

MEMO# 18425

January 18, 2005

SUMMARY OF MEETING WITH SEC STAFF ON E-MAIL COMMUNICATIONS

[18425] January 18, 2005 TO: SEC RULES COMMITTEE No. 4-05 COMPLIANCE ADVISORY COMMITTEE No. 5-05 CHIEF COMPLIANCE OFFICER COMMITTEE No. 5-05 CLOSED-END INVESTMENT COMPANY COMMITTEE No. 2-05 SMALL FUNDS MEMBERS No. 7-05 TECHNOLOGY ADVISORY COMMITTEE No. 2-05 INVESTMENT ADVISERS COMMITTEE No. 3-05 RE: SUMMARY OF MEETING WITH SEC STAFF ON E-MAIL COMMUNICATIONS Last month, Institute staff and members met with representatives from the SEC's Division of Investment Management (IM) and Office of Compliance Inspections and Examinations (OCIE) to discuss electronic communications. The substance of the meeting is summarized below. THE STAFF'S INTERPRETIVE GUIDANCE/ANTICIPATED RULE AMENDMENTS IM staff is currently developing interpretive guidance under the Advisers Act relating to electronic communications, which it plans to issue early this year. According to the staff, the guidance is intended to clarify an adviser's duties with respect to the monitoring, retention, and production of electronic communications, particularly e-mail and instant messaging. We discussed various approaches the staff might take in connection with this guidance and the issues surrounding them. During the meeting, we encouraged the staff, to the extent practical, to draft the interpretive guidance without reference to particular technologies (e.g., e-mail). This would enable advisers to rely on the guidance as new technologies are developed or deployed in the future (e.g., instant messaging). IM staff informed us that, in addition to the interpretive guidance, the SEC expects to address electronic communications when it proposes amendments to the recordkeeping rule under the Advisers Act. This rulemaking initiative is on a slower track than the interpretive guidance. SURVEILLANCE/SUPERVISION A significant area of concern to members that we raised with the staff relates to whether an adviser must supervise and/or conduct surveillance of their employees' e-mails. 2 Surveillance of all e-mail communications is problematic for advisers due to the widespread use of e-mail by employees for both for business and personal purposes. We noted that there is no specific requirement under the federal securities laws that requires an adviser to supervise or conduct surveillance of employee e-mails. In addition, the supervisory requirement in Section 203(e)(6) of the Advisers Act provides advisers with flexibility to determine how best to fulfill their supervisory obligations. We recommended that the interpretive guidance affirm an adviser's ability to determine whether e-mail surveillance is an appropriate means by which to ensure the adviser's compliance with the Advisers Act. ELECTRONIC MAINTENANCE OF RECORDS/UNDULY BURDENSOME E-MAIL REQUESTS In keeping with prior public statements, the staff reiterated its view that it may examine all records maintained by an adviser, regardless of whether or not they are required records under Rule 204-2. We emphasized to the staff the difficulties and burdens experienced by members in responding to broad e-mail requests, especially for e-mails that, for example, are maintained on legacy systems or are not

segregated based on whether they relate to business or personal matters. We also emphasized that, as a consequence of the foregoing, advisers are expending considerable resources in responding to these broad requests – resources that might be better spent handling other matters. OCIE staff told us that they are sensitive to these concerns and willing to reconsider, on a case-by-case basis, requests for e-mails that may be unduly burdensome or time-consuming for the adviser to produce. OCIE staff urged advisers, at the commencement of an inspection, to discuss with their examiners any concerns they may have with e-mail production and determine if an alternative approach can accommodate the examiners' request without impeding the inspection (e.g., a rolling schedule of production or alternative means of providing the same information). If this effort is unsuccessful, the staff encouraged advisers to pursue their concerns with more senior OCIE staff, first in the regional office and then, if necessary, in the Washington, D.C. office.

ASSERTIONS OF PRIVILEGE The staff indicated that it recognizes advisers' right to claim privilege in connection with discrete records. To facilitate the staff's consideration of an adviser's assertion of privilege, the staff encouraged advisers to be prepared to provide examiners with certain information about the privileged communication (i.e., the recipient(s) and sender(s) of the communication; its date; its general subject matter; and the privilege asserted). While the staff believes it is preferable for advisers to maintain, on an ongoing basis, a privilege log that contains this information, the staff indicated that the absence of such a log will not preclude the adviser's ability to assert privilege. The staff suggested that an adviser that does not maintain a privilege log should be prepared to provide the examiners, on a timely basis and in a manner that does not delay or impede the inspection, the information that would be included in such log. The meeting also covered instances when privileged documents are inadvertently provided to the staff. The staff expressed its willingness to consider a timely request from the adviser for the return of the documents to allow the adviser to attempt to retain the documents' 3 privileged status.

* An adviser making such a request may be asked to provide the staff with a letter of explanation and a signed affirmation that the adviser will not attempt to assert a "fruit of the poisonous tree" defense in connection with the documents in the future. This affirmation is intended to protect the SEC from an adviser alleging as a defense in any future proceeding that, but for the SEC staff having had access to the privileged communication (the "poisonous tree"), the SEC staff would not have been able to discover other allegedly incriminating evidence (the poisonous tree's fruit). Members wishing to discuss electronic communications further should contact the undersigned by phone (202-326-5825) or e-mail (tamara@ici.org). Tamara K. Salmon Senior Associate Counsel *

An adviser's ability to effectively claim privilege on a document that was inadvertently provided to the staff will ultimately be determined by a court of competent jurisdiction considering the issue and not by the Commission's staff.