FOR FURTHER INFORMATION CONTACT: Betsy Prout Lefler, Special Counsel, Gail Marshall-Smith, Special Counsel, or David Oestreicher, Special Counsel, (202) 942–0158, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Mail Stop 5–1, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

Background

On August 28, 1996, the Securities and Exchange Commission (''Commission'') adopted Rule 11Ac1–4, the ''Limit Order Display Rule,'' and amendments to Rule ''Ac1–1, the ''ECN Amendment,'' to require OTC market makers and exchange specialists to display certain customer limit orders, and to publicly disseminate the best prices that the OTC market maker or exchange specialist has placed in certain electronic communications networks (''ECNs''), or to comply indirectly with the ECN Amendment by using an ECN that furnishes the best market maker and specialist prices therein to the public quotation system.

On January 20, 1997, the Order Execution Rules became effective. As of that date, compliance with the rules became mandatory for all exchange-traded securities and 50 Nasdaq securities. Compliance with the rules for the remaining Nasdaq securities is to be completed in accordance with a schedule established by the Commission.[1] Under the previously announced schedule, compliance with the Order Handling Rules would have been required with respect to another 100 Nasdaq securities on February 7, 1997, and another 850 Nasdaq securities on February 28, 1997. In addition, on March 28, 1997, compliance would have been required with respect to all remaining Nasdaq securities under the ECN Rule, and with respect to another 1500 Nasdaq securities under the Limit Order Display Rule. Thereafter, compliance under the Limit Order Display Rule was to be phased-in over several months.

The Commission has been closely monitoring the implementation of the Order Execution Rules, and recently received two letters from representatives of numerous industry participants (''Industry Letters'') requesting that the Commission adopt a more conservative schedule for implementing the Order Execution Rules.[2] Accordingly, the Commission has determined that it is appropriate to modify the schedule to provide a more gradual phase-in to allow market participants more time to adapt to the Order Execution Rules.[3] The new schedule is as follows: On February 10, 1997, 50 Nasdaq securities, and on February 24, 1997, an additional 50 Nasdaq securities, shall be phased-in for compliance under the Order Execution Rules.[4] Furthermore, in response to the Industry Letters, the Commission is exempting responsible brokers and dealers, electronic communications networks, exchanges, and associations, until April 14, 1997, from the requirements of the ECN Amendment with respect to all Nasdaq securities not phased-in as of February 24, 1997, and from the requirements of the Limit Order Display Rule with respect to the 2350 Nasdaq securities that will not be phased-in as of February 24, 1997. Under the prior schedule, all Nasdaq securities would have been phased-in by March 28, 1997 for compliance with the requirements of the ECN Amendment. Likewise, 850 of these securities would have been phased-in on February 28, and another 1500 on March 28, 1997, for compliance with the Limit Order Display Rule.

The Commission believes it is imperative to continue to phase-in implementation of the Order Execution Rules with respect to additional Nasdaq securities. The Commission has granted exemptive relief to monitor operation of the rules carefully, and will develop a further phase-in schedule for the Nasdaq securities not phased-in as of February 24, 1997.

The Commission finds that the modifications of the compliance dates described above, and the exemptive relief provided herein to responsible brokers and dealers, electronic communications networks, exchanges, and associations are consistent with the public interest, the protection of investors and the removal of impediments to and perfection of the mechanism of a national market system.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30(a)(28), (61), and (62).

Dated: February 5, 1997.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 97–3432 Filed 2–11–97; 8:45 am]

BILLING CODE 8010–01–M

[1] *See* Securities Exchange Act Release Nos. 37619A (September 6, 1997) (''Adopting Release''), 37972 (November 22, 1996), 38110 (January 2, 1997), and 38139 (January 8, 1997). The Commission notes that a broker-dealer's duty of best execution discussed in the Adopting Release applies whether or not the security has been phased-in under the Order Execution Rules.

[2] *See* letter from Bernard L. Madoff, Securities Industry Association, to Richard R. Lindsey, dated January 30, 1997, and letter from John N. Tognino, Securities Traders Association, to Richard R. Lindsey, dated January 31, 1997.

[3] The Commission also amended subsection (a)(25)(ii) of the Quote Rule, thereby expanding the coverage of the Quote Rule to all exchange-traded securities. Thereafter, the Commission determined that it was appropriate to make this aspect of the amendments effective April 10, 1997. *See* Securities Exchange Act Release No. 38110, *supra* note 1. The present order does not change that date and, therefore, the effective date of subsection (a)(25)(ii) of the Quote Rule remains April 10, 1997.

