



# INVESTMENT COMPANY INSTITUTE

March 16, 2001

Mr. Donald S. Clark  
Secretary  
Federal Trade Commission  
Room H-159  
600 Pennsylvania Avenue, N.W.  
Washington, D.C. 20580

Re: ESIGN Study – Comment P004102

Dear Mr. Clark:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to provide comments to the Federal Trade Commission and the Department of Commerce in connection with their study of the benefits and burdens of the consumer consent requirement in §101(c)(1)(C)(ii) of the Electronic Signatures in Global and National Commerce Act (“ESIGN”). Mutual funds are leaders in using electronic means to increase efficiency and enhance the types and quality of services they provide to investors. Thus, for example, many mutual fund organizations have websites through which they provide investors with legally required documents, such as prospectuses and financial reports, as well as educational materials and other information and, in some cases, the ability to open accounts and/or conduct transactions in fund shares online. Fund shareholders increasingly are demanding the ability to access relevant information and conduct business in a “paperless” manner. For these reasons, the Institute has actively supported legislative and regulatory initiatives, such as ESIGN, that are designed to facilitate electronic commerce.

This letter first provides general comments regarding ESIGN. It then discusses issues related to §101(c)(1)(C)(ii) and other consumer consent provisions of ESIGN. Finally, it provides concluding remarks.

## I. General Comments on ESIGN

The Institute’s support for ESIGN was premised, in large part, on the notion that it would be appropriate and beneficial to establish uniform national standards governing the legal effect, validity and enforceability of electronic contracts, signatures and records. Some of these benefits already are being realized by consumers and businesses alike. For example, directly as a result of ESIGN, some Institute members now allow investors to open up and fund new

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<sup>1</sup> The Investment Company Institute is the national association of the American investment company industry. Its membership includes 8,391 open-end investment companies (“mutual funds”), 489 closed-end investment companies and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about \$7.2 trillion, accounting for approximately 95% of total industry assets, and over 83.5 million individual shareholders.

accounts online. At the same time, however, questions as to the scope of the legislation's application and interpretive issues concerning certain of its provisions have arisen. Some of these questions and issues arise from the fact that, before ESIGN, the Securities and Exchange Commission had issued regulatory guidance concerning the use of electronic media by mutual funds and other SEC-regulated entities that established standards for satisfying regulatory disclosure requirements through electronic means.<sup>2</sup> This guidance generally provides that electronic delivery of required disclosure documents will be considered effective for federal securities law purposes if: (1) the investor has notice that the information is available electronically; (2) the investor has access to the information that is comparable to that which would be provided if the information were in paper form; and (3) there is evidence to show delivery. The SEC guidance, which was carefully crafted to be fully consistent with the SEC's investor protection mandate, created a reasonable framework within which many fund groups had been operating successfully for several years.

The enactment of ESIGN raised questions concerning, among other things, its impact on the existing regulatory guidance concerning electronic delivery of disclosure documents. And while some fund organizations have undertaken or continued electronic disclosure initiatives since ESIGN went into effect, making good faith efforts to comply with what they reasonably believe applicable law requires, certain aspects of ESIGN have introduced a degree of uncertainty that could have the effect of frustrating its stated goal of facilitating the use of electronic records.

## II. Comments on Consumer Consent Provisions of ESIGN

### A. §101(c)(1)(C)(ii)

As indicated in the notice requesting comment, under §101(c)(1)(C)(ii) of ESIGN, before an electronic record may be used to provide or make available information that is required by law to be provided or made available to a consumer in writing, the consumer must consent electronically, or confirm his or her consent electronically, "in a manner that reasonably demonstrates that the consumer can access information in the electronic form that will be used to provide the information that is the subject of the consent." Assessing the relative benefits and burdens of this provision in the mutual fund context is somewhat difficult because of the open issues surrounding it, including questions concerning the circumstances in which it applies.

In this regard, the consent requirement by its terms applies where information is required to be provided or made available to a consumer *in writing*. Mutual funds are subject to a number of securities disclosure, tax reporting and other requirements to provide information that could trigger the consent provision, to the extent that funds seek to satisfy those requirements using electronic records. For example, under the federal securities laws, funds and/or intermediaries that sell fund shares must deliver prospectuses, transaction confirmations, shareholder reports, and proxy statements to fund shareholders. It may not be

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<sup>2</sup> See SEC Release Nos. 33-7233, 34-36345, IC-21399 (October 6, 1995), 60 Fed. Reg. 53458 (October 13, 1995); SEC Release Nos. 33-7288, 34-37182, IC-21945 (May 9, 1996), 61 Fed. Reg. 24644 (May 15, 1996); SEC Release Nos. 33-7856, 34-42728, IC-24426 (April 28, 2000), 65 Fed. Reg. 25843 (May 4, 2000). The IRS and the Department of Labor have provided similar guidance regarding retirement plans.

clear, however, to what extent any of the foregoing documents are required to be provided "in writing."

Moreover, to the extent that mutual fund disclosure documents *are* required to be "in writing" and thus are subject to the ESIGN consent provision, it is unclear whether existing interpretive guidance on electronic delivery of information, which also addresses consent (among other things), ceases to apply. Accordingly, regulatory guidance as to which mutual fund disclosures are *required* to be "in writing" would be helpful to clarify the reach of the ESIGN consent requirement. We expect that the SEC and other regulators will provide clarification on this point and encourage them to do so expeditiously. In the mean time, we offer the following comments on §101(c)(1)(C)(ii).

