SEC Warns About Third-Party Destruction of Broker-Dealer Records

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The SEC staff issued an April 12 letter addressing broker-dealer contracts with third-party recordkeeping service providers under which the service provider can delete or discard records of a broker-dealer who fails to pay fees due under the recordkeeping agreement, among other scenarios.

The letter, issued in response to an inquiry from the FINRA, reviews relevant requirements under the Securities Exchange Act of 1934, as well as related rules and SEC statements. These include:

- a requirement to file with the SEC a written undertaking by the third-party recordkeeper to make the broker-dealer records available to the SEC; and
- a provision to the effect that an arrangement with a third-party recordkeeper does not relieve a broker-dealer of its record preparation and maintenance obligations under SEC rules.

Such provisions are intended "to assure accessibility of broker-dealer records in situations where, for example, a service bureau refuses to surrender the records due to nonpayment of fees," according to the letter.

"[C]ontractual provisions that would permit, among other things, a service provider to delete or discard records in the event of non-payment by the broker-dealer are inconsistent with" the retention and undertaking requirements prescribed by the SEC, the letter concludes. Moreover, the letter emphasizes that deletion or disposal of records in a manner inconsistent with such requirements would not only constitute a "primary violation" by the broker-dealer, but may also subject a third-party recordkeeper to "secondary liability."

Accordingly, to avoid such violations, both broker-dealers and third-party recordkeepers have an incentive to review their practices and contractual arrangements – including those related to variable insurance products. In light of the staff's letter, it is likely FINRA and SEC exam personnel will be on the lookout for potentially problematic contractual provisions.