The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE
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Comment Letter to IRS on Paperless Technologies in Retirement Plans, October 1998

By Hand

October 7, 1998

Internal Revenue Service
CC:DOM:CORP:R
Courier's Desk
1111 Constitution Avenue, N.W.
Washington, DC 20044

Re: Announcement 98-62

Ladies and Gentlemen:

I am writing on behalf of the Investment Company Institute (the "Institute")[1] to comment on the issues raised by Announcement 98-62, 1998-29 I.R.B. 13 (July 20, 1998), regarding the use of "new" or "paperless" technologies in retirement plan administration.

Introduction

Institute members and their affiliates serve as directed trustees and third-party administrators that provide nondiscretionary recordkeeping and other services to retirement plans. They have extensive experience in applying new technologies to the administration of and recordkeeping for retirement plans and millions of non-retirement accounts. Using new technologies, investment companies have been able to provide their shareholders with timely, reliable information less expensively than is the case with a traditional "paper" system. In addition, shareholders with access to new technologies have the opportunity to implement their investment and distribution decisions promptly and accurately.

As we explain in detail below:

- Institute members currently use "paperless" technologies to deliver to and receive information from retail investors and retirement plan participants. Current uses of "paperless" technologies have proven efficient, secure, accurate and, thus, beneficial to retail and retirement plan investors.
- Current regulatory impediments to increasing the use of these cost-effective technologies should be addressed by general standards regarding the delivery, receipt, and authentication of communications between plans and their participants, not by rules tailored to specific, currently existing technologies.
- A regulatory approach which states generally applicable principles, rather than address specific technologies, could be applied to Internal Revenue Code sections 402(f) and 3405 notices and elections and pension information reporting.
- The new "paperless" technologies have proven themselves secure, accurate and subject to less risk of fraud than paper-based systems of plan administration. Procedures for authenticating election and consent requirements can be effectively substituted for "writing" and "signature" requirements.

Use of Technology in Retirement Plan Administration. Many retirement plan administrators currently use voice response systems ("VRS") and electronic mail ("e-mail") transmissions over the Internet to deliver information to plan participants in connection with their retirement plan administration and recordkeeping. Although less frequently available, some plans have established websites, where plan participants also can obtain significant information about their retirement plan.[2] Each of these electronic media—VRS, e-mail, and websites—enables plan participants to obtain access to (or request paper copies of) plan literature, such as descriptions of a plan's investment and distribution options, the summary plan description ("SPD") and prospectuses for a plan's investment options. In the case of e-mail, plan information can be sent directly to the plan participant upon either the participant's request or the plan

administrator's initiation. Similarly, plan administrators can post information on a plan's website, thereby making it readily available to participants who access the website. Moreover, a website can be designed to enable a plan administrator to identify which participants have accessed the website or specific information or notices posted there.

In addition to using these technologies to request and receive significant plan-related information, plan participants can use VRS, e-mail and website technology to enroll in their employer's plan, to make salary deferral, contribution and investment elections, to change prior elections, to request loans, withdrawals and distributions, and to obtain account statements and information regarding recent activity in their accounts. For example, many VRS systems allow participants to confirm that recent contributions were properly credited to their accounts.

The interests of participants and beneficiaries are protected and enhanced through the use of these technologies in that they make it easier—

- to obtain timely and accurate plan information;
- to make plan elections;
- to implement elections promptly and accurately;
- to maintain the plan's records securely and accurately;
- to obtain prompt access to the plan's records; and
- to administer the plan efficiently, so that plan expenses are reduced and plan investment returns are increased.

In the future, we anticipate that the benefits of these technologies will result in more extensive use of electronic forms of communication and greater availability of information and transactions through electronic media.

