

**PUBLIC**

SEP 6 1995

RESPONSE OF THE OFFICE OF CHIEF COUNSEL  
DIVISION OF INVESTMENT MANAGEMENT

Our Ref. No. 95-252-CC  
First Call Corporation  
File No. 132-3

Your letter of April 27, 1995 requests our assurance that we would not recommend enforcement action to the Commission under rule 204-2 under the Investment Advisers Act of 1940 ("Advisers Act") or rules 31a-1 and 31a-2 under the Investment Company Act of 1940 ("1940 Act") against a registered investment adviser that subscribes to the FIRST CALL Research Direct service ("Research Direct") provided by First Call Corporation ("First Call") if First Call and the investment adviser maintain in the manner described in your letter reports available electronically to Research Direct subscribers.

Research Direct provides subscribers with on-line research reports and analyses contributed by broker-dealers. The reports carried on Research Direct are identical to reports that the contributing broker-dealers provide to their clients in hard copy. Research Direct subscribers may view the reports on screen or print hard copies of part or all of any report carried on Research Direct, but cannot download the reports to their own computer systems. 1/ The reports carried on Research Direct cannot be altered either by First Call or by subscribers.

The reports will be maintained for approximately thirty days on the computer facilities furnished by First Call to its subscribers. Thereafter, First Call will store the reports on its host computer for six years from the end of the calendar year during which the report was first made available on the system. During this period, subscribers will be able to retrieve reports from storage by means of a two-way digital phone line. 2/ First Call creates backups of new and amended documents nightly, and, on a weekly basis, backs up the entire system onto tape. The tapes are stored off site for a minimum of six years in a fireproof, secure vault.

First Call monitors and records subscribers' use of reports carried on Research Direct. First Call will provide each Research Direct subscriber with a monthly statement identifying every report that was accessed by the subscriber.

Rule 204-2(a)(7) under the Advisers Act requires that investment advisers maintain "originals" of all written

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- 1/ Telephone conversation with Mari-Anne Pisarri on July 7, 1995.
- 2/ As further described below, First Call will provide subscribers that have terminated their Research Direct subscriptions with hard copies of reports under certain circumstances.

communications received by the adviser relating to any recommendation made or proposed to be made and any advice given or proposed to be given. 3/ Paragraph (e) (1) of rule 204-2 requires that most books and records specified under the rule be maintained in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry on the book or record was made, the first two years in an appropriate office of the investment adviser. Rule 31a-1(f) under the 1940 Act generally requires investment advisers to registered investment companies to maintain the same books and documents required to be maintained under rule 204-2 under the Advisers Act to the extent these records are necessary or appropriate to record the adviser's transactions with the investment company. Under rule 31a-2(e), the investment adviser must preserve such books and documents for six years.

We first address whether First Call's proposed electronic storage arrangement will satisfy the requirement of rule 204-2(e) (1) to maintain records "at an appropriate office of the investment adviser." We believe that if an adviser has essentially immediate access to a record (on the adviser's proprietary system or otherwise) through a computer located at an appropriate office of the adviser, then that record is being maintained "at an appropriate office of the adviser" as required by rule 204-2(e) (1). 4/

The arrangement proposed by First Call also implicates other requirements of rule 204-2, including the conditions set forth in paragraph (g) of the rule pursuant to which records can be maintained and preserved on magnetic disk, tape or other computer storage medium. 5/ Paragraph (f) of rule 31a-2 specifies

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3/ See Depository Trust Co. (pub. avail Sept. 4, 1992) (an electronic confirmation may be treated as an "original communication").

4/ Immediate access to records includes the ability to promptly provide to Commission examination staff hard copies of the records or access to the storage medium.

5/ Specifically, paragraph (g) (2) permits computer storage of records created by the adviser on electronic media or received by the adviser solely on electronic media or by electronic data transmission. Paragraph (g) (1) of the rule requires that an adviser (1) arrange the records and index the storage medium to permit the immediate location of any record, (2) be ready to provide Commission examiners with copies or printouts of the records, (3) store one copy of each record separately from the original, and (4) maintain

(continued...)

corresponding conditions for computer storage of certain records by investment companies. 6/ In addition, the proposed arrangement gives rise to issues under rule 204-2 because an adviser would no longer have immediate access through its computers to records carried on Research Direct if it ceased to subscribe to the service or if the service was no longer offered.

