

U.S. Securities and Exchange Commission
Asset Management Advisory Committee
Preliminary Recommendations of Operations Panel
Regarding COVID-19 Operational Issues

November 5, 2020

Executive Summary

The May 2020 Asset Management Advisory Committee (AMAC) meeting focused on operational issues relating to critical asset management and brokerage processes that arose at the onset of the pandemic. The pandemic highlighted a diverse set of operational challenges and potential solutions for the AMAC and the U.S. Securities and Exchange Commission (SEC) to consider and address. These issues were further developed and discussed at the AMAC's September 2020 meeting.

The AMAC offers the following recommendations for the SEC to undertake to improve core processes that were impacted due to the health and safety concerns brought about by COVID-19. These recommendations minimize the need for physical processes in favor of leveraging efficient and safe digital alternatives. The recommendations discussed below are designed to be permanent regulatory changes that provide viable long-term solutions for investors and the industry, and not short-term relief for the duration of the pandemic.

The recommendations are summarized briefly as follows:

Recommendations Regarding Digital Delivery:

- *The SEC should update its rules and interpretations, incorporating appropriate investor protection principles that include notice, choice and safeguards (with respect to invalid or inoperable digital contact information), to permit firms to use an investor's digital address, such as an email or smart phone telephone number, as the primary address when delivering regulatory documents, and should work closely with the Financial Industry Regulatory Authority (FINRA) and the Municipal Securities Rulemaking Board (MSRB) to evaluate and harmonize SRO rules with any changes to the SEC's approach to digital delivery.*
- *The SEC should amend its rules, and work with FINRA to amend its rules, to replace requirements in the regulatory text to provide or send investors "written notification" or notification "in writing"¹ of certain information or to disclose certain information, with a requirement to "furnish" or "provide" such documents, which recognizes transmittal through digital means and addresses application of the Electronic Signatures in Global and National Commerce Act (E-Sign Act).*

Recommendations Relating to Remote Work:

- *The SEC should work with FINRA to modernize the internal inspection requirements of FINRA Rule 3110(c) to provide firms the flexibility to conduct remote technology-assisted inspections.*
- *The SEC should work with FINRA, coordinating with state securities regulators where applicable, to revise its office registration and inspection requirements, including the definitions of broker-dealer locations, office of supervisory jurisdiction and the inspection requirements that are attached to those designations, in light of advances in technology and communications.*

¹ The discussion below identifies several SEC and FINRA rules containing this terminology.

- *The SEC should coordinate with the North American Securities Administrators Association (NASAA) and FINRA to make permanent remote testing capabilities for the Series 6, 7, 63, 65 and 66 securities licenses, and expand online testing capabilities to cover all qualification exams.*
- *The SEC should issue exemptive or interpretive relief to make permanent its existing relief from the in-person voting requirements for mutual fund boards.*

Recommendation to Permit E-Authorizations:

- *The SEC should adopt rules that permanently allow for digitized methods of authorization, including those relating to manual wet signature requirements and notarizations, in coordination with FINRA, other regulators, and states where applicable.*

Recommendation on a Dematerialization Roundtable:

- *The SEC should hold a roundtable on the topic of the dematerialization of physical (paper) security certificates, inviting the views of issuers, transfer agents, broker-dealers, clearing corporations, banks, investors, regulators, exchanges, underwriters, and industry experts, to help inform future SEC action on this topic.*

Background

The pandemic necessitated a move to nearly all-remote working environments. This required the SEC, asset managers, and broker-dealers to address quickly a variety of operational issues. The AMAC discussed many of these challenges at its May and September 2020 meetings.²

These issues included disruptions in delivering required regulatory paper documents to investors due to print vendors facing service issues, mail being delayed, and paper handling safety concerns—all of which made paper delivery an undesirable alternative. Registered representatives who are new to the industry were unable to complete required licensing testing and registration since physical testing centers were closed due to health and safety concerns. Similarly, broker-dealers were unable to complete required physical inspections of their locations. Even the administrative task of obtaining a physical signature or required notarization on multiple types of brokerage forms required by the SEC, FINRA, and states, including those for IRA purposes, proved impossible due to social distancing, travel restrictions, and other restrictions caused by the pandemic.

