The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

COMMENT LETTER

April 20, 2001

Comment Letter on SEC Electronic Recordkeeping Proposal, April 2001

April 19, 2001

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549-0609

Re: Electronic Recordkeeping by Investment Companies and Investment Advisers
(File No. S7-06-01)

Dear Mr. Katz:

The Investment Company Institute[1] is pleased to provide comments on the Securities and Exchange Commission's proposal to permit registered investment companies and registered investment advisers to preserve required records using electronic means.[2] The Commission's proposal would amend Rule 31a-2 under the Investment Company Act of 1940 and Rule 204-2 under the Investment Advisers Act of 1940 to expand the circumstances under which funds and advisers may use electronic storage media to maintain and preserve records.[3] The Proposing Release states that the proposed rule amendments are in response to the enactment of the Electronic Signatures in Global and National Commerce Act ("E-SIGN"), which, among other things, allows a federal regulatory agency to adopt specific performance standards with respect to its recordkeeping rules.[4]

The Institute generally supports the Commission's proposal.[5] Investment companies and investment advisers are continually developing ways to use electronic commerce to serve shareholders and to create greater efficiencies in conducting their business. By allowing the use of electronic records to meet record retention requirements under other law, E-SIGN promotes these efforts. Subject to the comments set forth below, which are mostly technical in nature, the Commission's proposal is a reasonable and appropriate interpretation of E-SIGN that will serve the policy objectives of E-SIGN and the Commission without imposing undue burdens on electronic recordkeeping by funds or advisers.

1. Clarification of Obligations to Provide Records

The Commission's proposal would clarify the obligations of funds and advisers to provide Commission examiners or other appropriate representatives with copies of and/or access to

required records that are stored on micrographic or electronic storage media. Currently, the rules require that funds and advisers "promptly provide" on request any "facsimile enlargement" of a photographic record or "computer printout or copy" of a computer storage medium. The proposed amendments would require a fund or adviser to "provide promptly" upon request: (1) a legible, true, and complete copy of a requested record "in the medium and format in which it is stored;" (2) a legible, true, and complete printout of the record; and (3) means to access, search, view, sort, and print records.

The amendments would define "provide promptly" for these purposes to mean in no case more than one business day after the request. As discussed below, we do not believe that it is appropriate to codify such a requirement in the recordkeeping rules.

The Institute appreciates the Commission's valid interest in having ready access to fund and adviser records. In addition, the use of electronic media for storing required records often can make it easier to retrieve and produce such records. It is important to note, however, that the time needed to provide requested information can vary based on a number of factors, including, among others, the amount of advance notice provided, the amount of information requested, and the location of the information at the time the request is made.6 Additional factors may include the type of medium on which the information is stored at the time the request is made, and the capabilities and capacity of the entity's computer and printer systems.

Because of the many factors that can be involved, adopting a rigid, one-size-fits-all definition of "promptly" is not appropriate. The Commission itself previously has recognized the need for a degree of flexibility. As stated in the Proposing Release, the Commission's position has been that computer-stored records must be provided within 24 hours of a request, "absent unusual circumstances."7 While the proposed rule language would liberalize the Commission's current interpretation by taking holidays and weekends into consideration, it makes no accommodation for "unusual circumstances." This lack of flexibility to take particular facts and circumstances into account is inconsistent with the Commission's mandate under Section 31(a)(2) of the Investment Company Act to minimize compliance burdens on funds when prescribing recordkeeping requirements under that section. Imposing a one business day time frame inevitably will result in rule violations despite good faith efforts to comply, and will create an additional layer of regulation not otherwise justified. There is no indication in the Proposing Release, nor are we aware, that problems have arisen under the current system or that Commission examiners have been materially inconvenienced or have experienced unreasonable delays in gaining access to requested records. In fact, Institute members have reported that they frequently discuss particular record requests with the examination staff, and are almost always able to reach agreement on time frames for delivery.

