

# Regulation FD: A Refresher and Update

By Peter Rossiter

*The SEC has been active in the enforcement of Regulation FD in recent years.*

Regulation FD of the Securities and Exchange Commission (SEC) was one of the legacies of Arthur Levitt, who served as chairman of the SEC from 1993 to 2001. He concluded that the SEC's Rule 10b-5, which had proven successful in addressing many types of insider trading abuses, was not well suited to preventing so-called selective disclosure. In the typical selective disclosure situation, a senior officer of a publicly held company would either inadvertently or deliberately reveal otherwise undisclosed material information to a favored securities analyst or major shareholder, thereby enabling the favored individual to get a jump on the market.

To combat what Levitt saw as a practice that disadvantaged the "average" shareholder, the SEC sought to level the playing field by adopting in 2000 a new rule, Regulation FD (standing for "fair disclosure"). The new regulation governs conduct by both companies and individual officers. Unlike Rule 10b-5, Regulation FD carries with it no right of suit by individuals or classes of private plaintiffs and is enforced only by the SEC.

The adoption of Regulation FD provoked a major ruckus, with widespread predictions that it would dry up communications between companies and securities analysts and severely impede the flow of information to the marketplace. The evidence as to whether that actually happened is mixed, although it is clear that the ruckus has now largely settled down.

Most publicly held financial institutions deal with Regulation FD on a continuing basis, since they understand that some form of proactive communication with analysts and shareholders is important to building and sustaining an informed market in the company's stock. Most, too, are

used to dealing with the regulation as a routine compliance matter. But the SEC has been active in the enforcement of Regulation FD in recent years, and now is a good time to take a look at how the SEC and publicly held companies have applied it and what best practices companies have developed as they have learned to live with it. But first, a refresher on what Regulation FD requires.

## What Regulation FD Requires

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In broad terms, Regulation FD requires that whenever a company, one of its directors or certain of its *officers* or *employees* discloses *material, nonpublic information* to specific *types of persons*, the company must *publicly release* the information. The release must be made *simultaneously* if the disclosure is *intentional* and *promptly* if the disclosure is not intentional.

This synopsis of the rule contains some key concepts, each indicated in italic type above, that need further elaboration.

- The rule applies to all directors but only to certain *officers* and *employees* of an institution. Executive officers of the institution, as well as investor relations and public relations personnel, are covered in all instances, as are other officers, employees and agents who communicate regularly with the types of persons to whom Regulation FD applies. An institution can adopt a policy that can help determine the

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*Peter Rossiter is Head of the Financial Institutions Client Service Group at Schiff Hardin LLP, Chicago, and a former General Counsel and Head of Corporate Risk Management at Northern Trust Corporation. Contact him at [prossiter@schiffhardin.com](mailto:prossiter@schiffhardin.com).*

other persons to whom Regulation FD applies by providing that only certain individuals are authorized to speak on behalf of the company with respect to financial disclosure matters.

- *Material, nonpublic information* is not defined in the rule and intentionally so. The term “material” has the same definition as in other securities law contexts. It covers information that would be important to the investment decision of a reasonable investor and significantly alters the “total mix” of information available with respect to the particular security.
- The rule covers disclosures only to certain *types of persons*, including broker-dealers, securities analysts and other securities professionals, as well as shareholders in circumstances when it is reasonably foreseeable that they will trade in the company’s securities. The rule specifically exempts communications to employees, although broad communications to an institution’s employee base may precipitate rumors or leaks that create other problems under the securities laws. Regulation FD also exempts advisors to the company such as lawyers, accountants and bankers who owe the company a duty of trust, as well as rating agencies and persons bound by confidentiality agreements. It also excludes by omission persons such as the general media, vendors, customers and business partners.
- In certain circumstances, Regulation FD requires that information be *publicly released*. So far as the rule is concerned, a filing with the SEC on Form 8-K always qualifies as “publicly released.” Short of that, the rule says only that other forms of “broad non-exclusionary distribution to the public” will qualify. Discussion in a conference call covering quarterly earnings qualify, if the call has been properly announced and is open to the public, as a result of the provisions of Item 2.02 of Form 8-K.
- The rule requires *simultaneous* disclosure of matters that are selectively disclosed on an intentional basis. “Simultaneous” appears to mean just that, making it essentially impossible to accomplish. An intentional violation of Regulation FD is, for all practical purposes, not curable—although that does not mean that steps should not be taken to limit the damage.

- An *intentional* selective disclosure means that the person making the disclosure knows that the information is both material and undisclosed or is reckless in not knowing that.
- Information that is disclosed selectively on a nonintentional basis must be publicly disclosed *promptly*. “Promptly” means as soon as practicable but in no event after the later of 24 hours following the disclosure or the next market opening.

