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A legal update from Dechert's Financial Services Group

## SEC Proposes Extension of Interactive Data Voluntary Reporting Program on EDGAR System

### Mutual Fund Risk/Return Summary Information Included

#### Introduction

On February 6, 2007, the Securities and Exchange Commission (the "Commission" or "SEC") announced that it had proposed amendments to extend its interactive data voluntary reporting program<sup>1</sup> on the EDGAR System. The amendments, which were considered at the SEC's Open Meeting (the "Open Meeting") on January 31, 2007, would permit mutual funds to submit supplemental tagged information contained in the risk/return summary section of their prospectuses as exhibits to their registration statements.

At the Open Meeting, the SEC voted to issue a release (the "Release") setting forth details of the proposed amendments (the "Proposed Amendments"). The Release states that the Proposed Amendments are intended to help the SEC evaluate the usefulness of data tagging mutual fund information for investors, third-party analysts, mutual funds, registrants, the Commission, and the marketplace.

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<sup>1</sup> Release Nos. 33-8781, IC-27697 (Feb. 6, 2007). The SEC adopted rules in 2005 to institute a program that permits filers, on a voluntary basis, to submit specified, supplemental disclosure tagged in eXtensible Business Reporting Language ("XBRL") format as an exhibit to certain EDGAR filings. Release No. 33-8529 (Feb. 3, 2005). In 2006, the SEC initiated an interactive data voluntary reporting program, in which investment companies, among other companies, agree to voluntarily furnish data in XBRL format for at least one year and provide feedback to the Commission on their experiences. See Release Nos. 33-8781, IC-27697 (Feb. 6, 2007) at 8 (citations omitted).

#### Discussion

The Proposed Amendments seek to extend the current XBRL reporting program to enable mutual funds to submit tagged information contained in the risk/return summary section of their prospectuses on EDGAR as exhibits to Form N-1A filings. The Commission states in the Release that:

- The estimated impact of the Proposed Amendments would be limited because participation in the proposed expanded program would continue to be voluntary
- The SEC believes that the Proposed Amendments could promote efficiency by allowing the Commission and others to gain experience with tagged mutual fund information in Commission filings because the tagging of risk/return summary information has the potential to facilitate analysis of that information
- Tagging of risk/return summary information has the potential to help streamline the delivery of mutual fund information and provide investors and others with improved tools to compare funds based upon costs, investment objectives, strategies, and risks; thereby allowing more efficient allocation of investments by investors

and more efficient allocation of assets among competing funds<sup>2</sup>

- The Proposed Amendments are appropriate in the public interest and for the protection of investors because they are designed to permit mutual funds to provide information in a format that the SEC believes would be more useful to investors than the current format<sup>3</sup>
- The Proposed Amendments would enable the SEC to study further the extent to which interactive data tags enhance the comparability of data, the usefulness of data tags for data dissemination, and the ability of the SEC staff (“Staff”) to review and assess the accuracy and adequacy of that data
- The Proposed Amendments also would help the SEC assess the effect of interactive data tags on the quality and transparency of risk/return summary information, as well as the compatibility of data tagging with the its disclosure requirements
- The Commission believes the adoption of the Proposed Amendments would better enable it to study the extent to which interactive data enhances the:
  - Search capability of the EDGAR database to allow more efficient and effective extraction and analysis of specific data

<sup>2</sup> The Commission notes that in the future, companies that currently provide tagging and dissemination of EDGAR data may experience decreased demand for their services. However, the availability of mutual fund tagged data on EDGAR may provide these companies with alternative business opportunities.

<sup>3</sup> Certain provisions of the Investment Company Act of 1940 (the “1940 Act”) and the Securities Act of 1933 (the “Securities Act”) require the Commission to consider, in addition to the protection of investors, whether an action will promote efficiency, competition, and capital formation. The SEC states that it does not anticipate that the Proposed Amendments would have a significant impact on capital formation, but requests comment on whether the Proposed Amendments, if adopted, would, in fact, promote efficiency, competition, and capital formation. The SEC requests commenters to provide empirical data and other factual support for their views, if possible.

- Capability to perform comparisons among mutual funds
- Ability to perform analyses of mutual fund data and whether it would reduce the resources needed for data analysis

Finally, the SEC states in the Release that the Proposed Amendments would enhance its ability to evaluate the impact of tagged data on the Staff’s ability to review filings on a more timely and efficient basis, the use of tagged data for risk assessment and surveillance procedures, and the compatibility of such data with reporting quality, transparency, and other Commission reporting requirements.