[4] Currently, compliance with the Order Handling Rules is required for 50 of the 1000 Nasdaq securities with the highest average daily trading volume. These 50 securities have been identified by Nasdaq. Similarly, Nasdaq is to identify the next two groups of 50 stocks to be phased-in under the Order Handling Rules.

17 CFR Part 240

[Release No. 34–38245; File No. S7–21–93]

RIN 3235–AF91

Reporting Requirements for Brokers or Dealers Under the Securities Exchange Act of 1934

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission (''Commission'') is amending its broker-dealer record preservation rule to allow broker-dealers to employ, under certain conditions, electronic storage media to maintain records required to be retained. The amendments reflect a recognition of technological developments that will provide economic as well as time-saving advantages for broker-dealers by expanding the scope of recordkeeping options while at the same time continuing to require broker-dealers to maintain records in a manner that preserves their integrity. The Commission is also issuing an interpretation of its record preservation rule relating to the treatment of electronically generated communications.

EFFECTIVE DATE: The amendments become effective April 14, 1997.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, Associate Director (202/942–0132), Peter R. Geraghty, Assistant Director (202/942–0177) or Barbara A. Stettner, Staff Attorney (202/942–0734), Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, NW., Mail Stop 5–1, Washington, DC 20549.

SUPPLEMENTARY INFORMATION

I. Introduction

On July 9, 1993, the Commission issued a release (''Proposing Release'') requesting comment on proposed amendments to its broker-dealer record

preservation rule, Rule 17a–4,[1] that would allow broker-dealers to employ, under certain conditions, optical storage technology.[2] The proposed amendments also would codify a staff no-action position that allows broker-dealers to use microfiche as a storage medium.[3] Simultaneous with the issuance of the Proposing Release, the Division of Market Regulation (''Division''), with the concurrence of the Commission, issued a no-action letter allowing broker-dealers to utilize optical storage technology immediately, under certain conditions.[4] Based on the comments received and the experience gained by the Commission under the no-action letter, the Commission is adopting the proposed amendments with certain changes discussed herein.

Set forth below is a summary of the proposed amendments, a summary of the comment letters received in response to the Proposing Release, a description of the final rule amendments, and an interpretation relating to the retention of electronically generated communications. The Commission is also providing notice of a staff related no-action position regarding other recordkeeping requirements under the Securities Exchange Act of 1934 (''Exchange Act'').

The Commission's Proposal

The Commission proposed to amend its record retention rule, Rule 17a–4, to expand broker-dealer record retention options by permitting broker-dealers to use optical storage technology for information required to be maintained under these rules. The Proposing Release described optical storage technology as storage technology which ''allows for digital data recording in a non-rewriteable, non-erasable format, such as write once, read many (''WORM'') * * *. Non-rewriteable optical storage records digital information by employing a laser heat source to burn a pattern on a metallic film on a disk surface that can hold billions of bytes of data.''

In the Proposing Release, the Commission noted the importance for recordkeeping of ready access, reliability, and permanence of records. Therefore, the proposed rule included safeguards against data erasure, provisions for immediate verification of the stored material, and requirements for back-up facilities. Specifically, the conditions included requirements that broker-dealers using optical disk storage systems employ non-rewriteable, non-erasable technology that verifies automatically the quality and accuracy of the optical storage recording process, duplicate in a separate optical disk all information preserved and maintained by means of optical storage technology, serialize the original and duplicate optical disks, and time-date the information placed on the optical disks. In addition, to facilitate full access to records during examinations by the self-regulatory organizations (''SROs'') and the Commission, broker-dealers would be required to index the optical disks and place the index on optical disk, and would be required to have the capability to readily reproduce records kept on optical disks in any medium acceptable under the final rule amendment, as required by the SROs and the Commission.

The Proposing Release also solicited comment regarding the adequacy of optical disk technology to preserve handwritten records or records that contain handwritten text, given the difficulties associated with detecting alterations made to handwritten text preserved through optical disk technology.[5]

The Commission received 13 comment letters in response to the Proposing Release.[6] Several commenters explained that the description of optical storage technology in the Proposing Release included only one specific type of writing technology known as ablative writing,[7] and requested clarification that the final rule would apply to other forms of optical disk technology that met the requirements of the rule. In addition, a few commenters objected to limiting the acceptable storage medium to optical disk technology and recommended that the rule apply to other electronic storage media, including optical tape.[8] More recently, the SIA requested clarification as to whether the Commission considers CD–ROM to be a form of optical disk technology.[9] Commenters that addressed the issue of the adequacy of optical disk technology in preserving handwritten records or records that contain handwritten text objected to any restrictions on the types of records broker-dealers can maintain using optical storage technology.

