

## COMMENT LETTER

October 2, 1997

# Comment Letter on Proposed NASD Policy Relating to the Electronic Delivery of Information, October 1997

October 2, 1997

Jonathan G. Katz  
Secretary  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

Re: SEC Request for Comment on Proposed NASD Notice to Members Relating to the Electronic Delivery of Information Between Members and Their Customers  
(File No. SR-NASD-97-57)

Dear Mr. Katz:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to respond to the request for comment by the Securities and Exchange Commission on a proposed Notice to Members of the National Association of Securities Dealers, Inc. which sets forth the policy of NASD Regulation, Inc. applicable to the electronic delivery of information between members and their customers (the "Notice").<sup>2</sup> As discussed below, the ICI generally supports the Notice, but recommends certain additions to the list of NASD rules contained in the Notice that require or permit communications between members and their customers for which electronic delivery may be used.

## Background

The Notice references two SEC releases that establish a framework under which broker-dealers and others may use electronic media as an alternative to paper-based media to satisfy delivery obligations under federal securities laws.<sup>3</sup> The Notice states that use of electronic media is permitted to comply with certain listed NASD rules that require or permit communications between members and their customers, provided that members comply with the standards contained in the SEC releases.

The Institute generally supports this approach and believes that members should be permitted and encouraged to utilize electronic media to satisfy customer disclosure and consent requirements. As the SEC is well aware, members are increasingly using electronic

media, such as the Internet, to advertise their products and services and to communicate with their customers. Accordingly, the ICI supports efforts by the NASD and others to allow the use of electronic media to comply with regulatory requirements.

## **Security Measures to Assure Authenticity of Responses**

In footnote 6 of the SEC's release, the SEC requests comment on what types of security measures broker-dealers employ or will employ to reasonably assure themselves that the responses that they receive electronically from customers are authentic. We have not performed any sort of formal survey of our members to determine the range of procedures that the investment company industry uses to ensure the authenticity of customers' electronic communications. However, one member has indicated that it requires each customer who wishes to communicate electronically regarding his or her securities account to provide his or her social security number, customer account number and a personal identification number (PIN) before it will permit the customer to access his or her account electronically. Another member uses for certain institutional clients a multi-tiered security system which includes encryption technology and a password requirement.

## **Summary of SEC Releases**

The Notice includes a summary of the standards contained in the October 1995 Release and the May 1996 Release with regard to broker-dealers' use of electronic media to satisfy their delivery obligations under federal securities laws.<sup>4</sup> The ICI has previously commented to the SEC on these releases, and we continue to adhere to the recommendations contained in those comment letters.<sup>5</sup> To the extent that the SEC has not addressed issues raised in those letters, we encourage the SEC to do so in the future.

## **List of NASD Rules**

The Notice also contains a list of NASD rules that require or permit delivery of information between member firms and their customers and states that members may use electronic media to satisfy these rules' requirements provided that members meet the requirements of the October 1995 and May 1996 Releases. We generally concur with the inclusion of the rules currently listed in the Notice; however, we believe that certain other NASD Rules should be added to this list. The additional rules (or paragraphs thereof) that should be added to this list are set forth below:

Rule 2210(d) and (f): Rule 2210(d) sets forth the general and specific standards that apply to all member communications, including various disclosure standards. Rule 2210(f) provides standards that apply to the use and disclosure of a member's name. The list should include these provisions to confirm that their disclosure and other requirements may be satisfied using electronic media where the communication itself is made through electronic media. Of course, the notice and consent requirements contained in the October 1995 and May 1996 Releases that apply to certain types of communications, such as confirmations and account statements, do not apply to advertising or sales literature, since advertising and sales literature are voluntary communications to which the customer need not consent or have notice.

IM-2210-3: This interpretive release contains standards applicable to the use of rankings in investment company sales material. The list should include this interpretive release to clarify that its disclosure requirements may be satisfied using electronic media where the communication itself is made through electronic media.

Rule 2830(d): Rule 2830(d) imposes various requirements and limitations on investment company sales charges, including that they be disclosed in the prospectus. Additionally, Rule 2830(d)(4) prohibits members and persons associated with members from offering or selling shares of certain investment companies with asset-based sales charges unless their prospectuses disclose that long-term shareholders may pay more than the economic equivalent of the maximum front-end sales charge permitted by Rule 2830. The Notice should confirm that a prospectus that is delivered electronically and that contains the specified disclosures satisfies these requirements.

Rule 2830(k)(7): Rule 2830(k)(7) provides that a member may sell shares of, or act as an underwriter for, an investment company which follows a policy of considering sales of shares of the investment company as a factor in the selection of a broker-dealer to execute portfolio transactions, so long as best execution requirements are met and the policy is disclosed in the prospectus. The Notice should confirm this disclosure requirement may be met through electronic media in the case of an electronic prospectus.

Rule 2830(l)(1)(C): Rule 2830(l)(1)(C) prohibits investment company underwriters or associated persons thereof from offering or paying dealer concessions unless they are disclosed in the prospectus of the investment company. The Notice should confirm that electronic disclosure meets this requirement with respect to electronic prospectuses.

Rule 3010(g)(2): Rule 3010(g)(2) provides that certain locations at which a member conducts business will not be deemed a "branch office" of the member if, in the case of a location referred to in sales material, the sales material also discloses the address and telephone number of the branch office or office of supervisory jurisdiction from which the person(s) conducting business at the non-branch location are directly supervised and certain other requirements are met. The Notice should clarify that, in the case of sales material that is delivered electronically, these requirements may be met through electronic disclosure.

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We appreciate the opportunity to comment on this important issue. If you have any questions about this matter, please contact the undersigned at (202) 326-5819.

Sincerely,

Joseph P. Savage  
Assistant Counsel

cc: Mary Revell, Esq.  
Assistant General Counsel  
NASD Regulation, Inc.

#### **ENDNOTES**

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes 6,642 open-end investment companies

("mutual funds"), 443 closed-end investment companies, and 11 sponsors of unit investment trusts. Its mutual fund members have assets of about \$4.206 trillion, accounting for approximately 95% of total industry assets, and have over 59 million individual shareholders.

2 SEC Release No. 34-39025 (Sept. 5, 1997), 62 Fed. Reg. 46858 (Sept. 11, 1997).

3 See Securities Act Release No. 7233 (Oct. 6, 1995), 60 Fed. Reg. 53458 (Oct. 13, 1995) (the "October 1995 Release"), and Securities Exchange Act Release No. 37182 (May 9, 1996), 61 Fed. Reg. 24644 (May 15, 1996) (the "May 1996 Release").

4 See 62 Fed. Reg. at 47859-47860.

5 See Letter from Alexander C. Gavis, Assistant Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (Nov. 22, 1995) (ICI comments to October 1995 Release); Letter from Alexander C. Gavis, Assistant Counsel, Investment Company Institute, to Jonathan G. Katz, Secretary, Securities and Exchange Commission (July 1, 1995) (ICI comments to May 1996 Release).

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