In adopting paragraph (g) of rule 204-2, the Commission intended to provide investment advisers with the flexibility to determine the computerized medium on which to store their records. 7/ You state that, although subscribers may print out the reports accessed through Research Direct, requiring advisers to preserve printouts of all such reports would defeat one of the primary benefits of Research Direct, the elimination of the need to store large quantities of paper. You assert that the proposed storage of the reports on First Call's host computer for six years, the backup storage on tape, and the subscriber's ability to retrieve reports electronically ensure that the reports will be maintained and adequately safeguarded from loss or destruction for the requisite periods under the Advisers Act and the 1940 Act and will be accessible to Commission staff. 8/

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5/ (...continued)

procedures to reasonably safeguard records stored on computer from loss, alteration, or destruction.

6/ Under the proposed arrangement, First Call, rather than the investment adviser or the investment company, would maintain and preserve the reports carried on Research Direct. An investment adviser may delegate certain record creation and retention responsibilities to a third party, but the adviser cannot, by doing so, avoid liability for violating the Advisers Act, the 1940 Act, or the rules under those Acts if the third party fails to carry out those responsibilities. See National Regulatory Services (pub. avail. Dec. 2, 1992).

7/ Investment Advisers Release No. 952 (Jan. 16, 1985).

8/ We note that, because an adviser may retrieve reports stored on First Call's host computer at any time during the six-year storage period, removing such reports from the system after this period may not comply with the literal terms of rules 204-2, 31a-1, and 31a-2 with respect to an adviser that has used a report after the commencement of the required preservation period. Nonetheless, in light of the overall recordkeeping procedures you propose and the impracticability of restricting use of reports by advisers while they are available on the system, we will not object to the proposed procedures.

We would not recommend enforcement action to the Commission under rule 204-2 under the Advisers Act or rules 31a-1 and 31a-2 under the 1940 Act against an investment adviser that subscribes to Research Direct if records of the electronic reports available on Research Direct are maintained in the manner described in your letter. We also would not recommend enforcement action to the Commission under rule 31a-3 under the 1940 Act even though the reports may not be the property of the investment adviser. 9/ These positions are based on the facts and representations made in your letter and the telephone conversations, particularly your representations that:

- (1) First Call will provide each Research Direct subscriber with a monthly statement identifying every research report retrieved by that subscriber during the month; 10/
- (2) investment adviser subscribers will maintain hard copies of the monthly statements in accordance with the requirements of rule 204-2(e)(1); 11/
- (3) First Call will store the reports on its host computer for six years from the end of the calendar year during which the report was first made available on the system and will store backup tapes of the reports for six years;
- (4) in the event an investment adviser cancels its subscription to Research Direct, First Call will provide the former subscriber, within 48 hours of the

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9/ Rule 31a-3 provides that if a third party maintains records on behalf of a person required to maintain records under rules 31a-1 and 31a-2, such person must obtain an agreement from the third party to the effect that the records are the property of the person required to maintain the records and will be surrendered promptly upon request. Our position with respect to rule 31a-3 is based on the proprietary nature of the research reports carried on Research Direct. The staff would not otherwise be inclined to grant relief from the requirements of that rule.

10/ Paragraph (g)(1) of rule 204-2 requires an investment adviser that maintains electronic records to arrange and index records to permit the immediate location of any particular record.

11/ Investment advisers subject to the requirements of rule 31a-2(e) will maintain the monthly statements for six years from the date the statements are received.

former subscriber's request, with a hard copy of any report that the subscriber accessed that the Commission staff may request in connection with an examination, inspection, or investigation of the investment adviser; 12/ and

- (5) in the event First Call ceases operations or ceases to offer Research Direct, it will make arrangements reasonably acceptable to the Commission or its staff to ensure the availability of the reports carried on Research Direct for the remainder of the requisite period. 13/

You should note that any different facts or circumstances might require a different conclusion. This response (other than the interpretive position under rule 204-2(e)(1)) only represents the Division's position on enforcement action and does not purport to express any legal conclusion on the questions presented.

*Barbara Chretien-Dar/ecf*

Barbara Chretien-Dar  
Senior Counsel

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12/ Telephone conversation with Mari-Anne Pisarri on July 24, 1995.

