

COMMENT LETTER

July 1, 1996

Institute Comment Letter to SEC on Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers, July 1996

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Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, NW
Washington, DC 20549

Re: Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information
(File No. S7-13-96)

Dear Mr. Katz:

The Investment Company Institute¹ appreciates the opportunity to comment on the Commission's interpretation relating to the electronic dissemination of information under the federal securities laws by broker-dealers, investment advisers and transfer agents.²

The Institute strongly supports the Commission's continuing efforts to facilitate and encourage the use of electronic media by market participants, including investment companies and investment advisers. The Commission's guidance with respect to electronic media has greatly assisted investment companies and investment advisers in their growing use of electronic networks, such as the Internet, to provide information and services to investors. The Institute believes that the Commission's regulatory pronouncements in this area set appropriate national standards for investment companies and investment advisers. We urge the Commission to work with other federal and state regulators to assure that consistent and uniform regulatory standards are applied to all electronic communications.

With respect to the Interpretive Release, the Institute requests that the Commission clarify that the informed consent requirement for the electronic transmission of personal financial information does not apply to account balance information. We recommend that the Commission and the various self-regulatory organizations, including the National Association of Securities Dealers, Inc. ("NASD") and the New York Stock Exchange, Inc.

("NYSE"), coordinate their regulatory treatment of the electronic transmission of personal financial information by broker-dealers, investment advisers and transfer agents. We also recommend that both the Commission and the self-regulatory organizations adopt a content-based approach to the regulation of electronic mail messages that are transmitted by broker-dealers, investment advisers and transfer agents. Finally, the Institute recommends that the Commission reconsider its requirement that electronically distributed registration statements contain a legend that directs investors to the Commission's World Wide Web site for further information about the issuer. Each of these comments is discussed below.

I. Electronic Delivery of Personal Financial Information

The Interpretive Release provides guidance to broker-dealers, investment advisers and transfer agents who wish to transmit electronically information that is specific to a particular person's personal financial matters ("personal financial information"). According to the release, if such information is required to be delivered under the federal securities laws, the broker-dealer, investment adviser or transfer agent "should take reasonable precautions to ensure the integrity, confidentiality, and security of that information, regardless of whether it is delivered through electronic means or in paper form."³ It also requires that, unless a broker-dealer, investment adviser or transfer agent is responding to a request for information that is made through electronic media or the person making the request specifies delivery through a particular electronic medium, the broker-dealer, investment adviser or transfer agent should obtain the intended recipient's informed consent prior to delivery of personal financial information electronically.⁴ The Interpretive Release states that it does not apply to the electronic delivery of non-required information that, in some cases, is being provided voluntarily to customers or clients.

The Institute seeks clarification that the Commission's informed consent requirement would not apply to an investment company or its affiliated broker-dealer, investment adviser or transfer agent that provides information pertaining to investors' account balances on its Internet site, similar to providing such information through a telephone response system. Telephone response systems, which often include real-time account balance information, are provided voluntarily by investment companies or their affiliated broker-dealers or transfer agents to investors. The Commission does not presently require investment companies or their affiliates to obtain consent from shareholders or customers prior to making such information available through these systems.

The Institute believes that the same issues with respect to the integrity, confidentiality and security of information are applicable to information provided through telephone systems and through electronic networks such as the Internet. Both telephone response systems and electronic networks use computers and specialized software to provide information to shareholders. The Institute believes that the Commission's requirement that broker-dealers, investment advisers and transfer agents that transmit personal financial information take reasonable precautions to ensure that the information is reasonably secure from tampering or alteration should be sufficient to allow for the transmission of such account balance information to customers and clients.

The Institute also notes that the various rules of the self-regulatory organizations may conflict with the guidance provided by the Interpretive Release with respect to the transmission of personal financial information. For example, the NASD's Conduct Rules applicable to confirmations require that member firms at or before the completion of each

transaction with a customer give or send to such customers written notification that discloses the capacity in which the member is acting with respect to the transaction.⁵ In addition, the NASD's Conduct Rule that requires the delivery of quarterly account statements by member firms does not specify whether a member may transmit such statements electronically.⁶ Accordingly, the Institute recommends that the Commission and the self-regulatory organizations clarify that the guidance in the Interpretive Release is equally applicable under the rules of the self-regulatory organizations.

II. Electronic Mail Messages

The Interpretive Release does not directly address issues related to the use of electronic mail by broker-dealers, investment advisers or transfer agents to communicate with clients and customers. The release suggests that the self-regulatory organizations should provide guidance in this area. It also indicates that the Commission believes that self-regulatory organization rules concerning the supervisory requirements for electronic communications should be based on the content and audience of the message, and not merely on the electronic form of the communication.⁷

The Institute strongly supports the Commission's view that the regulatory treatment of electronic messages should be governed by the content and audience of the message, rather than by the form of delivery. For example, if a broker-dealer or investment adviser responds by electronic mail to a client's question about the client's account statement, the Institute believes that the electronic mail message should not be regulated as an advertisement or sales literature under the NASD's rules.⁸

This view comports with the general view articulated by the Commission that both paper and electronic-based communications should be treated the same under the federal securities laws. We are encouraged that the NASD appears to have adopted this approach in a recent discussion of the application of its Conduct Rules to electronic communications by member firms.⁹ Accordingly, we strongly encourage all of the self-regulatory organizations to adopt such an approach toward the regulation of electronic mail messages by member firms.

