

MEMO# 11856

May 4, 2000

SEC GUIDANCE AND REQUEST FOR COMMENTS ON USE OF ELECTRONIC MEDIA

1 SEC Release Nos. 33-7856, 34-42728, IC-24426 (Apr. 28, 2000). 2 SEC Release Nos. 33-7233, 34-36345, IC-21399 (Oct. 6, 1995); SEC Release Nos. 33-7288, 34-37182, IC-21945 (May 9, 1996). [11856] May 4, 2000 TO: INVESTMENT ADVISER ASSOCIATE MEMBERS No. 12-00 INVESTMENT ADVISER MEMBERS No. 13-00 SEC RULES MEMBERS No. 31-00 RE: SEC GUIDANCE AND REQUEST FOR COMMENTS ON USE OF ELECTRONIC MEDIA

The Securities and Exchange Commission recently issued an interpretive release providing additional guidance on application of the federal securities laws to the use of electronic media by securities issuers, including investment companies.¹ The interpretations are effective on May 4, 2000. The release also seeks comments on several issues related to the use of electronic media. Comments must be filed with the SEC by June 19th. A copy of the release is attached and it is summarized below.

Electronic Delivery The interpretive release first addresses the use of electronic media to deliver information to investors. Noting that the framework for electronic delivery established in two earlier Commission releases² continues to be appropriate, the release clarifies certain regulatory issues that have arisen in this area.

Telephonic Consent. The release expresses the SEC's view that an issuer or market intermediary may obtain an informed consent to electronic delivery telephonically. A record of the telephonic consent must be maintained, and it should be as detailed as any written consent, including whether the consent is global (i.e., it relates to all documents to be delivered) and what electronic media will be used. In addition, telephonic consent must be obtained in a manner that assures its authenticity.

Global Consent. The release clarifies that an investor who holds shares in a brokerage, trust, or other account through an intermediary may give the intermediary a global consent to electronic delivery of all documents of any issuer, not just those of a single issuer, so long as the consent is informed. The release also provides guidance on what would (and would not) constitute informed consent in this context.

Use of Portable Document Format (PDF). The release clarifies that issuers and intermediaries delivering documents electronically may use PDF "if it is not so burdensome as effectively to prevent access." Thus, for example, PDF may be used if the issuer or intermediary informs investors of the requirements necessary to download PDF when obtaining consent to electronic delivery, and provides investors with any necessary software and technical assistance at no cost. The release reminds issuers and intermediaries that the Commission does not consider an electronically delivered document to have been preceded or accompanied by another electronic document unless investors are provided with "reasonably comparable access" to both documents.

Clarification of the "Envelope Theory." The release refers to the Commission's 1995

electronic media guidance concerning the delivery of multiple documents simultaneously to investors when required by the securities laws (e.g., sales literature that must be preceded or accompanied by a prospectus). For example, the 1995 guidance indicated that documents in close proximity on the same web site menu are considered delivered together, and that documents hyperlinked to each other are considered delivered together as if they were in the same paper envelope. The release states that the premise underlying these examples has come to be called the “envelope theory.” It addresses certain ambiguities that have arisen under this theory when an issuer is in registration, including: (1) when information on a web site that includes an issuer’s Section 10 prospectus would be considered part of that prospectus; and (2) when such information would be considered “free writing” (i.e., an offer to sell a security by means other than a Section 10 prospectus). According to the release, information on a web site would be part of a Section 10 prospectus only if an issuer, or person acting on its behalf (such as an intermediary with delivery obligations), acts to make it part of the prospectus. For example, when a hyperlink is included within a Section 10 prospectus, the hyperlinked information becomes part of the prospectus and must be filed as part of the prospectus in the effective registration statement. By contrast, a hyperlink from an “external document” to a Section 10 prospectus results in both documents being delivered together, but does not result in the non-prospectus document being deemed part of the prospectus. The release indicates that whether a web site contains impermissible free writing would not turn on whether or where a Section 10 prospectus is posted. Rather, the web site content must be reviewed in its entirety to make such a determination.

Web Site Content Issuer Responsibility for Hyperlinked Information. The release discusses issuer responsibility for hyperlinked information under the anti-fraud provisions of the federal securities laws. (The release states that while the guidance provided addresses the responsibilities of issuers, broker-dealers and investment advisers also should carefully consider their responsibilities for hyperlinked information.) The release identifies a non-exclusive set of factors that are relevant in determining whether an issuer has adopted information on a third-party web site to which it has established a hyperlink. The release notes that once the threshold issue of whether an issuer has adopted third-party information has been addressed, a trier of fact would examine whether a claim has been established under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder based on whether certain required elements are present. Factors relevant to whether third-party information has been adopted include: (1) the context of the hyperlink; (2) the risk of confusion; and (3) the presentation of the hyperlinked information. Regarding context, the release states that what an issuer says about a hyperlink or what is implied by the context in which the issuer places the hyperlink is likely to influence whether third-party information to which an issuer has established a hyperlink is attributable to the issuer. The release further states that: “In the context of a document required to be filed or delivered under the federal securities laws, we believe that when an issuer embeds a hyperlink to a web site within the document, the issuer should always be deemed to be adopting the hyperlinked information.” In addition, if an issuer that is in registration establishes a hyperlink (not embedded within a disclosure document) from its web site to information that meets the definition of an “offer to sell,” “offer for sale” or “offer” under Section 2(a)(3) of the Securities Act of 1933, there is a strong inference that the issuer has adopted that information for purposes of Section 10(b) of the Exchange Act and Rule 10b-5. Risk of confusion refers to the presence or absence of precautions against investor confusion about the source of the hyperlinked information. Such precautions could include, for example, an intermediate screen before hyperlinked information can be accessed that clearly indicates that an investor is leaving the issuer’s web site, or a clear and prominent disclaimer of responsibility for, or endorsement of, the information. The release notes that the risk of

