Regulation FD: The Year That Passed and the Years Ahead

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REGULATION FD: THE YEAR THAT PASSED AND THE YEARS AHEAD

"[I]nvestors commit capital because they have a basic confidence in the quality and integrity of America's markets. That faith does more than fuel markets—it makes markets possible."¹

I. INTRODUCTION

This statement by Arthur Levitt, former chairman of the Securities and Exchange Commission (SEC), emphasizes the absolute necessity of investor confidence to the viability of financial markets in the United States. In no uncertain terms, Levitt suggests that in the absence of such confidence, true markets simply could not exist. It is hardly surprising, then, that during Levitt's tenure at the helm of the SEC, the agency seemed determined to take all steps necessary to prevent such a scenario from ever unfolding. More specifically, the SEC endeavored to sufficiently neutralize any threats that could ultimately lead to the common investor's loss of faith in American markets.² In an effort to eliminate perhaps the most significant of these threats, the SEC adopted Regulation FD³ (Fair Disclosure) on October 23, 2000. It was an extremely controversial move that was decried by many, but applauded by many more.

Regulation FD is a measure designed by the SEC to eliminate selective disclosure,⁴ a time-honored practice among the elite of the

⁴ The term "selective disclosure" refers to the disclosure of material nonpublic information by a corporate insider to an analyst, information the analyst could presumably trade upon for personal profit or the profit of others. This is distinguishable from ordinary insider trading, which refers to trading on
investment community, but one that many regard as the most potentially destructive threat to investor confidence. Prior to Regulation FD, corporate insiders were legally permitted to disclose material information to a select group of analysts while keeping shareholders and the public in the dark. During this time, CEOs, analysts, brokers, and money managers could shape the market to their advantage. They went to invitation-only conferences or took closed conference calls and heard exclusive financial details of what was coming up. It's no accident that stock prices often soared [or plummeted] after such meetings, leaving small investors wondering what they had missed.

When the SEC finally put an end to this distinctly unfair disadvantage and leveled the playing field for the common investor, an intense public debate erupted that seemed to take on a life of its own. While individual investors expected Regulation FD to benefit the markets by setting them on an even keel with even the most powerful members of the investment community, the business elite who stood to lose from the SEC's latest measure aroused fears in some by predicting, among other things, a sharp decrease in the quality and quantity of information and a dramatic increase in market volatility. This debate, however, was entirely forward-looking in nature and the predictions of both sides were untested because the

the basis of material nonpublic information by a company's own officers and directors in the absence of disclosure to the SEC. Investors can also engage in illegal insider trading by buying or selling securities based on material nonpublic information they receive from a corporate insider. See Clay Richards, Comment, Selective Disclosure: "A Fencing Match Conducted on a Tightrope" and Regulation FD—The SEC's Latest Attempt to "Electrify the Tightrope," 70 Miss. L.J. 417, 418-20 (2000).

6. See id.
8. See Final Rule, supra note 2, at 3.
market had never been free from selective disclosure practices until the adoption of Regulation FD. Only now, more than one full year since the passage of the statute, is preliminary empirical data available, and this data suggests that the grim prophecies of the critics lacked merit.\(^{10}\) Regulation FD has instilled confidence in the common investor by creating equality in American markets, and it has done so without the negative fallout that several had anticipated. The problem is, however, that there is a possibility that, despite its early success, Regulation FD could become the first casualty of the recent change in leadership at the SEC.\(^{11}\) Arthur Levitt resigned on February 9, 2001, with two years remaining in his term,\(^ {12}\) and his replacement as chairman, Harvey Pitt, has been welcomed with open arms by business elites because they expect his confirmation to "guarantee the reexamination of Regulation FD—a milestone of Levitt's tenure—which Pitt has openly criticized."\(^{13}\) If such a reexamination actually does take place, and if the repeal or the scaling back of Regulation FD results from it, the common investor will have suffered an incredibly disheartening setback in the battle for parity. Confidence in the markets, deemed absolutely crucial by Levitt, could be irreparably harmed, or perhaps even lost.

The remainder of this discourse is divided into four parts. Part II provides a backdrop to the discussion by examining the situation that existed before Regulation FD, the SEC's motivations for adopting it, and the rule itself. Part III assesses the impact of Regulation FD on American markets during the past year and contends that investor confidence seems to have been enhanced without incurring the costs that some had predicted. Part IV analyzes the effect that Regulation FD has had on financial analysts and asserts that those who rely on skill—and not access to insiders—will

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survive the inevitable shakeout that is looming. Finally, Part V concludes by addressing the changing of the guard at the SEC and the danger that it may pose to Regulation FD. It argues that Regulation FD is a statute that was designed more to modify business practices than to punish them; a statute that must be given a fair chance to reshape the behavior of the investment community before it is prematurely scaled back or repealed by the new leadership at the SEC. While it is still unclear how the SEC will handle Regulation FD during Pitt's tenure, the value of the controversial law to the common investor is both evident and substantial.

In the end, this Comment aims to relate that it is imperative for Regulation FD to emerge unscathed from the shifting winds at the SEC. The confidence of the common investor is inexorably linked to the integrity of American capital markets and should not be sacrificed merely to appease the more powerful interests that exist in the investment community. Regulation FD has finally brought equality and fairness to the markets. The common investor—and perhaps even the markets themselves—simply cannot afford to lose it now.

