

Securities Industry and Financial Markets Association

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November 2, 2006

Mr. Michael Macchiaroli
Associate Director
Division of Market Regulation
Securities and Exchange Commission
Station Place
100 F Street, NE
Washington, DC 20549

Re: Modernization of Securities Exchange Act Rule 17a-4

Dear Mr. Macchiaroli:

The Securities Industry and Financial Markets Association (“SIFMA”)¹ is hereby providing additional information requested by the Securities and Exchange Commission (“SEC” or “Commission”) staff during our meeting on May 15, 2006 regarding the proposed modernization of the SEC’s record retention requirements, particularly Rules 17a-4(b)(4) and 17a-4(f) under the Securities Exchange Act of 1934 (“‘34 Act”). During that meeting, based on the staff’s request, we offered to: (1) provide the SEC with additional information regarding a sampling of SIFMA member firms’ current e-mail volumes and practices; (2) propose additional details regarding what business functions/departments would be covered under a “Registration Plus” approach for e-mail retention; and (3) propose possible alternatives to the current non-erasable, non-rewritable (“WORM”) requirement. Each of those requests are addressed below.

1. E-mail Retention Statistics

In response to the questions posed at the May 15th meeting, SIFMA collected certain information from firms represented on the SIFMA E-Records Modernization Task Force² (the

¹ The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members’ interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

² The Task Force is made up of SIFMA member representatives who have broad legal, compliance, information technology, and other expertise. The Task Force is particularly suited to working with the SEC to modernize the electronic record-keeping rules. The Task Force now also includes some members of the NYSE Electronic Records Task Force.

“SIFMA Task Force”) about their e-mail volumes and retention practices.³ The average daily e-mail volume total for the reporting firms was approximately 2.1 million e-mails (which includes both internal and external e-mails). The firms reported that, on average, about 65% of all e-mails were internal and 35% were external.⁴

In an effort to assess an indication of the potential volume of e-mails that might be excluded under the Registration Plus retention proposal (discussed further below), we also gathered information on the volume of e-mails generated solely within the information technology (“IT”) departments of responding firms. The firms reported that, on average, about 18.5% of their total e-mail volume could be attributed to communications of IT personnel. The exclusion of IT personnel, as well as other functions not related to running the business of a broker-dealer, from the retention requirements under the Registration Plus proposal could reduce the overall volume of e-mails, which as a practical matter, are retained due to a lack of clarity around what constitutes “business as such” under Rule 17a-4(b)(4). As discussed in the May 15th meeting, these and similar reductions could lead to more efficient industry recordkeeping, and enhance response time to regulatory requests, without raising any additional investor protection concerns.

2. Functional Analysis of “Registration Plus”

The term “Registration Plus” was coined as a part of our proposal to limit the scope of communications that are required to be retained under ‘34 Act Rule 17a-4, to registered persons plus persons performing other functions which may not require registration but which may be of regulatory interest. We believe that Registration Plus can only work if the requirement to retain communications is limited to functions where there is a strong likelihood that a significant percentage, if not all, of the communications related to that function are of regulatory interest. The scope of functions falling within our Registration Plus proposal covers the broad range of activities broker-dealers engage in as broker-dealers.

The SIFMA Task Force proposes that the following functions should fall within the scope of Registration Plus and, therefore, firms would be required to retain the communications sent to or from such persons who perform these functions:

- Registered persons (meaning those persons required to be registered under applicable self-regulatory rules and covering at least twenty different activities as listed in Appendix A hereto)
- Sales assistants⁵

³ Of the 16 respondents more than two-thirds were large firms with more than 10,000 employees (although two respondents had fewer than 1000 employees).

⁴ “Internal” e-mails are defined as those sent by an internal sender to internal recipients, with no external recipients. “External” e-mails are defined as those sent by an internal sender with any external recipient (even if internal recipients are also included), or sent by an external sender to an internal recipient.

⁵ Although some sales assistants, investment banking personnel, and operations personnel may be required to be registered, we are including them here because of their functions, regardless of their registration status.

- Investment bankers
- Operations functions related to the following three functions:
 - capital and reserve computations under '34 Act Rules 15c3-1 and 15c3-3;
 - handling customer funds or securities; and
 - trade execution, clearing, and settlement.
- Risk management
- Asset management functions that fall within any of the following definitions:
 - any “access person” as that term is defined under Rule 17j-1(a)(1) of the Investment Company Act of 1940;
 - any “investment adviser representative” as that term is defined under Rule 203A-3(a)(1) of the Investment Advisers Act of 1940 (“Advisers Act”); or
 - any “supervised person” as defined under Section 202(a)(25) of the Advisers Act.⁶
- Legal & compliance functions that directly support the business functions that fall within the scope of Registration Plus, as outlined above (*e.g.*, legal or compliance staff who answer questions posed by trading desk personnel)

We believe that the following is a non-exclusive list of functions that would fall outside of the scope of Registration Plus:

- Information technology (including programming, software design, testing & implementation)
- Corporate administrative services (facilities, real estate, mail room, catering, food service, corporate travel, philanthropy, event planning, cleaning staff, maintenance, physical security & safety, procurement/purchasing, publishing)
- Human resources (benefits, recruitment, personnel)
- Corporate communications (press office, media relations, public affairs)
- Training and education
- Operations not otherwise included as noted above
- Finance, accounting, payroll, and tax
- Internal audit
- Legal & compliance not otherwise included as noted above

⁶ The Division of Investment Management has requested that asset management functions be included in the SIFMA Task Force’s Registration Plus proposal.

We note that any e-mail between an individual performing a function included in Registration Plus and individuals(s) performing a function not included in Registration Plus would be retained under the SIFMA Task Force's Registration Plus proposal.

