

EDGAR HARDSHIP EXEMPTIONS

EXECUTIVE SUMMARY

The hardship exemption rules in Regulation S-T (17 CFR 232.201 and .202) allow filers, under certain conditions, to submit their filings and exhibits in paper form instead of electronically. These rules help ensure the completeness of the EDGAR database while allowing filers that encounter problems filing electronically to submit their filings by their due dates.

The Divisions of Corporation Finance's (CF) and Investment Management's (IM) procedures related to receipt and review of continuing hardship exemption requests generally appear adequate to ensure that continuing hardship exemptions are justified. Also, CF is improving its continuing hardship exemption tracking system.

The Office of Filings and Information Services' (OFIS) procedures for screening paper filings generally appear adequate to ensure that the Commission accepts only properly submitted paper filings. OFIS also attempts to help filers properly resubmit their rejected paper filings.

To improve compliance with the hardship exemption rules, internal controls to ensure that submission of electronic confirming copies of filings and exhibits under the hardship exemption rules and resubmission of rejected filings should be enhanced. There is currently no routine follow-up to ensure that these filings are submitted.

Also, the electronic filing rules should be clarified to require that the exhibit indices in electronic filings identify all exhibits filed in paper and confirming copies, not just those subject to hardship exemptions. The lack of references in electronic filings to exhibits filed in paper makes it more difficult for the public to locate the exhibits. In addition, the Form SE needs to include more information (e.g., the applicable hardship exemption or other rule allowing the paper filing).

Objectives, Scope, and Methodology

The objective of this audit was to evaluate the Commission's effectiveness in ensuring compliance with the hardship exemption rules. We reviewed applicable regulations and procedures and interviewed appropriate staff in the Divisions of Corporation Finance (CF) and Investment Management (IM), and in the Office of Filings and Information Services (OFIS).

We reviewed filings on a judgment sample basis that were submitted between January 1998 and September 1999 pursuant to hardship exemptions. Also, we obtained information on filings rejected between January 1998 and November 1999. We compared this information, as applicable, to information from the Commission's WRKD (workload) system, electronic source filings in the Commission's Electronic Data Gathering, Analysis, and Retrieval (EDGAR)¹ system, and to source paper filings in OFIS. The audit was performed between September 1999 and February 2000, in accordance with generally accepted government auditing standards.

Background

The temporary and continuing hardship exemption rules in Regulation S-T (17 C.F.R. 232.201 and 202) allow registrants who are otherwise required to submit their filings electronically to the EDGAR system (electronic filers) to file in paper under certain conditions. Also, Rule 14 (17 C.F.R. 232.14), effective January 1998, does not allow the submission in paper form of any filing for which Regulation S-T requires electronic filing absent a temporary or continuing hardship exemption. CF and IM have delegated authority to approve or deny requests for hardship exemptions.

An electronic filer may take a temporary hardship exemption when unanticipated technical difficulties prevent them from timely submitting their electronic filing. To take the exemption, the electronic filer must submit the filing under cover of Form TH (Notification of Reliance on Temporary Hardship Exemption) no later than one business day after the filing due date. This exemption is automatic, and gives the electronic filer six business days to submit an electronic copy of the filing or exhibit (confirming copy) to the EDGAR system. CF, IM, and OFIS do not review the Form TH.

Regulation S-T also allows a continuing hardship exemption to electronic filers who show that they cannot submit their filings electronically without undue burden or expense. Electronic filers must request this exemption at least ten business days before the filing due date. CF and IM review and approve or deny these requests. If the exemption is granted, the filers must submit the affected documents by the filing due date. If the exemption is denied, the filers must submit the documents electronically. The rule does not include time frames for the expiration of the continuing exemption, nor does it require confirming copies. The divisions may, however, establish expiration dates and due dates for submission of confirming copies as appropriate.

Electronic filers must use Form SE (Form for Submission of Paper Format Exhibits) to submit paper exhibits associated with electronic filings. For temporary hardship exemptions, the exhibits must be filed under cover of form SE no later than one business day after the filing date. For continuing exemptions, the exhibits must be filed by the due date. CF, IM, and OFIS do not review the Form SE.

