

April 6, 2000

Jonathan G. Katz, Secretary,
Securities and Exchange Commission,
450 Fifth Street, N.W., Stop 6-9,
Washington, D.C. 20549.

Re: Proposed Regulation FD - File No. S7-31-99

Dear Mr. Katz:

The Ad Hoc Working Group on Proposed Regulation FD and the Legal and Compliance Division of the Securities Industry Association ("SIA")¹ are pleased to submit this response to Release No. 33-7787 ("Release") on behalf of SIA.

We are writing to comment on proposed Regulation FD and Securities Act Rule 181. Any comments on the other proposals will be submitted separately.

¹ SIA brings together the shared interests of more than 740 securities firms to accomplish common goals. SIA member-firms (including investment banks, broker-dealers and mutual fund companies) are active in all U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 50 million investors directly and tens of millions of investors indirectly through corporate, thrift and pension plans. The industry generates more than \$300 billion of revenues yearly in the U.S. economy and employs more than 600,000 individuals. (More information about SIA is available on its home page: <http://www.sia.com>.)

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I. Overview

At the very beginning of the proposing Release, the Commission states that "Information is the lifeblood of our securities markets." We agree. We believe in the maximum flow of information from issuers, whether directly or through securities analysts and the media, to the marketplace. We believe that in the last two years there has been a significant increase in the flow of this information. There are many reasons. Perhaps the most important is technology. The Internet has given rise to both a widespread demand for more information and an ability on the part of issuers to respond to that demand. The desire and ability to make roadshows available more broadly over the Internet has met with great demand for access to roadshows.

The Commission itself deserves credit for improvement in the flow of information. By criticizing inappropriate disclosure practices and encouraging greater openness, the Commission has caused issuers to improve their disclosure practices. For example, a recent survey by the National Investor Relations Institute (NIRI) indicates that 83% of the respondents conduct conference calls and another 7% plan to do so in 2000. Of the 83% that currently conduct

conference calls, 82% allow individual investors real-time access and 74% allow the media access to their calls.

(These are up from 29% and 14% in a survey conducted nearly two years ago.) The same survey indicates that the number of companies providing open access in 2000 should increase to 90% for individuals and 86% for the media.

Given the recent trends toward more open disclosure and the relatively small number of instances of inappropriate selective disclosure, we find it very puzzling and troubling that the Commission is considering a step that we believe will operate to constrict the flow of information. We believe that many conscientious issuers will seek to avoid the problems created by Regulation FD by eliminating meetings with individual analysts and small groups of analysts, becoming more circumspect in what they say at open meetings and eliminating the current practice of frequent telephone conversations with analysts. All of these steps will result in less information to investors. We also believe that Regulation FD would afford less forthcoming issuers an excuse to restrict the flow of information into the marketplace and an opportunity to exercise more editorial control over the information that reaches the marketplace. Again, the result is reduced

quantity and quality of information in the marketplace and thus less accurate pricing of securities.

We believe that communications between an issuer and individual analysts or small groups of analysts contribute to the overall mix of information in the marketplace, greater accuracy of market prices, less volatility and, in general, greater efficiency. In determining whether to adopt Regulation FD, we believe the Commission should consider seriously its adverse effect on issuers, analysts and the efficiency of the marketplace.

We also think that the term "selective disclosure", which the Commission uses in the proposing release, is overly broad. Disclosure that is made "selectively" to a favored analyst in order to obtain an improper quid pro quo is unquestionably problematic. However, the proposal targets ordinary channels of communication between an issuer and analysts that do not involve nefarious motives. As we discuss more extensively below, we believe that these communications help get information into the marketplace, whereas the proposal will discourage issuers from exchanging ideas or information with analysts, as well as deter analysts from vigorously competing to glean useful information for their clients and the markets.

Although proposed Regulation FD is apparently simple, it masks important changes in policy and law and would be very difficult to comply with in the real world. Rather than improving the flow of information into the marketplace, it would actually reduce the quantity and quality of information reaching the marketplace and increase market volatility.

