Securities Industry Association

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January 25, 1996

The Honorable Steven M. H. Wallman
Commissioner
Securities and Exchange Commission
Judiciary Plaza
450 Fifth Street, NW
Washington, D.C. 20549

Re: Brokerage Firm Use of Electronic Media

Dear Commissioner Wallman:

The Securities Industry Association ("SIA") [1] wishes to express its appreciation to the Securities and Exchange Commission (the "SEC" or "Commission") for the recent steps it has taken to address a number of lingering questions regarding the treatment under Federal securities laws of certain applications of emerging technology in the securities arena. Despite the Commission's thoughtful and helpful recent actions, our members remain concerned about a number of issues that have not been resolved relating to the regulatory treatment of their use of electronic media to communicate and transact business with their customers. Our members also are apprehensive about the possibility of conflicting treatment by different securities regulators.

In the Commission's earlier interpretive release with respect to the use of electronic media to deliver issuer and third-party disclosure documents (the "Issuer Release"), [2] the SEC directed its Division of Market Regulation to review certain rules under the Securities Exchange of 1934 (the "Exchange Act") to determine the feasibility of brokerage firms using electronic means to deliver the information required by those rules. We understand that the SEC is close to issuing a release in connection with that review (the "Broker Release") and plan to submit a detailed and comprehensive comment letter in response to that release.

We reiterate the sentiment expressed in our earlier letter, dated December 4, 1995, from SIA's Federal Regulation Committee to the SEC that the Issuer Release was an important first step in integrating the benefits of modern technology into the Federal securities disclosure system. We look forward to the Commission taking a similarly positive second step in the Broker Release by providing useful and practical guidance regarding brokerage firm use of electronic means to communicate and transact business with customers.

The Need for SEC Coordination and Leadership and for Dialogue among Regulators and the Industry

We urge the Commission to use its unique position among securities regulators to prevent the

adoption of piecemeal and inconsistent regulatory approaches to new technology by establishing definitive policies and encouraging various regulatory authorities to coordinate their activities with those of the SEC. A number of other securities regulators in the United States -- either because their rules are subject to SEC approval or simply because of the existing structure of securities regulation -- have informed us that they are looking to the Commission for guidance with respect to the proper regulatory framework for broker-dealer use of electronic media.

One way for the SEC to take the lead is for it to send a strong message to other regulators about the need for creative and constructive approaches to regulation in this area. The Commission could use the Broker Release to encourage state securities regulators and self-regulatory organizations to work with the SEC and the securities industry to avoid unnecessary regulatory obstacles to the beneficial use of emerging technologies by brokerage firms. If the SEC takes a different tact and uses the Broker Release simply to answer technical questions as to how firms may use electronic media in compliance with the Exchange Act or other Federal securities statutes, the Commission will be leaving the door wide open for other regulators to regulate away the benefits of electronic communication. In such an environment, securities firms will be inhibited from making or continuing to make the investment -- in terms of capital, training and resources -- necessary to develop innovations and implement systems that clients desire.

We appreciate the difficulty of attempting to regulate a moving target like technology and the marketplace's use of technology. Technology continually changes the manner in which the securities industry does business; it requires that the industry and its regulators be flexible to keep pace. The question, in our minds, is not so much how to discourage brokerage firm personnel from using computers or how to tell customers they cannot conduct business in the manner they prefer, as it is how to supervise properly the exchange of information between such personnel and customers. It is critical to the industry that the SEC play an integral part in ensuring that the means of supervision required by regulators does not box in brokerage firms in a way that leaves them with no alternative other than to limit their use of electronic media.

The use of electronic media can benefit all participants. It offers the industry opportunities to serve customers better, to maintain a level playing field with banks and other financial institutions and to compete both domestically and in the global financial marketplace. The use of electronic media gives regulators enhanced means to oversee the markets. It presents customers with more choices for better, faster, cheaper and convenient ways of sending and receiving information. In our view, regulations -- rather than being barriers to the development of technology -- should embrace and adapt to technology.

Content Rather than Delivery Mechanism Should Determine the Level of Supervision Required for Electronic Communication

Emerging technologies call for all of us to look at regulation in new ways, to shift paradigms and to devise novel definitions and classifications for various types of communications and methods of conducting business. When people think of electronic communication, the form that most commonly comes to mind is electronic mail or "e-mail," whether sent publicly via the Internet or World Wide Web, internally between employees of firms, or externally between associated persons and customers. Of course, numerous other forms of electronic communication

currently exist, are soon to be developed or will emerge in the future. E-mail itself means different things to different people at different times, depending upon the nature in which it is used. When brokers use e-mail as a proxy for telephone calls with their clients, they might view their messages as analogous to conversations. When sales departments use e-mail to do mass mailings of marketing material, they more likely interpret their distributions as the sending of advertising or sales literature. When registered representatives use e-mail to transmit solicitation letters, such use may be seen as most akin to correspondence.

We firmly believe that the regulatory treatment of electronic messages should be governed by the content of the message rather than the form of delivery. In other words, regulations must look beyond the envelope to the words on the letter inside the envelope. Regulatory analysis should not end merely with a determination that a message was sent to a customer via e-mail -- it should factor in the nature of the message transmitted.

