associated with this requirement for many broker-dealers, including affiliates of insurance companies and banks, will dwarf any potential investor protection benefit. It is simply unnecessary given the existing OSJ structure. The Associations strongly believe that books and records should be maintained in those offices where supervision using those records occurs.

No law or regulation, however, dictates that there be an OSJ in each state. The Associations submit that in those situations where a broker-dealer has an office or offices, but no OSJ, in a particular state, the securities administrator of that state might require the

broker-dealer, as part of initial registration and/or registration renewal, to file a written statement undertaking to produce records required by Rules 17a-3 and 17a-4 for persons conducting business at its offices within the state promptly upon the administrator's request. Such a written assurance of production is conceptually little different from other undertakings customarily required to obtain and maintain state registration, *e.g.*, written consents to service of process. By means of such registration-related submissions, the state administrator would possess a clear basis for both compelling prompt production of the specified records, regardless of where the firm keeps the records, and proceeding to revoke the firm's registration in the event the firm failed to comply.

2. Bureaucratic Convenience Is Insufficient Justification for Local Office Recordkeeping Provision

At the outset, it is important to recognize that nothing currently prevents regulators from obtaining records pertaining to the activities of a local office, thereby enabling them to conduct a "focused localized exam."[12] In each case, such records may be obtained, where necessary, from an OSJ. Thus, rather than addressing any substantive deficiency in local office records, the local office proposal appears to be targeted exclusively to the goal of promoting more convenient access to such records. The Associations believe that the local office proposal confuses enhanced investor protection, on one hand, with bureaucratic and administrative convenience on the other. As discussed below, the perceived added convenience is insufficient justification in light of the burden to the industry.

The local office records are documents that can easily be produced and forwarded to an examiner in a reasonable period of time at much less cost than if provisions were made to accommodate their maintenance at the branch offices. Moreover, there is minimal, if any, investor protection interest in maintaining these documents at branch locations. Anecdotal and isolated evidence of problems that state securities regulators may sometimes encounter in obtaining access to those records does not constitute a sufficient basis upon which to effect a radical change in firms' business and recordkeeping practices, as described above. The ability to produce records from a centralized or off-site location promptly after a request from a regulator is made would be

[12] Section 203 and 407 of the Uniform Securities Act of 1956 (modeled on Sections 17(a) and 21(a)-(d) of the Securities Exchange Act of 1934, respectively) grant state securities administrators broad powers to conduct inspections and investigations, and issue subpoenas. Failure to cooperate with the administrator can result in administrative sanctions, including suspension or revocation of the dealer's registration, or criminal prosecution.

a reasonable alternative.[13] In fact, immediate access could be accomplished if the regulators would furnish a list indicating the records they require in advance of the examination.

The industry believes that in establishing multiple local offices in a state, each maintaining duplicate copies of documents that are already maintained centrally or in an OSJ, there is a risk of inadequate document integrity safeguards that would outweigh any perceived benefit in the form of enhanced investor protection. The industry believes any changes to the location where documents must be retained should not be pegged to an arbitrary number of employees located in the office, but rather to the ability to provide a meaningful and cost-effective system of safeguards and supervisory responsibilities to assure adequate and reliable availability of services.

3. Cost Impact of a Two-Person Local Office Will be Significant

The costs of defining local office as a location where two or more associated persons regularly conduct a securities business would be significant. In addition to the costs of duplicating all local office records for the local office **and** the OSJ, additional storage capacity or facilities may be required. Moreover, whenever records are maintained pursuant to rule or regulation, there must be an audit process to assure proper maintenance and a compliance program for assuring ongoing adherence to the record maintenance and retention requirements. The costs related to additional personnel and other resources that would be needed for each local office to establish and maintain a separate record retention and maintenance capability would be prohibitive for many firms. Alternatively, there would be the systems-related costs to provide for electronic storage and retrieval of records in the field. In many instances, these costs also could be prohibitive.

Specifically, if records were stored on-site, the standard recordkeeping requirement per employee is generally 36 linear feet of space (10 lateral legal file drawers @36" wide).[14] Previous space planning decisions and leasing commitments would not

---

[13] Although a firm may be able to produce certain of the requested records on the day the request is made, responding to a regulator's document requests often takes more time. Depending on the nature of the request, the documents may have to be located at an off-site record storage facility, retrieved, copied, and shipped to the examination site, and organized for presentation to the examiner. The current proposal, which provides an exception from the same-day production requirement for "certain unusual circumstances," simply does not take into account the breadth and complexity of some document requests.