The pandemic highlights the need to modernize archaic rules that rely on paper mail delivery, physical presence, and fixed locations in order to reflect a new reality for investors, businesses, and the markets. Assisted by temporary relief provided by the SEC and FINRA, asset managers and broker-dealers employed digital tools when communicating with investors, providing a source of stability for firms and their investors during a volatile and uncertain time. This rapidly expanding use of digital tools – including capabilities relating to digital delivery of regulatory documents, remote inspections and testing taking the place of physical requirements, and e-authorizations such as e-notary, and e-signature – were essential for financial services operations and demonstrated that specific regulatory modernizations could be effective alternatives to certain outdated pre-pandemic rules.

In light of these notable events, the AMAC offers recommendations for the SEC's consideration that recognize an important transition to remote work environments and the rapid growth and evolution of digital alternatives. These alternatives allowed for the safe and successful fulfillment of customers' needs and regulatory tasks, while protecting the health and safety of investors and industry employees, which

² Transcripts of these meetings are available on the SEC's website at https://www.sec.gov/files/amac_052720_transcript.pdf and <https://www.sec.gov/files/amac-9-16-20-mtg-transcript.pdf>.

the pandemic brought to the forefront. Therefore, the SEC should adopt these recommendations as permanent changes rather than leaving them for short-term relief.

Recommendation Regarding Digital Delivery

The SEC has long been a leader in supporting digital delivery of regulatory documents. Over twenty years ago, the SEC issued a series of interpretive releases to establish electronic delivery policy for market participants and investors. These releases outline SEC requirements related to electronic delivery including notice, access, and evidence of delivery. Given the changes in technology and customer preferences, the time is right to reassess and modernize the SEC's regulatory approach.

The onset of COVID-19 accelerated longer-term trends that favor digital communications and interactions between financial firms and their customers. Additionally, disruption due to suspension of international mail service by the U.S. Postal Service has resulted in investors living abroad being unable to receive their regulatory documents by mail, and instead these investors are dependent on digital delivery to receive important financial documentation. At the start of the pandemic, print vendors were challenged in processing print prospectuses and other regulatory documents, and the reliance on digital delivery became even more paramount. The pandemic has created an opportunity to modernize document delivery, which is consistent with the long-term trend in investors' preferences for digital communications and their reliance on digital interactions over traditional paper communications.

The trend in favor of digital communications has been accelerating for decades across the entire global economy.³ U.S. regulators, including the SEC, have taken note of the preference and ease of digital communications. The SEC made significant progress in 2019 by amending Rule 30e-3 to make electronic delivery the default method for delivering mutual fund reports to investors. Recently, the Department of Labor amended its rules to make digital delivery the default method for delivering documents to investors in workplace retirement plans, recognizing that digital delivery of documents is the preferred means of communication for the majority of investors.⁴ Other federal agencies such as the Social Security Administration and the Federal Thrift Savings Program actively facilitated this shift towards digital delivery of financial communications to investors.⁵

Recent studies show the long-term trend of greater use of digital communications and increased investor preference to receive documents and brokerage information electronically via email, smartphone application, or when logged in to their brokerage account, versus paper sent through the mail.⁶ The

³ See Pew Research Center, *Mobile Fact Sheet* (2019), at <https://www.pewresearch.org/internet/fact-sheet/mobile/>; Pew Research Center, *Internet Broadband Fact Sheet* (2019), at <https://www.pewresearch.org/internet/fact-sheet/internet-broadband/>; Federal Reserve Board, *Consumers and Mobile Financial Services* (Mar. 2015), at <https://www.federalreserve.gov/econresdata/consumers-and-mobile-financial-services-report-201503.pdf>.

⁴ Default Electronic Disclosure by Employee Pension Benefit Plans Under ERISA, 85 Fed. Reg. 31,884, at 31,886 (May 27, 2020) ("The final rule reflects the Department's reliance on a wide variety of sources of evidence concerning individuals' access to, and use of electronic media in the United States...The Department believes that these trends have continued to the present and will into the future, increasing the number of individuals for whom electronic delivery of ERISA disclosures is appropriate or preferred.").

⁵ See Frequently Asked Questions, Social Security Administration, <https://faq.ssa.gov/en-us/Topic/article/KA-01741>; See also Methods of Providing Information, Federal Thrift Savings Program, 5 CFR 1640.6 (2003) ("The TSP will furnish the information described in this part to participants by making it available on the TSP website. A participant can request paper copies of that information from the TSP by calling the ThriftLine, submitting a request through the TSP website, or by writing to the TSP record keeper").