As you know, in genreral the four existing regulatory classifications of communications between brokerage firms and customers are: advertising, sales literature, correspondence and conversation. The four categories were developed long before the current widespread acceptance and preference for electronic communication. Advertising, sales literature and correspondence, in contrast to conversation, are subject in most cases to review by supervisory personnel at brokerage firms prior to use. Therefore, before a broker is permitted to send an item of correspondence to a customer, a supervisor generally needs to review it. We believe a regulatory approach that blindly attempts to fit all messages delivered electronically into one of these classifications, without regard to the content of the message, is ill-founded. The focus should be on the purpose and nature of a message and not on the manner of sending it. An approach that deems all messages delivered via e-mail to be correspondence, for example, not only is illogical, but also raises at least two serious practical concerns. It may require significant expenditures on the part of some brokerage firms to develop information systems that capture, index and maintain all e-mail messages and permit them to be retrieved, reviewed and transmitted to the intended recipient, as well as systems that allow a supervisor to indicate approval and that retain evidence of that approval. Moreover, such approach may effectively destroy the utility of e-mail.

As ownership and use of and comfort with personal computers in the United States has mushroomed, brokerage firm customers increasingly have sought to communicate with their brokers electronically. The reason e-mail has become so popular is due in large part to its immediacy and the manner in which it can eliminate delays prevalent in other forms of communication. Consider, for instance, a registered representative whose firm issues a research report regarding the stock of an issuer held by 15 of his clients. By the time the broker dials and speaks or leaves messages with the first few clients, the stock price may move. Compare that situation to what the registered representative can accomplish using e-mail. By creating one mailing list and pressing a few button, he can transmit the same information simultaneously to all 15 clients, perhaps in less time than it takes to dial and speak with even a single client.

E-mail often is used by brokerage firms' customers, brokers, traders and sales people to exchange short pieces of information. In this regard, the purpose of the e-mail is as a substitute for a telephone conversation -- or, more correctly, in lieu of part of a complete telephone conversation -- rather than as a letter or other type of more formal correspondence. We have

heard no serious arguments that all telephone conversations between customers and brokerage firms should be captured on some form of media, indexed, maintained for a specified period of time or reviewed by supervisory personnel.

Clients describe communications effected through electronic means not only as speedier, but also as more convenient, more valuable and more efficient than those effected through traditional delivery routes. Given investors' increasing desire that information be delivered to them either on demand or in a more detailed fashion, many brokerage firms view their ability to deliver data by computer as a key factor in differentiating themselves from other firms. The delivery of information electronically provides a means of controlling a number of expenses of traditional forms of communication, such as telephone usage charges or the costs of paper, printing and postage.

Broker-dealers greatly vary in the type of business they do, the customers they have, the operations they maintain and the technology they employ. We believe that it would be a mistake to create a one-size-fits-all rule at this time that might blunt technological innovation and take away from customers, firms and the markets the potential benefits of electronic communication. Instead, firms should be allowed to develop procedures that can be tailored to their divergent businesses, operations and clients. Each day in brokerage firms across the United States, managers and supervisory personnel make countless decisions in various contexts as to the level of supervision that is necessary. Securities firms have statutory obligations to have in place compliance procedures reasonably designed to ensure that supervised personnel comply with the securities laws and to enforce those procedures in a reasonable manner. With regard to the monitoring of e-mail or other forms of electronic communication between associated persons and customers, firms should have the same latitude, within the constrictions of those obligations, to adopt and enforce compliance procedures most suited to their individual circumstances.

Confirmations and Account Statements

We further hope that the Commission will use the Broker Release to clarify that electronic delivery of confirmations of transactions and customer account statements is permissible as long as the conditions similar to those set forth in the Issuer Release in connection with offering documents are met. [3] Permitting confirmations and statements to be delivered electronically permits the flow of data to customers on a faster and more efficient basis and better enables firms to satisfy the condensed settlement cycle from T+5 to T+3 and, eventually, to an even shorter cycle. Furthermore, the potential to deliver confirmations and statements through computers better enables firms to satisfy customer demands to see and measure their transactions and portfolios and other account information more often and more conveniently. Such delivery may actually serve as a more reliable and prompt means of exchanging information. In certain cases, for instance, the sender can receive a receipt verifying that the addressee has not only received the message but also has opened it or obtained other access to the information transmitted. The SEC has approved of similar means of delivering confirmations to a more limited category of customers in connection with DTC's Institutional Delivery system for the transmission of confirmations and affirmations to institutional clients. We believe that the rules should give all customers the benefit of this type of delivery.

Conclusion

Again, we applaud the Commission for the strong first step it took in the Issuer Release regarding electronic means to deliver disclosure materials. We look forward to the issuance of the Broker Release as an equally thoughtful and positive second step. We hope that the Broker Release will provide forceful direction to other regulatory authorities and useful guidance to the securities industry regarding the regulation of electronic means to communicate and transact business with customers. We would be pleased to provide assistance for such an effort.

We appreciate the opportunity to provide you with our views. Should you have any questions regarding this letter, please contact the undersigned at 202-296-9410 or Mark A. Egert, SIA Assistant General Counsel, at 212-618-0508.

Respectfully submitted,

Stuart J. Kaswell
Senior Vice President and General Counsel

cc:
The Honorable Arthur Levitt, Chairman
Richard Lindsey, Director of Division of Market Regulation

For more information, please contact Stuart Kaswell .

Footnotes:

[1] The Securities Industry Association is the industry's trade association representing the business interests of approximately 730 securities firms in North America. Its members include securities organizations of virtually all types -- investment banks, brokers, dealers and mutual fund companies, as well as other firms functioning on the floors of the exchange. SIA members are active in all exchange markets, in the over-the-counter markets and in all phases of corporate and public finance. Collectively, they provide investors with a full spectrum of securities and investment services and account for about 90% of securities firm revenue in the United States.

[2] SEC Release Nos. 33-7233, 34-36345 and IC-21399 (Oct. 6, 1995).

[3] See Issuer Release at Part II.B under the heading "Guidance Regarding Electronic Delivery" and at Part II.C under the heading "Evidence To Show Delivery."