III. Technical Amendments

The Institute is pleased that, along with the Interpretive Release, the Commission adopted technical amendments to certain of its rules and forms that were premised on paper documents in order to address their use in the electronic context.¹⁰ We were disappointed, however, with the amendment that requires investment company registration statement forms disseminated electronically to include a statement on their cover page that the Commission maintains a World Wide Web site that contains the Statement of Additional Information ("SAI"), material incorporated by reference and other information regarding registrants that file electronically with the Commission. This rule amendment was not proposed in the Commission's proposing release and therefore the Institute did not have the opportunity to comment on it at that time.

The Institute believes the required statement may not be of assistance to, and may even confuse, investors in their efforts to obtain additional information about a particular mutual fund. For example, investors may experience difficulty in locating a particular mutual fund's SAI and other information, if the EDGAR system contains similarly named filings that related to the fund's sponsor or to other series of the same investment company.¹¹ In addition,

when an investor accesses the EDGAR database and obtains an EDGAR version of a mutual fund's filing (e.g., an SAI or prospectus), the EDGAR document may appear to be formatted and structured differently than the electronic or paper version that the investor obtained from the mutual fund.¹² This also could result in confusion, if investors attempt to reconcile the formatting differences among various documents. Accordingly, the Institute recommends that mutual funds be given the option of providing a statement on the cover of the registration statement that directs investors to the funds' telephone number (e.g., toll-free telephone number) or electronic mail address from which they can order the SAI and other investor information.

The Institute appreciates the opportunity to comment on this matter. If you have any questions concerning our comments, please contact the undersigned at 202/326-5923.

Sincerely yours,

Alexander C. Gavis
Assistant Counsel

cc: Chairman Arthur Levitt, Jr.
Commissioner Isaac C. Hunt, Jr.
Commissioner Norman S. Johnson
Commissioner Steven M.H. Wallman

Barry P. Barbash, Director,
Division of Investment Management

Brian Lane, Director,
Division of Corporation Finance

Richard R. Lindsey, Director,
Division of Market Regulation

R. Clark Hooper, Senior Vice President,
National Association of Securities Dealers, Inc.

Edward Kwalwasser, Executive Vice President,
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ENDNOTES

1 The Investment Company Institute is the national association of the American investment company industry. 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 458 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 Release No. 33-7288; 34-37182; IC-21945; IA-1562 (May 9, 1996) [hereinafter May Interpretive Release].

3 Interpretive Release, at 14.

4 According to the Interpretive Release, if a consent is used, it must be an "informed consent," which specifies "the electronic medium or source through which the information will be delivered and the period during which the consent will be effective, and should describe the information that will be delivered using such means." See May Interpretive Release, at 13 n.23.

5 See NASD Conduct Rule 2230. Confirmations. NASD Manual ¶ 4211 (CCH 1996).

6 NASD Conduct Rule 2340. Customer Account Statements. NASD Manual ¶ 4293 (CCH 1996).

7 See May Interpretive Release at 5 n.5 (citing NASD Notice to Members 95-80 (Sept. 26, 1995), NASD Rules of Fair Practice § 35 and New York Stock Exchange, Inc. Rule 472, which govern member firm responsibilities relating to communications with the public, including electronic communications).

8 In addition, it is possible that such an electronic mail message might be analogous to a telephone conversation between the broker-dealer or investment adviser and its client and therefore should be treated as a conversation, rather than as a correspondence, under the NASD's rules.

9 See "Ask The Analyst About Electronic Communications," NASD Regulatory & Compliance Alert, National Association of Securities Dealers, Inc. (April 1996).

10 See Release No. 33-7289; 34-37183; IC-21946 (May 9, 1996).

11 We understand that the Commission has established a page on its Web site entitled "Fast EDGAR Mutual Fund Reporting" that allows investors to search a pre-written list of mutual funds based on time parameters in order to obtain the funds' EDGAR filings. The Institute understands that the list may not include all funds offered in a fund family or series and that the search feature is not currently functional. The Commission has also established a "prospectus search" page on its Web site that states: "This page gives you all '485' filings pertaining to a mutual fund of your choice." The Institute notes that the page provides no information to investors on how they might obtain a copy of a fund's SAI or annual or semi-annual reports. If an investor searches for a mutual fund's prospectus, a list of the fund's "485" forms by date appears with no other identification.

12 As part of the technical amendments, the Commission amended Rule 304 of Regulation S-T, which provides that whenever a document delivered to investors includes graphic, image or audio information that cannot be reproduced in an EDGAR filing, the EDGAR filing must include a fair and accurate narrative description, tabular presentation or transcript of the omitted material. See Release No. 33-7289; 34-37183; IC-21946 (May 9, 1996) at 15-16.