Even if Rule 31a-2 were amended as proposed, we expect that such discussions and informal accommodations between examination staff and registrants would continue. The critical difference, however, would be that, even if the examination staff agreed to an extension of time for providing particular records, the registrant technically would have committed a per se violation of the amended rule. While this could be cured by obtaining some type of exemptive relief from the Commission, the unintended effect of the proposed requirement would transform an otherwise informal process of accommodation (which we understand works effectively) into a more formal exemptive process, with the attendant burdens on the Commission's staff, registrants, and their counsel. For all these reasons, we urge the Commission not to adopt a one business day requirement in the rules and therefore recommend that it delete the parenthetical phrase "(but in no case more than

one business day after the request)" from the proposed rule amendments. 8

2. Proposed "General Requirements"

The Institute has three comments on the text of the proposed rule amendments under the subsections entitled "General requirements." First, subsection (f) of Rule 31a-2 (and corresponding subsection (g) of Rule 204-2) is divided into three distinct parts, each with its own subheading. Two of the subsections ((f)(1) and (f)(3) of Rule 31a-2 and (g)(1) and (g)(3) of Rule 204-2) make clear that they refer to micrographic and/or electronic storage. Subsection (f)(2) of Rule 31a-2 and subsection (g)(2) of Rule 204-2, entitled "General requirements," makes no such specific reference. Thus, it is unclear whether subsections (f)(2) and (g)(2) apply only to micrographic and/or electronic storage or to all types of storage media, including paper. Although the text of those subsections seems to imply application to micrographic and electronic storage, their scope should be more explicit. We suggest that the heading of each such section be modified to state "General requirements for micrographic and electronic storage" in order to clarify this point.

Second, the Institute is concerned about the requirement in proposed subsections (f)(2)(ii)(A) and (g)(2)(ii)(A) that funds and advisers provide to the examination staff a copy of a requested record "in the medium . . . in which it is stored." It is unclear why this requirement is necessary. We question the need, for example, to require a fund or an adviser that stores records on CD ROM to produce copies of its CD ROMs merely for the purpose of providing a copy of the record to the examination staff. In our view, a fund or adviser should be able to provide copies of its records in any medium, including paper, so long as the information provided is a "legible, true, and complete copy of the record (or the information necessary to generate the record." Accordingly, we recommend deleting the words "medium and" from the phrase "in the medium and format in which it is stored" in the proposed rule amendments.

Third, proposed subsections (f)(2)(ii)(C) and (g)(2)(ii)(C) would require that funds and advisers provide to Commission staff and others means to "access, search, view, sort, and print" requested records. It is not entirely clear what searching and sorting capabilities are contemplated, nor whether all electronic and micrographic media necessarily would have such "search" and "sort" capabilities. The Institute believes it should be sufficient for funds and advisers to provide means to view and print requested records, 9 and that the proposed "search" and "sort" requirements could raise questions in light of E-SIGN’s requirements that in adopting rules interpreting Section 101 of E-SIGN, the Commission must find that the methods selected to carry out the purposes of those rules "are substantially equivalent to the requirements imposed on records that are not electronic records," and "will not impose unreasonable costs on the acceptance and use of electronic records."10 We recommend that the Commission revise its proposal to eliminate the requirement that funds and advisers provide means to search and sort requested records. Alternatively, at the very least, the Commission should clarify that the ability to "search" and "sort" records will vary depending on the medium on which the record is stored and the capability of that medium.

3. Status of Other Recordkeeping Requirements

The Institute has two comments regarding the status of other recordkeeping requirements. First, we note that while the Commission’s proposal would amend certain recordkeeping rules for investment companies and investment advisers, there are other recordkeeping

requirements under the Investment Company Act that are not addressed in the Commission's proposed rulemaking. For example, Investment Company Act Rules 2a-7 (money market funds)11 and 17j-1 (codes of ethics) contain recordkeeping requirements in addition to those contained in Rules 31a-1 and 31a-2 under the Act. Yet, neither rule is mentioned or otherwise reflected in the Commission's proposal. It is logical and appropriate for the Commission to apply consistent standards to all records maintained by funds. Moreover, to the extent the Commission intends its proposed performance standards under Rules 31a-2 and Rule 204-2 to be the "exclusive means by which funds and advisers could comply with E-SIGN's standards of accuracy and accessibility,"12 it is all the more imperative that the Commission clarify the status of such other recordkeeping requirements.

