The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

COMMENT LETTER

March 17, 2000

Comment Letter to Subgroup on Legal Barriers to Electronic Commerce, March 2000

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Subgroup on Legal Barriers to Electronic Commerce
U.S. Department of Commerce
14th Street and Constitution Avenue, N.W., Room 2815
Washington, D.C. 20230

Ladies and Gentlemen:

The Investment Company Institute1 welcomes the opportunity to comment on policies, laws or regulations that need to be adapted in order to eliminate barriers to and promote electronic commerce, electronic services, and electronic transactions.2 Our members are on the cutting edge when it comes to using new technologies to increase efficiency and enhance the types and quality of services they provide to customers. Many mutual fund organizations have websites through which they provide educational materials and other information for investors, as well as, in some cases, the ability to conduct transactions in fund shares online. Fund shareholders increasingly are demanding the ability to access relevant information and conduct business in a "paperless" manner. Thus, we strongly support initiatives such as this one that are aimed at removing unnecessary impediments to electronic commerce.

The Institute's members conduct business not only throughout the United States but also, in many cases, on a global basis. As the Notice recognizes, "Barriers to electronic commerce may arise simply from a lack of uniformity in policies, laws, standards or codes among different jurisdictions."3 Our comments focus on two areas in which a lack of uniformity among the laws of different jurisdictions is a major concern. These areas, discussed in greater detail below, are: (1) electronic signatures and records; and (2) privacy of customers' nonpublic financial information.

Electronic Signatures and Records

Given their leading role in the world of electronic commerce, mutual fund organizations have a strong interest in efforts to facilitate the use of electronic signatures and electronic records. Currently, there is uncertainty as to whether electronic records and electronic signatures would satisfy requirements under federal or state law that a document or record

be "in writing" or "signed." This uncertainty serves as a significant impediment to the progress of electronic commerce in the mutual fund industry. Exacerbating this situation is the fact that states have taken a variety of approaches to authorizing the use of electronic records and signatures, resulting in a patchwork of inconsistent state laws in this area. Inconsistent state laws act as a barrier where, as in our members' case, transactions are conducted nationwide.

In July 1999, the National Conference of Commissioners on Uniform State Laws approved and recommended for enactment by individual states the "Uniform Electronic Transactions Act" ("UETA"). UETA provides generally for a functional equivalency between records and signatures which are in electronic or paper and ink form. It also incorporates the important concepts of party autonomy (i.e., giving parties to private commercial transactions flexibility in selecting the electronic signature technologies and methodologies appropriate for their needs) and technology neutrality (i.e., refraining from favoring any particular electronic signature technology over another). While the Institute supports this initiative, we note that UETA does not provide a complete solution to the issues. For example, states are not required to adopt UETA within any given timeframe ¯ or at all. If and when they enact UETA, they are specifically authorized to exclude an unlimited number of existing paper and ink "writing" and "signature" requirements from its scope, and they may adopt their own, state-specific variations to its provisions. The likelihood of this happening has been demonstrated by the early adoptions and introductions of UETA.4 Thus, while UETA contemplates uniform standards, it is unlikely that complete uniformity throughout the states can be achieved through this avenue. Moreover, because it is state law, UETA does not affect federal requirements that documents be "in writing" or "signed."

For these reasons, the Institute supports the enactment of federal legislation in this area. In particular, we support the general approach taken in H.R. 1714, the "Electronic Signatures in Global and National Commerce Act," which was passed by the U.S. House of Representatives on November 9, 1999.5 H.R. 1714, like UETA, would provide that the legal effect, validity or enforceability of contracts, agreements or records may not be denied on the ground that they are electronic records or signed by electronic signatures. It is designed to provide a uniform national baseline for the use of electronic records and electronic signatures while UETA is being considered and adopted by the states. In addition, H.R. 1714 provides that state electronic records and signature laws must be consistent with H.R. 1714. This will not prevent states from adopting their own variations to the many aspects of UETA that are not addressed by H.R. 1714, but it will ensure that the baseline rules established by the federal legislation will remain in effect on a uniform basis, nationwide.