We welcome the opportunity to discuss and explain these categorizations in detail, as well as answer any questions you may have, at a future meeting.

3. Proposed Revisions of Rule 17a-4(f) (WORM)

SIFMA member firms strongly believe that current storage solutions that meet the technical requirements under the current Rule 17a-4(f) are woefully inadequate for storage and retrieval needs given the volume of electronic documents, particularly e-mail, that the SEC requires to be retained today. Moreover, firms are exposed to greater regulatory and litigation risks as a result of having to maintain data on systems that are inefficient for purposes of search and retrieval. Other federal agencies, such as banking regulators and the Defense Department that have an equally strong interest in document integrity, have not imposed similar storage rules on their constituents. Further, the SEC rules applicable to other regulated entities including investment advisers and transfer agents are less restrictive and provide those regulated entities with more technological flexibility. Currently, broker-dealers do not have the flexibility they need to select electronic storage technologies that would permit them to more efficiently save, archive, and retrieve the documents that regulators require while still employing the safeguards designed to ensure the integrity of those records.⁷

There is no such thing as a "bullet proof" storage solution. We appreciate and share the Commission's view that broker-dealers should maintain accurate records that are not subject to alteration. Nonetheless, we do not believe that there is any storage system or feature that reduces the risk of deliberate or accidental alteration to zero. Because of the necessity of a transfer to WORM media from the point of creation (*i.e.*, the e-mail server), there is no rule which can *guarantee* document integrity. Even if documents are successfully transferred to WORM media, there is still no guarantee of safe storage. The evolutionary nature of technology dictates that whatever new solutions are developed today will be found to be vulnerable tomorrow. Moreover, claimed differences in the degree of security among storage devices (*i.e.*, hardware features vs. software features) are meaningless as long as there is at least one person who knows how to override or deactivate the feature.⁸ And once such a flaw is discovered, the technical know-how tends to become common knowledge almost instantly.

⁷ The Securities Industry Association has discussed these issues in depth in its previous letters in 2003 and 2005. http://www.sia.com/2005_comment_letters/4656.pdf; http://www.sia.com/2003_comment_letters/pdf/30547811.pdf.

⁸ "Every storage medium in existence can be altered. Optical storage and other computer-based technologies are no exception ... a WORM disk is much harder to alter than a signature, but in fact both are vulnerable to someone with sufficient access, the right tools, and adequate knowledge." (Safeguarding Data with WORM, Hewlett Packard, 1999). "Any record can be altered with enough effort and knowledge of technology. In that sense any storage medium is vulnerable to intentional alteration when security and internal controls fail." (Evidentiary Benefits and Business Implications of WORM Optical Disk Storage for Records Management, Cohasset Associates, August 2000).

In light of this complexity, the SIFMA Task Force urges the Commission to permit broker-dealers to use a combination of physical, technical, and procedural safeguards that satisfy the principles of record integrity, quality, and accuracy which underlie Rule 17a-4(f). This may be accomplished by amending Rule 17a-4(f) to create a standard for broker-dealers which is similar to the standard applicable to other regulated entities. Such a standard should focus on (1) reasonable security safeguards, (2) access controls, and (3) retrieval standards. These changes would also enable the broker-dealer industry, like other regulated and unregulated industries, to explore and adopt emerging technologies in the future that can protect the integrity of electronic records such as e-mail communications in a more economical, efficient, and effective manner.

* * *

The SIFMA Task Force would like to further discuss these issues and the next steps for revising '34 Act Rule 17a-4 with the Division of Market Regulation. If you so request, we will provide specific proposed revisions to Rule 17a-4. Please contact me at (202) 216-2034 to arrange a meeting or if you have any questions.

Very truly yours,

Melissa MacGregor
Assistant Vice President & Assistant General
Counsel

cc: Erik R. Sirri, Director, Division of Market Regulation, SEC
Brian Cartwright, General Counsel, SEC
Charles Fishkin, Director, Office of Risk Assessment, SEC
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Elisse B. Walter, Senior Executive Vice President, Regulatory Policy & Programs,
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Marc Menchel, Executive Vice President & General Counsel, Regulatory Policy &
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Patrice Gliniecki, Senior Vice President & Deputy General Counsel, Regulatory
Policy & Oversight, NASD
Ira Hammerman, Senior Vice President & General Counsel, SIA

APPENDIX A

REGISTERED PERSON STANDARD

I. Examples of securities-related activities that generally require registration include those that (excluding ministerial or other non-substantive clerical and/or support functions):

- Solicit or handle customer accounts
- Solicit orders or accepting unsolicited orders for the purchase or sale of securities
- Provide advice or recommendations relating to brokerage accounts and securities investing
- Draft written or oral communications to account holders
- Draft written or oral communications relating to sales or marketing activities (including e-mail, website, or other electronic communications with clients or prospective clients)
- Prepare the substance of any company, industry, sector, or security research report
- Securities lending activities
- Securities trading and market making activities
- Training related to the securities business
- Venture capital, corporate financing, mergers & acquisitions, private placements, underwriting, or other investment banking activities
- Prepare the substance of any regulatory communications or notices, agreements with clients, and other books and records required to be kept under the federal securities laws
- Develop new securities products and services

II. Examples of supervisory or management roles that generally require registration:

- Supervise the day-to-day activities of employees who perform functions listed above, including but not limited to registered representatives, branch managers and sales managers
- Approve new client accounts
- Approve client transactions
- Approve advertising and sales literature
- Supervise the conduct of business (including the development and modification of products, services, and client interfacing system applications)
- Supervise research analysts

- Supervise training related to registered representatives
- Supervise sales, trading, market making, underwriting, or research of any security
- Supervise back-office operations
- Executive management of the firm