Second, the Institute notes that the Commission previously had proposed amendments to Rule 17Ad-7 under the Securities Exchange Act of 1934 to allow registered transfer agents to use micrographic or electronic storage media to produce and preserve required records.13 That proposal was never adopted, however. Many funds have an affiliated transfer agent that performs recordkeeping functions for the funds. Given that E-SIGN will permit transfer agents to use electronic storage media as of June 1, 2001, it would be helpful if the Commission would clarify what standards will apply to such recordkeeping. Any such standards should be consistent with those for fund and adviser records.

4. Other Comments

While not specifically related to electronic recordkeeping, the Institute has an additional recommendation that is relevant to the Commission's overall effort to update its recordkeeping requirements. As noted above, Rule 31a-3 recognizes that investment company records may be prepared or maintained by someone other than the person required to maintain and preserve them. To provide additional flexibility to investment advisers, we urge the Commission to take this opportunity to amend the advisers recordkeeping rules to give specific recognition to similar types of arrangements in that context.

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The Institute appreciates the opportunity to present its views on the Commission's proposal. If you have any comments or would like additional information, please contact me at (202) 326-5923.

Sincerely,

Barry E. Simmons
Associate Counsel

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ENDNOTES

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,444 open-end investment companies ("mutual funds"), 490 closed-end investment companies and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about $6.868 trillion, accounting for approximately 95% of total industry assets, and over 83.5 million individual shareholders. Many of the Institute's investment adviser members render investment advice to both investment companies and other clients. In addition, the Institute's membership includes 358 associate members which render investment management services exclusively to non-investment company clients. A substantial portion of the total assets managed by registered investment advisers are managed by these Institute members and associate members.

2 Electronic Recordkeeping by Investment Companies and Investment Advisers, SEC Rel. Nos. IC-24890; IA-1932 (March 13, 2001); 66 Fed. Reg. 15369 (March 19, 2001) ("Proposing Release").

2 The Proposing Release notes that Rules 31a-2 and 204-2 already permit funds and advisers, respectively, to keep records on electronic storage media, provided the records were originally created or received in an electronic format. The Release adds that the Commission has provided no-action relief to permit funds and advisers to convert records into an electronic format and retain them electronically. The Commission’s proposal effectively would amend the recordkeeping rules to incorporate these no-action letters, but would eliminate certain of the conditions so as to subject electronic records, regardless of how they originated, to uniform requirements.

4 See Section 104(b)(3) of E-SIGN.

5 In particular, we support the Commission’s decision not to require funds and advisers to preserve their records in a non-rewriteable, non-erasable format, as we agree that the costs of such a requirement would outweigh any potential benefits.

6 In this regard, we note that Rule 31a-3 specifically contemplates that required fund records may be prepared or maintained by a third party. This practice has become increasingly common with the widespread use of third-party administrators as well as the proliferation of sub-advised and multi-manager funds. Thus, it is important that the Commission provide a reasonable degree of flexibility in Rule 31a-2 to accommodate such arrangements. For example, if an inspection is underway at a registrant’s site that is located on the west coast and the SEC staff makes a late afternoon request for particular records that are maintained with the registrant’s east coast administrator, it seems unreasonable to impose upon the east coast administrator the burden of having to satisfy that request within one business day of the time the west coast registrant received the request, particularly given that the administrator may not even be aware of the staff request until the following day.

7 Proposing Release at n. 9.

8 The Commission could clarify in the adopting release its expectation that micrographic and electronic records normally must be provided within one business day of a request.

9 We further believe that the ability to view and print records subsumes the ability to access them.

10 Section 104(b)(2)(C)(ii)(I)and (II).

11 We note, for example, that Rule 2a-7(c)(10) contains a provision authorizing the Commission to inspect the records of money market funds in accordance with Section 31(b) of the Investment Company Act "as if such documents were records required to be maintained pursuant to rules adopted under Section 31(a) of the Act." However, because the recordkeeping requirements of Rule 2a-7 technically are not covered by Rule 31a-2, it appears that the proposed rule amendments would not apply to records retained pursuant to Rule 2a-7.

12 See Proposing Release at 6.

13 See Recordkeeping Requirements for Transfer Agents, SEC Rel. No. 34-41442 (May 25, 1999); 64 Fed. Reg. 29608 (June 2, 1999).