[14] Letter from Peter R. Hermann, Executive Director, ARMA International, to Judith Poppalardo, Vice President and Associate General Counsel, SIA, dated December 8, 1998. ARMA International is an

have taken these increased storage requirements into account. Moreover, staff who have the training and responsibility for managing these records would now be required in each local office. Records management professionals have provided fully loaded wage rates (includes all overhead) averaging $23.00 per hour for a records administrator and $107.00 per hour for a compliance officer.[15] Electronic storage and retrieval of records, in addition to the cost of hardware, would also require systems support personnel. The fully loaded wage rate for systems support personnel averages $87.00 per hour.[16]

The impact of the definition is best illustrated by example. One member firm reports that under the proposed definition the firm would have 82 locations that would be designated as local offices, or a 16% increase in the number of offices where records would have to be maintained. Using estimates provided by records management professionals, we will assume that a records administrator devoting an average of eight hours per week would be required in each local office. Additionally, we will assume a compliance officer devoting 30 hours per year would be required to ensure proper record maintenance and retention in each local office. Using these very conservative estimates, the personnel costs of complying with just this provision for each local office would be $12,778 per year. For the member firm in the above example, the 82 locations would cost the firm approximately $1 million. Alternatively, if the firm instead chose to store the records and make them available electronically, and if we assume that systems support personnel devoting 150 hours per year would be required to support this effort, the firm would incur costs of over $1 million for personnel, without factoring in the cost of hardware and related systems expenses. A business decision regarding whether to keep those offices open would have to be made in light of the fact that those 82 locations account for only 2.5% of firm revenue.

The Associations also believe there may be an unintended harmful consequence to investors of defining local office in this manner. Many of the firms may simply close their smaller offices rather than incur the cost of compliance. This will eliminate highly desirable personal access to broker-dealer services for a significant number of people living outside major population centers. Rather than basing regulatory requirements on an arbitrary number of individuals, the SEC should be adopting rules that provide flexibility for the offices of the future. Firms must supervise all of their associated

---

association of records management professionals. Members of ARMA International's Securities and Investments Industry Sepcific Group provided recordkeeping data at our request. Their members are experienced records management professionals who work for leading firms in the securities industry.

[15] Id.

[16] Id.

persons regardless of location, whether they are conducting business in a city or in cyberspace. The OSJ structure captures all of these locations.

In the release the Commission seeks comment on whether state securities regulators should have authority to waive the requirement that a broker-dealer keep local office records at local offices within their respective states. As we have noted before, this would lead to the possibility of 50 different sets of state requirements. The Associations believe this would be an unconstitutional delegation of power from the federal government to the states in violation of the National Securities Market Improvement Act of 1996,[17] which prohibits states from implementing individual, and possibly divergent, books and records regulations.

V. Customer Account Information

The Commission has made a number of changes in the reproposed rules relating to customer account records[18] that address many of the concerns expressed by the industry in response to the original proposal. The Associations applaud these changes and believe that the reproposal represents a more reasonable approach to the collection and updating of customer information. Nevertheless, the reproposed amendments relating to customer account records still fail to adequately take into account the diverse nature of firms in the industry.

1. Collection of New Account Information

Rule17a-3(a)(16) requires broker-dealers to maintain, for each customer account whose owners are natural persons, both new and existing, basic identification and background information about the customer, including the customer's investment objectives.[19] This provision also provides a scheme for updating the information on a regular basis.

---

[17] Pub. L. No. 104-290, 110 Stat. 3416 (1996).

[18] The customer account record includes basic identification and background information about the customer, including the customer's investment objectives.

[19] The Associations believe it would be helpful if the Commission would clarify in the adopting release that, with respect to existing accounts, firms would have 36 months from the effective date of the rule amendment to collect this information, unless there was an intervening change in name, address, or investment objectives.

The reproposed rules would subject all broker-dealers to the same additional obligations and requirements, many of which are designed to provide regulators with customer suitability information. While such information would be relevant for many customer accounts of a retail firm, it is not necessarily relevant and an exemption would therefore be appropriate, for example, for accounts introduced and managed by an investment adviser registered pursuant to the Investment Adviser Act of 1940 or by a bank trust department or other fiduciary, or accounts carried by a broker-dealer acting as a clearing broker on a fully disclosed basis (unless the contract between the introducing broker and the clearing broker provides otherwise), or accounts as to which a broker-dealer neither solicits transactions nor makes recommendations as to securities transactions to the customer. In these instances, any benefit of the proposal is far outweighed by its costs.

