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CFTC Proposes Greater Flexibility for Electronic Record-Keepers

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In a move that affects everyone required under its rules to maintain records, the Commodity Futures Trading Commission ("CFTC" or "Commission") is proposing to permit greater flexibility in the technology used for electronic record retention and production, to remove the requirement that records be stored in their "native file format" and to no longer require use of a third-party technical consultant.[1] If adopted, the proposed rule will enable record-keepers to update and potentially streamline their current record storage technology and systems. And because the proposed amendments are technology-neutral (unlike the current rule), if adopted, they will not impede the adoption of future technologies as they become available. The Proposed Rule is an important step for aligning the CFTC's recordkeeping requirements with modern technological capabilities and standard industry practices. CFTC and Securities and Exchange Commission ("SEC") dual registrants should be aware that amendments to the CFTC's recordkeeping requirements will not change those entities' compliance obligations under the Securities Exchange Act ("Exchange Act").

I. Background

On January 12, 2017, the CFTC unanimously proposed to amend Rule 1.31 (Books and Records, Keeping and Inspection). These proposed changes are the most significant changes to CFTC rule 1.31 since the electronic recordkeeping provisions were added in 1999.[2] All registered entities (designated contract markets, swap execution facilities, swap data repositories and derivatives clearing organizations), registrants (futures commission merchants, swap dealers, introducing brokers, retail foreign exchange dealers, floor brokers, floor traders, commodity pool operators and commodity trading advisors), and certain market participants (specifically, large traders and market or clearing members) have record-keeping obligations. Unless otherwise specified, CFTC Rule 1.31 establishes the conditions under which records must be kept and produced.

As adopted in 1999, and currently in force, Rule 1.31 specifies certain acceptable technologies for the storage of electronic records, including micrographic media, optical disk, CD-ROM or "any digital storage medium or system that preserves the record exclusively in a non-rewritable, non-erasable format," a so-called "WORM" format. The 2012 amendment added the requirement that electronic

files be kept in their "native format." Finally, Rule 1.31 requires each electronic record-keeper to use a third-party technical consultant to be able to locate and provide access to CFTC and Department of Justice representatives upon request. These prescriptive provisions of Rule 1.31 impede the adoption of new record-keeping technologies by those covered by the rule and in recent years have resulted in record-keepers running parallel or dual systems to store information efficiently and to meet the regulatory requirements.

II. Proposed elimination of required native file format

The CFTC is proposing generally to reorganize Rule 1.31. Current Rule 1.31(a) provides that records be kept in their original form (for paper) or native file form (for electronic records) for a period of five years, and be readily accessible for the first two years. As revised, paragraph (a) would contain definitions and the retention period provision would be moved to paragraph (c). As proposed, the retention period remains five years. Electronic records would be required to be readily accessible throughout the retention period. Paper records would still only be required to be readily accessible for the first two years. The "native file format" requirement would be removed altogether. Accordingly, *information* maintained in an electronic system would not necessarily be maintained in its "native format."

III. Proposed elimination of the "WORM" requirement

Current Rule 1.31(b) establishes a design standard that requires electronic records to be stored using those technologies specified in the rule. These technologies were state-of-the-art when the rule was written almost 20 years ago. The Commission is proposing under Rule 1.31(d) to replace this design standard and the electronic storage technologies specified in the rule with a general performance standard. As proposed, the rule requires that a record-keeper must maintain electronic records in a manner that ensures "authenticity and reliability," including security, signature, chain of custody and data necessary to ensure the authenticity of the information in the electronic record. The Commission has made clear that the information to be retained is not limited to the data within a particular database or application, but includes the electronic information that identifies the way any regulatory record is altered (i.e., "metadata").[3]

IV. Proposed elimination of requirement for third-party Technical Consultant

Current Rule 1.31(b) requires that any person who uses only electronic storage media to preserve some or all its required records must retain a third-party technology consultant ("Technical Consultant") and provide them with access to and the ability to download information from the record-keeper's electronic storage media to any acceptable medium. The Proposed Rule eliminates this requirement as an anachronism.

V. Production

As proposed, Rule 1.31(e)(3) provides that a request from a Commission representative for electronic records "will specify a reasonable form and medium" for production and that such records must be produced "promptly upon request, unless otherwise directed." The Commission has stated that providing PDFs of such files "is not sufficient" and that production of records must be

in a format that the Commission can process.[4]

VI. Conclusions

These proposed amendments may have a significant effect on the cost and ease of compliance with recordkeeping requirements in the derivatives industry. Their impact may be far greater than the Federal Register release suggests. The comment period will close 60 days after publication in the Federal Register.

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[1] Recordkeeping, 82 Fed. Reg. 6356 (Jan. 19, 2017) (Proposed Rule or Release).

[2] Recordkeeping, 64 Fed. Reg. 28735 (May 27, 1999) (implementing the technical provisions regarding the use of electronic media in § 1.31(b) and (c), including the requirement to retain a technical consultant). In 2012 the CFTC amended the rule to incorporate swaps. In addition, that rulemaking included the requirement to retain records in their "native format. "Adaptation of Regulations to Incorporate Swaps," 77 Fed. Reg. 66288 (Nov. 2, 2012) (clarifying the retention period for records of oral communications leading to the execution of any swap or related cash or forward transaction for swap dealers and major swap participants, and requiring electronic records to be retained in their native file format).

[3] Even if the CFTC withdraws its WORM requirement, dual registrants should be aware that the securities regulators have emphasized that compliance with the Exchange Act Rule 17a-4(f) WORM requirement remains an enforcement priority, and have framed the requirement as critical to firms' cybersecurity controls. See FINRA 2017 Annual Regulatory and Examination Priorities Letter, Jan. 4, 2017. In December 2016, FINRA fined 12 firms a total of $14.4 million for failing to retain electronic records in WORM format, in violation of Rule 17a-4(f). Press Release, FINRA, "FINRA Fines 12 Firms a Total of $14.4 Million for Failing to Protect Records From Alteration," Dec. 21, 2016.

[4] Release at 6362.

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