



## REGULATORY INTERPRETATION 2002-RI-04

**Date:** April 22, 2002

**Subject:** Accounting Issues: Electronic Distribution of the Combined Annual and Quarterly Financial Reports of the Federal Home Loan Bank System.

### ***Request Summary:***

The Federal Home Loan Banks' Office of Finance (OF) has requested a regulatory interpretation regarding the distribution of the combined annual and quarterly financial reports of the Federal Home Loan Bank System<sup>1</sup> (Banks or Bank System) as required by section 985.6(b) of the Federal Housing Finance Board (Finance Board) regulations, 12 C.F.R. § 985.6(b). The OF seeks authority to distribute the combined financial reports either electronically or by sending a notice of online publication. In connection with its request, the OF also seeks relief from applicable Securities and Exchange Commission (SEC) delivery and notice requirements, in particular the requirement that the issuer should obtain prior written authorization to deliver such financial statements in electronic format. In support of the request, the OF notes that the combined financial reports are sent to Bank System members who may not own Bank System debt, rather than to potential investors who may base investment decisions on the information in the reports.

### ***Conclusion:***

The OF may distribute the combined financial reports in electronic format, but only upon the requirements set forth in the operative SEC guidance discussed below, because such requirements establish the best business practices regarding the electronic distribution of financial information.

### ***Background:***

As discussed more fully below, the OF prepares and distributes the combined financial reports in accordance with Finance Board regulations, which generally apply certain SEC requirements. Historically, the combined reports have been distributed in paper form and delivered via U. S. Postal Service mail to each Bank and Bank System member. In its request, the OF notes that this process involves the mailing of paper copies to nearly 8,000 members.<sup>2</sup> The OF opines that electronic distribution of the combined financial reports using "today's rapidly evolving technology" would provide "significant benefits" for Bank System members and investors. One key benefit would be the rapid, cost-effective, and widespread dissemination of Bank System financial information in the financial markets. The OF has received requests for electronic

copies, and currently lists its website on the cover of the combined financial reports to advise the reader where to access the report. The OF request asserts that the electronic dissemination of the combined financial reports should not be subject to the SEC's delivery and transmission requirements governing electronic documents, in part because the reports are going to members (commercial banks, thrifts, credit unions, and insurance companies), as opposed to individual investors, and "these members may not even own consolidated obligations."

### *Analysis and Discussion:*

Finance Board regulations<sup>3</sup> require the OF to prepare and distribute the combined financial reports within certain guidelines that mirror the requirements of the SEC's Regulations S-K and S-X (17 C.F.R. parts 229 and 210) in scope, form, and content. The Finance Board has sole discretion to determine whether or not a combined financial report complies with the standards set forth in part 985. 12 C.F.R. § 985.6(b)(5). Section 985.6(b)(4) of the Finance Board regulations requires the OF to file the combined annual financial report with the Finance Board and to distribute such reports to each Bank and Bank System member within 90 days after the end of the fiscal year. Similarly, the rule requires the OF to file the combined quarterly reports with the Finance Board and to distribute such reports to each Bank and Bank System member within 45 days after the end of each of the first three fiscal quarters of every year, in accordance with filing requirements set by the SEC.<sup>4</sup> The OF intends to adopt electronic distribution of the combined financial reports and notes that the SEC has issued "guidance on the use of electronic media by issuers of all types." It is that guidance from which the OF seeks relief.

In 1995 the SEC provided guidance to issuers and operating companies on the use of electronic media to deliver information to investors, including prospectuses, annual reports, and proxy solicitation materials, under the Securities Act of 1933,<sup>5</sup> the Securities Exchange Act of 1934,<sup>6</sup> and the Investment Company Act of 1940.<sup>7</sup> (Securities Act Release No. 7233, 17 C.F.R. 231, Oct. 6, 1995 (60 Fed. Reg. 53458) (1995 Release)).<sup>8</sup> The SEC updated that guidance in Securities Act Release No. 7856, 17 C.F.R. 231, April 28, 2000 (65 Fed. Reg. 25843) (2000 Release) (together, SEC releases). The 1995 Release concluded that any "issuer or third party information that can be delivered in paper [form] under the federal securities laws may be delivered in electronic format." Moreover, the SEC reasoned, "delivery of information through an electronic medium generally could satisfy delivery or transmission obligations under federal securities laws . . . if such distribution results in the delivery to the intended recipients of substantially equivalent information as these recipients would have had if the information were delivered to them in paper form." (1995 Release at 7-8).

The SEC measures the delivery of financial disclosures (such as annual reports) in an electronic format against certain delivery standards - notice, access, and evidence of delivery - that are satisfied by the mailing of a paper document.<sup>9</sup> Thus, an issuer may provide financial disclosure information in an electronic document, for example on a computer disk or CD-ROM, via electronic mail, or posted on a website, if these key elements of delivery are met. The SEC releases provide sufficient guidance outlining the necessary steps to accomplish delivery of an electronic document. In particular, the 1995 Release states that if the electronic document itself (whether on disk, CD-ROM, audio tape, videotape or email) is provided, that communication in itself will be sufficient notice - as long as the recipient has given prior consent to receive the document in an electronic format. But where the document is posted on a website, separate notice is required. The issuer must provide written notification of the location and instructions on how to obtain the document. Additionally, the use of the website should not be "so burdensome that intended recipients cannot effectively access the information," and the posted

document should remain on the website “for as long as the delivery requirement” is in effect in order that the intended recipients have actual access. In regard to annual reports, the 1995 Release states that “annual reports should be available electronically for a sufficient length of time for delivery to be satisfied.”<sup>10</sup>