The Associations also note that there are circumstances in which it would be unlikely for broker-dealers to be able to comply with the requirements of proposed Rule 17a-3(a)(16). For example, a broker-dealer that effects transactions for an account managed by an investment adviser or other fiduciary often cannot, as a practical matter, obtain information about the beneficial owner of the account. Fiduciaries acting on behalf of a beneficial owner, such as an investment adviser acting on behalf of its client, are frequently unwilling to provide the broker-dealer with the name, address or other basic information concerning the beneficial owner, or otherwise to permit the broker-dealer to communicate directly with such beneficial owner. Broker-dealers in these circumstances have no ability to compel the production of such information, and would therefore be unable to comply with the requirements of the proposed Rule.[20] We would therefore suggest that the language of proposed Rule 17a-3(a)(16) be modified to exclude accounts that are managed by a registered investment adviser or other fiduciary not affiliated with the broker-dealer.

Similarly, customer accounts carried by an introducing broker at a clearing broker on either a fully-disclosed or omnibus basis, where the clearing broker does not recommend securities, should be excluded from 17a-3(a)(16). In a fully-disclosed

---

[20] The Associations note that this same issue presently exists under current Rule 17a-3(a)(9), which requires that a broker-dealer make and keep records of each cash or margin account of such broker-dealer indicating, among other things, the name and address of the beneficial owner of such account. The Associations have previously discussed with SEC staff the need for no-action or other interpretive guidance to reconcile this inconsistency. No policy rationale would appear to support the initiation of enforcement proceedings against any broker-dealer that is unable to obtain, through a good faith effort, the name and address of the beneficial owner of an account managed by a fiduciary, particularly since the fiduciary—not the broker-dealer—is responsible for the broker-dealer's inability to comply with the applicable requirements of Rule 17a-3(a)(9).

clearing relationship, responsibility for customer account documentation, sales practices, account supervision, and suitability lies with the introducing firm pursuant to New York Stock Exchange Rule 382. Clearing firms do not have direct contact with customers of introducing firms with respect to account establishment and maintenance matters, and have no access to the type of information required by this provision.

Under NASD rules, suitability obligations are triggered upon making a recommendation.[21] Where accounts are limited to non-recommended orders, firms typically have not collected the detailed information required by this provision. Were the Commission to suggest that suitability assessments should be made on the opening of an account rather than upon making a recommendation, this is a new substantive requirement.[22] Such a proposal is inappropriate in a books and records rule, and itself should be subject to notice and comment. Accordingly, to the extent that the Commission does not intend to make any substantive changes to existing NASD and other SRO requirements, it should make clear that it is mandating merely the collection of certain specific customer information at account opening and that the remainder need be gathered only at the time of a subsequent triggering event (*e.g.*, gather suitability information when a recommended transaction occurs.)

Rule 17a-3(a)(16)(i)(A) would require firms to collect personal and financial information as well as investment objectives from each person on a joint account. The Associations strongly believe that each account should have only one set of investment objectives that reflects the consensus of the joint account holders. With respect to personal and financial information, such information is seldom critical and in the spousal joint accounts alone, it could easily double the amount of information the firm collects. Moreover, the provision will be particularly problematic for partnerships, limited partnerships, investment clubs, and other accounts with multiple owners.

---

[21] NASD Rule 2310.

[22] We do not believe this is the Commission's intent. Indeed, the Commission recently approved an NASD proposal to exclude directly marketed mutual funds from the obligation to obtain certain retail customer account information (*i.e.*, customer's tax identification or social security number, customer's occupation and name and address of employer, and information about whether the customer is an associated person of another broker-dealer) on the basis that such information is unnecessary as it applies to members that distribute directly marketed mutual funds and other unsolicited accounts that are limited to mutual fund shares and *for which no recommendation is made*. SEC Release No. 34-40048 (May 29, 1998), 63 FR 31255.

The reproposal contemplates that, in some cases, customers will refuse to provide the required information. In such cases, the broker-dealer is relieved of the obligation to obtain the information but the broker-dealer must make a record of the failure to obtain the required information, which record shall contain an **explanation** of the neglect, inability, or refusal of the customer to provide the information. The Associations request that the Commission replace the word "explanation" with "notation" so that firms can automate this process by indicating the customer's neglect, inability, or refusal by checking a box on the new account record. The customer's receipt of the new account record is the best evidence that the information was requested. A notation will capture the basic information for regulatory purposes without the significant increase in cost that a separate record would entail.

