

COMMENT LETTER

April 15, 1999

Comment Letter on Modernization of SEC's Edgar System, April 1999

April 15, 1999

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 5th Street, N.W.
Washington, DC 20549

Re: Rulemaking for EDGAR System, File No. S7-9-99

Dear Mr. Katz:

The Investment Company Institute¹ appreciates the opportunity to express its views on the proposed rule amendments associated with the modernization of the EDGAR system.² The Institute supports transition of the EDGAR system to a HTML/PDF environment. This new environment will enable filers to make their disclosure documents more attractive and readable to investors and others who access information through the EDGAR system. In contrast to the current ASCII format, HTML and PDF documents can include graphics, such as the risk return bar chart and the line graph performance comparison, which mutual funds are required to disclose in their prospectus or shareholder report. We believe that the transition to the new environment will not impose significant burdens on the filer community as they adopt HTML, and evaluate optional PDF filings. Our comments on specific aspects of the Commission's modernization plan and related rule amendments follow.

EDGAR Modernization

Use of HTML. The Release notes that the EDGAR system will accept HTML/PDF documents beginning May 24, 1999. During this HTML implementation period, EDGAR will continue to accept filings in the current ASCII format. The Release indicates that the Commission expects to require HTML for most filings as soon as practicable and requests comment on whether EDGAR should continue to accept all submissions in ASCII, or whether, in the future, all or some documents should be required to be filed in HTML. We believe HTML will substantially improve the appearance of EDGAR filings and encourage the Commission to require its use in most disclosure filings. However, we believe that there should be a two-year transition period during which registrants may file in either ASCII or HTML. This transition period will enable filers to implement requisite systems changes and staff training

in an orderly manner.

The Release notes that during the HTML implementation period, if HTML is used, each EDGAR document may consist of only one HTML file. We encourage the Commission to permit the use of multiple, linked HTML files within a filing as soon as practicable. Use of multiple linked files could offer substantial benefits in navigability and download times, especially in longer filings.

Use of PDF. The Release indicates that filers would have the option of submitting a single, unofficial PDF copy of each document contained in a submission. Many Institute member firms currently use PDF to display fund disclosure documents on their Internet web sites, and the Institute supports optional PDF filings. We recommend that the Commission's web site contain a legend or disclaimer indicating that the PDF files do not represent the official filing.

PDF files can be generated easily from source files created in many of the desktop publishing applications used to create print versions of disclosure documents, and even long documents converted to PDF in this way can download and display quickly. However, PDF files created from scanned documents can be very large, and they grow in direct proportion to document length. Even PDF files scanned from short documents can be very slow to display and scroll through. Regardless of whether it imposes a size limitation on PDF files, the Commission may want to caution filers about potential readability problems with PDF files created from scanned, as opposed to electronic, sources.

Further, we are concerned that the additional volume attributable to optional PDF filings may strain EDGAR's ability to accept filings from registrants. We note that on March 31, 1999, the deadline for corporate issuers filing Form 10-K, a number of registrants had difficulty accessing the system and were unable to complete filings until the following day. We urge the Commission to ensure that it has sufficient capacity to handle increased filing volumes as it proceeds with EDGAR modernization.

Graphic and Image Material. The Release notes that EDGAR will accept graphic or image material in HTML documents only after completion of the HTML implementation period. Further, due to concerns about data storage limitations and ease of viewing, the Commission may propose restrictions on the type and size of graphic and image material. The Release requests comment on whether filers should be able to merely provide the data (rather than a graph) in HTML filings where Commission rules require graphic information. We do not believe requiring graphic information in an HTML filing in response to a form requirement (e.g., the risk/return bar chart or the line graph performance comparison) would be burdensome to investment company filers. We understand that graph and image files supporting the risk/return bar chart and the performance graph comparison would not require substantial storage space relative to photos and other visual effects. Any restrictions on the type and size of graphic and image material included in an HTML filing should not limit an investment company's ability to include a bar chart or a line graph in response to disclosure form requirements in its HTML filing. Any limits on file sizes must consider the series company structure employed by many investment company registrants.

Method of Electronic Transmission. The Release indicates that after the HTML implementation period, filers will be able to make EDGAR filings through Internet-based technology via an internet service provider and that the Commission intends to ensure security through Secure Socket Layer (i.e., encrypted transmissions). The Release requests comment on whether the Commission should allow or require filers to acquire client side

certificates from designated vendors. We do not believe filers should be required to purchase client side certificates. Existing password protections (i.e., the Central Index Key, the CIK Confirmation Code, and the Password Modification Authorization Code) have worked well and we are unaware of any security breaches that would warrant mandatory client side certificates. We would, however, support a requirement that filers obtain and use web browsers that support 128 bit encryption.

Regulatory Impact of EDGAR Modernization on Filing Requirements. The Release includes a list of permissible HTML tags for use in HTML documents during the HTML implementation period. The permissible tags provide for limited formatting capability while eliminating active content and certain classes of hypertext links. We urge the Commission to make clear in the release adopting final rules that HTML documents produced by some commercial desktop web editors and office applications may not conform to the permissible tag set. We urge the Commission to expand the set of permitted HTML tags as soon as practicable. Further, given the rapid evolution of web publishing tools, we encourage the Commission to continue to examine a variety of other techniques, especially XML and style sheets, elements of which may be appropriate for inclusion in future EDGAR filing standards.