⁶ A survey by the Investment Company Institute in 2015 found that 91 percent of U.S. households who own mutual funds had Internet access (up from 68 percent in 2000), and that there was widespread use among various age groups, education levels and income levels. See Burham, K., Bogdan, M. & Schrass, D., *Ownership of Mutual Funds, Shareholder Sentiment, and Use of the Internet*, 2015, ICI Research Perspective 21, no. 5 (Nov. 2015), at www.ici.org/pdf/per21-05.pdf. Further, according to a recent survey by the FINRA Investor Education Foundation, investor "preference for paper disclosures sent by regular mail is losing ground to electronic delivery," and "the percentage of investors who prefer paper documents has decreased considerably relative to 2015, while preference

pandemic has only increased the movement towards digital.⁷ The AMAC understands that the vast majority of customers at financial services firms have already demonstrated a preference for digital by affirmatively “opting in” to electronic delivery and no longer receive paper statements, confirmations, and prospectuses by mail.⁸ Therefore, modernizing SEC interpretations and rules that are based on paper mail delivery as the default method of delivery is appropriate and timely. Based on this data, the AMAC recommends that the SEC update its digital delivery rules and interpretations to allow regulated firms to use an investor’s digital address, such as an e-mail or smartphone telephone number, as the default when delivering regulatory documents, with paper as an alternative for an investor to choose.

Digital delivery provides a secure experience for investors in accessing their regulatory documents, and it shortens the timeframe for correcting mis-deliveries and reduces the potential for delivery failures. With digital delivery, when a regulatory document is available (e.g., a confirmation or account statement or prospectus), investors typically receive a timely digital alert (e-mail or text message) that tells them that their document is available for immediate accessing and viewing on their financial services firm’s web or mobile site. In the notice that is sent, investors are provided with a hyperlink that will take them to a log-in screen at the financial services firm’s secure website or app. These websites and apps provide investors with the means to access confidentially their sensitive information using customer-selected IDs and passwords and typically offer additional security measures through multifactor and biometrics authentication capabilities. Financial institutions are subject to the federal Gramm Leach Bliley Act (GLBA) and associated SEC rules that require financial institutions to develop, implement, and maintain security programs to protect the personal information of customers. Broker-dealers are also subject to FINRA supervisory and reporting rules.

From the customer identity protection standpoint, paper documents sent by mail have some disadvantages versus digital documents. To mitigate identity theft risk, the customer must dispose of a paper document delivered by mail. This contrasts with digital delivery where a customer can access and review a document online without having to print or dispose of the paper document as the document is stored on the financial institution’s secure website. Paper delivery is also dependent on third parties for printing and delivery, which expands the potential for mis-delivery and theft of some information. Digital delivery provides a further benefit over paper by allowing for real-time alerts that can notify investors of the immediate availability of regulatory documents for review, account activity, or fraud warning notices, with a hyperlink back to the firm’s secure website in order for the customer to access the document or information about the alert.

for all other methods has increased.” See *Investors in the United States—A Report of the National Financial Capability Study*, FINRA Investor Education Foundation (2019), at https://www.usfinancialcapability.org/downloads/NFCS_2018_Inv_Survey_Full_Report.pdf.

⁷ See Pew Research Center, *53% of Americans Say the Internet Has Been Essential During the COVID-19 Outbreak*, at <https://www.pewresearch.org/internet/2020/04/30/53-of-americans-say-the-internet-has-been-essential-during-the-covid-19-outbreak/> (data as of 2020).

