

# Investor Information, Cyber Threats and WORM Storage

## The 411 on SEC Rule 17a-4

**It's All About WORM Formatting These Days.** Write once read many (WORM) describes a data storage device in which information, once written, cannot be modified. This protection assures the data cannot be tampered with once it is written.

### What Is SEC Rule 17a-4?

Exponential volumes of sensitive financial data are stored electronically and cybersecurity threats are among the more significant risks faced by firms. Because of this, industry regulators will maintain their heightened focus on cyber security in 2018. And one rule that will remain top of mind during regulatory exams is the Securities and Exchange Commission (SEC) Rule 17a-4.

This rule sets the requirements for data retention, indexing and accessibility for registered broker-dealers. It requires many types of electronic books and records to be kept and retained for several years, depending on the type of data. This information also should be on media that is readily accessible and indexed, with an audit trail that shows all changes made since creation. The information falling under the rule includes, but is not limited to:

- › Ledgers of assets and liabilities, income, expense and capital accounts
- › Order, purchase and sale memos
- › Put, call, spread and straddle records
- › Employees' original job applications and fingerprints
- › Written records of customer complaints
- › Accounts payable and receivable records
- › Electronic communications

### How Is the Rule Impacting Firms?

Many firms aren't as compliant with the rule as they think. This has left them unknowingly exposed to potential cybercrime activity, reputational risk and regulatory fines.

In the second half of 2017, close to \$4.5M in fines were handed down by the Financial Institution Regulatory Authority® (FINRA®) to a number of introducing broker-dealers for failing to adhere to rules related to maintaining electronic books and records in compliance with Rule 17a-4.<sup>1</sup>

The failures included multiple categories of electronic broker-dealer records, including client profile records, compliance records, financial records and transaction blotters. The impacted firms also failed to provide FINRA with notification prior to retaining an electronic storage vendor and failed to obtain the required third-party attestation letters, which are required to fully ensure compliance with Rule 17a-4.

<sup>1</sup> Source: <http://www.finra.org/industry/disciplinary-actions>



## What Is Needed to Comply With the Rule?

When the regulators arrive at your office, they are looking for you to provide proof that your records are stored in a WORM format. Specific attention has been given to firms using vendor-provided email review and retention services that do not fulfill the requirements. In December 2016 alone, 12 firms were fined a total of \$14.4 million by FINRA because of “significant deficiencies relating to the preservation of broker-dealer and customer records in a format that prevents alteration.”<sup>2</sup>

Supervisory controls are also a key area of focus for regulators. Breakdown of controls in day-to-day operations becomes increasingly prevalent when firms take on new businesses, mergers and acquisitions or onboard sizeable reps or advisors to the books. Regulators are looking for evidence of testing internal supervisory controls and any gaps that may be created when changing from legacy to new compliance or record-retention systems.

To determine your firm’s exam readiness, you should answer yes to these important questions related to books and records retention requirements:

Can I easily produce readable images of documents?	Yes ✓	No
Can I view documents that are greater than 10 years old?	Yes ✓	No
Can I provide separate duplicate copies from the original and electronic image?	Yes ✓	No
Can I verify when a document has been viewed or updated from when it was originally scanned until the present time?	Yes ✓	No
Do I have an audit system that enables control and preservation of records as it relates to that document’s retention requirements?	Yes ✓	No
Does the system have a user-friendly search function to find documents in indexes or folders?	Yes ✓	No

Selecting the right third-party electronic storage provider will be key to your success when it comes to navigating SEC Rule 17a-4. As you choose a new provider or review your existing provider, that firm’s capabilities should include:

- › Paperless system
- › Multiple data centers to provide redundancy
- › Assist with documenting processes such as:
  - KYC reviews
  - S24 review of new accounts
  - Changes in account details
  - Archived disclosure documentation
  - Review of client-signed documents for the entire firm’s business

Now more than ever, the need for Rule 17a-4 compliant electronic books and records storage is critical to keep firms out of the regulatory limelight. This issue is not going away and the regulatory focus on broker-dealers is expected to continue. Ultimately, this scrutiny will extend to financial advisors of broker-dealers where the issue may be even more problematic.

To learn about how Albridge is assisting firms to successfully navigate SEC Rule 17a-4 requirements, please contact Christopher Zuczek at (609) 512-3319, [czuczek@albridge.com](mailto:czuczek@albridge.com), Mansi Daptardar at (609) 620-5821, [mdaptardar@albridge.com](mailto:mdaptardar@albridge.com) or Maggie Cooke at (609) 512-9684, [margaret.cooke@pershing.com](mailto:margaret.cooke@pershing.com)

<sup>2</sup> Source: <http://www.finra.org/newsroom/2016/finra-fines-12-firms-total-144-million-failing-protect-records-alteration>

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