II. General Comments

A. Important Changes in Policy and Law

Proposed Regulation FD represents a significant departure from the U.S. disclosure regime as it has existed for over 65 years. The Securities Act and the Exchange Act were carefully drafted to authorize the Commission to require specific disclosures. The Acts then impose liability on (a) failure to disclose required facts, (b) material misstatements of fact and (c) materially misleading statements (i.e., statements that are misleading by virtue of what they fail to say or leave out).² Rules 408 and 12b-20 are premised on the absence of a

² In re N2K Inc. Securities Litigation, CCH Fed. Sec. L. Rep. ¶ 90,756 (2d Cir. 2000); Cooperman v. Individual, Inc., 171 F.3d 43 (1st Cir. 1999).

general requirement to disclose all material information. Form 8-K is consistent with this in explicitly permitting use of the Form to publicize information in addition to that specifically required by the Form. The Commission itself acknowledges in the Release that:

“... the federal securities laws do not generally require an issuer to make public disclosure of all important corporate developments when they occur. ... [I]n the absence of a specific duty to disclose, the federal securities laws do not require an issuer to publicly disclose all material events as soon as they occur.”

Yet, in Regulation FD, the Commission is proposing to change that by subjecting an issuer to a general obligation to make public disclosure of any material fact that it discloses to any person outside the issuer - other than persons who owe a duty of trust and confidence to the issuer and persons who have expressly agreed to maintain the information in confidence (hereinafter referred to as “outsiders”). This is a novel springing obligation to disclose a material fact, not because of the nature and importance of the fact itself or its relationship to other disclosures but just because it has been disclosed to an outsider.

The Securities Act and the Exchange Act contemplate a parity of access to required information and, beyond that, the information the issuer chooses to include in registration statements and reports or otherwise makes

public. Neither Act contemplates the unattainable goal of a parity of access to all material information relevant to the issuer that is available anyplace outside the issuer. The Commission proposes to change that by establishing a new goal that goes beyond the requirements of Commission registration statement and report forms and the current legal regime, namely, that "all investors should have access to an issuer's material disclosures at the same time." In 1980 and 1983 the Supreme Court expressly denied the Commission's authority to impose an equal information rule under Securities Act § 17 and Exchange Act § 10(b).³ In fact, while we cannot say whether the Court contemplated Commission action under Exchange Act §§ 13 and 15(d), it said in Chiarella⁴ and repeated in Dirks⁵ that formulation of an absolute equal information rule should not be undertaken absent some explicit evidence of Congressional

³ Chiarella v. United States, 445 U.S. 222 (1980); Dirks v. SEC, 463 U.S. 646 (1983).

⁴ "Formulation of such a broad duty [a general duty between all participants in market transactions to forgo actions based on material, nonpublic information] ... should not be undertaken absent some explicit evidence of congressional intent." Chiarella v. United States, 445 U.S. at 233.

⁵ "In Chiarella, we noted that formulation of an absolute equal information rule 'should not be undertaken absent some explicit evidence of congressional intent.'" Dirks v. SEC, 463 U.S. at 657 n.16.

intent. Without debating here whether Regulation FD is within the Commission's authority,⁶ the stated goal is unrealistic and unwise, and the rule does not and cannot achieve that goal.

Even if there is absolute theoretical compliance with a Regulation FD, some will get the information and act on it sooner than others. The investor who is watching the first screen on which the information appears will have an advantage over the investor who is not watching but receives a news alert signal regarding that issuer. Investors who instead of working follow their stocks at the office will have an advantage, including especially the ability to trade immediately in a more liquid market, over those who wait until they get home from work. Investors monitoring electronic communications will have an advantage over those who get the news over radio and TV. And all the foregoing

⁶ We seriously doubt that the Commission has authority to adopt a general requirement that registrants promptly disclose publicly and report to the Commission all material developments or facts relevant to the issuer. We wonder whether it is that much different to impose an obligation to disclose a material development or fact just because it has been disclosed to an outsider.

"In my opinion, we have neither the mandate nor the authority to regulate every business communication." Hon. Isaac C. Hunt, Jr., Speech at 26th Annual Cleveland Securities Law Institute on Securities Regulation (Feb. 18, 2000).

will have an advantage over those who get the news in the next day's morning newspaper. In any event, the beneficiary of accidentally disclosed material information would have an advantage over everyone until the issuer makes public disclosure. If the issuer elects to meet the public disclosure requirement by filing a Form 8-K instead of a press release, the relative impacts are quite unpredictable because of the great disparity in the ways and times in which information contained in Form 8-Ks finds its way into the marketplace. If the Commission were to mandate disclosure by Form 8-K only, this would ensure a disparity of disclosure.