⁸ A White Paper by the Securities Industry and Financial Markets Association (SIFMA), SIFMA’s Asset Management Group (SIFMA AMG), The Financial Services Institute (FSI), and the Investment Adviser Association (IAA) states that financial firms surveyed by SIFMA reported year-over-year increases in electronic delivery adoption each year (without exception) by their clients in the last several years. See *E-Delivery: Modernizing the Regulatory Communications Framework to Meet Investor Needs for the 21st Century* (September 2020), at <https://www.sifma.org/wp-content/uploads/2020/09/E-Delivery-Paper.pdf> (SIFMA White Paper). According to the SIFMA White Paper, one national broker-dealer and investment adviser with over 5,000 brokers in its organization reported an increase from 65% in 2009 to 81% in 2020. Another increased its electronic participation from 0% in 2016 to 50% in 2020, and a third from 38% in 2009 to 73% in 2019. According to the SIFMA White Paper, the number of street-name positions receiving email deliveries (which is only a portion of digital processing) grew by 6 million this proxy season over last season, despite a decline both in the number of shareholder meetings and in the total number of shares processed. The AMAC is also aware of two major financial firms that reported over 70% of their customers have elected digital delivery to access their regulatory documents.

It is important to note that modernization does not mean ignoring investor preferences. Recent SEC and Department of Labor amendments do not deny investors paper documents. The AMAC recommends that any future rule and policy changes should incorporate certain essential investor protection principles that include clear notice alerting investors of the switch to digital default delivery, that permit an investor to affirmatively choose paper and change that preference at any time, and that provide safeguards to address invalid or inoperable digital contact information.

In order to further support a digital delivery approach, the AMAC also recommends replacing terminology that appears in SEC and FINRA rules that require a firm to send its customers “written notification” or notification “in writing” of certain actions or to disclose certain information.⁹ The reason for this recommendation is to eliminate any confusion that the SEC’s rules and interpretations apply to the delivery of regulatory documents instead of being regulated under the E-Sign Act.¹⁰ The SEC has expertise in the area of regulated entities and could clarify that its digital approach applies instead of the E-Sign Act by using more general terms in its regulatory text, such as stating that firms should “furnish” or “provide” documents.

- *The AMAC recommends that the SEC update its rules and interpretations, incorporating appropriate investor protection principles that include notice, choice and safeguards (with respect to invalid or inoperable digital contact information), to permit firms to use an investor’s digital address, such as an email or smart phone telephone number, as the primary address when delivering regulatory documents, and should work closely with FINRA and the MSRB to evaluate and harmonize SRO rules with any changes to the SEC’s approach to digital delivery.*
- *Additionally, the AMAC recommends that the SEC amend its rules, and work with FINRA to amend its rules, to replace requirements in the regulatory text to provide or send investors “written notification” or notification “in writing” of certain documents or disclose certain information, with a requirement to “furnish” or “provide” such documents, which recognizes transmittal through digital means and addresses application of the E-Sign Act.*

Recommendations Relating to Remote Work

Remote Supervision

The pandemic triggered an unprecedented shift to “work from home” for financial services employees, including registered broker-dealer employees. This paradigm shift has created a series of challenges, including the inability to comply with existing obligations under FINRA Rule 3110(c) to perform on-site inspections of broker-dealer locations. Acknowledging the unacceptable health risks of on-site inspections due to the pandemic, FINRA provided temporary relief extending the period in which broker-dealer firms can perform their 2020 annual branch office on-site inspections to March 31, 2021. Due to the continuing nature of the pandemic, likely future travel restrictions and health and safety concerns, this extension is

⁹ A non-exhaustive list of SEC and FINRA rules that require a firm to send its customers “written notification” or notification “in writing” of certain actions or to disclose certain information include, but are not limited to the following: Securities Exchange Act of 1934 (Exchange Act) Rule 10b-10 and FINRA Rules 2230 and 2232 (Confirmations); FINRA Rule 2231 (Customer Account Statements), Exchange Act Rule 15l-1 (Regulation Best Interest), Exchange Act Rule 607 (Regulation NMS Customer Account Statements), Regulation S-P (Delivery of Privacy Notice), and Exchange Act Rule 15c3-3(j) (Free Credit Balance Notice Requirements).

¹⁰ The E-Sign Act states that “if a statute, regulation, or other rule of law requires that information relating to a transaction or transactions in or affecting interstate or foreign commerce be provided or made available to a consumer in writing,” then specific requirements concerning consent, which are different from the SEC’s, must be met to deliver the document digitally. See 15 USC S.7001, at <https://www.law.cornell.edu/uscode/text/15/chapter-96>. For example, while the SEC’s rules and interpretations permit consent for electronic delivery to be obtained over the telephone or through a paper account application, since this consent contains SEC documents covered under the E-Sign Act due to an “in writing” reference in the respective rule, a firm is required to also confirm the client’s affirmative consent via email or other electronic means and the client must respond in kind. Removal of the “in writing” language would clarify that SEC guidance and rules concerning consent for electronic delivery apply, not the E-Sign Act.

unlikely to be sufficient and the AMAC understands that FINRA is working on a proposal for filing with the SEC that would allow member firms to conduct remote, rather than on-site, inspections for 2020 and 2021.