13/ Telephone conversation with Mari-Anne Pisarri on July 24, 1995. As noted above (see supra n. 6), this letter would not relieve investment advisers from liability for violations of the recordkeeping rules under the Advisers Act or 1940 Act that would occur in the event First Call failed to comply with the representations set forth above.

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ACT IAA  
SECTION -  
RULE 204-2(e)(1)  
PUBLIC  
AVAILABILITY 9-6-95

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April 27, 1995

By Hand

Jack W. Murphy, Esq.  
Chief Counsel, Division of Investment Management  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Dear Mr. Murphy:

This letter is submitted on behalf of First Call Corporation ("First Call"), to request confirmation that electronic storage in the manner described below of reports transmitted through the FIRST CALL Research Direct service satisfies the recordkeeping requirements of both the Investment Advisers Act of 1940 (the "Advisers Act") and the Investment Company Act of 1940 (the "Company Act").

Description Of FIRST CALL Research Direct

Jointly owned by the Thomson Corporation, a \$6 billion publisher of specialized professional and business information, and ten major U.S. broker-dealers, First Call Corporation has provided the investment management community with electronic access to commingled financial research since 1984.

The new FIRST CALL Research Direct service (hereinafter "Research Direct" or the "Service") delivers in-depth research and analytics, on line, twenty-four hours per day from broker-dealer contributors through First Call's host computer to investment manager subscribers.<sup>1</sup> The reports transmitted through the Service in read-only format are exact replicas of those which the broker-dealers otherwise would send to their clients by mail, including full text and all associated graphs, tables, spread-sheets, color and artwork.<sup>2</sup>

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<sup>1</sup> At the present time, more than twenty broker-dealers contribute an aggregate of approximately 70 to 100 reports per day to Research Direct. This number is expected to increase substantially in the future.

<sup>2</sup> Neither the subscriber nor First Call has the ability to alter the contents of the contributors' reports.

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Research Direct subscribers can search the Service's database of reports by analyst, broker, company name, company symbol, country, industry, portfolio, region or subject. The Service's "free-text" feature permits database searches by specific words, phrases, concepts or multiple subjects; and the "relevancy grade" feature tells subscribers which documents best fit their search criteria. Subscribers can print hard copies of all or part of the Service's reports if they so desire. They are not, however,<sup>3</sup> allowed to download these reports to their own computer systems.

Research Direct also allows subscribers to create customized portfolios containing up to 1000 companies each, in order to track information on issuers of particular interest. And, by either emitting an audible signal, automatically printing relevant documents, or displaying a written message on the user's computer screen, the Service's "Alert" feature enables subscribers to monitor the receipt of all new reports on particular companies, industries or subjects, or by any word or sentence.

Research Direct is available on a dedicated terminal or through a desktop personal computer via a Windows™-based Local Area Network. Hardware provided with the Service includes a data service unit, router, hub, 486 network server running SCO Open Systems UNIX, and workstation (486 PC with 600 dpi printer). The enabling technology for Research Direct includes Adobe™ Acrobat™ software, which provides cross-platform viewing, navigation and printing of electronic documents, and Fulcrum's full-text retrieval technology combined with proprietary software.

The Service's host computer, located in Boston, Massachusetts is an Ethernet network of Sun 1000 workstations. The host currently consists of two workstations, and can be expanded as demand grows by adding additional workstations. The host stores reports on a mirrored disk subsystem which allows "mirror" storage of reports to ensure data integrity. The mirrored disk subsystem currently consists of 18 Gigabytes of disk storage, and is expandable. All changes to the reports database (new or modified documents) are backed up every night. Every weekend, a full backup of the entire system is done to tape. These tapes are stored off site every Monday in a fireproof, secure vault for a minimum of six years.

Reports contained in Research Direct's database are stored electronically on the facilities furnished to subscriber by First Call for a period of approximately thirty days, and are stored

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<sup>3</sup> The prohibition against downloading Research Direct reports stems from the contributing brokers' desire to prevent the electronic redistribution of their proprietary analysis.