confusion is higher when third-party information is “framed” or “inlined” (hyperlinking techniques that involve importing the third-party information into the issuer’s web site). It also makes clear that a disclaimer, in and of itself, would not be sufficient to shield an issuer from adoption of, and liability under Section 10(b) of the Exchange Act and Rule 10b-5 in connection with, information on a third-party web site to which the issuer has established a hyperlink. Statements and disclaimers similarly would not insulate an issuer from liability for hyperlinked information when the relevant facts and circumstances otherwise indicate that the issuer has adopted the information. How hyperlinked information is presented – such as selectively providing hyperlinks to direct an investor’s attention to particular information, selectively establishing and terminating hyperlinks to third- party web sites depending on the nature of the information about the issuer on particular sites, and the layout of a screen containing a hyperlink – also is relevant to a determination of whether the issuer has adopted the information.

Issuer Communications During a Registered Offering. The release also provides guidance on the permissible content of information on issuers’ web sites when they are in registration. (The release notes that mutual funds “continuously offer and sell their shares to the public and, therefore, are continuously subject to the limitations on issuer communications under the Securities Act.”) Issuers in registration are advised to consider the application of Section 5 of the Securities Act to all of their communications with the public, including information on their web sites and information on any third-party web site to which the issuer has established a hyperlink. The release notes that information on a hyperlinked third- party web site that meets the definition of an “offer to sell,” “offer for sale” or “offer” under Section 2(a)(3) of the Securities Act “raises a strong inference that the hyperlinked information is attributable to the issuer for purposes of a Section 5 analysis.” The release lists certain categories of permissible “ordinary-course business and financial information” and indicates that information falling into any of those categories, or a safe harbor under the Securities Act (e.g., Rule 482), may be posted on an issuer’s web site when in registration, either directly or indirectly through a hyperlink to a third-party web site.

Online Offerings
Online Public Offerings. The release outlines the fundamental legal principles that should guide issuers, underwriters and other offering participants in online public offerings. Rather than prescribing specific procedures for online offerings, the release indicates that the Commission will continue to analyze this area, with a view to possible regulatory action in the future.

4Online Private Offerings under Regulation D. The release discusses issues raised where third-party service providers who are not registered broker-dealers establish web sites that invite prospective investors to qualify as accredited or sophisticated as a prelude to participation in limited or private offerings transmitted on those web sites. These issues include whether such offerings involve prohibited general solicitations, and whether the web site operators are engaging in activities that require them to register as broker-dealers.

Broker-Dealer Capacity. The release suggests that as broker-dealers increasingly rely on electronic facilities, they should consider taking steps to maintain their operational capability during high-volume usage, and high-volume and high-volatility trading days.

Technology Concepts The release expresses the SEC’s intent to reexamine its regulatory system and interpretive guidance as technology evolves. It requests comment on certain specific issues, as well as on any issues involving electronic media under the federal securities laws that the SEC has not identified. The specific areas in which comments are solicited include: (1) whether there are circumstances in which an “access equals delivery” model (under which investors would be assumed to have access to the Internet, and an issuer could accomplish delivery by posting a document on its web site or a third party’s web site) might be appropriate; (2) whether the SEC should permit notice of the availability of electronic disclosure documents to be provided through messages posted to investors’ accounts on an Internet web site; (3) whether issuers and intermediaries should be

permitted to rely on implied consent to electronic delivery; (4) electronic-only offerings (including whether in the case of mutual funds, there would be any potential adverse effects of limiting electronic-only offerings to investors who provide an irrevocable consent to electronic delivery of all future disclosure documents, including shareholder reports, proxy solicitation materials and prospectuses provided in connection with the purchase of additional fund shares); (5) issues raised by the continuous availability of information posted on an issuer's web site; (6) issues concerning communication when an issuer is in registration (including whether there are special considerations in this area for mutual funds); and (7) issues relating to Internet discussion forums. Examples The release concludes with a series of examples designed to illustrate various applications of the interpretations outlined in the release to specific facts and circumstances. According to the release, the examples are non-exclusive methods of complying with the interpretations. The release also notes that different facts might require a different conclusion as to compliance. Comments are requested on whether other examples might be appropriate for publication. Frances M. Stadler Deputy Senior Counsel Attachment Note: Not all recipients receive the attachment. To obtain a copy of the attachment referred to in this Memo, please call the ICI Library at (202) 326-8304, and ask for attachment number 11856. ICI Members may retrieve this Memo and its attachment from ICINet (<http://members.ici.org>).

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