Parity of access to all material information is therefore illusory. Pursuit of this goal is likely to result in less information reaching the market, to the detriment of all investors. The above may be readily illustrated by an example. Issuers are not required to publish earnings projections. In fact, notwithstanding Rules 175 and 3b-6, the Commission's encouragement to publish projections, and even the Private Securities Litigation Reform Act of 1995,⁷ most U.S. issuers

⁷ In fact, we believe that Regulation FD would frustrate Congress's objective in enacting the Private Securities Litigation Reform Act - namely, encouragement of
(continued...)

steadfastly refuse to publish projections. And yet, under proposed Regulation FD, if the issuer is deemed to have intentionally or unintentionally furnished a material projection in a roadshow, to an institutional investor or to a rating agency without obtaining an express agreement to keep the projection confidential, then the issuer would be obligated to make public disclosure (as defined) of the projection. And, if it fails to do so, it has violated Section 13 and/or 15(d) of the Exchange Act, is subject to an enforcement action by the Commission and loses its eligibility (if any) for "shelf" registration and Rule 144. This will operate to chill such communications on these subjects as issuers may currently be willing to make.

We respectfully suggest that the Commission ask itself what is the basis for its assumption that "it is unlikely, given the robust, active capital market, that the flow of information to the market will be significantly chilled."⁸ We believe that Regulation FD, rather than increasing the flow of information into the marketplace,

⁷(...continued)
disclosure of projections.

⁸ Elsewhere in the Release the Commission does admit the existence of a risk of chilling the flow of corporate information to the marketplace.

will constrict the flow of information⁹ and will thereby impair the operation of the marketplace as a reflector of value. We believe that before proceeding with the proposed rule, the Commission should explore other voluntary ways of reducing what it perceives as the adverse effects of inappropriate selective disclosure.

We also believe that the Commission is imposing on all reporting issuers and tens of thousands of daily communications onerous and intrusive requirements, all because of a relatively few - but highly publicized - misguided incidents, some of which on investigation may have proved to have been entirely innocent. We believe that the Commission needs to continue to address inappropriate

⁹ "Imposing a duty to disclose or abstain solely because a person knowingly receives material nonpublic information from an insider and trades on it could have an inhibiting influence on the role of market analysts, which the SEC itself recognizes is necessary to the preservation of a healthy market. It is commonplace for analysts to 'ferret out and analyze information,' 21 S.E.C. Docket, at 1406, and this often is done by meeting with and questioning corporate officers and others who are insiders. And information that the analysts obtain normally may be the basis for judgments as to the market worth of a corporation's securities. The analyst's judgment in this respect is made available in market letters or otherwise to clients of the firm. It is the nature of this type of information, and indeed of the markets themselves, that such information cannot be made simultaneously available to all of the corporation's stockholders or the public generally." (Emphasis added; Footnotes omitted.) SEC v. Dirks, 463 U.S. at 658-59.

selective disclosure problems with vigorous enforcement of existing insider trading prohibitions and an educational campaign aimed at issuers' practices that concern the Commission.

B. Issuers' Perspective - Living with Regulation FD

As stated in the proposing Release, proposed Regulation FD does not address situations that would constitute insider trading under current case law. Rather, we are dealing with a rule-created duty to publicize "material" information (1) "simultaneously" in the case of "intentional" disclosure to "outsiders" and (2) "promptly" in the case of "non-intentional" disclosure to "outsiders".

The Commission says in the proposing Release:

"... we do not believe that selective disclosure of material nonpublic information to analysts ... is beneficial to the securities markets."

In the abstract it is a fine sounding principle. Applying it in real-life situations is an altogether different matter.

1. Materiality. In the proposing Release the Commission says that information is "material" if "there is a substantial likelihood that a reasonable shareholder would consider it important" in making an investment decision or it would have "significantly altered the 'total mix' of

information made available". It describes this as the same definition that is generally applicable under the Federal securities laws and cites TSC Indus. Inc. v. Northway, Inc., 426 U.S. 438, 449 (1996).¹⁰ The first of these two tests is very broad. In all the information authorized employees communicate to outsiders every day, or even to securities analysts, it may be very hard to say what would not be considered "important" by a reasonable shareholder in making an investment decision. In fact, in something of a Catch 22, from the mere fact that a knowledgeable and experienced analyst asks a question, it could be argued that a reasonable investor would consider the answer important in making an investment decision. In the same footnote in which the Commission cites to Northway, it refers the reader as well to "Staff Accounting Bulletin No. 99 ... (discussing materiality for purposes of financial statements)". Given the perceived vastly greater reach of "material" in SAB No. 99, it would be extraordinarily troubling if the SAB No. 99 standard rather than the Northway standard applied to financial statements and financial statement items for the purpose of Regulation FD.