2. Updating of Account Information

The Associations support the general notion that customers be provided with an opportunity to update the account information on file. However, the current proposal needs modification. The proposal would require the customer account record to be updated and sent to the customer at least every 36 months or when the customer notifies the broker-dealer of a change in name, address, or investment objectives. We suggest the alternative updating requirement apply only when the broker-dealer is *required* to gather information on investment objectives and the customer has notified the broker-dealer of a change in investment objectives.

The Associations do not believe it is necessary for the account record to be mailed for a change in name or address. Customers receive account statements on a regular basis and have ample opportunity to review and make any necessary name and address changes. With respect to these changes, firms generally have standard procedures in place which, for good reasons, do not include sending a copy of the actual new account record. It appears the Commission recognizes the risk of sending sensitive information when it asks whether a customer's social security number should be included. Anyone seeking to perpetrate a fraud on an account could manipulate this requirement to receive unauthorized comprehensive information on a customer. We suggest that the requirement to send to the customer a copy of the actual new account record to verify a name or address change be eliminated.

Additionally, the Associations urge the Commission to consider an exception to the updating requirement where an account has had no activity for a period of two years. The cost of sending these mailings to customers who are simply holding on to long-term investments is not justified and updated information about financial status and investment objectives serves no purpose.

3. Record of a Record Is Unnecessary

The reproposed amendments also would require a broker-dealer to create a record indicating whether it has complied with applicable securities regulatory authority rules governing the information required when opening or updating a customer account. The Associations strongly object to this and other "record of a record" requirements found in the reproposal.[23] Each of these rules involves independent regulatory requirements, with which firms must be able independently to demonstrate their compliance. We know of no way to effectively demonstrate compliance with the substantive requirements without producing the actual record reflecting the required information. From a regulatory perspective, a separate record adds very little but, for firms, the administrative burden associated with producing the separate record is significant.

Finally, with respect to the customer account record, the Associations do not object to the requirement that the record contain the dated signatures of the person granting discretionary authority and the person to whom it is granted. The Associations believe, however, that this requirement should be drafted in a way that accommodates digital signatures or other comparable technological advances.

VI. Exception Reports

The original proposal would have required broker-dealers to produce reports to monitor unusual occurrences in customer accounts such as frequent trading, unusually high commissions, or an unusually high number of trade corrections and cancellations. The reproposed amendments would not require broker-dealers to make these types of reports, but instead, would require broker-dealers to retain these reports, if created, or be able to recreate them upon request.

The Associations fear that this provision will be counter-productive. To retain or recreate every report produced would be extremely burdensome given the number and variety of reports that firms employ. One firm reports using over 900 "screens" or "filters" each day to review trading activity. In addition, much of the review is conducted on-line where the life of the "report" is usually no more than seconds, although it may be as long as one day. If the provision is adopted as proposed, it will discourage critical self-examination because firms will dramatically reduce the reports they produce. As an

---

[23] Reproposed Rule 17a-3(a)(17)(ii) is another example of a "record of a record" requirement. Again, the record itself should suffice.

alternative, we suggest that the rule require firms to produce, recreate, or "to describe how any report *regularly produced and distributed to branch supervisory personnel* was created at a given time and identify the raw data used." The Associations are aware of no problems encountered by the regulators in connection with exception reports and therefore we believe the alternative places the burden more appropriately on the state securities regulators who are seeking a change to the status quo. Notably, those firms that present the greatest regulatory challenge will simply not produce exception reports.

VII. Technical Suggestions

Reproposed Rules 17a-3(a)(6) and 17(a)(7) require that an order ticket note the identity of any **person**, other than the associated person, who entered or accepted the order on behalf of the customer. As we have suggested before, this provision should be drafted to accommodate the use of data entry clerks by identifying a terminal location rather than an associated person. This would be consistent with the NASD Order Audit Trail System ("OATS") rules,[24] which require NASD members to record, at the point an order is received or originated, certain information including the identification of any department or **the identification number of any terminal** where an order is received directly from a customer.[25] Similarly, just as the OATS rules recognize that in many firms' order entry systems the time of receipt will be the same as the time of order entry, the proposed rules should not require a separate record for time of entry when orders are entered into such an automated system.

The Commission specifically seeks comment on how this provision should be applied to firms whose customers use an e-mail address, an electronic trading system, a general telephone number or other system or procedure to submit orders. The Commission has recognized that with today's web-based trading capabilities, many investors have direct access to markets and may have little or no contact with an agent of the firm. With such access, there generally will not be an identifiable order taker. Therefore, any new rule should make clear that these provisions do not apply to orders entered in this manner or to automated trading systems generally.