Recommended Regulatory Guidance. The Institute urges the Service and Treasury to revise regulations to expand the range of services that plans can offer through the use of new technologies, particularly in the areas of participant elections and consents. Although Institute members have provided employers sponsoring plans and plan participants with enhanced services that new technologies make possible, they have been constrained in making maximum use of the available technologies because of existing regulations and interpretations that were formulated before the advent of these technologies. For example, the requirement in regulations under section 411(a)(11) of the Code that certain distributions cannot be made without the participant's written consent has inhibited the use of new technologies in plan distributions.[3] Similarly, uncertainty regarding the use of technology in the context of required tax withholding notices and individual withholding elections under section 3405 of the Code has hampered the implementation of less cumbersome methods of processing IRA distributions.[4]

Regulatory guidance addressing new technologies, however, should take the form of generally applicable principles or standards, rather than focus on specific uses of existing technologies. The pace of technological development is so rapid that any effort to provide guidance tailored to specific uses of existing technologies would be futile. Indeed, the guidance would likely be obsolete either immediately upon or shortly after release.

Guidance issued by other government agencies concerning technology has taken this approach. For example, the Department of Labor in 1997 issued interim rules that permit group health plans to furnish SPDs, as well as other health care related disclosures, through "electronic media."[5] Rather than establishing technical specifications concerning existing technology, the interim rules set forth general criteria designed to ensure that electronic communication results in the delivery of disclosure information that is "equivalent in both substance and form" to the information participants would have received if furnished in paper form. These criteria include, among other things, "appropriate and necessary measures" to assure receipt, such as a return-receipt electronic mail feature or a survey to confirm receipt, and participants' ability to effectively access at their worksite documents furnished in electronic form.

The Securities and Exchange Commission has taken a similar approach in providing interpretive guidance concerning the use of various types of electronic media for information delivery under the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, and the Investment Advisers Act of 1940. [6] The Commission's releases do not specify the electronic media that investment companies and others may use; instead, they set forth basic principles for such communications. First, the releases direct investment companies and others to consider the extent to which electronic communication provides timely and adequate notice that such information is available electronically. Second, the releases indicate that persons to whom information is sent electronically should be given access to information that is comparable to that which would have been provided if the information were available in paper form. Third, the party delivering the information should have reason to believe that the electronically delivered information was actually received by the intended recipients.

The Service and Treasury similarly should discuss generally applicable principles, rather than address specific electronic media, in

their guidance concerning new technologies in plan administration. Indeed, the Service recently took such an approach with respect to electronic submission of Form W-9 by establishing general requirements to ensure that the information received by the payor was the information sent by the payee, to document all occasions of user access, and to ensure that the person accessing the system is the person identified in the form.[7]

Delivering Information to Participants

The Announcement raises two issues concerning notices to participants and beneficiaries in connection with certain elections. Any pronouncements concerning the delivery of notices and other information should state only generally applicable principles rather than detailed standards, and should both take into account the available technology and anticipate further advances in technology.

Provision of Certain Notices. Two specific notices that might be provided via paperless technologies include section 402(f) notices concerning eligible rollover distributions and section 3405 notices concerning withholding from IRA distributions. Each of these could be provided electronically via VRS, e-mail or website access. The rules regarding delivery and receipt of these notices, however, should be drafted in terms of the objectives of notice delivery, rather than in terms of these specific means of delivery.

Thus, while we support the general approach of the Announcement with respect to section 402(f) notices, we recommend further expansion. As suggested in the Announcement, the plan could provide a written copy of the full section 402(f) notice on a less frequent basis than that currently required,[8] and give an oral or recorded summary of the notice and the opportunity to obtain a copy of the full notice when the participant or beneficiary initiates the distribution transaction through the use of new technologies. Indeed, this transaction-based approach to notification may be more effective than the current notice requirement, because it provides an individual with an opportunity to review the implications of a distribution decision at the most relevant time. Revised regulations, however, also should establish a broad standard by which section 402(f) notice delivery is satisfied. For instance, the plan administrator's one-time delivery of a full copy of the notice should be satisfied by any means of delivery reasonably calculated to assure receipt by plan participants, regardless of whether delivery is in the form of paper, e-mail, Internet or some other form.[9] Standards regarding the provision of a clear opportunity for the participant to obtain the full notice at the time of distribution should be similarly structured.