¹⁰ Although the Commission states these tests in the alternative, we believe that the correct reading of the Supreme Court's language is that the requirements are cumulative.

In the case of written disclosure, it is feasible for an issuer, in consultation with counsel, to craft the disclosure carefully, seek to determine whether it includes nonpublic material information and, if so, issue a press release etc. However, it is a very different situation when management engages in a dialogue with one or more securities analysts. Management will inevitably receive unanticipated questions. Management may well know the answer but not know whether the information is "material". Must management always be accompanied by a lawyer? Must management suspend the dialogue while conferring with counsel to determine whether the information is or might be material? Perhaps they will need to obtain more information from others in the organization in order to determine materiality or confer with more senior counsel as to the legal conclusion. And as the Commission itself acknowledges, "materiality judgments can be difficult."¹¹ The frequent resolution - in case of doubt, disclose - is not a particularly happy one in this

¹¹ "Materiality has become one of the most unpredictable and elusive concepts of the federal securities laws. The SEC itself has despaired of providing written guidelines to advise wary corporate management of the distinction between material and non-material information, and instead has chosen to rely on after-the-fact, case-by-case approach, seeking injunctive relief when it believes that the appropriate boundaries have been breached". SEC v. Bausch & Lomb Inc., 565 F.2d 8, 10 (2d Cir. 1977).

context. Won't the mere fact that management had to stop and consider convey information to the analysts? Would it be any better if, in case of doubt, management simply declines to answer the question?

There may be times when management will be able to evaluate the issues and be comfortable in concluding that the answer to the question is not material. But it may be that the analysts (and subsequently the marketplace) regard the answer as very significant. Articles appear and the stock price jumps up or down, or the stock price jumps and then the articles appear.¹² For example, the analyst may have obtained comparable information from the issuer's competitors and determined that the issuer's information is outside the pattern of the competitors (better or worse).

¹² "In some situations, the insider will act consistently with his fiduciary duty to shareholders, and yet release of the information may affect the market. For example, it may not be clear - either to the corporate insider or to the recipient analyst - whether the information will be viewed as material nonpublic information. Corporate officials may mistakenly think the information already has been disclosed or that it is not material enough to affect the market." SEC v Dirks, 463 U.S. at 662.

Given the increased volatility of markets and the disproportionate changes in market price and market cap that seemingly result from changes in estimated earnings of a penny or two a share, one is led to question the reliability of changes in market price as the litmus test of legal materiality under our Federal securities laws.

This is sometimes referred to as “putting together the mosaic” or “connecting the dots.” Or it may be that based on information the analyst has obtained from other sources, the analyst appreciates better the significance of the issuer’s answer than the issuer does. That in itself may tell the analyst something about the quality of the issuer’s management.

If management honestly believes that the information called for by the question is not material, the disclosure should not be intentional under the rule. But determining subjective intent often requires a substantial investigation and the mere possibility of subjecting an issuer or an individual to such an investigation will have a chilling effect. The same problem arises regarding investigations of when and whether management realized that a “non-intentional” disclosure of material nonpublic information has occurred.¹³

What does management do if the apparently “material” information that has gotten out is wrong, and the true information is not material or the true information is material for a different reason?

¹³ Footnote 47 indicates that the obligation arises when a “senior official” sees a significant change in the market price and/or trading volume of his company’s securities and “become[s] aware of his mistake.”

Suppose an analyst comes to an issuer and says that he or she is going to say something significant about the issuer that the issuer knows is wrong or, properly understood, is not significant. If it prevents the analyst from making this mistake, has it communicated nonpublic material information that must be publicly disclosed? Isn't the better view that the issuer has avoided misinformation in the marketplace and unwarranted volatility?

