

Electronic Document Storage: Separating Compliance Reality from Rumors

By Jo Day
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Regulatory agencies, broker-dealers, and colleagues all seem to say something different when it comes to meeting compliance requirements for electronic document storage. What's an advisor to do? How do you navigate through everyone's advice and still meet the requirements?

Compliance specific to electronic recordkeeping often sparks confusion with advisors for a variety of reasons:

- There are different compliance requirements specific to electronic recordkeeping from the Securities and Exchange Commission (SEC) than for the NASD (formerly known as National Association of Securities Dealers, Inc.). Broker-dealer affiliated advisors have to meet requirements from both regulatory bodies. If you are an independent Registered Investment Advisor (RIA), you are obligated to meet the SEC requirements or, if you are independent and state registered, then you must meet your state's requirements (which tend to mirror the SEC requirements in this particular area).
- There are also different compliance requirements for Broker-dealers than for RIAs.
- Some broker dealers create their own compliance requirements in addition to what the SEC and the NASD mandate. Sometimes, these requirements are written in the name of "meeting the SEC and NASD requirements," which would lead an advisor to believe that the requirements are originating from the SEC and NASD – in some cases they are not.

How is an advisor to know what requirements to meet? Our firm always recommends seeking legal counsel on compliance issues, yet I've also heard some compliance presenters provide misleading information related to recordkeeping procedures. So, for the straight scoop, let's go to the original source – the regulating bodies themselves – the SEC or NASD.

Fortunately, the SEC rule ("Final Rule: Electronic Recordkeeping by Investment Companies and Investment Advisers") is straightforward and surprisingly brief. The rule can be found at <http://www.sec.gov/rules/final/ic-24991.htm>. The highlights are:

- WORM (Write Once, Read Many) technology, in which you burn compliance-related documents to non rewritable media, is not required for investment advisors by the SEC, though it is required for broker-dealers. For clarity as to why there is a different requirement for RIAs than for broker-dealers, the SEC spells it out beautifully in this footnote:

"...the costs of such a requirement [WORM technology] would be likely to outweigh the benefits (with respect to advisers and funds). Based on our consideration of costs, benefits, and other factors described in the proposing release we are not adopting such a requirement at this time. We recognize that the standards for electronic recordkeeping we are adopting for funds and advisers are different from the rules that we have adopted for broker-dealers, which require brokerage records to be preserved in a WORM format (emphasis, mine). We have not experienced any significant problems with funds or advisers altering stored records. Moreover, most advisory and mutual fund arrangements

involve multiple parties (e.g., brokers, custodians, transfer agents), each with its own, often parallel, recordkeeping requirement. As a result, our compliance examiners typically have an alternative means to verify the accuracy of adviser and fund records. In light of these factors, the costs of requiring funds and advisers to invest in new electronic recordkeeping technologies may not be justified.”

- While the SEC does not require WORM technology for RIAs, “the investment adviser must establish and maintain *procedures (emphasis mine)* (i) To maintain and preserve the records, so as to reasonably safeguard them from loss, alteration, or destruction; (ii) To limit access to the records to properly authorized personnel and the Commission (including its examiners and other representatives); and (iii) To reasonably ensure that any reproduction of a non-electronic original record on electronic storage media is complete, true, and legible when retrieved.”

Note that the SEC uses the word “procedures” as opposed to “technology.” That means that while you can use any type of software or hardware to safeguard your files, (tape, DVD, hard drives, web-based), you need to create a “procedure” to ensure the integrity of the information.

Back-ups and the Audit Trail

While taking your backed-up data off-site protects files from loss or destruction, a consistent back-up schedule helps meet the other SEC requirements to ensure files are “complete” and “not altered.” A back-up rotation schedule such as a Grandfather-Father-Son (GFS), for example, allows you to recover data from over multiple time periods (e.g., any day of last week, any week of last month, any month of last quarter, any quarter of last year, and then a full year). Such a robust back up schedule in combination with your media choice helps demonstrate a given document has not been altered over time and is indeed, “complete” and “true.” For example, with such a robust back up schedule, you could demonstrate that the signed client agreement you scanned in 2003 is the same file size as it is today. If an employee wanted to alter the document, they would not only have to alter it on your server, but alter the file exactly the same way on all of your back-up media.

Keep in mind that most document management software maintains an audit trail of the files. Audit trails track information such as who last opened a file, when it was last modified and by whom, among other data. If a given file has changed over time, the event log of the audit trail along with your robust back-up schedule, would help recreate what happened.

Regarding the requirement to “limit access” to files by authorized personnel, document management software employed by advisors should have features to allow you to create security groups or otherwise restrict specific users from seeing certain types of files. For example, if your bookkeeper has no reason to view the financial planning documents of your clients, then you would restrict her from accessing files that are unrelated to client billing.

Just as in the past, your filing staff ensured they made a quality copy of a document for your paper records, likewise they should ensure they obtain a good quality scan for your electronic records in order to ensure the document is “legible.”

Once you knowing the actual requirements, they are not all that challenging to meet – many of our clients have sailed through audits from a variety of sources.

The bottom line is that any time you feel compelled to spend money or time on additional technology to meet a compliance “requirement,” ask your source to provide references to the

original source documents from the SEC or NASD's Web site. This little bit of due diligence will eliminate a lot of head scratching and statements that typically begins with "I heard that..."

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TOOLS TO USE

For information on compliance requirements specific to broker-dealers, see these SEC releases:

"Books and Records Requirements for Brokers and Dealers Under the Securities Exchange Act of 1934" at <http://www.sec.gov/rules/final/34-44992.htm> and

"SEC Interpretation: Electronic Storage of Broker-Dealer Records" at <http://www.sec.gov/rules/interp/34-47806.htm>

Likewise, the NASD rule specific to broker-dealers is titled: "Records to be preserved by certain exchange members, brokers and dealers" and is located at: http://nasd.complinet.com/nasd/display/display.html?rbid=1189&element_id=1160000356

Read more about storage requirements specific to e-mail by Jo Day and Kevin Day in a May 2005 article in the *Journal of Financial Planning* http://fpanet.org/journal/articles/2005_Issues/jfp0505-art5.cfm