II. BACKGROUND

A. The State of Affairs Prior to Regulation FD

Rule 10b-5 of the Securities Exchange Act of 1934 clearly sets out that trading on the basis of material nonpublic information is prohibited. Although the regulation appears rather straightforward, the courts have been reluctant to interpret it strictly. Instead, they have been sympathetic to the problems that face corporate executives and analysts in their communications with each other. These discussions were once even characterized as "a fencing match conducted on a tightrope," in which the executive "is compelled to

15. See id. § 240.10b5-1.
16. See, e.g., Dirks v. SEC, 463 U.S. 646 (1983) (finding that there must be some sort of manipulation or deception in addition to a breach of fiduciary duty); SEC v. Bausch & Lomb, Inc., 565 F.2d 8, 14-15 (2d Cir. 1977) (holding that a duty to disclose only arises when it is certain that the information will substantially affect the market price).
parry often incisive questioning while teetering on the fine line between data properly conveyed and material inside information that may not be revealed without simultaneously disclosing it to the public. In recognition of the deceptive pitfalls of insider trading law, the United States Supreme Court has attempted to shield executives and analysts from liability with a series of decisions, most notably its ruling in the seminal case of Dirks v. SEC.

In Dirks, an analyst received information from a corporate insider who claimed that the assets of his former firm were vastly overstated as a result of fraudulent corporate practices. The analyst proceeded to disclose this information to both clients and investors, some of whom later relied on it in liquidating their positions in the corporation. Much to the dismay of the SEC, the Supreme Court used this case to reject the argument that a person is subject to liability simply by virtue of trading while in the possession of material nonpublic information provided by an insider.

The Court instead established a new standard, one that imposes liability on the recipient of insider information only when: 1) the insider breaches a fiduciary duty to the corporation by disclosing the information; 2) the insider derives a personal benefit, either directly or indirectly, from making the disclosure; and, 3) the tippee then trades on the information while the tippee knew or should have known that the insider had breached. The Court’s tough new test has been widely recognized as both insulating executives and analysts from insider trading liability and permitting selective disclosure, especially since the “personal benefit” requirement of the second prong often has been interpreted as a financial benefit, something insiders rarely derive when selectively disclosing information. In Dirks, therefore, the SEC paid a high price because

19. See id. at 649. The insider actually urged the analyst to verify the fraud and disclose it publicly. See id.
20. See id.
21. See id. at 667.
22. See id. at 654-67.
it lost not only an important case, but also its ability to effectively prevent selective disclosure practices.

B. The SEC's Motivations for Adopting Regulation FD

Nearly two decades after the Supreme Court handed down its unfavorable ruling in *Dirks*, the SEC boldly adopted Regulation FD because the situation simply had gotten out of control. According to a study conducted by the National Investor Relations Institute (NIRI) in 1998, over one-quarter of the responding companies admitted to engaging "in some type of selective disclosure practices." This figure, as shockingly high as it was, naturally did not even include those companies that engaged in selective disclosure practices but refused to admit it. As the SEC has noted, it is "difficult to quantify precisely the amount of selective disclosure—just as it is difficult to quantify precisely the amount of ordinary insider trading. Incidents of selective disclosure, like insider trading, by definition are not conducted openly and in public view." Hence, since the percentage of companies that voluntarily admitted to the practice was substantial, there was serious cause for concern that companies secretly engaged in the practice of selective disclosure would lift the percentage to frightening levels.

Such a possibility seemed even more likely when, upon releasing the proposal for Regulation FD, the SEC received nearly 6,000 comment letters, the vast majority of which were from individual investors who almost uniformly urged the adoption of the measure. The letters "expressed frustration with... selective disclosure" and several "cited personal experiences in which they believed they had been disadvantaged by the practice"; in fact, many "expressed surprise that existing law did not already prohibit this practice." These disturbing accounts were accompanied by numerous troublesome media reports that the SEC could not help but

25. Final Rule, supra note 2, at 4.
26. See id. at 3.
27. Id.
These reports alleged that several public corporations had engaged in selective disclosure practices to the detriment of the market and investors—even after Regulation FD had been proposed. Selective disclosure practices thus posed clear threats to investor confidence that were very real, incredibly harmful, and in need of an immediate solution.

That solution was provided by the SEC in the form of Regulation FD, which the agency claimed to have adopted for two compelling reasons. First, as previously mentioned, the SEC and then-Chairman Arthur Levitt strongly believed that selective disclosure practices ultimately led to a “loss of investor confidence in the integrity of American capital markets.” The agency asserted that “[i]nvestors who see a security’s price change dramatically and only later are given access to the information responsible for that move rightly question whether they are on a level playing field with market insiders.” In truth, there appears to be little practical difference between selective disclosure and ordinary insider trading in terms of the bottom line for the common investor. In both cases, a relatively small number of individuals with superior access to information profit from their connections, rather than from their skill or effort, and in both cases the individual investor is left either holding on to a stock that sinks or missing out on a stock that soars. The SEC perceived this disparity as an unacceptable reality that threatened to erode the sense of fairness needed by markets in order to function properly and to thrive.