The OF request indicates that it contemplates using both electronic documents and the website to deliver Bank System financial information to Bank System members. The OF requests relief from the requirement that it obtain prior written authorization from each Bank System member to send the combined financial reports electronically. In its request the OF states that it intends to send the combined financial reports to each Bank System member electronically in a PDF<sup>11</sup> document, as soon as it has compiled all of the members’ e-mail addresses. The 2000 Release affirms the use of PDF documents on certain conditions: the system must be user friendly; the issuer must inform the user of the requirements necessary to download the PDF when seeking the consent to electronic delivery, and the issuer must provide the user with any necessary software and technical assistance at no additional cost.<sup>12</sup> In the interim, OF intends to post the annual report on its website. OF proposes to send a post card to all Bank System members notifying them that the combined financial reports have been published and will be posted on its website and provide them with instructions on how to access the website and download the document. The OF will offer members the option of receiving the combined financial reports in paper copy by mail.

When the database is complete, as stated above, the OF intends to send the combined financial reports electronically without obtaining the prior written authorization from Bank System members. The OF argues that it should be excused from this obligation, citing the fact that Bank System members, who may not own any Bank System debt, are “largely commercial banks, thrifts, credit unions and insurance companies rather than individual investors, as contemplated by the SEC when drafting their requirement.” This argument<sup>13</sup> is unavailing because Bank System members are entitled to receive the financial disclosures and are entitled to elect whether or not to receive such financial information in an electronic format. By its terms, the 1995 Release applies to annual reports on Form 10-K and elective information such as quarterly reports to security holders, as well as documents required by the federal securities laws to be delivered to investors, security holders and offerees. Finance Board staff has determined that membership in the Bank System is the qualifying criteria for entitlement to receipt of the quarterly and annual combined reports. The 2000 Release relaxed the notice and proof of delivery requirements somewhat by stating that investors may consent to electronic delivery telephonically, as long as the issuer retains a record of the consent and the consent is obtained in a manner that assures its authenticity.<sup>14</sup>

Finance Board staff has determined that the SEC requirements for electronic distribution of information are reasonable and currently constitute best business practice. The 1995 Release provides that “[t]he ultimate responsibility for satisfying the applicable statutory requirements remains with the issuer or other party to whom the law assigns the responsibility.” Accordingly, Finance Board staff has determined that the OF may distribute the combined financial reports by electronic transmission to recipients or by electronic posting on the OF website if, prior to any electronic transmission, the OF fully complies with the notice, access, and evidence of delivery requirements governing the electronic distribution of financial information, as set forth in the SEC releases.

A Regulatory Interpretation applies only to the particular transaction or activity proposed by the requestor, may be relied upon only by the requestor, and is subject to modification or rescission by action of the Board of Directors of the Finance Board. 12 C.F.R. §§ 907.1 and 907.5.

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<sup>1</sup> The twelve Federal Home Loan Banks (Banks) and the Office of Finance (OF) comprise the Federal Home Loan Bank System (Bank System). *See* 12 C.F.R. § 985.1. The OF is a joint office of the Banks pursuant to 12 U.S.C. § 1422b(b)(2).

<sup>2</sup> The OF suggests the current process is cumbersome because the Finance Board provides the mailing list for the members and “it is difficult to keep the list up to date.” This has resulted in delivery errors: “[e]ach quarter the OF has had several hundred Financial Reports returned for bad addresses and changes of address.”

<sup>3</sup> *See generally* 12 C.F.R. Parts 985 and 989.

<sup>4</sup> The Finance Board’s regulations provide certain exceptions for information and disclosure standards that are otherwise inapplicable to the combined Bank System annual and quarterly financial reports, which are set forth in the Appendix to part 985. *See* 12 C.F.R. § 985.6(b)(3). These exceptions are not relevant to this analysis.

<sup>5</sup> 15 U.S.C. § 77a *et seq.* (Securities Act).

<sup>6</sup> 15 U.S.C. § 78a *et seq.* (Exchange Act).

<sup>7</sup> 15 U.S.C. § 80a-1 *et seq.* (Investment Company Act).

<sup>8</sup> In 1996, the SEC issued Securities Act Release No. 7288, May 9, 1996, 17 C.F.R. 231 (61 Fed. Reg. 24644), which addressed electronic delivery of required information by broker-dealers under the Exchange Act, and by investment advisers under the Investment Advisers Act of 1940, 15 U.S.C. § 80b-1 *et seq.* (Investment Advisers Act) (1996 Release).

<sup>9</sup> “Providing information through postal mail provides reasonable assurance that the delivery requirement is satisfied. The Commission believes that issuers and others providing electronic delivery of information should similarly have reason to believe that any electronic means so selected will result in the satisfaction of the delivery requirements.” (1995 Release at 10).

<sup>10</sup> *See* 1995 Release at 9, n. 26.

<sup>11</sup> PDF refers to portable document format, it is a proprietary medium owned by Adobe. PDF documents must be downloaded and read in Acrobat. In practice, a website would contain a link to access a free Acrobat reader.

<sup>12</sup> 2000 Release at 7.

<sup>13</sup> The argument also is unsupported by any critical analysis. The request for a regulatory interpretation fails to fully satisfy the procedural and information requirements set forth in the Finance Board’s Procedures Regulation, 12 C.F.R. § 907.6. The submission fails to include, among other things required, a reasoned opinion of counsel that presents a compelling legal analysis supporting the interpretation sought and distinguishing any adverse authority. *See id.* § 907.6(c)(8).

<sup>14</sup> 2000 Release at 6.

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