With this background, let’s take a look at how the SEC has enforced Regulation FD since its adoption.

### Enforcement Activities

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**Raytheon (2002).** In the *Raytheon* matter, the company’s CFO gave guidance on earnings during a Webcast but did not specifically discuss distribution of earnings throughout the year. Following the Webcast, the CFO provided guidance to individual analysts about the distribution of earnings throughout the year. He also told some of the analysts that their estimates were “too high,” “aggressive” or “very aggressive.” The end result of the SEC’s ensuing charges was a cease and desist order to which both the company and the CFO consented.

**Secure Computing (2002).** Here, in individual communications *via* e-mail and phone, the CEO revealed to two portfolio managers a new, significant contract before it had been publicly announced, although there was some technical information about contract specifications available on the company’s Web site. As it realized its error, the company watched its stock trade up and responded to phone calls inquiring about rumors concerning the deal. In one of those calls, the CEO again provided information about the contract. The company tried to get permission from the other party to reveal the contract and failed to do so. Ultimately, the company did disclose the contract without permission. The end result was a cease and desist order to which the CEO and the company consented. Since the CEO’s original disclosures were inadvertent, the SEC said that prompt disclosure of the contract at that stage could have avoided an FD violation. It was the later, deliberate disclosure in responding to follow-up calls that led to the charges.

**Siebel Systems I (2002).** In this matter, the CEO's remarks at an invitation-only investor conference were found to be significantly more upbeat than public statements made a few weeks earlier when the company announced quarterly earnings. The stock closed up 20 percent on the day of the conference. The result was a settlement and a \$250,000 penalty to which the company consented.

**Motorola (2002).** After a press release and conference call disclosing "significant" weakness in sales, the investor relations director noticed that a number of analysts were misinterpreting what the company meant by "significant"—they hadn't lowered their estimates enough. He called the errant analysts to straighten them out but only after confirming with counsel that he could do so. In counsel's view, the Motorola meaning of "significant" was public for Regulation FD purposes. The SEC's investigation resulted in a report of investigation, rather than a proceeding and a sanction, only because the officer had acted in good faith on the advice of counsel. Seeking and giving advice in good faith, although the advice was wrong in the SEC's view, avoided an enforcement action. The report contained some warnings about relying on this advice-of-counsel defense to a Regulation FD charge in the future, however.

**Schering-Plough (2003).** In this situation, the SEC filed suit, charging that the CEO had given negative guidance to several analysts in private meetings through "spoken language, tone, emphasis, and demeanor" and had also provided new information to the effect that he did not favor a buyback of stock, in contrast to earlier company statements that no decisions on a buyback had been made. The CEO also provided some explicit, newly negative guidance at an analysts' meeting, which was followed by a press release to the same effect. The result of all this was a settled federal civil lawsuit with a \$1 million civil penalty for the company, a \$50,000 administrative penalty for the CEO and a cease and desist order.

**Siebel Systems II (2004).** In a second round under Regulation FD with this company, the SEC found liability after a detailed parsing of the CFO's conversations with analysts at a one-on-one meeting and an invitation-only dinner, concluding that his comments, on balance, conveyed a different view of the company's situation and prospects

from the "total mix" of information publicly available about the company. A federal court disagreed, finding in essence that the SEC had parsed the CFO's conversation too finely.

**Flowserve, Inc. (2005).** In this case, the CEO confirmed earlier earnings guidance toward the end of a fiscal year in a private meeting with analysts. Confirmation at this point in the fiscal year was thought to convey information different than guidance given earlier, even though the guidance was unchanged. The resulting federal lawsuit against the company, the CEO and the director of investor relations was settled, with penalties and a cease-and-desist order.

## Best Practices

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After the adoption of Regulation FD, financial institutions and other companies established protocols for a number of activities. These protocols have been adjusted in light of some of the enforcement actions described above and have evolved in the six years since Regulation FD was adopted. Here are some highlights.

**Earnings release.** The release of earnings is now a familiar drill. The company announces, well in advance, when it will release earnings. The company also announces that it will hold a conference call to discuss the earnings release and "other developments in the business." The company will then name the time of the call and give call-in information. Before the call, which is often also Webcast, the company issues the press release announcing earnings (the provisions of Item 2.02 of Form 8-K impose a practical limit of 48 hours, but the interval is usually much shorter). In addition, the press release is filed with the SEC in a Current Report on Form 8-K.

The most important exercise here is to draft the press release in a way that creates a platform that will help the company avoid Regulation FD problems. The goal is to make sure that all comments and answers to questions qualify as nonmaterial "detail" about information already disclosed in the press release. This requires considerable effort and the full participation of senior-level officers who understand the analysts' perspectives on the company and can help anticipate areas of concern and likely questions about them. The text of the

conference call announcement is important, in order to make sure that there has been proper notice if a need arises to discuss any unexpected developments between the announcement of the call and the call itself (hence, the reference to “other developments in the business”). Some companies have developed the practice of filing a transcript of the call afterwards.

