Some Answers to Your Questions Regarding Regulation FD

- ***A review of the new rule and its impact on corporate communications best practices***

On Thursday, August 10, 2000, the SEC adopted Regulation Fair Disclosure ("FD"). Although the rule will not formally take effect for two months, it has already caused considerable consternation and confusion among company managers and Wall Street professionals. The intention of the ruling is to put an end to the practice of "selective disclosure," by which many companies have traditionally relayed material information to the sell-side analysts who cover them, or to large institutional investors, prior to disseminating it to the broader public. This has long been a gray area in the practice of investor relations. And while most companies do not blatantly feed market-moving information to favored professionals, the promise of "guidance" or an additional informational edge underlies the familiar ritual of meetings and calls with Wall Street. It is the stated intent of Regulation FD to put an end to such practices.

Initial Reactions to the Ruling

The Commission released the initial draft proposal of Regulation FD on December 20, 1999, and over the consultation period, received responses from over 6,000 individuals and organizations. While the vast majority were supportive, many Wall Street firms were fiercely opposed to the regulation, on the grounds that it would severely restrict the flow of information to investment professionals and have a "chilling" effect on companies' willingness to talk with the street. Based on the input from these organizations, the rule that the Commission formally adopted on August 10 contained some significant modifications.

Despite this, many have predicted that flow of information to the marketplace will decrease as a result of this measure. While this was clearly contrary to the SEC's intent, some legal counsel have advised companies to err on the side of caution and severely restrict all communication with investment professionals. A recent survey of 2,492 companies showed that 42% intended to limit communications practices. A further 12% said that they would limit their practices "significantly," while a third of the respondents said they would limit participation in broker-sponsored analyst meetings. A third also concluded that they would no longer comment on analyst reports at the request of analysts.

While this is clearly a complex area, it is the position of CCG that companies can more successfully cope with Regulation FD through a strategy of *increased*, albeit more carefully planned, communications. The following is intended as a guide to how current corporate communications practice will be impacted by this ruling.

Overview

What is the reasoning behind Regulation FD?

The new rule is intended to address three issues:

1) end the practice of selective disclosure of material nonpublic information;
2) more closely define when insider trading liability arises in connection with a trader's use of such information;
3) clarify when the breach of a family or other non-business relationship may create a liability under the misappropriation theory of insider trading.

The thrust of the rule is to correct what the SEC perceived to be a growing problem of selective disclosure that has had a potentially negative impact on the integrity of the securities markets, similar to the impact of insider trading. As self-directed, individual investors have become increasingly important to driving the stock market, and as the rapid growth of online financial information has created alternatives to the traditional broker and analyst guidance, the SEC has grown concerned that all investors have a "level playing field" in making investment decisions. The Commission believes investor confidence in the fairness of the markets is shaken when it is known that certain participants may exploit "unerodable informational advantages" derived from access to corporate insiders. Regulation FD is also designed to prevent company insiders from treating privileged information as a commodity to be used to gain or maintain favor with particular analysts and investors. In short, the intention is to make sure that any advantage that the investment professional enjoys is due to superior acumen and hard work, rather than relationships and back-scratching.

What types of information are currently being selectively disclosed?

Recent publicized reports have noted that disclosure of important non-public information, such as advance warnings of changes in earnings estimates to selected analysts or institutional investors, has resulted in sharp movements in stock value before many individual investors are able to act on this information. Such differential disclosure is clearly contrary to the best practices that CCG has recommended to our clients and practiced in the past. However, the new ruling goes much further in restricting such gray areas as providing "guidance" to sell-side analysts on their models and discussing corporate strategy with institutional investors prior to articulating it in a widely disseminated form. While it does not change the type of information covered, Regulation FD significantly raises the bar in defining best practices for disclosure.

How do I know what is and is not material information?

The SEC deems information to be material if "there is a substantial likelihood that a reasonable shareholder would consider it important" in making an investment decision. Rather than drawing a clear but inflexible "bright line" standard on materiality, the Commission has chosen to rely on a standard of materiality based on "the exercise of judgment in the light of all the circumstances." Realizing that there will always be a factor of subjective determination needed

in considering if a piece of information is material, the Commission still believes that this standard is preferable to a rules-based standard, that would of necessity be under- or over-inclusive.