2. Persons Acting on Behalf of an Issuer.

Although the Release is confusing on this point, the definition of "person acting on behalf of an issuer" includes any employee or agent communicating information within the scope of his/her authority to an "outsider". Literally, this is broad enough to cover the purchasing agent who tells suppliers of the kinds and quantities of things needed to produce some exciting new product or a salesman who tells prospective customers of a great new product (e.g., a new medical drug) in the pipeline.¹⁴ Are suppliers and customers persons who owe the issuer a duty of trust or confidence, or should the purchasing agent or

¹⁴ Indeed, the Commission asks whether the Regulation (in permitting communication under express confidentiality agreements) adequately permits issuers to engage in legitimate business communications with customers or suppliers.

salesman be obtaining an express agreement to maintain the information in confidence? If the purchasing agent or salesman fails to obtain an express confidentiality agreement, it would seem that the disclosure is intentional and simultaneous disclosure is required, which won't happen. How is a senior official to know whether an employee has made such a communication, whether the employee should have obtained an express confidentiality agreement, and whether the employee did in fact do so? Are senior officials reckless in not establishing procedures to ensure that confidentiality agreements are obtained in every case? Or in not requiring employees to sign disclosure policy statements and undertake to report disclosures of material nonpublic information (if they could even know what that means) to outsiders in the absence of a confidentiality agreement? Even if disclosure is deemed to be non-intentional, the issuer is obligated to make prompt public disclosure, namely, within 24 hours after the senior officer was reckless in not knowing it. When does the 24-hour period begin to run in the case of recklessness?

If a "senior official" (especially a director) becomes aware that a material fact is known by outsiders, how is he or she to know whether it has been publicly disclosed by the issuer, intentionally disclosed by a

"person acting on behalf of an issuer," unintentionally disclosed by a "person acting on behalf of an issuer," disclosed by an employee or other person with access to the information in violation of a duty of confidentiality or simply obtained by the possessor of the information in some other legitimate way? Suppose a "senior official" (especially a director) becomes aware that the information is known by outsiders but does not appreciate that it is material. Suppose an outside director, because of the press of duties in his/her own business, delays communicating to the issuer the existence of this information outside the issuer or consulting with the issuer as to how it got out and whether it is material. When does the duty to make prompt public disclosure commence?

Suppose an issuer deliberately discloses material information to someone who has expressly agreed to maintain the information in confidence. What if there is disagreement or a difference in recollection concerning the existence or scope of a confidentiality undertaking? What are the issuer's obligations if the recipient of the information violates the undertaking? Does the issuer have to make public disclosure of the information? When?

Suppose a senior official of the issuer learns of intentional or non-intentional disclosure of material

nonpublic information to an outsider who, prior to receipt of the information, had not agreed to maintain the information in confidence. But thereafter and before the recipient has either used the information in any way or communicated it to others, the recipient agrees to maintain the information in confidence. Has the issuer violated Regulation FD if it has not and does not make simultaneous or prompt public disclosure thereof?

These very practical issues, and many other issues created by the proposed regulation, will not be subject to definitive resolution. As a result, many issuers will avoid the problems altogether by restricting the flow of information that they now provide.

3. Road Shows. Road shows are used in most common stock offerings (not just IPOs where the proposed Regulation would not be applicable), high-yield offerings and some large bond offerings. What will be the impact of the proposed rule on roadshows? As is well known, syndicate managers at road shows frequently communicate their earnings estimates, which may be higher or lower than the issuer's own projection. This estimate will be based on many factors, including extensive access to issuer information and to management's interpretation of that information. If issuer representatives at the roadshow make no comment on

the syndicate manager's estimate, are they implicitly representing that their own projection is not any lower? Are they implicitly adopting the syndicate manager's projections as either accurate or a minimum? Is the issuer then obligated to make simultaneous public disclosure of the syndicate manager's estimate, with all the implicit underlying assumptions that sophisticated persons at the road shows understand without being told? If so, the issuer may refuse to let syndicate managers issue such estimates. If there are no estimates, are investors and the marketplace better off?

4. Capital Raising. Regulation FD should inevitably result in a great increase in the volume of Form 8-Ks filed with the Commission. In the case of non-intentional disclosures, they would have to be hurriedly prepared and filed. In the case of issuers registering securities on Securities Act Form S-3, all these reports would be incorporated by reference in their registration statements. In the event of sales of registered securities, issuers will be absolutely liable under Securities Act § 11 for any material misstatements or misleading statements in such filings. Directors, signing officers, underwriters and controlling persons will also be liable, subject to a due diligence defense. Notwithstanding the Commission's

predictions, there could be a flood of 8-Ks requiring significant due diligence and perhaps the filing of superseding disclosures. These filings could also affect the balance and materiality level of the registration statement and incorporated documents taken as a whole.