II. Description of Rule Amendments

A. Scope of Permissible Electronic Storage Media

In the Proposing Release, the Commission did not intend the definition of optical storage technology to include only an ablative methodology of storage. The Commission recognizes that other methods of electronic storage technology exist, including optical tape and CD–ROM, which are available in a WORM, non-rewriteable version.[10] The Commission is adopting a rule today which, instead of specifying the type of storage technology that may be used, sets forth standards that the electronic storage media must satisfy to be considered an acceptable method of storage under Rule 17a–4. Specifically, because optical tape, CD–ROM, and certain other methods of electronic storage are available in WORM and can provide the same safeguards against data manipulation and erasure that optical disk provides, the final rule clarifies that broker-dealers may employ any electronic storage media that meets the conditions set forth in the final rule.[11]

B. Handwritten Records

In the Proposing Release, the Commission expressed concern and requested comment regarding the use of optical disk technology to preserve

[1] 17 CFR 240.17a–4. Rule 17a–4 sets forth the records to be preserved by certain exchange members, brokers, and dealers.

[2] Securities Exchange Act Release No. 32609 (July 9, 1993), 58 FR 38092 (July 15, 1993).

[3] Letter from Nelson S. Kibler, Assistant Director, Division of Market Regulation, SEC to Robert F. Price, Alex. Brown & Sons (November 3, 1979).

[4] Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, SEC to Michael D. Udoff, Chairman, *Ad Hoc* Record Retention Committee, Securities Industry Association (''SIA'') (June 18, 1993).

[5] In response to these concerns, the Division's no-action letter permitted optical storage of all paper records, including handwritten records, except those records required to be made under paragraphs (a)(6) and (a)(7) of Rule 17a–3 (proprietary and customer order tickets).

[6] The comment letters are available for public inspection and copying in the Commission's public reference room located at 450 Fifth Street, NW., Washington, DC. (File No. S7–21–93).

[7] Ablative technology means that, by use of a laser, a pattern is burned onto a metallic film on an optical disk. Other methods of optical disk technology utilize a laser to record information onto the optical disk, but unlike ablative technology, the laser does not necessarily ''burn'' a pattern onto the disk.

[8] The SIA commented that optical tape provides the same safeguards against data erasure and manipulation as optical disk provides but allows for storage of greater amounts of data. Letter from Michael D. Udoff, Chairman, *Ad Hoc* Record Retention Committee of the SIA to Jonathan G. Katz, Secretary, SEC (September 30, 1993).

[9] Letter from Mark A. Egert, Assistant General Counsel, SIA to Michael A. Macchiaroli, Associate Director, Division of Market Regulation, SEC (February 15, 1996) (arguing that CD–ROMs are simply one of several different optical disk sizes that are commercially available.)

[10] The Commission understands that additional methods also available in a WORM, non-rewritable version include, for example, alloying, bubble-forming, moth-eye (Plasmon), phase-change, dye/polymer, and magneto-optic.

[11] The amendment the Commission is adopting today also permits the use of ''micrographic media'' which is defined to include microfilm or microfiche, or any similar media, which codifies an earlier Commission staff no-action position. *See* Letter from Nelson S. Kibler, *supra* note 3.

handwritten records and records containing handwritten text. As indicated in the Proposing Release, the Commission's primary concern was that, from the standpoint of examinations and enforcement of the securities laws, optical disk images (as well as microfilm or microfiche images) make it difficult to detect forgery and alterations made to handwritten text.

The Commission recognizes that microfilm is a form of record retention for handwritten records that has been permitted since 1970, and the Commission understands few broker-dealers currently keep documents in hard copy or paper format. The Commission's experience since 1970 relating to the retention of handwritten records on microfilm has generally been positive. The Commission further understands that many of the larger broker-dealers no longer create traditional order tickets (with or without handwritten notations) because such broker-dealers enter most orders directly through electronic systems which automatically retain an electronic record of the trade entry.