### Expansion of Current Program Content

The XBRL data furnished under the current program must consist of at least one item from a list of enumerated mandatory content, including financial statements, earnings information, and, for registered management investment companies, financial highlights or condensed financial information. This may be accompanied by one or more related items from a list of optional content, including:

- Audit opinions
- Interim review reports
- Reports of management on the financial statements
- Certifications
- Management’s discussion and analysis of financial condition and results of operations
- Management’s discussion and analysis or plan of operation
- Operating and financial review and prospects
- Management’s discussion of fund performance

The Commission proposes to add the risk/return summary information set forth in Form N-1A as a new item of mandatory content. As with all tagged exhibits under the Program, submissions of tagged exhibits containing risk/return summary information would be

supplemental and would not replace the required HTML or the American Standard Code for Information Interchange version of the information called for in Form N-1A.

Volunteers would be required to file their complete official registration statements to ensure that all investors have access to information upon which to base their investment decisions. Tagged exhibits would be required to reflect the same information contained in the risk/return summary section of the prospectus in the Form N-1A filing, but the SEC emphasizes in the Release that investors and others would be advised they should continue to rely on the official filing rather than the tagged exhibit.

Form N-1A filings differ from other filings used in the current program in that they are often subject to revision prior to effectiveness. Consequently, the Proposed Amendments would not permit the submission of a tagged exhibit that is related to a registration statement or an amendment that is not yet effective. Rather, the Proposed Amendments would provide that a tagged exhibit to a Form N-1A filing could be submitted only as an amendment to the filing to which the tagged exhibit relates, and only after the effective date of such filing.<sup>4</sup>

Other elements of the Proposed Amendments are as follows:

- Volunteers would be free to submit tagged risk/return summary information regularly or from time to time, and volunteers could stop and start as they choose
- Participation in the Proposed Amendments would not create a continuing obligation; however, a volunteer would be required to amend any tagged risk/return summary exhibits that do not reflect the same information as the corresponding official filing

<sup>4</sup> This is the case whether the filing is an initial registration statement or an amendment thereto. An exhibit containing tagged risk/return summary information could be submitted pursuant to rule 485(b) under the Securities Act, which provides for immediate effectiveness of amendments filed to make non-material changes and would need to contain the new exhibit, a facing page, a signature page, a cover letter explaining the nature of the filing, and a revised exhibit index. If a fund does not wish to rely on rule 485(b) and files a delaying amendment, then the registration statement will become effective on the date that the fund supplies.

- The Proposed Amendments would require investment companies to tag information in a manner that will permit the information for each class to be separately identified; this is a change from the requirement that investment companies participating in the current program submit tagged documents in a manner that permits the information for each series of an investment company registrant and each contract of an insurance company separate account to be separately identified
- The Proposed Amendments would provide mutual funds with an additional option to submit tagged financial highlights or condensed financial information, similar to the current rule allowing mutual funds to submit this information as an exhibit to Form N-CSR

## Requests for Comment

The Commission requests comment on the proposed expansion of the current program to include tagged risk/return summary information:

- Is it beneficial to tag mutual fund risk/return summary information? Is this portion of the mutual fund prospectus an appropriate place to begin evaluating the tagging of non-financial information? Should other mutual fund information be included under the Proposed Amendments?
- What effect would tagged data have on investors', analysts', and other users' ability to analyze mutual funds' risk/return summary disclosure? Would tagged risk/return summary information have an effect on the usefulness of disclosure in Commission filings?
- The Commission does not propose to amend the rule that currently requires that mandatory content "consist of a complete set of information for all periods presented in the corresponding official EDGAR filing." Should mutual funds that submit tagged risk/return summary information be required to tag all of the information in the risk/return summary section of the corresponding official filing, or should they be per-

mitted to tag some, but not all, of the information? For example:

- If a fund's official EDGAR filing contains information for more than one series or class, should the fund be permitted to submit tagged risk/return summary information for fewer than all of the series and classes?
- Should a mutual fund be permitted to tag discrete portions of the risk/return summary information, such as cost and performance information, while not tagging other portions, such as narrative information?
- Should mutual funds be permitted to submit tagged risk/return information related to registration statements or post-effective amendments that are not yet effective? Would this raise any liability issues? If mutual funds are permitted to submit tagged risk/return summary information prior to effectiveness, what safeguards would be appropriate?
- Should mutual funds be required to submit revised tagged documents if there are any changes (or any material changes) to the risk/return summary disclosure in the effective registration statement or amendment, and/or should there be additional required disclosure to specifically caution investors and others that the information may differ from that in the effective filing?
- When a mutual fund that has submitted tagged risk/return summary information amends its registration statement, should the Commission require the fund to submit updated tagged risk/return summary information? Should it depend on the materiality of the amendments? How would a requirement to update tagged exhibits affect participation in the voluntary program? If the Commission does not impose a continuing obligation to update tagged exhibits,

should it require additional disclosure or other safeguards?