Second, the SEC was deeply concerned that selective disclosure practices, if permitted to continue, would keep in place a corrupt market environment in which corporate insiders would strategically circulate material information to only those analysts who would paint a flattering picture of the corporation’s financial health. The SEC noted that “in the absence of a prohibition on selective disclosure,

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28. See id. at 4. The SEC provided a list of over twenty media reports that it found particularly distressing. See id. at 4 n.11.
29. See id. at 5.
30. Id. at 2.
31. Id.
32. See id. at 3.
33. See id.
34. See id.
35. See id.
analysts may feel pressured to report favorably about a company or otherwise slant their analysis in order to have continued access to selectively disclosed information." This conclusion was hardly lacking support, as the SEC had received reports stating that, in some instances, analysts who had published negative comments about a corporation had been excluded by that corporation from calls and meetings to which other analysts had been granted access. The possibility, then, that corporate management may have been using material information "as a commodity . . . to gain or maintain favor with particular analysts" presented a serious problem that the SEC needed to address.

In essence, selective disclosure practices provided corporations with the power to control the flow of material information, the power to suppress the truth whenever the need arose. As far as the SEC was concerned, such a power posed a substantial threat to investor confidence and the integrity of the markets. The Supreme Court disagreed, however, and with its decision in Dirks, the inappropriate exchange of material information between executives and analysts became a legally acceptable practice, even though it put the common investor at a severe disadvantage and it engendered a rather palpable sense of injustice in American markets. Rendered powerless to combat selective disclosure practices with the existing insider trading laws, and faced with an increasingly unequal investing environment, the SEC adopted Regulation FD, which Levitt has called "probably the single most important rule the SEC has embraced in its 65-year history."

C. Regulation FD

Regulation FD is regarded by many as an essential development in the field of securities regulation because it finally protects individual investors and the markets from the harmful effects of selective disclosure practices. This Comment will now turn to the rule itself and briefly examine the specific provisions of Regulation

36. Id.
37. See id.
38. Id.
39. See id. at 2-3.
The basic rule that governs selective disclosure is set forth in Rule 100 of Regulation FD. It provides that when an issuer, or person acting on its behalf, discloses material nonpublic information to certain enumerated persons—primarily "securities market professionals" or holders of the issuer’s securities who may trade on the basis of the information—it must make public disclosure of that information. The rule states that the nature of the selective disclosure will determine the timing of the public disclosure. If the disclosure is intentional, the information must be simultaneously disclosed to the public. If, however, the disclosure is non-intentional, the information must be promptly disclosed to the public. This, in its most basic form, is Regulation FD. At first glance, the rule may appear rather unambiguous, but upon closer examination, a few issues do require clarification.

41. As previously mentioned, this Comment intends to analyze the early impact of Regulation FD and what the future holds for the controversial rule. That being said, it shall address in detail only those provisions of Regulation FD that are necessary to inform the reader and to further the purposes of this discussion. For a more technical analysis of the specific provisions and procedures of Regulation FD, see Final Rule, supra note 2, at 7-20; John P. Jennings, Regulation FD: SEC Reestablishes Enforcement Capabilities Over Selective Disclosure, 32 ST. MARY’S L.J. 543, 566-77 (2001); Richards, supra note 4, at 428-35.

42. "[S]ecurities market professionals" are "(1) broker-dealers and their associated persons, (2) investment advisors, certain institutional investment managers and their associated persons, and (3) investment companies, hedge funds, and affiliated persons." Final Rule, supra note 2, at 8 (providing a brief restatement of those identified in 17 C.F.R. § 243.100(b)(1)(i-iii) (2001)). Exempt from this group are "temporary insiders" (like attorneys, investment bankers, and accountants), persons who expressly agree to keep the disclosed information in confidence, and credit-rating entities. See 17 C.F.R. § 243.100(b)(2)(i-iii) (2001). Disclosures made in connection with most securities offerings and disclosures to the media are also outside the scope of Regulation FD. See id. § 243.100(b)(2)(iv); Final Rule, supra note 2, at 6.

43. See 17 C.F.R. § 243.100.

44. See id. § 243.100(a)(1)-(2).

45. See id. § 243.100(a)(1).

46. "Promptly" means "as soon as reasonably practicable" but never after twenty-four hours or the start of the next day's trading on the New York Stock Exchange. Id. § 243.101(d).

47. See id. § 243.100(a)(2).

48. The statute containing the general rule regarding selective disclosure has been provided in infra Appendix.
First, Regulation FD is concerned only with "material" nonpublic information; but rather than define the term, it "relies on existing definitions . . . established in the case law." The common law definitions referred to by the SEC are derived mainly from TSC Industries, Inc. v. Northway, Inc. In TSC Industries, the Court held that information is material if "there is a substantial likelihood that a reasonable shareholder would consider it important" in arriving at an investment decision, or if the information "would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." Although the SEC complemented these definitions with a list of certain types of information that usually will be deemed material, some critics maintained that materiality was still too vague a standard for practical purposes. They argued that while materiality offered the courts guidance, executives would remain uncertain, and hence, unwilling to disclose as much information for fear of liability. The SEC's stance on the issue of materiality—and the critics' claims that it would have a chilling effect on corporate disclosure practices—is that a more rigid standard would be inadequate because it would lack the flexibility to fit the circumstances of each case. In the end, Regulation FD was drafted to accord with this position.