A similar approach could be used in the context of withholding notices required under section 3405 of the Code. Section 3405 requires the payor of an IRA distribution "to notify" the individual payee of the right to elect not to have withholding apply. Neither the statute nor the regulations specifically states that the notice must be provided in writing, but payors have sought clarification as to the permissibility of providing the notice orally by telephone. Any regulatory guidance in this area should address both telephonic and electronic notices in terms of a similar, general standard that does not specifically define or delimit the means of delivery and accommodates a wide range of technologies, which can effectively deliver information to participants.

Additionally, the Institute further urges that the Service and Treasury specifically permit the electronic delivery to plan participants and beneficiaries of pension information reporting forms, such as Forms 1099-R and 5498, provided that the means of delivery satisfy similar standards. Ironically, the Service and Treasury permit, and even require, most payors to provide this information to the Service in electronic form.[10]

Ensuring Adequate Time For Participants' Retirement Savings Decisions. The Announcement also requests comment as to the appropriate standards for ensuring that participants and beneficiaries have sufficient time and opportunity to consider their options when making significant decisions about retirement savings. Consistent with our prior comments, we believe that it is unwise to prescribe detailed rules regarding the timing of notices and elections, and support the establishment of general principles, rather than detailed standards, in this area. Again, such principles should be set forth in terms of the objective, rather than the means by which the objective is carried out. The purpose of imposing rules regarding the timing of notices and elections is to assure that participants' elections are voluntary and informed. Although these objectives are entirely appropriate, they are not advanced by detailed rules that are likely to be incompatible with either current or future technology.

For example, Announcement 98-62 suggests a rule that would allow participants and beneficiaries to review and change the content of any communication or instruction after it is transmitted in a paperless form, but before completion of the transaction. Such a rule would be incompatible with the way in which plans are administered today. Electronically administered plans allow participants' instructions to be implemented nearly instantaneously; this allows no time for retroactive revocation of an election. On the other hand, a plan that relies on the new technologies typically summarizes for the participant, at the end of the telephonic or electronic session, the instructions that the participant has given, and asks the participant to confirm the previous instructions. In this way, the plan gives the participant ample opportunity to revoke his or her election before it is implemented.

In addition, the Announcement asks whether participants also should have a right to receive communications on paper as an alternative to paperless communications. We have a number of concerns about establishing such a right. First, we question the need to give a participant the right to receive a paper copy of every paperless communication that he receives. For example, many plans permit a participant to receive at any time, 24 hours a day, seven days a week, a telephonic or electronic statement of his account. It

would be extremely costly, as well as unnecessary, to require a plan to give a written copy of each electronic statement to each participant upon request. Any such requirement would be inconsistent with ERISA section 105(b), which requires only one written statement to be furnished per year upon participant request, and might discourage plans from offering telephonic or electronic statements.

Second, assuming that a participant has a right to a paper communication, the plan should be deemed to meet its obligation to provide the paper communication if the information is communicated electronically to the participant and the participant has the ability (by pushing a button) to print out the information; in these circumstances, there is no justification for requiring the plan to send out a separate written communication.

On the other hand, an election or instruction initiated electronically (for instance, changing the asset allocation of account balances or contributions, initiating loans, or changing beneficiary designations) may require confirmation of the transaction. In such cases, the Service and Treasury should consider establishing a delivery requirement, but not a "paper" or "mailing" requirement. As discussed above with respect to notices and other information, delivery methods should simply be required to meet the objective—to ensure receipt— regardless of the form of delivery.

Appropriate Standards for Authentication, Substantiation and Security

As described in Part I, the fund industry has used VRS, and increasingly Internet technology, to communicate with retail and retirement plan investors. Voice response and other technologies have proven accurate and less subject to fraud than paper-based systems, through the implementation of personal identification numbers ("PINs"), passwords and other security devices to authenticate participant instructions. Thus, although authentication is a vital element of plan administration, it is not necessary that such authentication be provided through a writing or a signature. In this regard, the Announcement raises several authentication issues.

Security of Paperless Technology. The Announcement requests suggestions as to the appropriate standards for authentication, substantiation, and security in paperless plan administration and recordkeeping. Under any administrative system, including a paper-based system, there is a risk that mistakes, loss, or fraud will occur. The protection accorded participants and beneficiaries depends on how the technology is implemented, rather than on the nature of the technology. Third-party administrators have every incentive to minimize their exposure to such risks in order to maintain customer goodwill and minimize liabilities to plan sponsors, participants and beneficiaries. Indeed, Institute members would not advocate expanding the use and availability of these technologies if they had been shown to increase the risks of mistake, loss, or fraud.