- Will the Proposed Amendments' requirement that investment companies tag information in a manner that will permit the information for each class to be separately identified raise any issues with respect to any investment company information that may be tagged under the those Amendments? Should the Commission specify that only risk/return summary information must be tagged in a manner that will permit the information for each class to be separately identified? Will the risk/return summary taxonomy in its current state of development permit the information for each series and class to be separately identified? If not, how should it be modified to permit this?
- Should mutual funds be required to submit separate tagged risk/return summary exhibits for each series or class? Instead, should they be permitted to submit exhibits that combine multiple series or classes of the same registrant, provided that the information is tagged in such a manner that the information may be separately identified by series and class?
- The Commission plans to permit all filers on Form N-1A to submit documents containing tagged risk/return summary information as exhibits to their official EDGAR filings, so long as they comply with the requirements of the Proposed Amendments. Should the Commission limit participation, such as by size or type of mutual fund? If so, what should be the criteria for participating? If so, why?
- What steps can the Commission take to encourage mutual funds to participate in the expanded voluntary program?

## Required Disclosure

Under the current program, any official EDGAR filing with which tagged exhibits are submitted must disclose that the purpose of submitting the tagged exhibits is to test the related format and technology, and, as a result, investors should not rely on the exhibits in

making investment decisions. The Commission proposes to require this disclosure in the exhibit index of any Form N-1A filing that includes a tagged exhibit.

The current program also requires any Form N-1A with which tagged exhibits are submitted to disclose that the information contained in the exhibits is “un-audited” or “unreviewed.” The Commission proposes to require this disclosure in a Form N-1A filing with which tagged financial highlights or condensed financial information is submitted. The Commission is not proposing to require this disclosure in a Form N-1A filing when the tagged exhibits to the filing contain only risk/return summary information because this information is not ordinarily audited or reviewed by an independent auditor.

## Requests for Comment on Substantive Matters

The Commission requests comment on the proposed cautionary disclosures that would be required to accompany the submission of tagged information that accompanies a Form N-1A filing:

- Should the Commission require the disclosure concerning whether the information is “unaudited” or “unreviewed” to accompany exhibits containing tagged risk/return summary information?
- Is additional or different language necessary for the cautionary disclosures?
- Is the exhibit index to a Form N-1A filing the appropriate place for the cautionary disclosures?

## Liability Issues

The Commission proposes to extend to tagged risk/return summary information limited protection from liability that is similar to the protection provided under the current program. As is the case with the current program, the Commission would provide this protection because liability remains for the official filing; and the program is experimental, contains certain safeguards, and should not unnecessarily deter volunteers from participating.

The Release notes that, currently, tagged exhibits are not deemed filed for purposes of the Securities Exchange Act of 1934 (“Exchange Act”) or the Investment Company Act of 1940 (the “1940 Act”) (collectively, the “Acts”), or otherwise subject to the liability of the pertinent sections of the Acts. In addition, the current rules also provide more general relief from liability under the securities laws, including the Securities Act, the Exchange Act, the Trust Indenture Act of 1939, and the 1940 Act, for information in a tagged exhibit that complies with the content and format requirements of the current program to the extent that the information in the corresponding portion of the official EDGAR filing is not materially false or misleading.

Unlike the filings included in the current program, Form N-1A is a registration form under both the Securities Act and the 1940 Act; volunteers submitting tagged exhibits to that form also could face potential registration statement liability under the Securities Act. Consequently, the Release states that the Commission proposes to extend the liability protection under the Proposed Amendments to include Section 11 of the Securities Act.

Specifically, the Proposed Amendments provide that tagged exhibits are not deemed filed for purposes of Section 11, or otherwise subject to the liabilities of that section. In addition, the Proposed Amendments would amend Rule 402 under the Securities Act to state explicitly that tagged exhibits are not part of any registration statement to which they relate. The Release notes that the Commission would caution users on its website that documents submitted under the Proposed Amendments should not be relied upon for making investment decisions, and users should continue to rely on the company’s official filing.