49. Final Rule, supra note 2, at 10.
51. Id. at 449.
52. See Final Rule, supra note 2, at 11. Some examples from the list furnished by the SEC are: earnings information, mergers, acquisitions, new products, changes in management, and bankruptcies. It is important to note that the SEC explicitly warned that this list is neither exclusive nor exhaustive. See id.
53. See id. at 10.
54. See id.
55. In support of its position, the SEC cited Basic Inc. v. Levinson, 485 U.S. 224 (1988), in which the Court held:
A bright-line rule indeed is easier to follow . . . [b]ut ease of application alone is not an excuse for ignoring the purposes of the Securities Acts and Congress' policy decisions. Any approach that designates a single fact or occurrence as always determinative of an inherently fact-specific finding such as materiality, must necessarily be over- or underinclusive.

Id. at 236.
Second, Regulation FD requires simultaneous public disclosure in cases of "intentional" disclosures. The SEC will consider a selective disclosure of material nonpublic information to be intentional only when "the person making the disclosure either knows, or is reckless in not knowing, that the information he or she is communicating is both material and nonpublic." By requiring either knowledge or recklessness to establish an intentional disclosure, the SEC hopes to reassure issuers that they will not be second-guessed in difficult situations where the materiality of the information is not readily apparent. The SEC has made it abundantly clear that Regulation FD will not be enforced in any cases where issuers or their personnel make mistaken materiality determinations in the absence of recklessness.

Third, a violation of Regulation FD will not result in private liability for the issuer. The SEC recognized the possibility that creating private liability for an issuer's failure to make a material nonpublic disclosure ultimately could have a chilling effect on corporate communications. Accordingly, "private plaintiffs cannot rely on an issuer's violation of Regulation FD as a basis for a private action alleging Rule 10b-5 violations." If an issuer fails to abide by Regulation FD, it will be subject only to an SEC enforcement action. In such a situation, the agency could bring either an administrative action or a civil action against the issuer. In some cases, it may even bring an enforcement action against the individual responsible for the selective disclosure. Nevertheless, since the SEC decided against creating private liability for Regulation FD, the liability associated with a breach of the rule is relatively limited.

In sum, while Regulation FD may have complicated the lives of some executives and analysts, the SEC has made every reasonable effort to ensure that the rule itself is as uncomplicated as possible.

57. Id. § 243.101(a).
58. See Final Rule, supra note 2, at 6.
59. See id.
60. See id.
61. See id. at 19.
62. Id. at 20.
63. See id.
64. See id.
65. See id.
As with any new law, there will be some confusion regarding the precise prescriptions of Regulation FD, but the uncertainty will gradually fade with the passage of time. For the moment, Regulation FD must be given the chance to fulfill its potential and bring fairness and equality to the markets. The preliminary data indicates that it has already made significant strides toward leveling the playing field for the common investor. Although many critics preemptively condemned Regulation FD as a failed experiment that was doomed from the start, in reality, the measure has produced results that perhaps even its most strident detractors may not be able to disregard.

III. THE IMPACT OF REGULATION FD ON THE MARKETS

In 1999, Abercrombie & Fitch, a popular retailer, was accused of privately informing an analyst that its third-quarter earnings were going to fall short of expectations. The company’s stock lost forty percent of its value over a span of five days before the bad news was finally shared with the public. That same year, Hewlett-Packard told a select group of analysts that it had experienced a problem with component flow outside the United States. It took approximately one week for the company to disclose this information to the public, but by that time its shares had already fallen a full twelve points. These corporations, as well as several others like Goldman Sachs, Pepsi, and Compaq, recently found themselves the subjects of intense media scrutiny as a result of the preferential treatment they afforded particular members of the investment community.

In all of these cases, the considerable injustice fostered by corporate exclusionary practices was clearly demonstrated. While a number of broker-dealers, their clients, and other well-connected investors were able to liquidate their positions in these corporations with time to spare, most individual investors were left holding on to their shares as they searched in vain for the reason for such dramatic price drops. When they were finally apprised of the negative

66. See Labate & Hill, supra note 9, at 22.
67. See id.
69. See id.
70. See Final Rule, supra note 2, at 4 n.11.
information several days later, there was little that they could do beyond lamenting their losses. For some, it was too late to get out; for others, it was simply too risky to stay in.\textsuperscript{71} In the view of the SEC, the sheer sense of inequity that had pervaded the market had to be eliminated before further damage could be done.\textsuperscript{72} With the adoption of Regulation FD, the SEC believed that it had remedied the situation. According to critics of the rule, however, the SEC only succeeded in making matters worse.

The detractors of Regulation FD primarily contend that the measure negatively affects the market by increasing volatility and decreasing the quality and quantity of information disclosed to the public.\textsuperscript{73} With respect to their first claim, the creation of a more volatile market environment, the critics argue that the cessation of selective disclosure practices directly undermines the stability of the market.\textsuperscript{74} Previously, Corporation X would leak adverse information to preferred analysts, who would then advise their clients and firms accordingly, and Corporation X's stock price would gradually adjust to the information as the news slowly trickled down to the remaining shareholders and the public at large.\textsuperscript{75} Now, in contrast, Regulation FD clearly obliges Corporation X to disclose the adverse information to everyone at once, likely causing its shares to rapidly decline in value as a flood of investors rush to close out their positions in the company. In light of this change, the opponents of Regulation FD claim that while "selective disclosure cannot prevent an issuer's stock from declining, such disclosures can reduce the chance that nervous investors will exaggerate the decline by selling shares."\textsuperscript{76}

\textsuperscript{71} For some investors—specifically those who bought stock on margin—it may have been \textit{impossible} to maintain their positions. Buying on margin allows investors to borrow a portion of the money needed to buy stock from the broker. If, however, the stock price plummets, as it did in these instances, the investors could lose their initial investments \textit{and} owe substantial sums to their brokers. For these investors, therefore, the cost of selective disclosure was particularly steep.