**Analysts’ conferences.** Many companies announce their participation in analysts’ conferences in advance of the conference. The conferences are often Webcast. Many companies also file in advance of their appearance the slide presentations to be used at the conference, and some have developed the practice of filing a transcription of the presentation.

**Analysts’ one-on-one meetings.** Regulation FD does not apply to disclosures made to persons who are under an obligation of confidentiality to the company. It is therefore possible to arrange one-on-one meetings with analysts under a “delayed release” confidentiality agreement, much like an embargoed interview with a reporter. As a condition of the meeting, the company requires that the analysts agree to keep any information revealed confidential for a brief period of time—say, 24 hours—to allow the company to do a Regulation FD analysis and make any necessary disclosures. Of course, this requires the company to carefully monitor the meeting and conduct a postmeeting analysis of the need for follow-up disclosures.

**Shareholders meetings.** Many companies Webcast their shareholders’ meetings and announce in advance that they will do so. They also file on Form 8-K prior to the meeting any announcements they intend to make at the meeting, such as board actions taken prior to the meeting with respect to matters such as dividends and stock buyback programs. Particularly if there is any new material in the presentations, companies will also file the slides to be used by the officers making presentations at the meeting. Some issuers file the prepared remarks themselves, either before or after the meeting, and some file a transcript of the entire meeting.

**Individual analyst inquiries.** It is very important to centralize the response point for all Regulation FD-sensitive inquiries. This means that, under the company’s disclosure policies, there should be a

limited number of people who are authorized to respond to analyst inquiries—perhaps the CFO and the director of investor relations. Contacts with other officers, such as the CEO or heads of significant business units, should be discouraged in some situations in order to centralize all such disclosures. Where these other contacts are necessary, they should be channeled and, if at all possible, arranged sufficiently in advance so that the company spokesperson can be fully prepared. Those taking individual inquiries from analysts should make a record of the questions and responses. In addition to reducing the company’s liability under Regulation FD, these practices help control the process of analyst interaction and increase the likelihood that the company will share, and will be able to demonstrate that it shared, only the accurate information it intended to share.

**All settings.** In whatever setting the officers of an institution are dealing with analysts, it is essential to know the company’s “disclosure posture”—that is, what the Annual Reports on Form 10-K, the Quarterly Reports on Form 10-Q and the Current Reports on Form 8-K have and have not disclosed. Officers are constantly considering all kinds of information and business decisions. They need to know, and have at the front of their minds, where the public record stands. Analyst and stockholder questions must be answered with that context firmly in mind.

In advance of any significant appearance before analysts or stockholders, it is important to brainstorm about possible questions and to prepare any written materials in light of the likely questions. This will help avoid intentional Regulation FD violations and minimize the likelihood of unintentional disclosures of previously undisclosed material information.

Every appearance before analysts, and every one-on-one meeting with analysts or stockholders, should be evaluated for a possible “follow-up” Form 8-K filing or other public disclosure. That means having at least one other knowledgeable person—such as the director of investor relations—in each such meeting and conducting and memorializing a postmeeting analysis. In most settings, and especially in smaller groups, it will not be necessary and may even lead to unwelcome complexities to use a lawyer as the observer; in all

but large-group settings, it can also set the wrong tone. A lawyer's participation in the postmeeting analysis, on the other hand, is very helpful and perhaps even essential.

## Damage Control

When the postmeeting review leads to the conclusion that there has been an inadvertent disclosure of material information, it is essential to prepare and file a Current Report on Form 8-K as soon as possible. Even if the disclosure was not inadvertent—a judgment that may not be made with finality for some time if the SEC considers taking enforcement action—a prompt filing will at least limit the damage.

Depending upon the nature of the information disclosed, the institution may want to issue a press release at the same time. For many companies, this will result in broader dissemination, and the New York Stock Exchange takes the view that a press

release is preferable to a Form 8-K to accomplish disclosure in any event. From the standpoint of damage control, moreover, using a press release—which then forms the “guts” of the Current Report on Form 8-K—makes the whole filing seem more “ordinary course,” because it looks more like the vehicle by which disclosure of material information is normally made.

It is also important to attend to the lessons of *Secure Computing*. Know in advance who needs to make decisions about a prompt filing; it should be a relatively small group, with each member having a backup. Make sure the communications lines are set up in advance and that all necessary participants and their backups have the relevant phone numbers (or even a standby bridge line). And don't delay. The problem doesn't get any better as it gets older. A quick, complete response, even if it is a little rough, is generally better than a delayed, polished one.

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