The Commission does not propose to modify the provision that affords volunteers general relief from liability under the federal securities laws to the extent that the information in the corresponding portion of the official EDGAR filing is not materially false or misleading. That provision includes liability protections under the Securities Act, and it would apply to tagged documents submitted as exhibits on Form N-1A.

## Additional Requests for Comment Regarding Liability Provisions

The Commission requests comment on the proposed liability protections for tagged risk/return summary information:

- Is it necessary or appropriate to extend liability protection to Section 11 of the Securities Act? Should the Commission modify the proposed liability provisions in any way?
- Should the tagged risk/return summary information be considered filed or furnished for purposes of the voluntary program? Should the tagged risk/return summary documents be deemed not to be part of any registration statement to which they relate?
- With regard to risk/return summary submissions, are the proposed liability provisions sufficient to protect volunteers and to encourage participation in the voluntary program? To encourage participation in the voluntary program, should liability protections be increased beyond those proposed? Would investors have sufficient protection under the Proposed Amendments? For the protection of investors, should liability protections be decreased from those proposed?

## The Risk/Return Summary Taxonomy and Software Tools

The Investment Company Institute (the “ICI”) is developing the taxonomy to tag the risk/return summary information described in the Proposed Amendments. The Release notes that the ICI has released the draft risk/return summary taxonomy for public review and comment, and that the Commission expects that the ICI will submit the taxonomy to XBRL US, Inc., for evaluation and approval in accordance with their procedures. Because the purpose of the Program is to test and evaluate tagging technology, the Commission anticipates permitting mutual funds to submit documents containing risk/return summary information that is tagged using the ICI’s taxonomy prior to final approval of the taxonomy by XBRL US, Inc.

The Release also points out that commercial, off-the-shelf products providing a means to view tagged information in a rendered, or human readable, format as well as to compare or analyze tagged information are available. Thus, the Commission will assess whether to provide such software tools on its website for use with risk/return summary information.

For example, the SEC’s website currently provides access to a prototype XBRL Web application that converts tagged data received in the current program into rendered format. If the Commission provides rendering or analysis tools, it states that it intends to include appropriate cautionary language to the effect that investors should rely only on the information in the official version of a filing, and not on the tagged documents submitted under the Proposed Amendments, in making investment decisions. Moreover, while the Commission may decide to proceed with the expansion of the current program without providing rendering or analysis tools, it will continue to evaluate the use of such tools to aid the investing public.

The Commission also requests comments on the proposed use of the ICI’s risk/return summary taxonomy and the need for the development of rendering and other tools, including:

- Is the taxonomy for risk/return summary information created by the ICI sufficiently developed such that the Commission should permit its use in the voluntary program? Commenters should explain what changes or procedural steps are needed prior to use and what specific criteria should be applied to determine whether the risk/return summary taxonomy is sufficiently developed.
- Is there anything related to the process for developing and approving the risk/return summary taxonomy that should affect its use or otherwise raise concerns?
- The process for approving a taxonomy as XBRL includes testing and technical modification. Should the Commission permit use of a risk/return summary taxonomy in the voluntary program that has not been acknowledged or approved as XBRL?
- A tagged submission that a volunteer creates can adhere to either a standard taxon-



omy or a standard taxonomy with extensions. Extensions to a standard taxonomy are additional tags defined by a particular user that further refine the tags contained in the standard taxonomy. The Commission expects that mutual funds will be permitted to submit extensions to the standard risk/return summary taxonomy. Given the narrative format of much risk/return summary information, does tagging of this information raise particular problems with regard to extensions or other facets of data tagging?

- What are the advantages and disadvantages of the Commission providing tools on its website to render the tagged risk/return summary information in human readable form or to permit users to analyze and compare tagged risk/return summary information submitted by different mutual funds?

## General Comment Requests and Effective Date

In addition to the specific requests for comment noted above, the Commission requests comment from any interested persons, including those required to file information on the EDGAR system, investors, disseminators of EDGAR data, industry analysts, and EDGAR filing agents, on any other approaches or issues for

the Commission's consideration in connection with the Proposed Amendments. The Commission also requests empirical data and other factual support for all submissions, to the extent possible.

The comment period ends March 14, 2007. If the Commission adopts the Proposed Amendments, it expects the effective date to be thirty days after publication of the adopting release in the Federal Register.

## Conclusion

If the Proposed Amendments are adopted, they will provide investors and mutual fund industry participants with valuable analytical tools to compare the suitability of different mutual funds for various investment programs and goals. They also will enhance the SEC's ability to evaluate the impact of tagged data on the Staff's ability to review filings on a more timely and efficient basis, and to use tagged data for risk assessment and surveillance procedures.



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