In view of the existing use of microfilm and microfiche for record retention, the Commission believes that allowing preservation of handwritten records in electronic storage media would not significantly increase the difficulty of detecting forgery or alterations on these records. Accordingly, the Commission is permitting storage of handwritten records and records containing handwritten text using electronic storage media meeting the requirements set forth in the final rule adopted today.[12] Nonetheless, in the future, if difficulties arise in detecting abuses in handwritten records stored in electronic format, the Commission may revisit this issue both with regard to electronic storage media, as well as microfilm and microfiche.[13]

C. Creation of a Duplicate Record

The Proposing Release would have required a broker-dealer to copy all of the information contained on an original disk onto a separate, duplicate disk. The SIA commented that broker-dealers should be permitted to store the duplicate record on any medium acceptable under Rule 17a–4. The SIA explained that clearing firms frequently have to provide copies of records to their correspondent firms that may not have optical disk technology. Therefore, according to the SIA, clearing firms may be obligated to maintain certain records in another media for the correspondents' use.[14] The Commission agrees that it is appropriate to permit storage of the duplicate record on any medium acceptable under Rule 17a–4, and accordingly, the final amendments reflect this change.[15]

D. Audit System Requirement

The Proposing Release would have required a broker-dealer to ''have in place an audit system providing for accountability regarding all access to records maintained and preserved using optical storage technology and any changes made to every original and duplicate optical disk.'' Commenters sought clarification as to whether this provision requires maintenance of a log of all persons who have the capability or authority to access optical disks, or maintenance of a log indicating each instance where data is added to a disk. The rule adopted by the Commission today requires an audit system to be utilized only when records required to be maintained under Rule 17a–4 are being entered or when any additions to existing records are made. Therefore, an audit record is not required when a record is accessed but cannot be altered by the reader.

E. Third Party Down-Load Provider

The Proposing Release would require broker-dealers to have arrangements with at least one third party that has the ability to download information from the broker-dealer's electronic storage system to another acceptable medium. The third party must submit undertakings to the SRO for the broker-dealer indicating that it agrees to promptly furnish information necessary for the Commission's staff and its designees to download information from a broker-dealer's electronic storage system to another acceptable medium, and take reasonable steps to provide access to information contained on a broker-dealer's electronic storage system. The Commission is adopting this requirement substantially as proposed.

F. Escrow Agent

Under the Proposing Release, broker-dealers would be required to keep current all information necessary to download records and indices stored on optical disks. Alternatively, broker-dealers who use outside service bureaus to preserve records could place in escrow and keep current a copy of the information necessary to access the format (i.e., the logical layout) of the optical disks and to download records stored on optical disks. This condition was intended to ensure access to information preserved on optical disks when the broker-dealer is no longer operational, when the broker-dealer refuses to cooperate with investigative efforts of the Commission or the SROs, or when the optical disk has not been properly indexed. The SIA commented that they believed this requirement duplicated the required third party undertaking in the proposed amendments. The third party undertaking was intended to act as a back-up to the escrow requirement, and therefore the Commission does not agree that it would be unnecessary and duplicative to require broker-dealers to keep or escrow the information necessary to download records from optical disk. Accordingly, the final rule adopted today includes such proposed requirement.

III. Staff No-Action Position

The Commission also is providing notice that the staff of the Division will not recommend enforcement action to the Commission if broker-dealers, transfer agents, and clearing agencies fulfill their record retention and preservation requirements set forth in the following rules under the Exchange Act by using electronic storage media as permitted by the final amendments to Rule 17a–4(f) described herein:

Rule 3a51–1 (17 CFR 240.3a51–1)
Rule 15a–6 (17 CFR 240.15a–6)
Rule 15c1–7 (17 CFR 240.15c1–7)
Rule 15c2–5 (17 CFR 240.15c2–5)
Rule 15c2–11 (17 CFR 240.15c2–11)
Rule 15c3–1 (17 CFR 240.15c3–1)
Rule 15c3–3 (17 CFR 240.15c3–3)
Rule 15g–3 (17 CFR 240.15g–3)
Rule 15g–4 (17 CFR 240.15g–4)
Rule 15g–5 (17 CFR 240.15g–5)

[12] *But see infra* note 16 and accompanying text for certain limited exceptions.

[13] Recently, the Commission published its views with respect to the use of electronic media by broker-dealers, transfer agents, and investment advisers to deliver information as required under the Exchange Act and the Investment Advisers Act of 1940. Securities Exchange Act Release No. 37182 (May 9, 1996), 61 FR 24644 (May 15, 1996) (''May Interpretive Release''). As the Commission noted in the May Interpretive Release, the staff of the Division also reminds broker-dealers, transfer agents, and clearing agencies of their responsibilities to prevent, and the potential liability associated with, unauthorized transactions. In this regard, broker-dealers, transfer agents, and clearing agencies should have reasonable assurance that information preserved by means of electronic storage media, including customer signatures, is authentic. *See id.* at note 29.