Electronic filers may also use Form SE to submit certain exhibits in paper without hardship exemptions. These include: exhibits, originally filed in paper form, relating to

¹ The EDGAR system is an electronic database containing filings required by the Commission in accordance with the securities laws (securities registration filings, annual reports, etc.). The public may access the filings in EDGAR through the Internet at no cost after the filing has been in the database for 24 hours.

schedules of beneficial ownership or tender offers; certain computational materials filed as exhibits to Form 8-K; and annual reports to security holders filed by public utility holding companies.

Companies that do not comply with Regulation S-T are ineligible to use short-form securities registration forms S-3 and S-8 and may not incorporate the paper filings into an electronic filing by reference. Also, filers are subject to the applicable legal consequences for failing to make the particular filing or for making the filing after the due date.

CF's Office of EDGAR & Information Analysis (OEIA) receives the requests for continuing hardship exemptions. A staff person performs an initial review of the request and inputs it into an automated database. The staff then forwards the request to either the Chief of OEIA or the Associate Director for Regulatory Policy for approval or denial. CF developed written guidance for review of continuing hardship requests.

Within IM, two separate offices handle requests for continuing hardship exemptions. The Senior Special Counsel, Office of the Associate Director for Legal and Disclosure, reviews, approves, or denies requests submitted by investment companies (including variable insurance products). The Office of Public Utility Regulation handles requests submitted by public utility holding companies. IM has no automated database of continuing exemptions. Also, in reviewing requests, IM is referring to the continuing hardship exemption rules in Regulation S-T instead of developing its own written procedures because it has not received many requests (six between 1998 and 1999).

OFIS's Filer Support II branch receives and screens paper filings and exhibits submitted to the Commission and rejects improperly submitted paper filings. It developed written procedures to guide the staff in processing the paper filings. Prior to rejecting the filing, senior OFIS staff contact the filers (or filing agents) to determine if they can assist them in resubmitting the filing electronically. When OFIS rejects the paper filing, it sends a letter of rejection that also reminds the filer of their filing obligations. OFIS maintains a file of the paper documentation related to each filing rejected.

Approximately 186,000 filings were submitted between January 1998 (when Rule 14 became effective) and September 1999. During this period, approximately 390 filings were submitted in paper pursuant to hardship exemptions. Approximately 4400 exhibits were filed in paper under cover of Form SE. We could not determine the number of exhibits filed pursuant to hardship exemptions because the Form SE does not provide this information. Also, approximately 2,300 filings were rejected between January 1, 1998 and November 30, 1999.

During this period, CF received approximately 72 requests for continuing hardship exemptions in 1999 and granted 64. In 1998, it received 128 requests and approved 111. IM received and approved approximately six requests for continuing hardship exemptions between 1998 and 1999. Also, the Commission received approximately 84 temporary hardship exemptions on Form TH in 1999 (to September 1999) and 131 in 1998.

Audit Results

Controls to ensure that continuing hardship exemptions are granted according to Regulation S-T generally appear adequate. Also, controls to ensure that filers submit paper filings according to Regulation S-T generally appear adequate.

Controls to ensure that filers submit confirming electronic filings and resubmit rejected filings, however, need improvement. CF, IM, and OFIS do not routinely ensure that electronic filers submit their electronic confirming copies or resubmit rejected filings.

Regulation S-T needs clarification to require that electronic filers identify all their exhibits filed in paper and to provide whether paper exhibits filed under a temporary hardship exemption should be filed under cover of Form TH or SE or both. Also, Form SE needs to identify the rule in Regulation S-T that allowed the paper filing of the exhibit.

RESUBMISSION OF FILINGS

To determine whether companies submitted confirming electronic copies, we obtained a list of approximately 215 Form THs filed between January 1998 and September 1999 from the Commission's WRKD system. We could not find confirming copies in the EDGAR system for approximately 61 (28%) of the 215 Form THs, suggesting that in some cases electronic confirming copies were not submitted.

Also, we obtained documentation on 114 paper filings rejected by OFIS between July 1999 and November 1999 because they were not in compliance with Regulation S-T. We researched the EDGAR system to determine if these filings were resubmitted. We could not find evidence of resubmission for 31 of the rejected filings (approximately 27%).

CF and IM did not follow up on every temporary hardship filing because of the volume of other filings coming in for review. When CF and IM select filings for review that were filed under cover of Form TH, they inform the filers of their obligation to submit the confirming copies as appropriate. There is no follow up by CF, IM, or OFIS on rejected filings.