In fact, Institute members have found that the new technologies present less risk of mistake, loss, or abuse than do paper-based systems. Plan recordkeepers, including Institute members, rely on PINs, passwords, confirmations and other techniques to protect the security of plan information, to verify the identity of the individuals who are communicating with them, and to confirm that each transaction that is implemented is the transaction that was elected.[11] When properly implemented, these techniques provide greater protection to the interests of participants and beneficiaries than does hand-processing under a typical paper-based system.

Election and Consent Need Not Require a "Writing" or "Signature."

The Announcement asks whether statutory and regulatory references to "election" and "consent" imply a "writing" or "signature" requirement. As a practical matter, a participant election or consent does not require a "writing" by or the "signature" of the participant.[12] The term "election" implies a voluntary choice that can be evidenced in writing, orally, telephonically, or electronically. Similarly, the term "consent" implies a voluntary agreement that can be expressed through any of these means.

Properly designed paperless identification systems can achieve the objectives of a "writing" or "signature" requirement. A "writing" or "signature" requirement has several objectives: (1) providing a record of the action taken; (2) authenticating the action as that of the person providing the signature; and (3) impressing upon the person providing the signature that the action he or she is taking will have consequences. A properly designed paperless identification system meets each of these objectives. If a plan adequately preserves a record of the action taken and appropriately maintains the reliability and security of its paperless identification system, and if the individual is adequately informed of the significance of the action he or she is taking, the paperless identification system should be treated as the equivalent of a "writing" or "signature." [13]

* * *

The Institute appreciates this opportunity to provide information concerning these important aspects of plan administration. Please contact me at 202/326-5835 if we can provide further information.

Sincerely,

Russell G. Galer

cc: Carol D. Gold
Daniel S. Evans
Catherine Livingston Fernandez
J. Mark Iwry

ENDNOTES

[1] The Investment Company Institute is the national association of the American investment company industry. Its membership includes 7,301 open-end investment companies ("mutual funds"), 448 closed-end investment companies, and 9 sponsors of unit investment trusts. Its mutual fund members have assets of about $4.672 trillion, accounting for approximately 95% of total industry assets, and have over 62 million individual shareholders.

[2] to a recent Sedgwick Noble Lowndes survey, approximately 26 percent of mid-size companies currently provide access to employee benefits elections via the Internet; 20 percent currently provide Internet access to 401(k) plan information or plan to do so in the future. Twenty percent said they use or will use Internet-based enrollment, and 27 percent use or plan to implement a voice response system. "Employee Benefits: One-Fourth of Companies Provide Benefits Elections Information Via Internet," BNA Daily Report for Executives, October 1, 1998.

[3] Treas. Reg. § 1.411(a)-11T(c)(2)(ii), -11(c)(3).

[4] See Letter to Evelyn Petschek, Assistant Commissioner, Employee Plans & Exempt Organizations, from Russell G. Galer, Investment Company Institute, dated August 8, 1996. [Ed. Note: not available on website]

[5] See U.S. Labor Dep't, Interim Rules Amending ERISA Disclosure Requirements for Group Health Plans, 29 C.F.R. § 2520.104b-1(c), 62 Fed. Reg. 16985 (April 8, 1997). The Department of Labor specifically requested comment as to whether this approach should be applied to other types of plans and disclosures. 62 Fed. Reg. at 16982. The Institute submitted a comment letter to the Department of Labor that urged the Department to consider extending the rule for electronic communication to pension plan SPDs, as well as expanding the scope of the rule to other pension plan documents and disclosures, including participant benefit statements and summary annual reports. Letter to Gerald B. Lindrew, Office of Policy and Research, Pension and Welfare Benefits Administration, from Kathryn A. Ricard, Investment Company Institute, dated May 14, 1997.

