



Securities Industry Association

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March 11, 1997

The Honorable Conrad Burns
Chairman
Communications Subcommittee
Senate Committee on Commerce, Science & Transportation
227 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Burns:

The Securities Industry Association **1** commends you for introducing legislation to relax the export restrictions on strong encryption technology. The *Promotion of Commerce on Line in the Digital Era (Pro-CODE) Act of 1997* (S. 377) will enhance the global competitiveness of the U.S. securities industry by allowing our firms to use strong, user-friendly privacy and security technology in their international electronic communications. SIA has long been a champion of the use of technology to lower the cost of capital and raise returns for investors. Through our Technology Issues and Technology Management Committees, we work to ensure that regulatory and legislative proposals that affect technology usage do not impair the industry's ability to raise capital or suppress investment in any way.

The U.S. has the largest, most vigorous capital markets in the world. By providing a steady source of low-cost funds to business and government, they affect all areas of the economy. In the last 10 years, the amount of capital raised in the markets has increased more than 1,000 percent. It took over 200 years to reach the first \$100 billion year in 1982; only 10 years later, the capital markets reached the \$1 trillion mark. Since that time, the securities industry has raised over \$1 trillion every year for U.S. business -- capital that is used to fund expansion, job growth, and investment in new technologies and equipment. Internationally, the U.S. securities industry is a global leader. Our firms have operations around the world, from the largest money centers in London and Tokyo to the emerging markets of Latin America and Southeast Asia.

Encryption is a Key Technology in the Securities Industry

Sophisticated information technology is largely responsible for the explosion of our international business. As technology facilitates our expansion into world markets, it also presents our firms with serious challenges to stay one step ahead of electronic pirates and con artists who would use the same technology to invade our firms' customer accounts and proprietary information. Security is critical to the securities industry. We have a responsibility to our customers and shareholders to maintain the confidentiality, integrity, and availability of our data. For our firms, this responsibility is a matter of business survival -- each year, the industry spends millions of dollars building, implementing, and testing the security of its systems and networks.

Encryption -- the process by which electronic messages are disguised from all but the authorized recipients -- is a core technology to secure communications between ourselves and our overseas colleagues. Because encryption relies on complex mathematical formulas to scramble messages, encrypted messages cannot be read unless the receiver has a corresponding formula, or key, that will unscramble the message. The more bits of information used in an encryption key, the stronger it is considered to be and the more difficult it is for an unauthorized party to decode.

The securities industry currently uses encryption technology to protect sensitive store-and-forward electronic communications that will be preserved for long periods of time, as well as to secure real-time transactions such as those carried by the Financial Information Exchange ("FIX") protocol. Our firms also use encryption to authenticate the originator of information, including digital signatures.

Given the sensitive nature of the information transmitted between our firms and their clients, it is imperative that our firms have the tools to ensure the confidentiality of their overseas business communications. Much stronger encryption technology is available today from foreign companies, and many U.S. firms purchase these products overseas to obtain sufficient security and to avoid U.S. legal restrictions. It is difficult, however, to get technical support for foreign products. In addition, because our firms can export strong encryption to their overseas offices under current law, some firms have developed different standards for colleagues and clients. Maintaining two (or more depending on the products used by clients) encryption standards -- based on U.S. technology and foreign technology -- is expensive and burdensome for our firms. Clearly, encryption export laws and regulations need to be reformed if the U.S. is to maintain its preeminence in world markets.

Administration Proposal

The Commerce Department sought to address inadequacies with current

law when it published regulations last December.² SIA does not support this proposal, and maintains that the industry will be at a serious competitive disadvantage if it is adopted in its current form.³ In exchange for permission to export 56-bit encryption, the Administration proposal requires the key to be deposited with a third-party escrow agent. To address law enforcement concerns, the proposal would allow government officials to obtain the keys by demonstrating "proper legal authority and without cooperation or knowledge" of our firms. The securities industry is concerned that this standard has a very high potential for abuse.

We cannot know what "proper legal authority" will mean around the world. Will governments authorize access to confidential business information under the auspices of national security? Could governments construe "proper legal authority" to include efforts to keep businesses from moving across borders, directing investments inconsistent with that government's interest, preserving a tax base, or other national economic goals? There is strong evidence that some NATO countries -- including our closest allies -- perform industrial espionage on behalf of their domestic industries.⁴ Escrow agents are heavily beholden to their local governments and would have little recourse in the face of government pressure to disclose keys.

Even without the abuse that could occur under the guise of "proper legal authority," our responsibility to clients prevents the securities industry from trusting escrow agents throughout the world who are susceptible to compromise from any number of outside influences. Given the nature of the technology, it may be impossible to even trace a bad agent. Coupled with the Administration's intent to introduce legislation to limit the liability of escrow agents, our firms will have little recourse if confidential information is compromised by a key agent, whether intentionally or otherwise.

Need for Legislative Action

The Pro-CODE legislation, however, addresses the industry's concerns in a number of ways. It would promote electronic commerce by facilitating the use of strong encryption, while recognizing the legitimate needs of law enforcement. Of great importance to the securities industry, S. 377 would ease export restrictions on encryption technology to a level deemed "generally available" worldwide by the U.S. Department of Commerce, and prohibit a mandatory system under which producers or users of hardware and software would be required to surrender a decoding key to a third party. We believe your legislation strikes the right balance between our clients' need for security and legitimate law enforcement issues.

Again, thank you for all your hard work on this important issue. We look forward to working with you again this year. If you need any additional

information on the industry's position on encryption, please contact Kristin Hofeditz on my staff at 202-296-9410.

Sincerely,

Marc E. Lackritz
President

Footnotes

1 The Securities Industry Association is the leading proponent of U.S. capital markets, bringing together the shared interests of more than 730 securities firms throughout North America to accomplish common goals. SIA members -- including investment banks, broker-dealers, specialists, and mutual fund companies -- are active in all markets and all phases of corporate and public finance. In the U.S., SIA members collectively account for approximately 90 percent, or \$100 billion, of securities firms' revenues and employ about 350,000 individuals. They manage the accounts of more than 50-million investors directly and tens of million investors indirectly through corporate, thrift, and pension plans.

2 61 Fed. Reg. 68,572 (1996) (proposed Dec. 31, 1996).

3 Letter from Mr. Mark Sanders, Chairman, SIA Technology Management Committee to Under Secretary William A. Reinsch (Feb. 13, 1997) (commenting on Docket No. 960918265-6366-03).

4 139 Cong. Rec., H2104 (daily ed. Apr. 27, 1993) (statement of Rep. Wolf quoting "CIA: French Targeting Secrets of U.S. firms -- Hughes Cancels its Exhibit at Paris Air Show," *Washington Post*, 27 Apr. 1993).