As we read proposed Rule 100(a) and 101(e)(1), an issuer that has disclosed material nonpublic information to an “outsider” is obligated to file a Current Report on Form 8-K unless it has publicized the information in one of the ways contemplated by Rule 101(e)(2). This means that an issuer that fails to comply with Rule 100 “in a timely manner” would lose its eligibility to use Forms S-2 and S-3, even though the failure was inadvertent or accidental.¹⁵ Further, in many cases it will be difficult or impossible to determine whether an issuer or “person acting on its behalf” has disclosed to an outsider information that is material or in many cases (especially where the triggering event is recklessness) when the obligation to disclose commences. Finally, it is not clear (and as a matter of strict construction, it is unlikely) that the ineligibility is

¹⁵ Footnote 56 supports this interpretation in saying that an issuer will not lose its eligibility for short-form registration if it satisfies the alternative means of public dissemination (presumably including timeliness) in lieu of filing a Form 8-K.

cured once the issuer has made public disclosure of the material information. As a result, management will be further intimidated with respect to its communications with outsiders.

The loss of eligibility to use Form S-3 may result in holders of "control" and "restricted" securities being unexpectedly unable to freely sell their securities off shelf registration statements.

5. Litigation Risk. The Commission has explicitly stated that Regulation FD is not intended to create duties under Exchange Act §10(b) and, as a result, no liability will arise from an issuer's failure to file or make public disclosure. But will the fact that an issuer makes public disclosure of a fact in one of the ways contemplated by Regulation FD constitute an admission that that fact is material? And will the plaintiffs' bar be able to make something out of that? And, of course, the Commission expects to bring actions for violation of Sections 13 and 15(d) of the Exchange Act only in what it regards as egregious cases. But we all know that reasonable men and women can and do differ on facts, their interpretation and what is egregious. In the end, many issuers will be unwilling to take the risk of public proceedings and attendant damaging publicity.

6. Likely Corporate Reaction. When faced with these uncertainties, what will be the natural reaction of management? The Commission itself admits that "corporate officials may therefore become more cautious" or "may feel compelled to consult with counsel more frequently." We believe that they will indeed. And, rather than taking some of the mitigating steps the Commission suggests, which themselves raise troubling legal and practical concerns (keeping records of the substance of private communications, recording conversations, having a witness present or declining to answer questions pending consultation with others), management will take the easier course and curtail considerably their access and openness to securities analysts. Is this a desirable outcome for investors?

It is also worth mentioning that communication between issuers and analysts is not a one-way street. Frequently, issuers communicate with analysts in an effort to encourage commencement of research coverage. Issuers also use analysts as sounding boards in an effort to test the marketplace's possible reaction to various courses of action. Imagine how difficult it would be for the Commission to regulate if it were not able to discuss possible rules and changes in rules with those subject to them and their counsel and instead had to hold all such

discussions in open meetings. Accordingly, if communications between issuers and analysts dry up or can only be conducted in open publicly accessible meetings, issuers as well as the marketplace will be the losers.

C. Analysts' Perspective

It hardly needs saying that analysts perform a necessary and very valuable function in the U.S. capital market. They, together with the media, are the principal way in which important financially significant information (including information contained in prospectuses and reports filed with the Commission) effectively reaches most investors and gets reflected in the marketplace. The alternative model of millions of individual investors and potential investors poring over prospectuses and periodic reports is highly theoretical and out of sync with the real world. But it does need to be said that analysts cannot do their work nearly as well as they do now if they are forced to do their work, at least when it comes to interaction with issuers, collectively – in a pack. Yes, they can elicit some facts, they can eliminate management “spin”, they can bring their expertise to the analysis, and they can give the markets rapid guidance as to the significance of new

information, thereby mitigating individual knee-jerk reactions to specific information.