[6] Securities and Exchange Commission, Use of Electronic Media for Delivery Purposes, Release No. 33-7233, 60 Fed. Reg. 53458 (Oct. 13, 1995) and Use of Electronic Media by Broker-Dealers and Investment Advisers for Delivery of Information, Release No. 33-7288, 61 Fed. Reg. 24644 (May 15, 1996).

[7] Announcement 98-27, 1998-15 I.R.B. 30. The Service has proposed similar requirements for submission of Form W-8. Prop. Treas. Reg. § 1.1441-1(e)(4)(iv)(B)(1).

[8] Under the current regulations, a written explanation of a participant's direct rollover rights must be provided to the participant no less than 30 days and no more than 90 days before the distribution. Temp. Treas. Reg. § 1.402(c)-2T, Q&A 12.

[9] Section 402(f) itself specifically requires the provision of a "written explanation." A visual copy of the notice that could be readily retrieved, and stored or saved by participants should satisfy this requirement. Thus, e-mail or website notice delivery would be permitted by the statute, whereas VRS or oral delivery would not. This result also makes "policy sense" in light of the nature of the Section 402(f) notice, which contains significant amounts of information. Thus, the full Section 402(f) notice could not be appropriately transmitted via VRS or the plan's live telephone representative, although initiation of transmittal of the written notice should be permitted by such means. The Section 3405 notice may be so appropriately transmitted because (1) the statute does not require it to be written and (2) it is short and comprehensible in oral form.

[10] See Rev. Proc. 98-35, 1998-21 I.R.B. 6 (requiring magnetic media or electronic delivery to the Service of Forms 1099-R and 5498 for persons required to file 250 or more returns).

[11] Such techniques include the use of encryption, which converts electronic data into unreadable code so that unauthorized parties cannot read the content.

[12] The Service and Treasury have in some instances assumed a "writing" requirement and explicitly imposed one by regulation. For example, although Code Sections 417(a) and (e) allow a participant to waive a qualified joint and survivor annuity only if the participant's spouse consents "in writing," Code Section 411(a)(11) generally requires only "the consent of the participant" to an immediate distribution from a retirement plan. Despite the absence of a "writing" requirement in Section 411(a)(11), the regulations under Section 411(a)(11) require the participant's "written consent." Treas. Reg. § 1.411(a)-11T(c)(ii), -11(c)(3). The Section 411(a)

(11) regulations thus appear to go beyond the statute and to be inconsistent with Congress's decision to impose a "writing" requirement in Section 417 but not in Section 411(a)(11). At the very least, the Service and Treasury have considerable flexibility to decide what "writing" means under the Section 411(a)(11) regulations.

The Service demonstrated such flexibility in stating that proposed regulations requiring that a plan loan be "evidenced by a legally enforceable agreement . . . set forth in writing" will not fail to be satisfied merely because the plan participant does not sign the document containing the terms of a plan loan, as long as the loan agreement is legally enforceable and the other requirements for a loan are satisfied. General Information Letter to Theodore Rhodes from Ken Yednock, Chief, Projects Branch 1, Employee Plans Division, dated June 25, 1997. See also Rev. Rul. 98-30, 1998-25 I.R.B. 8 (regarding automatic salary deferrals) and Department of Labor ERISA Opinion Letter 94-27A, dated July 14, 1994 (regarding salary deferral elections).

[13] The Service has recognized the validity of voice and electronic signatures in other contexts. See Temp. Treas. Reg. §§ 1.6012-7T, 1.6061-2T, 1.6065-2T (voice signature); Treas. Reg. § 31.3402(f)(5)-1 (electronic signature); Ann. 98-27, 1998-15 I.R.B. 30 (electronic signature). Such authentications are generally accepted in other contexts. See, e.g., UCC § 1-201(39) ("'signed' includes any symbol executed or adopted by a party with present intention to authenticate a writing"); see generally B. Wright, The Law of Electronic Commerce ch. 16 & § 16.4.4 (1992 Supp.) ("The telegram, telex, mailgram, computer disk recording, fax, and tape recording cases furnish compelling support for the proposition that a durably recorded electronic message, bearing a symbol or code intended as a signature, is written and signed.").
