



## Risk Management Update August 2011

### BOOKS AND RECORDS – HOW TO STAY AHEAD OF THE CURVE

The thought of books and records and their retention - what to keep and when a document may be destroyed – can be a daunting task for any Chief Compliance Officer, Head of Operations, or other senior business executive. Adding to this confusion, the SEC has not specifically addressed when a firm may destroy such records; rather, only minimum maintenance standards are provided. For example, Rule 204-2 of the Investment Advisers Act of 1940 generally provides that certain books and records of an investment adviser must be preserved for a period of not less than five years from the end of the fiscal year during which the document was last used, with the first two years in a readily accessible place (*e.g.*, such as in the adviser's office) in order to allow for prompt production.

Broker-dealers, too, are provided with similar guidance. In October 2001, the SEC adopted amendments to Rules 17a-3 and 17a-4 under the Securities Exchange Act of 1934, which went into effect on May 2, 2003.<sup>1</sup> These amendments helped to clarify and expand record keeping requirements in connection with purchase and sales documents, customer records, associated person records, customer complaints, and certain other matters. In effect, this expanded the types of records that broker-dealers are required to keep and maintain and called for expanded policies and supervisory procedures by financial firms.

In order to stay ahead of the curve when preserving required books and records, here are some of the protocols that firms should consider.

#### 1. Identify What Are Acceptable Mediums and Storage Methods

Records that are required to be maintained and preserved for a particular period of time may be stored on microfilm, microfiche, via digital storage or other similar medium. Prior to storing such information, the firm should take the following steps:

- Arrange and index the records in a way that permits easy location, access, and retrieval of any particular record;
- Conduct a quality control test to ensure that a legible, true and complete copy of the record is provided for in a medium and format accepted by the Commission;
- Be able to readily access, view and print records promptly;
- Document which records are original and the safeguards taken to preserve the original record (such as storing a duplicate copy on any permissible medium or system afforded for by the SEC); and
- Develop a books and records storage policy, customized to your business model.

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<sup>1</sup> See New and Amended Recordkeeping Requirement Checklist, FINRA May 2003, at page 1 as found at <http://www.finra.org/web/groups/industry/@ip/@issues/@br/documents/industry/p006378.pdf>.

In the case of records on electronic storage media, firms must establish and maintain procedures to:

- Maintain and preserve the records so as to reasonably safeguard them from loss, alteration, or destruction;
- Limit access to the records to authorized personnel only; and
- Reasonably ensure that any reproduction of a non-electronic original record on electronic storage media is complete, true, and legible when retrieved.

## **2. Create an Inventory of What Books and Records Need to be Maintained and for How Long**

The Chief Compliance Officer or such Supervisory Person should create an inventory of the type of records required and the retention period.

Record requirements for Investment Advisers under Rule 203(a)-2 requires every investment adviser registered with the SEC to make and keep true, accurate and current the following books, ledgers and records:

- Journals, Ledgers
- Trade Order memoranda
- Correspondence
- Discretionary Accounts, Powers of Attorney, Written Agreements
- Form ADV and Disclosure Brochure
- Code of Ethics
- Performance Calculations, Advertisements
- Policies and Procedures Manual
- Security Record by Client and by Security

Under the new consolidated FINRA Rule 4511 general requirements, all member firms need to preserve books and records in accordance with FINRA Rules and in a format and media that complies with Rule 17a-4 of the Securities and Exchange Act. This includes, among other things:

- Communications with the Public, which includes certain forms of social media<sup>2</sup>
- Organizational Documents
- Special Reports
- Compliance, Supervisory and Procedures Manuals
- Exception Reports

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<sup>2</sup> Both brokerage and investment advisory firms are encouraged to review FINRA's new Regulatory Notice 11-39 as well as FINRA Regulatory Notice 10-06 for guidance on recordkeeping requirements and supervisory considerations for social media as found at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p124186.pdf> and <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p120779.pdf>, respectively.

### 3. Consider Adopting a Books and Records Destruction Policy

In April 2011, FINRA released Regulatory Notice 11-19 regarding FINRA's consolidated rules governing Books and Records, which goes into effect on December 5, 2011.<sup>3</sup> Notably, neither within this or other FINRA Regulatory Notices nor within the Securities Exchange Act is there guidance regarding the destruction of records. It is therefore left up to the firm's management team to decide what, if any records can be destroyed after their required retention and maintenance period. Many firms have decided to maintain books and records for a period of seven (7) years in order to ensure all relevant records are maintained in accordance with the IRS' requirements. Others have decided to keep everything, while others compile a specific destruction policy based on SEC and FINRA maintenance requirements.

Regardless of the approach, consider these following tips when developing your destruction policy.

- Most investment advisers and broker-dealers are going paperless and scan all documents that are required to be retained. These documents should be saved on the firm's servers and not individual desktop computers. Be sure that the server is backed-up periodically, and create back-up copies to be stored off-site.
- Consider the safeguarding protections afforded under Regulation S-P. This means that when destroying records, you must ensure that the disposal of "consumer report information occurs by *reasonable measures*."<sup>4</sup>
- Implement practical procedures such as labeling boxes with a content description and destruction date for shredding depending on the firm's destruction policies.
- Establish a consistent, systematic and routine method for retention and deletion of e-mails so as not to appear to be discretionary.
- Periodically review the destruction guidelines with your senior management team.
- Provide training for employees so they are aware of procedures. Review your policy on at least an annual basis to ascertain it is practical, current, and being followed.
- Consider contracting with a third-party vendor who is insured and bonded, to gather and perform the shredding of documents for the firm.
- Hard drives in servers and/or any electronic storage that is to be disposed of needs to have the hard drive removed and destroyed. Shredding vendors can also shred the hard drives or the firm can have the data scrambled electro-magnetically.

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<sup>3</sup> FINRA Regulatory Notice 11-19 found at <http://www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p123548.pdf>; also see Securities and Exchange Act Release No. 63784 (January 27, 2011), 76 FR 5850 (February 2, 2011) (Order Approving Proposed Rule Change; File No. SR\_FINRA-2010-052) (Approval Order).

<sup>4</sup> Rule 30(b)(1) of Regulation S-P was amended to cover the disposal of "consumer report information" and provides that each covered entity should evaluate what would be an appropriate disposal method given the firm's size and complexity. Due to this, some firms have instituted multiple wastebaskets or secured shredding boxes strategically place throughout the firm in order to comply with these requirements.

## Conclusion

When reviewing your books and records protocols, keep in mind that your procedures should be practical based on your size and capabilities for storage. Books and records continue to be one of the most frequently cited deficiency areas in regulatory examinations. By staying ahead of the curve, and periodically assessing and testing your maintenance policies and procedures, you will be able to identify additional efficiencies and controls to comply with federal and SRO requirements.

For more information on books and records protocols, or to learn about how CCLS may be of assistance with evaluating your current procedures, please do not hesitate to contact us at (619) 278-0020.

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