

DATE: May 2, 2003

TO: Members and Member Organizations

FROM: Regulatory Services Division

RE: Effective Date for "Books and Records" Rule Amendments

Members and member organizations are reminded that amendments to Rules 17a-3 and 17a-4 (the "Books and Records Rules" or the "Rules") under the Securities and Exchange Act of 1934 (the "Act") become effective May 2, 2003.

The Rules specify minimum requirements with respect to the records that broker-dealers must make and how long specified records must be kept. The following is provided as a summary of the amendments and is intended as a general compliance guide. However, members and member organizations should review the full text of the amendments in the Securities and Exchange Commission's Release¹ approving the changes (the "Release"). A copy of the release can be obtained at www.sec.gov. All necessary steps should be taken to timely comply with these new requirements. Please be aware that any Exchange Rules that are more stringent than the SEC requirements remain in full force and effect.

Customer Account Records

Account Information

The Rules generally require the creation of a record relating to each account with a natural person as customer or owner.² A good faith effort must be made to obtain specified information including each account's investment objective as well as customer identification information such as: name, tax ID, address, telephone number, date of birth, employment status (including occupation and whether the customer is an associated person of a member or broker-dealer), annual income, and net worth (excluding value of primary residence). Such information must be obtained for new accounts (those opened on or after May 2, 2003) when the account is opened. For existing accounts (those opened before May 2, 2003) the required information must be obtained within 36 months of May 2, 2003.

Delivery of Account Information to Customers

The following is also required:

- Customers must be sent a copy of the account record or an alternate document containing the required information either within 30 days of opening an account

¹ See SEA Release No. 44992 at 66 FR 55,818 (Nov. 2, 2001). Also see corrective Release No. 34-44992A; File No S7-26-98 dated 3/26/03.

² See 17a-3(a)(17).

or with the next scheduled statement mailed to the customer after the opening of the account.³ Customers must also periodically receive updates of such account record information at intervals of not greater than 36 months. The information should include or be accompanied by an explanation of any terms regarding investment objectives as well as a prominent statement instructing the customer to notify the member or member organization of any necessary changes or corrections.

- Customers, and any associated persons responsible for an account, must receive notice of a change in the account's investment objectives within 30 days or with the next scheduled statement mailed to the customer.
- Notice of any change in an account's name or address must be sent to the customer's old address, and to any associated person responsible for the account, within 30 days.

Associated Persons

Definition of "Associated Persons"⁴

The term "associated person" is defined as any partner, officer, director, or branch manager of a broker-dealer (any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common control with a broker-dealer, or any employee of a broker-dealer. This includes order-takers. The Commission interprets the term "associated person" to include any independent contractor, consultant, franchisee, or other person providing services to a broker-dealer equivalent to those services provided by persons specifically referenced in the statute and shall not include persons whose functions are solely clerical or ministerial.

Records Pertaining to Associated Persons

The Rules⁵ require maintenance of:

- A record listing every associated person and every office from which each associated person regularly conducts business.
- Detailed records relating to each written complaint against an associated person and notice to customers of the address and telephone number of the department to which such complaints may be directed.
- Detailed records of each associated person's compensation arrangement including each purchase and sale of a security attributable, for compensation purposes, to that associated person.

³ CBOE Rule 9.7(c) still requires that the background and financial information shall be sent to the customer for verification within fifteen (15) days after the customer's account has been approved or after the member organization becomes aware of any material change to the customer's financial situation.

⁴ See 17a-3(h)(4).

⁵ See 17a-3(a)(12), (18), and (19) respectively.

Offices and Office Records

Definition of “Office”

The term “office” is defined as any location where one or more associated persons regularly conduct a securities business.⁶

Office Records

Members and member organizations are required to make and keep current, as to each office, the following books and records⁷:

- Blotters
- Brokerage Orders
- Orders for the Broker-Dealer’s Account
- Records Relating to Associated Persons
- Customer Account Records
- Records of Customer Complaints
- Associated Persons’ Compensation Records
- Advertisements, Sales Literature, or other Communications with the Public
- Identity of Principals Responsible for Establishing Policies and Procedures

In addition, a current record must be maintained, by name or title, of each person at an office who, without delay, can explain the types of records the member or member organization maintains at that office and the information contained in those records.

Availability of Office Records

Required records as to each office must be maintained either at the office to which they relate or otherwise be promptly made available to a regulator. The Commission has indicated in its Release that requests for records that are readily available at the office (either on-site or electronically) should be filled on the day it is made. If a request is unusually large or complex, then the member or member organization should discuss with the regulator a mutually agreeable time-frame for production.

If an office is a private residence where only one associated person (or multiple associated persons who reside at that location and are members of the same immediate family) regularly conducts business, and it is not held out to the public as an office nor are funds or securities of any customer handled there, records need not be maintained at that office. However, records must be maintained at another location, within the same State, as the member or member organization may select.⁸

⁶ See 17a-3(h)(1).

⁷ See 17a-3(g).

⁸ See 17a-4(j).

Memoranda of Orders

The Rules require that a memorandum either for a brokerage order⁹ or for a principal transaction¹⁰ with a public customer shall contain:

- The identity of the associated person, if any, responsible for the account and any other person who entered or accepted the order on behalf of the customer.
- Whether it was entered subject to discretionary authority.
- Information regarding any modifications to the order.
- Time of receipt.

A brokerage order ticket must include its "time of entry," i.e., the time at which the member or member organization transmits the order or instruction for execution.

An assigned ID number or computer terminal code may be used to comply with the requirement to record the identity of the person entering an order; however, upon request, the actual identity of the person who entered the order must be provided.

General Record Retention Requirements

Communications

Retention of communications that are subject to SRO rules regarding "communications with the public"¹¹ (such as advertising) is required.¹² It is noted in the Commission's Release that a written advertisement that is never released to the public would not be covered by this rule; however, a sales script that is used by an associated person when communicating with the public would be covered even if the script itself is not delivered to the public.

Special Reports

Each report that a securities regulatory authority has requested or required pursuant to an order of settlement, and each securities regulatory authority examination report must be maintained in an easily accessible place for three years after the date of the report.¹³

Manuals

Each compliance, supervisory, and procedures manual, including all revisions thereto, describing the policies, practices, and supervisory procedures of a member or member organization must be maintained in an easily accessible place for three years after termination of its use.¹⁴

⁹ See 17a-3(a)(6).

¹⁰ See 17a-3(a)(7).

¹¹ See CBOE Rule 9.21 ("Communications with the Public").

¹² See 17a-4(b)(4).

¹³ See 17a-4(e)(6).

¹⁴ See 17a-4(e)(7).

Exception Reports

All reports produced to review for unusual activity in customer accounts shall be maintained in an easily accessible place for eighteen months after the report was generated. In lieu of maintaining report hard copies, a member or member organization may promptly reproduce a requested report in a comprehensible format using historical data. If the requested report cannot be adequately reproduced using historical data, the member or member organization shall promptly produce a record of the parameters used to generate the report at the time specified, including a record of the frequency with which the report was generated.¹⁵

Questions regarding this Memo may be directed to Robert Gardner at (312) 786-7937 or Barry Szurgot at (312) 786-7756.

¹⁵ See 17a-4(e)(8).