\textsuperscript{72} See Final Rule, \textit{supra} note 2, at 2-3.


\textsuperscript{75} See Jennings, \textit{supra} note 41, at 597.

\textsuperscript{76} Id.
To avoid exaggerated price drops and to preserve stability in the market, the critics assert that Regulation FD ought to be repealed.\textsuperscript{77}

Although the end of selective disclosure may mark the beginning of a slightly higher level of volatility in the market, this alone certainly would not justify the repeal of Regulation FD. To begin with, any increased volatility spurred by the widespread disclosure of information likely would be limited and relatively inconsequential. In the wake of disappointing earnings, a corporation's stock may suffer a sharp decline over the span of a day or two in the absence of selective disclosure practices, but the critics of Regulation FD have yet to argue that the stock would lose any more value than it would if selective disclosure practices continued to take place. In other words, the stance of the critics on this point is only that Regulation FD causes the price drop to be more rapid, not more severe.

So, since the decline would only take place over a shorter period of time and would not be any more extensive, the issue becomes whether Regulation FD is worth a somewhat greater degree of short-term volatility. One would assume that almost any investor would gladly trade a stable and unfair market for one that is volatile and fair. The sudden release of negative information may send a horde of panic-stricken shareholders to the doors, but at least Regulation FD provides them with the chance and the choice to sell their shares at a fair price. If the price decline takes place over two days as opposed to one week, but all investors have an equal opportunity to sell their shares, a somewhat more temporarily volatile market is a natural—and also a necessary—consequence of creating a level playing field.

It is important to further note that the critics of Regulation FD often fail to mention that volatility is a two-way street. They never seem to discuss the instances when companies have positive news to report; they appear to focus their attention only on the instances when companies possess adverse information. The reality is,

however, that selective disclosure not only prevented most investors from discarding sinking stocks at reasonable exit points, but it also prevented most investors from buying soaring stocks at cheap entry points. Executives commonly tipped off their favored analysts as to both negative and positive news, so when the latter was divulged, only well-connected investors were able to purchase rising stocks at comparatively low prices. As usual, selective disclosure robbed the common investor of the information necessary to make the often-difficult decision of whether to invest hard-earned capital in a particular corporation. Regulation FD finally gives individual investors an equal opportunity to reap the benefits of sharp upward price spikes that even the most vocal opponents of the rule would normally welcome with open arms.

Therefore, even though the sudden public disclosure of negative information may blindside investors and trigger immediate large-scale sell-offs of disappointing stocks, Regulation FD at the very least ensures that the common investor will be in the same position as the well-connected investor should it become necessary to sell the shares of a corporation that appears to be headed for a fall. Further, the rule also affords the common investor the chance to get in on a rising stock before it nears or reaches its peak. If a slight increase in volatility is the price that must be paid to restore fairness and equity to the markets, then so be it. After all, “[t]he purpose of the regulation was to remedy unfairness, not to smooth out market fluctuations, protect investors from themselves or make life easier for analysts.” If the critics of Regulation FD value a less volatile market over a fair market, they clearly have lost sight of—or simply cannot appreciate—the SEC’s primary objective in eliminating selective disclosure practices.

Aside from claiming that Regulation FD is the direct cause of a higher degree of volatility in the market, the detractors of the rule also maintain that it has had a “chilling effect” on corporate disclosure, “resulting in information of reduced quantity and quality.” In support of their assertion, the critics often point to

78. See Don’t Roll Back Fair Disclosure, supra note 7, at 124.
79. See Weber, supra note 77, at 42.
80. Barbash, supra note 10, at H1.
various surveys that have been conducted that seem to corroborate the existence of a "chilled" market environment.\textsuperscript{82} For example, approximately five months after the adoption of Regulation FD, NIRI conducted a survey of 577 companies and determined that twenty-four percent were providing less information since the passage of the rule.\textsuperscript{83} Similarly, the Association for Investment Management and Research (AIMR) reported that fifty-seven percent of over 6,000 analysts and portfolio managers surveyed indicated that the volume of substantive information disclosed had decreased after Regulation FD took effect.\textsuperscript{84} While these figures may seem somewhat distressing at first glance, their importance is substantially mitigated upon further investigation.