[14] *See* Letter from Michael D. Udoff, *supra* note 8.

[15] Another issue raised by several commenters concerns the time at which the duplicate must be created. Broker-dealers will be permitted to wait to make the duplicate until the original optical disk is full, provided that broker-dealers maintain the duplicate data on another acceptable medium such as paper or micrographic media until it creates the duplicate optical disk.

Rule 15g–6 (17 CFR 240.15g–6)
Rule 17a–2 (17 CFR 240.17a–2)
Rule 17a–5 (17 CFR 240.17a–5)
Rule 17a–6 (17 CFR 240.17a–6)
Rule 17a–7 (17 CFR 240.17a–7)
Rule 17a–8 (17 CFR 240.17a–8)
Rule 17f–1 (17 CFR 240.17f–1)
Rule 17f–2 (17 CFR 240.17f–2)
Rule 17Ad–6 (17 CFR 240.17Ad–6)
Rule 17Ad–10 (17 CFR 240.17Ad–10)
Rule 17Ad–11 (17 CFR 240.17Ad–11)
Rule 17Ad–13 (17 CFR 240.17Ad–13)
Rule 17Ad–15 (17 CFR 240.17Ad–15)

The staff of the Division believes that the recordkeeping requirements under Exchange Act Rules 15g–2 and 15g–9 [16] should not be met by means of electronic storage media, and the records required by such rules should be maintained and preserved in paper format for the prescribed time period. Rules 15g–2 and 15g–9 require broker-dealers to obtain from a customer prior to effecting transactions in penny stocks (1) a manually signed acknowledgement of the receipt of a risk disclosure document, (2) a written agreement to transactions involving penny stocks, and (3) a manually signed and dated copy of a written suitability statement. Because the Commission, in the May Interpretative Release, did not permit the use of electronic media to satisfy the requirements of Rules 15g–2 and 15g–9, the staff of the Division believes it would not be appropriate to permit the storage of records required by such rules using electronic storage media.[17]

IV. Electronic Communications

Finally, the Commission is aware that many questions have been raised regarding the applicability of Rule 17a–4(b)(4) to electronic mail communications (''e-mail'') and Internet communications. In the May Interpretive Release, the Commission discussed its beliefs regarding the adaptation of SRO supervisory review requirements governing communications with customers to accommodate the use of electronic communications by broker-dealers. The Commission recommended that the SROs work with broker-dealers with respect to the adaptation of such rules and recommended that the SRO rules concerning the supervisory requirements for electronic communications ''should be based on the content and audience of the message and not merely the electronic form of the communication.'' [18]

The Commission understands that broker-dealers use e-mail and the Internet to communicate important information relating to the broker-dealer's business internally, to customers, and to the general public. The Commission is also aware that many broker-dealers use such electronic systems to communicate about issues unrelated to the business of the broker-dealer. Consistent with the Commission's recommendation to the SROs regarding the appropriate standard for prior supervisory review for electronic communications, the Commission believes that for record retention purposes under Rule 17a–4, the content of the electronic communication is determinative, and therefore broker-dealers must retain only those e-mail and Internet communications (including inter-office communications) which relate to the broker-dealer's ''business as such.''

V. Summary of Final Regulatory Flexibility Analysis

The Regulatory Flexibility Act, which became effective on January 1, 1981, imposes procedural steps applicable to agency rulemaking that has a ''significant economic impact on a substantial number of small entities.'' [19] The Chairman of the Commission has certified pursuant to the Regulatory Flexibility Act that the final amendments to Rule 17a–4 will not have a significant economic impact on a substantial number of small entities because the amendments do not alter the regulatory requirements for broker-dealers using currently accepted media for record retention purposes (i.e., paper, microfilm, or microfiche). A copy of the certification is attached to this release as Appendix A.

VI. Paperwork Reduction Act

In connection with the Proposing Release, on August 12, 1993, notice was published in the Federal Register [20] that, pursuant to the Paperwork Reduction Act of 1980 (''Old PRA''), [21] the Commission had submitted to the Office of Management and Budget (''OMB'') request for approval of the proposed amendments to Rule 17a–4. No comments were received with respect to the notice. The OMB control number, 3235–0279, was originally issued in 1993 and was reauthorized on June 30, 1996. Comment was sought with respect to the reauthorization and no comment was received. [22] The OMB number was issued pursuant to the Old PRA, prior to the amendment of such act in 1995.