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thereafter in First Call's host computer for an additional eleven months. As explained below, if the staff grants the no-action relief requested herein, each report will be stored in the First Call host computer for a period of six years from the end of the calendar year in which the report was produced. Subscribers will be able to retrieve reports from storage in two minutes or less, at any time during this period by means of a two-way digital phone line.<sup>4</sup>

First Call monitors usage of the Service and produces a record indicating which subscribers have obtained access to which specific reports. A broker-dealer disseminating research through the Service has the authority to block particular subscribers' access to that contributor's reports, if it so desires.

#### Advantages Of The Service

Among the most notable benefits of Research Direct are speed and efficiency. By delivering complete copies of broker-dealers' reports electronically in real-time, the Service eliminates delays encountered in delivering research through the mail. And the Service's various search, monitoring and retrieval features enable portfolio managers to hone in on and keep track of the precise information they need without reviewing thousands of pages of irrelevant material. In this way, managers are able to take maximum advantage of the enormous volume of investment research being produced today. Electronic delivery of brokers' reports also eliminates clutter in the manager's office and saves paper.

The question arises, however, of how to allow money managers to reap the full benefits of the Service and still comply with their recordkeeping obligations under the Advisers and Company Acts.

#### Recordkeeping Requirements

Rule 204-2(a)(7) under the Advisers Act requires investment advisers to maintain originals of all written communications they receive relating to any recommendations made or proposed to be made and any advice given or proposed to be given. This requirement presumably encompasses broker-dealer research reports which relate

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<sup>4</sup> To retrieve a report from storage, the subscriber "clicks" on the document headline with a mouse and the document is automatically downloaded from the host computer to the subscriber's server, and then to the subscriber's desktop computer.



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to advice given or recommendations made by the adviser, including reports transmitted through FIRST CALL Research Direct.

Books and records covered by Rule 204-2 must be maintained in an easily accessible place for a period of not less than five years from the end of the fiscal year during which the last entry was made thereon.<sup>5</sup> For the first two years, the records must be kept in "an appropriate office of the investment adviser." Rule 204-2(e).

Although the recordkeeping rule originally contemplated the preservation of paper documents, the rule was subsequently amended to permit advisers to store required records on computers under certain conditions.<sup>6</sup> In this regard, Rule 204-2(g) was revised in 1985 to provide that records which the adviser receives solely on electronic media or by electronic data transmission may be stored on a computer storage medium so long as the following conditions are satisfied:

- (1) the records are arranged and indexed so as to permit the immediate location of any particular record;
- (2) printouts of the records or copies of the computer tape or disk are made available to Commission examiners promptly upon request;
- (3) a duplicate of the computer storage medium is stored separately from the original; and
- (4) procedures are implemented for the maintenance, preservation of and access to records so as to reasonably safeguard records from loss, alteration or destruction.

In adopting this amendment, the Commission explained that the modified rule would "provide flexibility to advisers to determine the medium on which required records would be stored." 50 Fed. Reg. 2542 (January 17, 1985). The Commission also expressed its belief that allowing each adviser to design its own procedures for safeguarding computer records was preferable to dictating specific

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<sup>5</sup> Rule 31a-2(e) under the Company Act requires every investment adviser (other than a majority-owned subsidiary of a registered investment company) to preserve for six years those documents required under Section 204 of the Advisers Act which are "necessary or appropriate" to record the adviser's transactions with registered investment company clients. See also, Rule 31a-1(f). An adviser which is a majority-owned subsidiary of a registered investment company is subject only to the five year requirement of Rule 204-2(e). Rules 31a-1(e) and 31a-2(d).

<sup>6</sup> Provisions also were made for document retention on microfilm.

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protective measures that all advisers must adopt, because the former approach would avoid imposing requirements "which, in some cases, might be unnecessarily restrictive or which might become outdated as newer technologies become available." Id.

The Commission's flexible approach to electronic record retention clearly conforms to Congressional intent in this area. As far back as 1975, Congress endorsed the notion that recordkeeping under the federal securities laws is a dynamic concept which must keep pace with advances in technology. For example, the Securities Acts Amendments of 1975 added the following definition of "records" to the Securities Exchange Act:

The term "records" means accounts, correspondence, memorandums, tapes, discs, papers, books and other documents or transcribed information of any type, whether expressed in ordinary or machine language.