First, although NIRI found that twenty-four percent of companies surveyed were disclosing less since the adoption of Regulation FD, it also discovered that forty-eight percent had been issuing about the same amount and twenty-eight percent had actually been disclosing more information to the public following the passage of the rule.\textsuperscript{85} Second, NIRI also reported that while only sixty percent of the companies surveyed allowed full public access to conference calls prior to Regulation FD, eighty-nine percent were doing so less than six months later.\textsuperscript{86} Third, NIRI's findings have been supported by a similar survey of 164 corporations by PricewaterhouseCoopers, in which fifty-one percent said that Regulation FD has had no impact on the frequency of disclosure, and of the forty-seven percent that saw an impact, forty-eight percent said they were disclosing more frequently.\textsuperscript{87} With respect to Regulation FD's effect on the quantity of information disclosed, the survey revealed that fifty-four percent saw an impact, and of that

\begin{footnotes}
83. See NIRI Finds Some Members 'Clam Up' with Reg FD, supra note 82, LEXIS, Nexis Library, News File.
84. See analysts, Portfolio Managers Say Volume, Quality of Information Have Fallen, supra note 82, at 9.
85. See NIRI Finds Some Members 'Clam Up' with Reg FD, supra note 82, LEXIS, Nexis Library, News File.
86. See id.
87. See Barbash, supra note 10, at H1.
\end{footnotes}
group, fifty-seven percent revealed that they were disclosing *more* since the SEC's adoption of the rule.88 Finally, First Call/Thompson Financial has also reported a positive impact, as it found that the number of companies that provided preannouncements of positive or negative news prior to releasing their regular quarterly results rose a remarkable eighty percent over the closing quarter of 1999.89 Hence, it would be more than reasonable to conclude, based on these figures, that Regulation FD has not led to a disturbing chill of corporate disclosures. Clearly, the overwhelming majority of the data confirms that "the doom-and-gloom scenario that some had predicted is not happening."90

This conclusion may be based on information that was gathered mostly through informal questionnaires, but it has also been echoed by the first large-scale, formal empirical analysis of the effects of Regulation FD on the quality of information in the capital markets.91 A joint study by the University of Southern California and Purdue University has failed to uncover any evidence to support the dire predictions made by the critics of Regulation FD since the adoption of the rule.92 The study revealed:

If poorer information were available to investors since Regulation FD, stock prices would converge more slowly toward their post-announcement levels. However, since implementation of Regulation FD, the typical (median) firm's stock price converges faster towards its post-announcement level, suggesting that the market is not receiving lower-quality information about the upcoming earnings.93 Therefore, the USC-Purdue study found that Regulation FD has not damaged the market's information environment. In fact, the study found that the only major change the SEC's latest measure has been responsible for is almost *doubling* the number of voluntary earnings

88. See id.
89. See Weber, supra note 77, at 42.
90. Barbash, supra note 10, at H1.
92. See id.
93. Id.
disclosures by companies.\textsuperscript{94} Overall, then, the study concluded that there actually had been "no deterioration, and perhaps even some improvement, in the financial information environment prior to earnings announcements."\textsuperscript{95} This is hardly consistent with the harsh criticism from the detractors of Regulation FD, who appear prepared to hold their ground despite the fact that the available data seems to completely contradict their stance.

To put it mildly, Regulation FD may be unpopular among certain sectors of the investment community,\textsuperscript{96} but the SEC probably never meant to gain admirers when it adopted the controversial rule. Regulation FD was intended to remedy a glaring flaw in the market, a harmful inequity that could no longer be permitted to persist. The opponents of the measure likely would have little difficulty agreeing with its proponents that Regulation FD has clearly succeeded in restoring fairness to the market. However, the former sharply depart from the latter by taking the position that the volatility and information chill supposedly caused by the elimination of selective disclosure warrant the repeal of Regulation FD and a return to a two-tiered market.

Such a stance, though, is simply untenable. First, a minor increase in short-term volatility is a small price to pay for equality in the market. Second, a formal study and a number of surveys have determined that the quality and quantity of corporate disclosures have in fact improved since Regulation FD took effect. While some companies may be disclosing less for fear of liability, they will likely begin to disclose more once they realize that the SEC does not intend to enforce Regulation FD in close cases.\textsuperscript{97} The chairman of the SEC, Harvey Pitt, has reassured companies that the agency will not try "to second-guess reasonable, good faith judgments by persons who honestly attempt to comply with Regulation FD."\textsuperscript{98} Thus, in time, it should become quite evident that Regulation FD aims to create a

\begin{itemize}
\item \textsuperscript{94} See id.
\item \textsuperscript{95} Id.
\item \textsuperscript{97} See Pitt Concurs in Staff Views on ‘Good Faith’ Reg FD Compliance, BNA.com (Aug. 20, 2001), at http://corplawcenter.bna.com/corplawcenter/1,1103,2_919,00.html.
\item \textsuperscript{98} Id.
\end{itemize}
level playing field in the market, not to set a trap for executives attempting to abide by the rule.99 For now, though, it should be apparent that the value of Regulation FD to the market and to the individual investor ought to outweigh the seemingly unjustified assaults by the rule's detractors.

IV. THE IMPACT OF REGULATION FD ON ANALYSTS

Without a doubt, those who stand to lose the most from the passage of Regulation FD are the securities analysts who are no longer able to obtain advance notice of material developments from the companies that they cover. It should come as little surprise, then, that a senior partner at a Boston law firm stated: "The only people I know who still purport to be discomforted [by the measure] are securities analysts."100 In truth, the hostility felt toward Regulation FD by many analysts is understandable. After all, the rule has taken away their most direct and accessible source of advance material information—the companies themselves. For the first time ever, analysts have been compelled to rely entirely on effort and skill, not inside information.