The Proposing Release included certain requirements that would be unique to broker-dealers which chose to use optical storage systems and which qualified as collections of information under the Old PRA. The final rule amendments do not contain substantive modifications to the collections of information originally set forth in the Proposing Release. The collection of information is in accordance with the clearance requirements of 44 U.S.C. 3507. The final amendments clarify that broker-dealers may use any electronic storage media that meets the requirements of the rule. Since the final rule amendment expands the scope of recordkeeping options and does not alter the options currently permitted under the rule, broker-dealers may chose to continue to store information using paper, microfilm, or microfiche, or may chose to employ electronic storage media as permitted by the final rule amendments. If broker-dealers chose the electronic storage media option, then compliance with the collection of information requirement is mandatory.

A. Collection of Information Under Rule 17a–4

Under the final rule amendments, users of electronic storage media must have in place an audit system that provides for accountability regarding inputting of records required to be maintained and preserved pursuant to

[16] 17 CFR 240.15g–2 and 240.15g–9.

[17] *See* May Interpretive Release at note 50.

[18] *See id.* at note 5. The Commission notes that the New York Stock Exchange, Inc. (''NYSE'') has submitted a proposal to modify its supervisory rules which will require prior supervisory review of those communications with the general public and customers which include advertisements, market letters, sales literature, and similar types of communications, as well as research reports. The proposal also requires members to develop reasonable procedures for review of registered representatives' communications with the public relating to their business. *See* File No. SR–NYSE–96–26.

[19] Although Section 601(b) of the Regulatory Flexibility Act defines the term ''small entity,'' the statute permits agencies to formulate their own definitions. The Commission has adopted definitions of the term ''small entity'' for purposes of Commission rulemaking in accordance with the Regulatory Flexibility Act. Those definitions are set forth in Rule 0–10, 17 CFR 240.0–10. *See* Securities Exchange Act Release No. 18452 (January 28, 1982), 47 FR 5215 (February 4, 1982). A broker-dealer is a ''small business'' or ''small organization'' under Rule 0–10 if the broker-dealer (i) had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to 17 CFR 240.17–5(d) or, if not required to file such statements, a broker-dealer that had total net capital (net worth plus subordinated liabilities) of less than $500,000 on the last business day of the preceding fiscal year (or in the time that it has been in business, if shorter); and (ii) is not affiliated with any person (other than a natural person) that is not a small business or small organization as defined in 17 CFR 240.0–10.

[20] 58 FR 42992 (August 12, 1993).

[21] 44 U.S.C. 3501 et seq.

[22] 61 FR 14586 (April 2, 1996).

Rules 17a–3 and 17a–4 to electronic storage media and inputting of any changes made to every original and duplicate record maintained and preserved thereby. Although the Commission is not specifying the contents of each audit system, data automatically or otherwise stored (in the computer or in hard copy) regarding inputting of records and changes to existing records will be part of that system. The Commission envisions that names of individuals actually inputting records and making particular changes, and the identity of documents changed and the identity of new documents created, are the kind of information that automatically would be collected pursuant to the audit system requirement. The results of the audit system must be available for examination by the staffs of the Commission and the appropriate SROs and must be preserved for the time required for the audited records.

In addition, the entity employing the electronic storage media must organize and index all information maintained on both original and duplicate electronic storage media, and each index must be duplicated. The entity employing the technology must also maintain, keep current, and provide promptly upon request by the Commission or SROs all information necessary to access records and indexes stored on electronic storage media, or escrow and keep current a copy of the physical and logical file format, the field format of all different information types written on the electronic storage media and the source code, together with appropriate documentation and information necessary to access records and indexes.

The recordkeeping requirements described above are unlikely to prove burdensome to users because the recordkeeping requirements are specifically tied to the design and use of electronic storage media. To the extent that the final rule amendments create any burden on users, however, such burden should be small, even negligible, relative to the reduced recordkeeping burden that will result from broker-dealers' ability to use electronic storage media.

B. Proposed Use of the Information

The information contained in the records required to be preserved by those subject to Rule 17a–4 will be used by examiners and other representatives of the Commission and the SROs to ensure that broker-dealers are in compliance with applicable financial responsibility, antifraud, and antimanipulation rules as well as other rules and regulations of the Commission and the SROs. The collections of information generally will not be made publicly available. The ultimate purpose of the final amendment is the protection of investors.

VII. Statutory Analysis

Pursuant to the Securities Exchange Act of 1934 and particularly section 17(a)(1) thereof, 15 U.S.C. 78q(a)(1), the Commission is adopting amendments to § 240.17a–4 of Title 17 of the Code of Federal Regulations in the manner set forth below.