The EDGAR database is incomplete to the extent that confirming copies are not submitted and rejected filings are not resubmitted, making it more difficult for the public to obtain the information. If filers do not submit electronic confirming copies, the public must pay to obtain copies of the desired paper filing and sometimes wait days for delivery of the copies. If filers do not resubmit rejected filings, the filing is never made with the Commission and the information will not be publicly available.

The number of filings and exhibits affected is small compared to the total number of filings submitted. Each filing and exhibit filed in paper, however, represents information delayed or potentially denied (if the public can not locate the filing or exhibit) to the public.

OFIS currently has to telephone CF to verify continuing hardships. On-line access to CF's database of continuing hardships would enhance their ability to process paper filings.

In a 1996 audit memorandum, the OIG pointed out that penalties imposed by Regulation S-T for improper paper filings were not implemented.² With the current levels of follow-up, it would still be difficult to implement these penalties.

The EDGAR system could help ensure compliance with the hardship exemption rules. The EDGAR modernization project already includes developing capabilities to match paper filing information with electronic confirming copies. For example, it will store paper filing header data input manually by OFIS staff. Also, it will look for the file number of the paper copy in the electronic confirming copy.

Recommendation A

The Divisions of Corporation Finance and Investment Management, and the Office of Filings and Information Services, should coordinate to develop and implement procedures (e.g., spot-checks) to ensure that confirming copies of filings submitted pursuant to temporary hardship exemptions, as well as rejected filings, are submitted electronically according to Regulation S-T.

Recommendation B

The Office of Information Technology should ensure that the modernized EDGAR system includes the capability to identify filings and exhibits subject to hardship exemptions, link or match filings to the associated confirming copies, and provide information that will enable the staff to enforce the EDGAR filing eligibility rules.

The Office of Information Technology has already considered this issue, and is looking at ways to use the capabilities of the modernized EDGAR to help track temporary hardship exemptions and confirming copies.

Recommendation C

The Division of Corporation Finance should request that the Office of Information Technology develop and implement the necessary programming to give the Office of Filings and Information Services the appropriate access to the database of continuing hardship exemptions.

EXHIBITS

Regulation S-T requires that filers identify the exhibits that they file in paper pursuant to hardship exemptions. They are to annotate the exhibit index of the applicable electronic filing with the letter "P" for exhibits filed in paper pursuant to hardship exemptions and with "CE" for exhibits filed electronically elsewhere as confirming copies (confirming copies of exhibits should be filed as amendments to the related filing). These notations

² Office of Inspector General Audit Memorandum No. 6, page 3.

in the exhibit index ensure that the public can locate and view exhibits submitted separately from the filing.

On the other hand, electronic filers do not have to identify exhibits allowed in paper form under other provisions of Regulation S-T. The lack of references in the electronic filing to these exhibits makes it more difficult for the public to locate them.

Also, Form SE is a cover page that includes the form type to which the exhibit relates as well as the name, address, and signature of the filer. It does not provide information on the specific rule in Regulation S-T relied upon in submitting the exhibit in paper or identify it as made pursuant to a temporary or continuing hardship exemption. As a result, it is more difficult for OFIS staff to determine if the exhibit was properly filed in paper. Also, it is more difficult for CF and IM to identify the exhibits for which electronic confirming copies will be required.

Recommendation D

In connection with upcoming EDGAR modernization rulemaking, the Divisions of Corporation Finance and Investment Management should recommend that the Commission modify Rule 102(d) of Regulation S-T regarding references to paper filings in the electronic filings' exhibit indices to require references to all exhibits filed in paper. Also, these Divisions should coordinate to determine whether rule 201(a) of Regulation S-T should require filers to submit exhibits filed in paper pursuant to a temporary hardship exemption under cover of Form TH, Form SE, or both, and recommend the appropriate rule change to the Commission.

Recommendation E

The Divisions of Corporation Finance, Investment Management, and the Office of Filings and Information Services should jointly identify the information that would make the Form SE more useful (*e.g.*, identify the applicable rule in Regulation S-T allowing the exhibit to be filed in paper). They should then, in connection with upcoming EDGAR rulemaking, recommend that the Commission modify the form as appropriate.