Consequently, it has been stated that Regulation FD "has made most analysts stock-guessers rather than [stock-]pickers because they do not receive that wink and nod from company management."101 It is perhaps this line of thinking that has prompted some to predict that Regulation FD will either lead to a lesser role for analysts (since corporate disclosures are now available to everyone at once)102 or a large-scale "shakeout" that will claim the jobs of analysts who simply cannot perform a proper analysis without the aid of selective disclosure.103

The latter would appear to be the more probable scenario. Securities analysts will always be needed to make sense of data that the vast majority of investors are not qualified to evaluate. The fact

99. See id.  
102. See Final Rule, supra note 2, at 4.  
that the public will have equal access to material information will not change the reality that many investors still will have a genuine need for analysts to interpret that information for them. On the other hand, analysts who are entirely dependent upon well-placed connections for their so-called "analyses" and are unable to conduct a proper assessment of information on their own, will be expendable because investors now have access to the identical information—at no cost—through the companies directly. Regulation FD, therefore, will almost certainly lead to a fatal "differentiation between analysts who regurgitate information from companies and those who" actually conduct a proper analysis.  

Ironically enough, by bringing about this much-needed differentiation, the SEC may have indirectly improved upon the performance of securities analysts. According to a survey, twenty-eight percent of analysts said that, since Regulation FD, "they were conducting more of their own original research, such as digging through public documents and probing customers and competitors of the companies they cover ...."  

As one analyst has stated: ""I find it somewhat frustrating with some companies, but to be honest that's what we're supposed to do—find that information from outside the company ...." Somewhat surprisingly, the result of cutting off analysts from inside information over the past year has been a remarkable increase of thirty percent in analyst accuracy in regard to predicting earnings. Hence, in the process of leveling the playing field for the common investor, the SEC may have stumbled upon a way to improve both the effort and the accuracy of securities analysts.  

Furthermore, by eliminating selective disclosure, it seems as though the SEC may have also unintentionally leveled the playing

104. Labate & Hill, supra note 9, at 22.
105. Labate, supra note 5, at 8.
107. See id.
108. In fact, a recent PricewaterhouseCoopers survey of 101 chief financial officers and managing directors found that "executives believe the 'best' analysts are spending more time on fundamental research since the advent of Regulation FD ...." Top Executives Say "Best" Analysts Focus More on Fundamentals than Forecasts, PricewaterhouseCoopers, Aug. 14, 2001, at http://www.barometersurveys.com/pr/mg010814.html.
field for analysts, not just investors. Prior to Regulation FD, the primary recipients of selective disclosure were analysts from the largest and most powerful brokerage firms in the nation. As a result, somewhat less notable analysts and firms were actually in no better shape than the common investor when selective disclosure played such a prominent role in the investment community. No matter how much research they did, the accuracy of their analyses could never come close to matching that of the beneficiaries of selective disclosure. Since the passage of Regulation FD, however, the situation has dramatically changed. In today's market, the absence of selective disclosure means that an independent money manager from Kansas City is no worse off than even the most influential securities analyst on Wall Street. The information that was once reserved only for select analysts from powerful firms is now available to anyone who wants or needs it. Thus, Regulation FD has not only put an end to the long-standing disparity that separated investors, but it has also cured the underemphasized inequality that existed among securities analysts themselves.

It is rather evident, then, that Regulation FD has changed the rules of the game for everyone, investors and analysts alike. With respect to the latter, there seems to be little dispute that the analysts who cannot play by the new rules likely will not be playing for much longer. The analysts who adapt, in contrast, will be performing their duties properly, without the guidance of a corporate insider. Further, if the past year is any indication of the future, the reformed analysts may find that independent research will lead to better results in conducting their analyses. As previously noted, in the short time since the adoption of Regulation FD, analysts' forecasts have become remarkably more accurate. If this positive trend continues, post-Regulation FD analysts may actually become far more important to the investment community than ever before.

V. CONCLUSION

On any given day prior to October 23, 2000, by the mere act of buying or selling shares of a publicly traded corporation in the

110. See id.
United States, the common investor may have become the unknowing victim of a terrible injustice, one that had been deliberately implemented and perpetuated by Wall Street itself. For, as it turns out, the average investor had been contributing hard-earned capital to a market that had not provided a level playing field to all of its participants until just over one year ago. The investor was investing in a corrupt market that permitted corporations to legally disclose material information to a group of favored financial analysts without so much as saying a word to its shareholders or the public. It was only with the adoption of the wildly controversial Regulation FD on October 23, 2000, that the SEC finally prohibited the odious practice—or, to some, the sacred ritual—of selective disclosure.

The difference of opinion that existed between the proponents and opponents of Regulation FD was plainly evident well before the passage of the rule. To this day, a massive rift remains between the two sides. While the supporters of Regulation FD contend that the restoration of fairness and equity to the market justifies any volatility or information chill that may result, the detractors of the rule strongly insist that the market will not be able to function properly until the measure is repealed. Although principles of fairness have prevailed up until this point, there is still cause for concern that ignoble interests could undermine the SEC's efforts to finally bring parity to the market.

Though the critics of Regulation FD are careful not to draw any attention to them, there are a number of problems associated with the rule that must be worked out. For one, the SEC created a "media carve-out" in the measure that permits the overt disclosure of material nonpublic information to members of the media based on the view that they will disseminate, and not trade upon, the disclosed information. ¹¹¹ This exception poses a clear threat to the integrity of the rule because "if a company official ... disclosed material, nonpublic information to a reporter, who in turn called an analyst for comment on that information before the story was published or aired,

that official would not be in violation of Regulation FD." The potential for abuse is troubling and readily apparent.