Pre-pandemic, supervisors had the ability to supervise associated persons working remotely and the AMAC understands many firms successfully completed significant portions of their inspections remotely. Firms are able to do this because the days of filing cabinets with hard copy records are long gone. Today, books and records are maintained almost exclusively through electronic systems that are subject to ongoing supervisory and surveillance reviews. Advancements in technology, including that information is stored and accessed electronically through a firm's secure electronic systems, allows firms to effectively supervise employee and customer activities leveraging technology. This includes the ability to review trades, money movement, electronic correspondence and customer survey responses remotely via authorized electronic systems and platforms.

The pandemic has demonstrated that a firm of any size can conduct a thorough inspection of broker-dealer locations remotely with readily available technology, including Zoom, WebEx, FaceTime and other video conference tools. These reviews can also be conducted at any time, with or without notice, and from any location where the broker-dealer's electronic systems and platforms can be accessed. The time and cost previously spent on travel for on-site inspections can be deployed for more productive purposes, such as developing technology to continue to maintain and enhance a digitally enabled supervisory structure.

- *The AMAC recommends that the SEC work with FINRA to modernize the internal inspection requirements of FINRA Rule 3110(c) to provide firms the flexibility to conduct remote technology-assisted inspections.*
- *The AMAC recommends that the SEC work with FINRA, coordinating with state securities regulators where applicable, to revise its office registration and inspection requirements, including the definitions of broker-dealer locations, office of supervisory jurisdiction and the inspection requirements that are attached to those designations, in light of advances in technology and communications.*

Remote Testing and Licensing

At the onset of the pandemic, due to safety and health concerns, no testing sites were opened for a period of time, delaying some candidates from taking their securities licensing exams, including FINRA's Securities Industry Essentials (SIE), Series 6, and Series 7 exams as well as certain state securities licensing exams. Even when certain testing sites were able to reopen when it was safe to do so, there was a backlog of candidates waiting to take these exams. These closures caused a disruption to firms seeking to hire and license new representatives to respond to unprecedented call volumes due to market volatility caused by the pandemic. To their credit, FINRA and NASAA, working with input from other regulators and the industry, accelerated the delivery of an online testing service administered and remotely proctored by Prometric for the Securities Industry Essentials (SIE), Series 6, Series 7, Series 63, Series 65, and Series 66 exams.¹¹ The AMAC understands from industry participants that the remote testing pilot was a success by facilitating the testing and registration of thousands of existing and new employees who were able to assist customers during the periods of market volatility caused by the pandemic. With the pandemic continuing, the AMAC suggests there are further opportunities for this model to be expanded and remain a permanent option for firms even post-pandemic.

- *The AMAC recommends that the SEC coordinate with NASAA and FINRA to make permanent remote testing capabilities for the Series 6, 7, 63, 65 and 66 securities licenses, and expand online testing capabilities to cover all qualification exams.*

¹¹ See Coronavirus Impact on FINRA-Administered Exams, at <https://www.finra.org/rules-guidance/key-topics/covid-19/exams>.

In-Person Board Meetings Under the Investment Company Act of 1940

COVID-19 highlighted the operational challenges that resulted from the Investment Company Act's in-person meeting requirements for boards of investment companies (funds) when approving new, amended and renewed advisory and underwriting contracts, and selecting auditors. Travel restrictions, and health and safety concerns made the ability for fund directors to meet in a single room to comply with the Investment Company Act's requirement impossible in many instances. In response, the SEC issued an exemptive order, which it extended twice, that provided relief to permit virtual meetings during the pandemic, subject to the condition that a fund board must ratify all of the contract approvals the next time they meet in person.¹²

The pandemic has led to video meetings becoming the new normal, not the exception. While the pandemic continues to make the SEC's temporary relief necessary, the AMAC questions whether the in-person meeting requirement continues to be needed, in light of the fact that fund directors can, and have, satisfied their voting obligations through the use of technology with virtual meetings during the course of the pandemic. Post-pandemic, fund directors may choose to return to in-person meetings, and may have an incentive to do so, but the AMAC suggests the in-person requirement should no longer be mandated.