List of Subjects in 17 CFR Part 240

Brokers, Reporting and recordkeeping requirements, Securities.

Text of Final Rule

In accordance with the foregoing, Title 17, chapter II, part 240 of the Code of Federal Regulations is amended as follows:

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934.

1. The authority citation for part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78f, 78i, 78j, 78k, 78k–1, 78*l*, 78m, 78n, 78o, 78p, 78q, 78s, 78w, 78x, 78*ll*(d), 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4 and 80b–11, unless otherwise noted.

* * * * *

2. Section 240.17a–4 is amended by revising paragraph (f) to read as follows:

§ 240.17a–4 Records to be preserved by certain exchange members, brokers and dealers.

* * * * *

(f) The records required to be maintained and preserved pursuant to §§ 240.17a–3 and 240.17a–4 may be immediately produced or reproduced on ''micrographic media'' (as defined in this section) or by means of ''electronic storage media'' (as defined in this section) that meet the conditions set forth in this paragraph and be maintained and preserved for the required time in that form.

(1) For purposes of this section:

(i) The term *micrographic media* means microfilm or microfiche, or any similar medium; and

(ii) The term *electronic storage media* means any digital storage medium or system and, in the case of both paragraphs (f)(1)(i) and (f)(1)(ii) of this section, that meets the applicable conditions set forth in this paragraph (f).

(2) If electronic storage media is used by a member, broker, or dealer, it shall comply with the following requirements:

(i) The member, broker, or dealer must notify its examining authority designated pursuant to section 17(d) of the Act (15 U.S.C. 78q(d)) prior to employing electronic storage media. If employing any electronic storage media other than optical disk technology (including CD–ROM), the member, broker, or dealer must notify its designated examining authority at least 90 days prior to employing such storage media. In either case, the member, broker, or dealer must provide its own representation or one from the storage medium vendor or other third party with appropriate expertise that the selected storage media meets the conditions set forth in this paragraph (f)(2).

(ii) The electronic storage media must:

(A) Preserve the records exclusively in a non-rewriteable, non-erasable format;

(B) Verify automatically the quality and accuracy of the storage media recording process;

(C) Serialize the original and, if applicable, duplicate units of storage media, and time-date for the required period of retention the information placed on such electronic storage media; and

(D) Have the capacity to readily download indexes and records preserved on the electronic storage media to any medium acceptable under this paragraph (f) as required by the Commission or the self-regulatory organizations of which the member, broker, or dealer is a member.

(3) If a member, broker, or dealer uses micrographic media or electronic storage media, it shall:

(i) At all times have available, for examination by the staffs of the Commission and self-regulatory organizations of which it is a member, facilities for immediate, easily readable projection or production of micrographic media or electronic storage media images and for producing easily readable images.

(ii) Be ready at all times to provide, and immediately provide, any facsimile enlargement which the Commission or its representatives may request.

(iii) Store separately from the original, a duplicate copy of the record stored on any medium acceptable under § 240.17a–4 for the time required.

(iv) Organize and index accurately all information maintained on both original and any duplicate storage media.

(A) At all times, a member, broker, or dealer must be able to have such indexes available for examination by the staffs of the Commission and the self-

regulatory organizations of which the broker or dealer is a member.

(B) Each index must be duplicated and the duplicate copies must be stored separately from the original copy of each index.

(C) Original and duplicate indexes must be preserved for the time required for the indexed records.

(v) The member, broker, or dealer must have in place an audit system providing for accountability regarding inputting of records required to be maintained and preserved pursuant to §§ 240.17a–3 and 240.17a–4 to electronic storage media and inputting of any changes made to every original and duplicate record maintained and preserved thereby.

(A) At all times, a member, broker, or dealer must be able to have the results of such audit system available for examination by the staffs of the Commission and the self-regulatory organizations of which the broker or dealer is a member.

(B) The audit results must be preserved for the time required for the audited records.

(vi) The member, broker, or dealer must maintain, keep current, and provide promptly upon request by the staffs of the Commission or the self-regulatory organizations of which the member, broker, or broker-dealer is a member all information necessary to access records and indexes stored on the electronic storage media; or place in escrow and keep current a copy of the physical and logical file format of the electronic storage media, the field format of all different information types written on the electronic storage media and the source code, together with the appropriate documentation and information necessary to access records and indexes.