Another serious issue that must be addressed concerns the allegations that, while there has been a dramatic rise in the number of public access audio conferences since the adoption of Regulation FD, some companies have found a new way to restrict their disclosures. Evidently, "[w]hat some companies have done is selectively decide who will ask the questions. Conference calls have become stacked with favored analysts." If this practice is taking place, it clearly violates the spirit of Regulation FD by essentially reviving the inappropriate relationship that the SEC aimed to abolish by eliminating selective disclosure. It limits corporate disclosures in a manner that negatively affects the public because "the most penetrating questions often come from the least likely sources." Unless the SEC puts an end to these types of technical violations, the ability of Regulation FD to level the playing field in the market will be significantly hampered.

Finally, perhaps the most disturbing problem of all is the refusal of certain companies to abide by the standards set forth in Regulation FD. The SEC has been investigating the possible violation of the rule by at least half a dozen companies already, including the likes of Raytheon, the third-biggest U.S. defense contractor, and Motorola, the second-largest mobile phone maker. In fact, it may even be preparing to bring its first enforcement action in the coming months. As previously stated, companies will soon learn that Regulation FD is primarily meant to change behavior, not to punish it. Nonetheless, companies that persist in refusing to adhere to the prescriptions of the rule will soon find out that if they do not change their behavior, they will be punished.

Naturally, the above assumes that Regulation FD will overcome the considerable efforts that have been made, and will almost certainly continue to be made, to arrest the restoration of fairness to

112. Id. (emphasis omitted).
113. See Alster, supra note 81, LEXIS, Nexis Library, News File.
114. Id.
115. Id.
117. See id.
the market. The key to the survival of the SEC’s controversial rule likely will rest in the hands of the agency’s newest chairman, Harvey Pitt. Due to his criticism of the rule prior to his nomination as chairman, Pitt has been expected by many to find a way to render Regulation FD toothless or to repeal the measure altogether. However, since taking office, he has done nothing to suggest that he will strip the market of the equality that is essential to its well-being. In fact, it has been said that ""[w]hether in the public or private sector, Harvey Pitt has represented his client admirably...""118 Thus, as long as Pitt keeps in mind that the small investor is currently the client who is most in need of his protection, the detractors of Regulation FD will have no choice but to get accustomed to a market free from selective disclosure practices.

In sum, Regulation FD may not be perfect, but laws rarely are. By ridding the market of selective disclosure, the SEC may have slightly increased volatility and led some companies to temporarily disclose less information to investors. Yet, in doing so, the SEC made an essential covenant with the common investor, that all participants in the market thereafter would be equal. This pledge more than makes up for any increased volatility or information chill. To paraphrase Arthur Levitt, it is a promise that truly makes markets possible. It is a promise that must be kept.

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§ 243.100 General rule regarding selective disclosure.

(a) Whenever an issuer, or any person acting on its behalf, discloses any material nonpublic information regarding that issuer or its securities to any person described in paragraph (b)(1) of this section, the issuer shall make public disclosure of that information as provided in § 243.101(e):

(1) Simultaneously, in the case of an intentional disclosure; and

(2) Promptly, in the case of a non-intentional disclosure.

(b)(1) Except as provided in paragraph (b)(2) of this section, paragraph (a) of this section shall apply to a disclosure made to any person outside the issuer:

(i) Who is a broker or dealer, or a person associated with a broker or dealer, as those terms are defined in Section 3(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a));

(ii) Who is an investment adviser, as that term is defined in Section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11)); an institutional investment manager, as that term is defined in Section 13(f)(5) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(f)(5)), that filed a report on Form 13F (17 CFR 249.325) with the Commission for the most recent quarter ended prior to the date of the disclosure; or a person associated with either of the foregoing. For purposes of this paragraph, a "person associated with an investment adviser or institutional investment manager" has the meaning set forth in Section 202(a)(17) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(17)), assuming for these purposes that an institutional investment manager is an investment adviser;
(iii) Who is an investment company, as defined in Section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), or who would be an investment company but for Section 3(c)(1) (15 U.S.C. 80a-3(c)(1)) or Section 3(c)(7) (15 U.S.C. 80a-3(c)(7)) thereof, or an affiliated person of either of the foregoing. For purposes of this paragraph, "affiliated person" means only those persons described in Section 2(a)(3)(C), (D), (E), and (F) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(3)(C), (D), (E), and (F)), assuming for these purposes that a person who would be an investment company but for Section 3(c)(1) (15 U.S.C. 80a-3(c)(1)) or Section 3(c)(7) (15 U.S.C. 80a-3(c)(7)) of the Investment Company Act of 1940 is an investment company; or

(iv) Who is a holder of the issuer's securities, under circumstances in which it is reasonably foreseeable that the person will purchase or sell the issuer's securities on the basis of the information.

(2) Paragraph (a) of this section shall not apply to a disclosure made:

(i) To a person who owes a duty of trust or confidence to the issuer (such as an attorney, investment banker, or accountant);

(ii) To a person who expressly agrees to maintain the disclosed information in confidence;

(iii) To an entity whose primary business is the issuance of credit ratings, provided the information is disclosed solely for the purpose of developing a credit rating and the entity's ratings are publicly available; or

(iv) In connection with a securities offering registered under the Securities Act, other than an offering of the type described in any of Rule 415(a)(1)(i)-(vi) (§ 230.415(a)(1)(i)-(vi) of this chapter).