Exchange Act, Section 3(a)(37). The Senate Report which accompanied this legislation explained the rationale for this addition as follows:

. . . the Committee believes a modern and expansive definition of this important term "records" is desirable. Thus, the definition would explicitly recognize the impact of advanced technology on traditional business methods by including within the definition tapes, discs, and other documents or transcribed information of any type whether expressed in ordinary or machine language.

S. Rep. No. 75, 94th Cong., 1st Sess., reprinted in [1975] U.S. Code Cong. & Ad. News 179.

To ensure that the Commission's recordkeeping rules continue to keep pace with the dramatic technological advances which have occurred since Rule 204-2(g) was revised in 1985, it appears that a slight modification of the rule's application is now in order.

#### Record Retention And Research Direct

We begin this discussion with the observation that requiring Research Direct's subscribers to print and save hard copies of all reports relating to their advice and recommendations would obliterate one of the primary benefits of the Service and would force the retention of a vast amount of paper at very great expense. However, because subscribers are prohibited from downloading Research Direct reports onto their internal computer

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systems, the Service may not lend itself to electronic storage within the confines of Rule 204-2 as it is presently configured.<sup>7</sup>

Nevertheless, as explained herein, more than adequate safeguards can be designed to ensure that the Service's reports are not altered, lost or destroyed during the periods prescribed by the Advisers and Company Acts' recordkeeping rules, as well as to ensure that the Commission and its staff have prompt and thorough access to these reports for regulatory purposes. In this regard, we propose the following recordkeeping arrangement for reports disseminated to investment advisers through Research Direct:

1. First Call would provide each Research Direct subscriber with a monthly statement identifying every research report that was disseminated to the subscriber during that month.
2. Investment adviser subscribers to Research Direct would maintain hard copies of the foregoing monthly statements in accordance with Advisers Act Rule 204-2 and/or Company Act 31a-1 and 31a-2.
3. First Call would store at its Boston headquarters, each report disseminated through the Service for a period of six years from the end of the calendar year during which the report was produced.<sup>8</sup>
4. During the six-year period described in Paragraph 3, subscribers would be able to access Research Direct reports from subscribers' on-site terminals. In the event that a subscriber terminates its subscription to First Call, the subscriber will be able to obtain within 48 hours, for a fee, a hard copy of any report covered by Rule 204-2(a)(7) which the Staff of the Division of Investment Management may request in connection with any examination, inspection or investigation.

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<sup>7</sup> In particular, because Research Direct reports are stored at the subscriber's premises for only thirty days, relevant documents may not be deemed to be maintained for two years "in an appropriate office of the investment adviser" as required by Rule 204-2(e). Nor may advisers be in a position to comply with all of the conditions enumerated in subsection (g) of the rule.

<sup>8</sup> Because Research Direct disseminates reports in real time, the date of production and date of availability through the Service would be the same. A calendar year rather than fiscal year basis has been chosen since it would be impossible to calibrate the Service's document retention with every adviser's fiscal year. For many advisers, the fiscal year ends on December 31 anyway.

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5. In the event that First Call ceases operations, it will make arrangements reasonably acceptable to the Commission or its staff to ensure the continued availability of Research Direct reports for regulatory purposes during the remainder of the period described in Paragraph 3.

We believe that the foregoing arrangement would comport with Congressional directives to incorporate technological advances into securities regulation; would facilitate advisers' compliance with their recordkeeping obligations; would reduce costs and regulatory burdens on investment advisers; and would simplify the staff's inspections of advisers' operations.

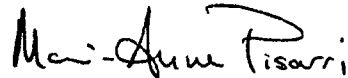
Therefore, please advise us that you would not recommend that the Commission take enforcement action against a registered investment adviser under Advisers Act Rule 204-2 or Company Act Rule 31a-1 or 31a-2 if the adviser maintains and makes available to the SEC relevant Research Direct reports, through the facilities of First Call in accordance with the arrangement outlined herein.

#### Conclusion

In view of the many salutary characteristics of FIRST CALL Research Direct, and in further view of the fact that the electronic storage proposed in this letter meets the fundamental goals of the recordkeeping requirements under the Advisers and Company Acts, we respectfully request that you grant the no-action relief described herein.

If you need any further information on this matter, please do not hesitate to contact the undersigned.

Very truly yours,



Mari-Anne Pisarri

cc: Alex Bentley  
Barbara Chretien Dar, Esq.