While not exhaustive, the Final ruling states that the following types of information or events should be reviewed carefully to determine whether they are material:

- Earnings information;
- Mergers, acquisitions, tender offers, joint ventures or changes in assets;
- New products or discoveries, or developments regarding customers or suppliers;
- Changes in control or in management;
- Change in auditor, or auditor notification that the issuer may no longer rely on an auditor's audit report;
- Events regarding the issuer's securities – defaults, re-purchase plans, stock splits, change in dividends;
- Bankruptcies or receiverships.

As before, management should rely on a reasoned judgement that is informed by regular consultation with CCG to determine if a specific event does or does not meet this threshold of materiality.

Who is subject to the new regulation?

The scope of the rule covers material communications between company executives and authorized spokespersons to analysts, institutional investors and holders of the company's securities. On the company side, this includes senior management, IR professionals and others who regularly communicate with investors. On the Street side, this includes broker-dealers, institutional investment managers, hedge funds and any holder of the issuer's securities who might reasonably be expected to trade on the information. Journalists and ratings organizations such as Standard & Poor's have been exempted, as have "temporary insiders" such as attorneys, investment bankers or accountants who are brought inside to provide advice or counsel related to a particular transaction. Material, non-public information may still be discussed with customers, suppliers, and strategic partners necessary to the conduct of the company's business. Also exempt from coverage of the regulation are foreign private issuers.

What if something slips out?

The Commission makes it clear that the ruling is not targeting accidental slips of the tongue or hair splitting judgments of materiality. Enforcement of the rule will be focused on instances where company officials intentionally disclose material, non-public information selectively or are "reckless" in making a materiality decision. The SEC will not try to second guess, in its enforcement effort, those officials who make good-faith determinations on whether information is material or not, particularly in situations where officials are responding to questions during meetings with analysts and institutional investors or during conference calls. However, in order

to avoid a regular stream of corrective press releases and to create an optimum information flow to investors, companies should make sure that they adequately plan comments and responses they will make in every meeting with investment professionals. CCG has deep experience in helping companies prepare for events ranging from investor conferences to one-on-one meetings.

The Final ruling states that in the case of non-intentional selective disclosure, the issuer must make public disclosure promptly thereafter. "Promptly" in this case means within 24 hours during weekdays or before the market opens over weekends and holidays. Under the regulation, the required public disclosure may be made by filing or furnishing a Form 8-K or by "another method or combination of methods that is reasonably designed to effect broad, non-exclusionary distribution of the information to the public."

If I am found in breach of Regulation FD, will I be liable privately?

In a word, no. The rule provides greater assurance that materiality decisions are not subject to private legal liability, but could be subject to SEC action. This action may involve either sanctions or fines or both. The communication of fraudulent information, however, would be subject to private litigation under Rule 10b-5.

Talking to Analysts

What can I say to an analyst who calls me to comment on an earnings forecast?

Regulation FD now makes it very risky to have any private conversations with sell- or buy-side analysts on the subject of earnings estimates. This presents a major change in the way in which many companies communicate with investors. Traditionally, many analysts have created predictive "models" of future earnings and then sought "guidance" from management on the accuracy of such models in the form of comments as to the accuracy of various assumptions behind them. The analyst benefits by enjoying a greater confidence in the accuracy of his or her predictions, while the company benefits by keeping expectations within a band that management is confident it can meet, if not beat. However, Regulation FD puts an end to this contrived dance, making it clear that companies cannot render information immaterial simply by breaking it into ostensibly non-material pieces.

However, the Commission goes on to say that issuers are not prohibited from divulging a non-material piece of information to an analyst, even if this non-material information contributes to the analyst completing a "mosaic" of information that, taken together, is material. The ruling notes that "Analysts can provide a valuable service in sifting through and extracting information that would not be significant to the ordinary investor to reach material conclusions." The thrust is that the accuracy of the analyst's predictions should be due entirely to his or her superior acumen and diligence, not to superior access to information.

Couldn't I delegate a junior company official to communicate with an analyst?