Rule Amendments to Accommodate EDGAR Modernization

Rule 105(a)—Limitation on Use of HTML Documents. New rule 105(a) under Regulation S-T would prohibit Form N-SAR, Form 13F, and Financial Data Schedules from being submitted as HTML documents. The Release notes these documents have standard formats and tagging designed for presentation in ASCII. We agree that these filing types should continue to be filed in ASCII format. They are rarely accessed by investors and any appearance enhancements associated with HTML do not justify abandoning applications filers have developed to prepare these filing types.

Rule 105(c)—Limitation on Hypertext Links. Proposed rule 105(c) would initially prohibit electronic filers from including in HTML documents hypertext links to sites or documents outside the HTML document. However, if an accepted EDGAR filing includes external links in contravention of this rule, the information in the linked material would not be considered part of the official filing for determining compliance with reporting obligations, but such information would be subject to the civil liability and anti-fraud provisions of the federal securities laws.

In response to the Commission's request for comment on whether permitting hyperlinks from official filings in the future is advisable, the Institute believes that allowing hypertext links from EDGAR filings to other documents or web sites following the HTML implementation period should be permitted. Allowing such hyperlinks would enhance filer ability to present information and provide greater public access to valuable information.

When the Commission considers permitting the use of hypertext links from EDGAR filings, the Institute suggests that the Commission consider following a similar approach to liability for the hyperlinked material as it follows for "attachments" to paper filings. For example, paper prospectuses filed with the Commission may attach a document (e.g., a prospectus "wrapper"), which is not considered part of the prospectus for liability purposes under the 1933 Act.³ Similarly, in the Internet context, a fund could attach a document to its online prospectus via a hyperlink, whereby a user is led to the document by a clearly delineated

box, set apart in the prospectus, followed by a buffer page which alerts the user that he is leaving the prospectus and entering a third-party site. The Institute notes that the field of electronic communications is rapidly evolving and urges the Commission to defer its consideration of liability for hyperlinks from EDGAR submissions until it considers permitting those links, so as to carefully consider the issues in tandem and have the benefit of further developments in the field of electronic communications. The Institute recommends that the Commission seek public comment before taking any final action on this issue.

Rule 106—Prohibition Against Executable Code. In order to minimize security risks, proposed rule 106 would prohibit submissions containing executable code. Executable code is defined as instructions to a computer to carry out operations that use features beyond the viewer's, reader's, or Internet browser's native ability to interpret and display HTML, PDF, and static graphic files. Executable code also would include disruptive code intended to damage, destroy, or disrupt file content or operation of the EDGAR system. The proposed rule provides the staff with the authority to suspend attempted filings which contain executable code and to delete accepted filings which the staff determines contains executable code.

While we acknowledge the need to protect the EDGAR system from those with malicious intent, we are concerned that suspension or deletion of filings could have substantial adverse consequences for registrants. For example, if a registration statement is declared effective and the staff subsequently determines the filing contained executable code and deletes the filing from the EDGAR system, what is the status of the registrant's offering and any sales that may have taken place? If a filer that inadvertently includes executable code that is not disruptive code in a submission, and that submission is accepted, the filing should not be deleted from the system. If the filing must be deleted due to technical or system constraints, then the subsequent filing, which removes the executable code and replaces the original filing, should be deemed to have been filed and accepted on the date the original filing was accepted.

Financial Data Schedules. The Institute supports amendments to the investment company registration forms that delete the requirement to include a financial data schedule as an exhibit to the registration statement. Financial data schedules would continue to be required to be filed as an exhibit to Form N-SAR. We urge the Commission to consider accelerated approval of these registration form changes as soon as possible, so that filers with a December 31 year-end can omit the financial data schedule when they file their annual prospectus update on May 1. We believe accelerated approval of these registration form changes would ease the filing burden on both registrants and the EDGAR system as we approach peak filing season for investment companies. Alternatively, if the staff deems it appropriate to implement this change in policy through a staff announcement or other means, the Institute would be pleased to assist.

We recommend the Commission consider incorporating the financial data schedule information into Form N-SAR (rather than as an exhibit to the Form) as part of its project to update the Form. Incorporation of the financial data schedule information into the Form would ease preparation and filing of the Form.

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The Institute appreciates the opportunity to express its views on modernization of the EDGAR system and the related rule amendments. If you have any questions, please contact the undersigned at 202/326-5851.

Sincerely,

Gregory M. Smith
Director - Operations/Compliance & Fund Accounting

cc: Ruth Armfield Sanders, Division of Investment Management

ENDNOTES

1 The Investment Company Institute is the national association of the American investment company industry. Its membership includes 7,470 open-end investment companies ("mutual funds"), 458 closed-end investment companies, and 8 sponsors of unit investment trusts. Its mutual fund members have assets of about \$5.554 trillion, accounting for approximately 95% of total industry assets, and have over 73 million individual shareholders.

2 Release No. IC-23735 (March 16, 1999) (the "Release").

3 Additionally, in connection with authorizing mutual funds to use a "profile," the Commission indicated that advertisements permitted under Rule 482 of the 1933 Act may be bound to or wrapped around a paper profile and would not be considered part of the profile for liability purposes under the 1933 Act. See Securities and Exchange Commission Release No. 33-7513 (March 13, 1998), 63 FR 13968 (March 23, 1998) at footnotes 121-123 and accompanying text; Letter from Barry D. Miller, Associate Director, U.S. Securities and Exchange Commission to Craig S. Tyle, General Counsel, Investment Company Institute (Oct. 2, 1998) at Q&A No. 28, page 11.

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