Reproposed Rule 17a-3(a)(12)(v) requires each broker-dealer to maintain a list of any internal identification numbers and CRD numbers assigned to associated persons and a list of associated persons working at, out of, or being supervised at or from each local

---

[24] *See* NASD Rules 6950 through 6957.

[25] NASD Rule 6954(b)(4).

office. The Associations believe it is unreasonable to expect to find a list of all associated persons for the entire firm at each local office although that is what the proposed rule appears to contemplate. Staffing of branch offices is a dynamic process; to be current, such a list would have to be updated daily. It would, however, be reasonable to require a list of associated persons in a local office to be maintained at that local office.

With respect to commission and compensation records for each associated person (reproposed Rule 17a-3(a)(18)), the Commission has provided needed flexibility in how those records are retained. However, the reproposal requires that records be kept for non-monetary as well as monetary compensation. The addition of non-monetary compensation will necessitate costly new systems to track this compensation. We believe instead compensation records should be limited to what is reported on the associated person's Form W-2. Regarding each associated person's purchase and sale transactions, such information currently resides in firm systems although it may not be available *chronologically*. Additionally, this record should be keyed to transactions for which the associated person was compensated, rather than for which the associated person entered the order or was primarily responsible. Clearly, if there is the potential for inappropriate behavior, it generally can be traced back to the person who was compensated for the transaction.

Reproposed Rule 17a-3(f) dealing with local offices, however the term is defined, should be limited to local offices within the United States. To extend the requirement to offices outside of the United States would do nothing to advance the objectives of the proposal.

VIII. Customer Complaints

In the 1996 draft amendments, the Commission proposed that all customer complaints, whether written or oral, be retained. Many commenters stated that the meaning of an oral complaint was vague and involved too much uncertainty as to when an oral communication becomes so critical of a broker-dealer's practices that it rises to the level at which required records would need to be created and maintained. Whether or not a customer puts a complaint in writing is an important gauge of the seriousness of the complaint. Requiring oral complaints to be maintained may inadvertently raise some inquiries to a status they don't deserve. Notably, the reproposal will require that broker-dealers retain only written complaints.

The Associations commend the Commission for acknowledging the difficulty with oral complaints. The reformulation of this provision is consistent with National Association of Securities Dealers, Inc. rules and new Form U-4, which requires reporting

of written complaints only. Nevertheless, the industry is faced with inconsistent and conflicting regulatory schemes because of a New York Stock Exchange ("NYSE") interpretation indicating that any oral complaint is a complaint reportable under NYSE Rule 351(d).[26] The Associations believe, in the interest of uniformity, the Commission should direct the NYSE to withdraw this interpretation or, at a minimum, file it as a proposed rule change so that the industry has an opportunity to point out the practical difficulties in a public comment process.

IX. Conclusion

In conclusion, the Associations believe that the reproposal represents progress toward reasonable books and records requirements. Nevertheless, there remain areas where the costs and administrative burdens on the securities industry are simply not justified by the benefits that will accrue. We have proposed alternatives that will assist state regulators in gaining access to documents maintained by broker-dealers and, at the same time, will not significantly upset longstanding business practices. We believe the alternatives represent reasonable compromises that the industry could accept.

As we have indicated on numerous occasions, the industry favors general rules which state the information required to be produced, rather than the detailed direction regarding how the records should be created and produced. Given the varied systems that firms employ, we strongly believe that the Commission should consider a general provision that says, "notwithstanding the foregoing provisions, any record that provides the relevant information satisfies the requirements of the Rule."

---

[26] NYSE Information Memo, Number 98-16, April 14, 1998.

Thank you again for the opportunity to provide comments on this important proposal. If you would like additional information or clarification of any of the matters discussed in this letter, please contact George Miller, TBMA Vice President and Deputy General Counsel, at (212) 440-9403, or Judith Poppalardo, SIA Vice President and Associate General Counsel, at (202) 296-9410.

Sincerely,

Stuart J. Kaswell
Senior Vice President and
General Counsel

Paul Saltzman
Senior Vice President and
General Counsel

CC: The Honorable Arthur Levitt, Chairman
The Honorable Norman S. Johnson, Commissioner
The Honorable Isaac C. Hunt, Jr., Commissioner
The Honorable Paul R. Carey, Commissioner
The Honorable Laura S. Unger, Commissioner
Richard R. Lindsey, Director, Division of Market Regulation
Robert L. Colby, Deputy Director, Division of Market Regulation
Michael A. Macchiaroli, Associate Director, Division of Market Regulation
Thomas K. McGowan, Assistant Director, Division of Market Regulation
Deana A. LaBarbera, Attorney, Division of Market Regulation