No. The regulation is designed to cover senior management, investor relations professionals and others who regularly interact with securities market professionals or security holders. The Final ruling, however, goes on to state quite categorically that "neither an issuer nor such a covered person could avoid the reach of the regulation merely by having a non-covered person make a selective disclosure. Thus, to the extent that another employee had been directed to make a selective disclosure by senior management, that member of senior management would be responsible for having made the selective disclosure."

What about reviewing draft analyst reports?

Although it has been commonplace for many companies to review drafts of analyst reports in the past, this activity carries substantial risks in the light of the new ruling. If such a review is undertaken, companies should limit its scope to non-material facts and take every precaution to ensure that the review process does not lead to a change in the analysts forecast that could result in a significant movement in the stock value. The SEC would undoubtedly seize upon this.

How can companies now set or manage earnings estimates?

Every company must develop a strategy for setting and managing earnings expectations that reflects the company's own predictive capability, volatility in earnings, and depth of sell-side coverage. It is highly likely that many companies will see the band of analyst expectations begin to diverge as they no longer have access to "guidance" from management as to the accuracy and completeness of their financial models. In this event, many companies may find it desirable to issue their own, publicly disseminated guidance or earnings estimates. Such guidance or estimates can be issued at regular, pre-determined intervals during the quarter, or as material events occur that impact the accuracy of prior estimates. CCG will work with each of our clients to help design an appropriate program.

Talking to Investors

Can I continue one-on-one meetings with portfolio or investment managers?

The Regulation is not designed to stop senior management meeting with investors and potential investors. The legislation is designed to ensure that management refrain from disclosing material information under such circumstances, or if it does, that it promptly rectify the situation by filing the required Form 8-K or issuing a press release. It is our experience that investors find great benefit in meeting with management in terms of enhancing their understanding of previously disclosed information and gaining confidence in management's capacity to execute their strategies and plans. CCG would counsel management to continue to participate in such valuable meetings. However, Regulation FD increases the responsibility to articulate the corporate strategies that are typically discussed in such encounters in publicly disseminated filings and releases.

Should we still have quarterly earnings calls and can questions be "by invitation only?"

The Commission directly encourages management to host conference calls that are open to the public via web casting, and embraces this as a viable means of achieving full disclosure. As long as the call is adequately publicized beforehand so that all interested parties are able to listen in on a real-time basis, the Company is quite at liberty to limit participation in the Q&A session to invitees. Proper notification requires a press release detailing how to access the web cast sufficiently in advance of the actual call. CCG anticipates that such conference calls will be seen as increasingly valuable "safe zone" to provide investors with insight as to company performance in a real-time, universally disseminated basis. However, as the importance of such calls increases, so does the importance of thorough preparation of both management comments and responses to anticipated questions.

What about investor conferences?

Unless they are adequately publicized and made available to the public through real-time web casting, investor conferences are subject to the same strictures as regular meetings with investors. This means management should seek to avoid disclosing any non-public material information, and is obligated to promptly rectify any non-intentional selective disclosure by means of a press release. CCG believes that these venues will continue to be valuable means of gaining exposure, although break-out sessions may be less free-wheeling than in the past.

If I post material information on the company website, is this considered "broad disclosure?"

Posting of a news release on the company website is deemed insufficient at this time to constitute full and fair disclosure. However SEC General Counsel David Becker has made it clear that the Commission is keen to encourage companies to "find new ways that are reasonably designed to provide non-exclusionary means of dissemination." They are anxious that Regulation FD does not prove counter-productive and reduce the flow of information to the marketplace.

My Company is preparing to go public. Will the new ruling affect us?

The SEC has determined that the current regulations governing communications prior to and immediately after an Initial Public Offering are sufficient. Regulation FD will not apply to companies in this position.

Summary

We hope that this brief summary of Regulation FD is of benefit. We expect that there will be a period of some months during which the parties directly affected come to terms with the practical implications of the new ruling. CCG will work with each of our clients as to how to successfully cope with this new informational and legal environment. CCG has consistently advocated that companies adopt a policy of broad disclosure, and we believe that ultimately Regulation FD will contribute to companies moving towards best practices in terms of regular, high quality communications with investors. This may lead to an increase in the flow of information, rather than a “chilling” which some opponents of the regulation have predicted. In the end, increased communication is the most successful strategy for dealing with this new rule, as management is always at liberty to comment on any aspect of their business to the investment community, if such information has already been released into the public domain.