- *The AMAC recommends that the SEC issue exemptive or interpretive relief to make permanent its existing relief from the in-person voting requirements for mutual funds boards.*

Recommendation to Permit e-Authorizations

The pandemic has increased the difficulties associated with obtaining customary types of authorizations that are required by SEC, FINRA, and state rules and regulations. These include the manual signature requirements pursuant to the SEC's rules and regulations (i.e., broker-dealer FOCUS reports, Form 144, ATS forms) and notarization requirements including for IRA purposes. The SEC staff issued statements that, among other things, provided flexibility regarding manual "wet" signatures in the current extraordinary environment.¹³ However, the safety and security of industry employees and investors requires minimizing the need for "physical" processes and artifacts in an era of rapidly improving and utilized digitized alternatives.

For example, the prevalence of online video software technology and remote notaries has been well-used during the pandemic and has effectively taken the place of a physical presence requirement. Electronic signatures have been used for many years in the business world and are viewed with equal confidence as the collection of a manual signature. Electronic authentication can also provide an additional layer of security, for example, through two-factor authentication or audit trails recording the date, time, and identity of the signer making them just as reliable, if not more, than manual processes which are susceptible to forgeries or other forms of tampering.

¹² See Release No. IC-33897 (June 19, 2020) (Order Under Section 6(c) and Section 38(a) of the Investment Company Act of 1940 Granting Exemptions from Sections 15(c) and 32(a) of the Investment Company Act and Rules 12b-1(b)(2) and 15a-4(b)(2)(ii) Thereunder; Release No. IC-33824 (March 25, 2020) (Order Under Section 6(c) and Section 38(a) of the Investment Company Act Granting Exemptions from Specified Provisions of the Investment Company Act and Certain Rules Thereunder; Commission Statement Regarding Prospectus Delivery); and Release No. IC-33817 (March 13, 2020) (Order Under Section 6(c) and Section 38(a) of the Investment Company Act Granting Exemptions from Specified Provisions of the Investment Company Act and Certain Rules Thereunder; Commission Statement Regarding Prospectus Delivery).

¹³ See Updated Division of Trading and Markets Staff Statement Regarding Requirements for Certain Paper Submissions in Light of COVID-19 Concerns (June 18, 2020).

- *The AMAC recommends that the SEC permanently adopt rules that allow for digitized methods of authorization, including those relating to manual wet signature requirements and notarizations, in coordination with FINRA, other regulators, and states where applicable.*

Recommendation on a Dematerialization Roundtable

The AMAC has discussed the processing of physical (paper) securities certificates during the COVID-19 global pandemic. Although most U.S. securities are offered in paperless form, certain asset classes continue to issue physical certificates of ownership, notably the equity markets. This practice makes the U.S. markets less competitive relative to their international peers, many of whom have stopped issuing physical certificates altogether.¹⁴ While the number of physical certificates processed has declined, the fixed infrastructure to process physical certificates remains. Thus, costs to process physical certificates has increased, with many of these costs passed along to investors. Moreover, from a risk management standpoint, an industry decision to “immobilize” physical certificates in a central location has been problematic during events such as 9/11, Hurricane Sandy, and COVID-19, when market participants have experienced issues regarding the ability to gain timely access to inventory.

- *The AMAC recommends that the SEC hold a staff roundtable on the topic of the dematerialization of physical (paper) security certificates, inviting the views of issuers, transfer agents, broker-dealers, clearing corporations, banks, investors, regulators, exchanges, underwriters, and industry experts, to help inform future SEC action on this topic.*

¹⁴ See DTCC White Paper: *From Physical to Digital: Advancing the Dematerialization of U.S. Securities* (Sept. 2020), at <https://www.dtcc.com/news/2020/september/29/dtcc-outlines-steps-to-achieve-dematerialization> noting that “Dozens of countries across Europe, Asia-Pacific, Africa and Latin America have stopped issuing physical certificates altogether.” More generally, AMAC is aware of European Commission efforts to improve settlement efficiency through the Central Securities Depository Regulation which imposes a mandatory dematerialization and settlement discipline for transferable securities.