

Glasser LegalWorks Conference

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Electronic Delivery Problems and Solutions from the Brokerage “Frontier”

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Delivery of Consumer Records / Disclosures

- **Identify the problem to solve**
- **Specify the records at issue**
- **Understand the substantive legal requirements and potential liabilities**
- **Determine the procedural requirements (consent)**
- **Review the inconsistencies and gray areas**
- **Consider solutions**

Business Problem

- **ABC Brokerage has 100,000 accounts.**
- **Delivers on average 12 notices or disclosures a year to each client:**
 - **4 trade confirms**
 - **4 quarterly statements**
 - **4 other records or disclosures**
 - **Simple assumption: \$12 per account per year = \$1.2 million**
- **Interested in good communication and strengthening client relationships.**
- **Interested in timely disclosures: it's good for the client, it's good for the regulator.**

Records / Disclosures

- **Trade confirmations**
- **Mutual fund prospectuses**
- **Account Statements**
- **Periodic notices (examples)**
 - **Privacy**
 - **Statement of financial condition**
 - **Order routing practices**
 - **Account agreement amendments**
 - **Pricing changes**

Substantive Regulatory Requirements for “Delivery”

- **Trade confirmations: Exchange Act Rule 10b-10:**

Unlawful for broker-dealer to effect purchase or sale unless “at or before completion of such transaction, gives or sends to customer written notification” disclosing enumerated transaction information.

- **Prospectuses: Securities Act Sections 2(a)(10), 5, and 10:**

With narrow exceptions, it is unlawful to offer a security through any written, radio, or television communication unless “accompanied or preceded by” a “written” prospectus containing information found in the registration statement.

Substantive Regulatory Requirements for “Delivery”

- **Account statements: NASD Rule 2340:**

Each member “shall send” a statement of account “not less than once every calendar quarter.”

- **Privacy: Regulation S-P, Rule 9:**

Must provide initial and annual privacy notices and opt-out notices “so that each consumer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, electronically.”

- **Account agreements: Exchange Act Rule 17a-3:**

Must keep a record for each margin account that includes “the signature” of the account owner.

Must keep a “record for each account indicating that each customer or owner was furnished with a copy of each written agreement entered into.”

Procedural Requirements

- **SEC Interpretive Guidance (1995, 1996, 2000)**
 - **Equivalence**
 - **Right to paper**
 - **Reliability, integrity, security**
 - **Notice**
 - **Evidence to show delivery**
 - **Informed consent – manual or electronic**
 - **If personal financial information: special security and informed consent requirements**
 - **Access does not equal delivery**
 - **Global consent may not be permissible**

Procedural Requirements

○ **ESIGN Act – Does it apply?**

- **Key language of the consumer consent provision, Section 101(c):**

“[I]f a statute, regulation, or other rule of law requires that information relating to a transaction . . . be provided or made available to a consumer in writing, the use of an electronic record ... satisfies the requirement that such information be in writing if [certain consent requirements are met].”

- **SEC Interpretive Guidance Pre-dates ESIGN: Did it effectively amend the original “writing” requirements so that ESIGN does not apply?**

Procedural Requirements

- **ESIGN Act – Does it apply?**
 - **Is Regulation S-P outside the scope of ESIGN?**
 - **Do some securities law requirements imply a written record or disclosure, or manual signature?**
 - **What about NASD or NYSE requirements?**

Procedural Requirements

- **SEC actions post-ESIGN – Do they clarify ESIGN applicability?**
 - **Exemption from Section 101(c) of [ESIGN] for Registered Investment Companies” [Release No. 33-7877 (July 27, 2000)]**
 - **Commission Guidance to Broker-Dealers on the Use of Electronic Storage Media under [ESIGN] with respect to Rule 17a-4 [Release No. 34-44238 (May 1, 2001)]**
 - **Proposed Amendment to the Penny Stock Rules [Release No. 34-49037 (January 8, 2004)]**
 - **Proposed Rule: Limitations on Affiliate Marketing (Regulation S-AM) [Release No. 34-49985 (July 8, 2004)]**

Procedural Requirements

○ Summary

- **Most reasonable conclusion is that ESIGN applies, and firms need to try to comply with ESIGN and SEC interpretive rules on electronic delivery.**
- **SEC has taken narrow reactive positions, but issued no general guidance relating to electronic delivery and consumer consent post-ESIGN.**
- **SPeRS Standard 2-2: when in doubt, follow ESIGN to achieve consumer agreement to transact business electronically.**

Procedural Requirements

- **ESIGN Act – Consumer Consent Requirements (see SPeRS Standards 2-3, 2-4, 2-5, and 2-6)**
 - **Affirmative consent provided at a meaningful stage**
 - **Clear and conspicuous statement of 6 required disclosures to assist informed choice**
 - **Global consent is permitted**
 - **Fees for paper copies permitted; absolute right to paper?**
 - **Reasonable demonstration:**

Consumer “consents electronically, or confirms 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.”

Inconsistencies or Open Issues

- **Right to paper**
- **Fees for paper**
- **Access = delivery (see late-breaking news on final prospectus delivery in IPO context)**
- **Paper or telephonic consent and reasonable demonstration**
- **Use of PDF and reasonable demonstration**
- **Effect of technical violations in terms of SEC compliance**

Example of Appropriate Consent Process

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Example of Reasonable Demonstration Process

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Electronic formats and access

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Statement Period: September 1, 2003 to September 30, 2003
Last Statement: August 31, 2003

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