*Electronic consent.* By requiring that consumers consent or confirm their consent electronically, §101(c)(1)(C)(ii) may actually increase the burden on consumers, including mutual fund shareholders, who wish to receive information electronically. Under ESIGN, a fund shareholder cannot simply call or write to a fund organization, or walk in to a fund customer service center, and complete a request to change document delivery preferences from paper to electronic. Rather, the shareholder would have to reconfirm (or confirm consent) from his or her own computer upon returning to his or her own home or office. Several of the Institute's members have expressed concern that this inconvenience will discourage, rather than encourage, increased use of paperless technologies.

It should be noted that the SEC's electronic media guidance, discussed earlier in this letter, provides that obtaining an investor's "informed consent" to electronic delivery of information is one means through which evidence of effective electronic delivery can be established. The SEC guidance – which is designed to address the very same consumer protection concerns that underlie §101(c)(1)(C)(ii) of ESIGN – does not require that such consent be provided electronically. Thus, for example, paper and telephonic consents are sufficient so long as the "notice" and "access" requirements outlined above also are satisfied. The Institute believes that an approach such as that outlined in the SEC's electronic media guidance provides reasonable assurance that the consumer can access the information being delivered without unduly constraining the means through which consumers may provide consent. Indeed, our members had been operating successfully under the SEC's approach before ESIGN's enactment and to our knowledge it raised no significant issues with consumers. By contrast, requiring *electronic* consent (or electronic confirmation) imposes a substantial burden on the consent process, will likely increase customer confusion, and is not necessary to adequately protect the interests of consumers.

*Reasonable demonstration.* As noted above, §101(c)(1)(C)(ii) requires not only that a consumer's consent or confirmation be electronic, but also that it be given in a manner that reasonably demonstrates that the consumer can access information in the electronic form in which it will be provided. In general, our members have attempted to take a common sense approach to the "reasonable demonstration" requirement, employing different compliance methodologies depending on the context. In some instances, our members seek to obtain an email affirmation of the consumer's ability to access the information, after giving the consumer an opportunity to test a sample record in the specified form. In other cases, such as when a consumer accesses a fund's website in order to request electronic delivery and the information

will be provided along with any software (such as Adobe Acrobat) needed to read it, members have concluded that providing a "test" document should not reasonably be required. In the proper context, such as when it can be shown that the consumer has actually accessed a document in the relevant format, no affirmative statement that the consumer can access information in that format should be necessary.

As a policy matter, the "reasonable demonstration" requirement appears to parallel the SEC's requirement that an investor must have access to electronic information comparable to that which would be provided if the information were in paper form. The SEC has not limited the ways in which such investor access could be evidenced. The Institute cautions against narrow interpretations of the reasonable demonstration requirement that would make compliance highly impractical or impossible and, as a result, potentially deprive consumers of the benefits of electronic delivery of information.

It also should be noted that, while the "reasonable demonstration" requirement is well-intentioned, it may not readily accommodate technological advances that expand potential ways to communicate information electronically in the future. Similarly, the provision in ESIGN §106(c)(6) that "oral communications" or recordings thereof do not qualify as electronic records for purposes of the consent requirements may inhibit the use of wireless and mobile computer systems that utilize oral inputs or outputs but that are not mere telephone conversations. Periodic reevaluation of the consent requirement will be advisable to assure that it is serving its intended purpose without unduly constraining the use of new technologies.

#### B. Other Consent Issues

Other elements of ESIGN's consumer consent requirements also potentially create unnecessary burdens. For example, §101(c)(1)(B)(ii) provides that a consumer must receive a clear and conspicuous statement prior to consenting concerning, among other things, whether the consent applies only to the particular transaction that gave rise to the obligation to provide the record, or to "identified categories of records" that may be provided or made available during the course of the parties' relationship.

A reasonable interpretation would permit a mutual fund investor to consent at the outset to electronic delivery of all information relating to his or her investment in the fund. The mutual fund's clear and conspicuous statement could indicate, for example, that the consent applies to all fund prospectuses, trade confirmations, shareholder reports, proxy materials, and other notices, documents and information relating to the investor's fund investment. Such an interpretation would be consistent with the existing SEC guidance permitting global consents (e.g., consents relating to electronic delivery of all documents to be delivered by or on behalf of a single issuer, such as a mutual fund).

Another provision that potentially could create undue burdens if interpreted too narrowly is §101(c)(1)(D)(ii). That provision requires that a new consent be obtained if, after a consumer's consent is first obtained, a change in the hardware or software requirements needed to access or retain electronic records "creates a material risk that the consumer will not be able to access or retain a subsequent electronic record that was the subject of the consent." Consumers should not be required to re consent if they have the hardware or software needed

to access documents in the modified format. Rather, adequate protection would be provided if consumers receive sufficient advance notice of the change along with instructions on how to implement any hardware or software revision and on how to withdraw their consent to electronic delivery. In these circumstances, there would not be a material risk that the consumer could not access or retain the subsequent electronic record.

III. Conclusion

As the foregoing comments illustrate, while the enactment of ESIGN has provided significant benefits for mutual funds and investors, it also has raised questions in certain areas. Until these questions are resolved, the uncertainty they create could hamper progress toward broader use of electronic media.

To reduce this uncertainty and allow mutual fund investors to receive the benefits of broader use of electronic media in the fund industry, federal agencies such as the SEC and the IRS should issue guidance that accommodates reasonable and workable approaches to conducting business with mutual fund investors electronically. Review of these issues by regulators also will help identify areas where legislative changes might be warranted.

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Thank you for considering our comments on these important issues. We look forward to continuing to play an active role in seeking elimination of legal and regulatory impediments to the use of electronic commerce by mutual funds.

Sincerely,



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