Privacy

The mutual fund industry's continued success depends upon its ability to maintain investors' confidence. Thus, for example, investors must remain confident that mutual fund organizations adequately protect the privacy of their personal information.6 With this in mind, the Institute supported the enactment last fall of the privacy provisions in Title V of the Gramm-Leach-Bliley Act. We look forward to commenting on the rules that the Securities and Exchange Commission has proposed to implement those provisions with respect to investment companies (e.g., mutual funds), investment advisers and broker-dealers.7

The Act and related rules will provide extensive privacy protection to mutual fund shareholders. For example, mutual fund organizations will be required to adopt privacy

policies and procedures and to disclose specified information about those policies and procedures to their customers. In addition, customers must be given the opportunity to "opt out" of the sharing of their personal information with unaffiliated third parties, subject to limited exceptions. Disclosure of account access information to third parties for marketing purposes is prohibited. Finally, the SEC (with respect to entities it regulates) must prescribe standards for protecting the security and confidentiality of nonpublic personal information. As required by the Act, the implementing rules are on a fast track, and are expected to be issued in final form by May 12, 2000, with an effective date in November of 2000.

Our support for the privacy protections in Title V is based on our conclusion that the legislation achieves an appropriate balance between two important interests of mutual fund shareholders: giving shareholders control over uses of their personal information that reasonably might be considered objectionable and ensuring that shareholders efficiently receive financial products and services. Thus, for example, while the Act generally requires that customers have the ability to prevent a financial institution from selling or otherwise disclosing their personal information to unaffiliated third parties, it permits a financial institution to share customer information with third parties for the purpose servicing the customer’s account.

We are concerned, however, that without giving these comprehensive new federal privacy protections a chance to prove themselves effective, individual states may adopt inconsistent privacy requirements that could upset this balance. Non-uniform privacy requirements would be very burdensome for mutual fund organizations that do business nationwide, and also could be confusing to investors if different rules apply in different states. We urge the Department of Commerce and the United States Government Working Group on Electronic Commerce to encourage states to refrain from rushing to adopt their own financial privacy requirements. It is important to provide the opportunity to gain experience from the implementation of the balanced approach embodied in the new federal privacy requirements for financial institutions.

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The Institute appreciates the opportunity to comment on these important issues. If you have any questions concerning our comments, please contact me at (202) 326-5822.

Sincerely,

Frances M. Stadler
Deputy Senior Counsel

ENDNOTES

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,018 open-end investment companies ("mutual funds"), 495 closed-end investment companies, and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about $6.802 trillion, accounting for approximately 95 percent of total industry assets, and over 78.7 million individual shareholders.

2 Department of Commerce, Office of the General Counsel; Laws or Regulations Posing Barriers to Electronic Commerce, 65 Fed. Reg. 4801 (February 1, 2000) ("Notice").

3 65 Fed. Reg. at 4802.

4 To date, UETA has been adopted in California and Pennsylvania, but only with certain state-specific variations. In the case of California, these variations are both numerous and substantive and are coupled with more than 60 exclusions. Nearly all of the approximately twenty states that have introduced UETA so far this year have included their own variations, exclusions or both.

5 On November 19, 1999, the Senate passed S. 761, the "Millenium Digital Commerce Act." In contrast to H.R. 1714, S. 761 covers only contracts and thus does not cover non-contractual electronic records, such as notices. In the Institute's view, omitting electronic records from the scope of federal legislation in this area would significantly limit its usefulness in promoting electronic commerce. Legal uncertainty and non-uniform state laws would continue to serve as barriers to the use of electronic records. We strongly urge that any federal legislation that ultimately may be enacted extend to electronic records.

6 Although this issue is not limited to the electronic commerce context, the ease with which information can be collected and transmitted electronically has been an important factor in creating a high level of sensitivity to privacy concerns.

7 SEC Release Nos. 34-42484, IC-24326, IA-1856 (March 2, 2000), 65 Fed. Reg. 12354 (March 8, 2000).