(vii) For every member, broker, or dealer exclusively using electronic storage media for some or all of its record preservation under this section, at least one third party (''the undersigned''), who has access to and the ability to download information from the member's, broker's, or dealer's electronic storage media to any acceptable medium under this section, shall file with the designated examining authority for the member, broker, or dealer the following undertakings with respect to such records:

The undersigned hereby undertakes to furnish promptly to the U.S. Securities and Exchange Commission (''Commission''), its designees or representatives, upon reasonable request, such information as is deemed necessary by the Commission's or designee's staff to download information kept on the broker's or dealer's electronic storage media to any medium acceptable under Rule 17a–4.

Furthermore, the undersigned hereby undertakes to take reasonable steps to provide access to information contained on the broker's or dealer's electronic storage media, including, as appropriate, arrangements for the downloading of any record required to be maintained and preserved by the broker or dealer pursuant to Rules 17a–3 and 17a–4 under the Securities Exchange Act of 1934 in a format acceptable to the Commission's staff or its designee. Such arrangements will provide specifically that in the event of a failure on the part of a broker or dealer to download the record into a readable format and after reasonable notice to the broker or dealer, upon being provided with the appropriate electronic storage medium, the undersigned will undertake to do so, as the Commission's staff or its designee may request.

* * * * *

By the Commission.

Dated: February 5, 1997.

Margaret H. McFarland,

Deputy Secretary.

Note: Appendix A to the Preamble will not appear in the Code of Federal Regulations.

Appendix A—Regulatory Flexibility Act Certification

I, Arthur Levitt, Chairman of the Securities and Exchange Commission, hereby certify pursuant to 5 U.S.C. 605(b) that the final amendments to Rule 17a–4 set forth in Securities Exchange Release No. 34–38245 will not have a significant economic impact on a substantial number of small entities. Specifically, the amendments do not alter the regulatory requirements for broker-dealers using currently accepted media for record retention purposes (i.e., paper, microfilm, or microfiche). Instead, the amendments expand the record retention media options by allowing broker-dealers to utilize certain electronic storage media to store records required under 17 CFR 240.17a–3 and 240.17a–4. Accordingly, the amendments will not change the impact of current regulatory record preservation requirements on a substantial number of small entities.

Dated: January 31, 1997.

Arthur Levitt,

Chairman.

[FR Doc. 97–3426 Filed 2–11–97; 8:45 am]

BILLING CODE 8010–01–P

17 CFR Part 240

[Release No. 34–38248; File No. S7–7–94]

RIN 3235–AG14

Net Capital Rule

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission (''Commission'') is amending Rule 15c3–1 under the Securities Exchange Act of 1934 (''Exchange Act''), the net capital rule, to permit broker-dealers to employ theoretical option pricing models in determining net capital requirements for listed options and related positions. Alternatively, broker-dealers may elect a strategy-based methodology. The amendments are intended to simplify the net capital rule's treatment of options for capital purposes and more accurately reflect the risk inherent in broker-dealer options positions.

EFFECTIVE DATE: The amendments become effective September 1, 1997.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, Associate Director (202) 942–0131, Peter R. Geraghty, Assistant Director (202) 942–0177, or Louis A. Randazzo, Special Counsel (202) 942–0191, Division of Market Regulation, Securities and Exchange Commission, 450 Fifth Street, N.W., Mail Stop 5–1, Washington, D.C. 20549.

SUPPLEMENTARY INFORMATION:

I. Introduction

The Commission is adopting amendments to Rule 15c3–1 under the Exchange Act to permit broker-dealers to employ theoretical option pricing models to calculate required net capital for listed options and the related positions that hedge those options. In adopting these amendments, the Commission is continuing its process of revising the net capital rule that was contemplated when the Commission solicited comments on a range of capital related issues in 1993.[1] The amendments being adopted today were proposed in initial form in March of 1994 and would allow broker-dealers to use an options pricing model to determine capital charges for listed options and related positions.[2] Simultaneously with the Commission's proposal, the Division of Market Regulation (''Division'') issued a no-action letter allowing broker-dealers to utilize the options pricing approach immediately.[3] Based on the experience gained by the Commission under the no-action letter, and the nature of the comments received during the public comment period, the Commission is

[1] Securities Exchange Act Release No. 32256 (May 4, 1993), 58 FR 27486 (May 10, 1993) (''Concept Release'').

[2] Securities Exchange Act Release No. 33761 (March 15, 1994), 59 FR 13275 (March 21, 1994) (''Proposing Release'').

[3] Letter from Brandon Becker, Division of Market Regulation, SEC to Mary L. Bender, First Vice President, CBOE and Timothy Hinkas, Vice President, The Options Clearing Corporation (''OCC'') (March 15, 1994) (''1994 No-Action Letter'').