But it is also the few analysts operating independently of, and in competition with, each other that can relentlessly pursue an independent line of inquiry and ferret out negative information that management would rather not disclose or would prefer to disclose at a time of its choosing and with its own spin. They can glean information from changes in the level of confidence (sometimes evidenced in subtle ways such as changes in choice of words or tone of voice) over a series of telephone conversations or face-to-face meetings. They can test their hypotheses by comparing information about different issuers in the same industry or sector. This kind of work results in more continuous disclosure, fewer surprises and less volatility. The marketplace itself provides incentives for such diligence, for it is the analysts who get to the market "firstest" with the "mostest" that under the current system reap the reputational and financial rewards. Leveling the playing field for analysts, as among themselves and vis-a-vis the general public, will undermine the great advantages of the current system.

The proposal could result in issuers declining to engage in dialogues with individual analysts or small groups

of analysts and instead insisting on sessions at regular intervals open to a number of analysts, with listen-only access to the media and the public. These are likely to take on the orchestrated character of a Presidential news conference in which members of the audience are authorized to ask one question, and perhaps a short follow-up question, but not a series of questions in dogged pursuit of the facts. Undoubtedly, the questions from the different participants will not be coordinated or follow in any logical order or comprehensive way. Due to fierce competition among analysts to obtain the best information, they will be reluctant to ask questions in an open session that tip off their competitors as to the direction of their thinking or information that they think would be meaningful. If the questions cannot be asked in private, they may not be asked at all.¹⁶ Is that good for the market?

¹⁶ Because analysts cannot perform their roles effectively under the burden of confidentiality agreements, as discussed below under "III. Specific Comments - C. Confidentiality Agreements," we believe there will be very few confidentiality agreements between issuers and analysts.

D. Significant Investors or Potential Investors

The Commission has acknowledged that an issuer may, under a confidentiality agreement, provide material nonpublic information to a potential party to a business combination or purchaser in a private placement and, by necessary inference, that such party or purchaser may act on the basis of that information. However, the Commission has not addressed how the Rule would work in the context of an issuer's relations with an investor that owns a significant percentage of the issuer's outstanding stock, significant institutional investors such as state pension plans or major mutual fund complexes.

Issuers' ability to communicate with large investors will be chilled. The issuer will have to make the same determinations of materiality as with securities analysts. If the requested information is determined to be material, are the possible courses of action to withhold the information, publicly disclose it or disclose it under an undertaking of confidentiality? We believe that, except in exceptionally unusual circumstances, institutional investors will be unwilling to sign confidentiality agreements because of the uncertain scope and duration of limitations on their freedom of action.

E. Cost-Benefit Analysis

The Commission identifies as benefits of the proposed Regulation: (1) increased investor confidence in the fairness and integrity of the markets, (2) benefits to issuers of more open and fair disclosure practices, including larger analyst following, narrower consensus in earnings estimates, low stock price volatility and lower cost of equity capital, and (3) benefits to securities analysts and others in the market for information, including more equal access of all analysts to material information and freedom to express opinions without fear of being denied access to valuable corporate information. If we are right in our expectations as to the effect of the Regulation, the second will turn into a cost and not a benefit, and the third will prove not to be significant.

On the cost side, the Commission estimates that on average each issuer will make five public disclosures under Regulation FD per year. We are unclear as to the basis for this estimate. Unless issuers are very loose in their definition of "material", we think the number of public disclosures per year, whether truly required or filed out of an excess of caution, will be far in excess of that amount. Since materiality is to a large extent a function of size, it may be that this will be more of a problem for small

issuers than large issuers, a factor the Commission is required to take into account. More importantly, we believe that the Commission has failed to address a very much larger issue than out-of-pocket issuer costs - the cost to the marketplace in terms of accuracy of pricing, surprise and volatility - if we are right that the Regulation will chill the flow of information into the marketplace.

Just as the Commission has candidly admitted that it cannot quantify the benefits it sees, so we candidly admit that we cannot quantify many of the costs of the effect of the Regulation on our information system as it currently exists. In such a standoff we urge the Commission to not take an action the benefits and costs of which are so nebulous and unquantifiable and the risks and results of which are so unforeseeable, particularly in light of increased investor access to information. Instead, we urge the Commission to advise issuers as to what it would like to see them do and then let issuers and analysts work it out.

III. Specific Comments

We believe for the general reasons described above that proposed Regulation FD is fundamentally flawed and should not be adopted in any form. We believe that the following specific problems constitute additional reasons why the Regulation should not be adopted.

A. Persons Subject to Rule

1. Foreign Government and Political Subdivision Issuers. Although foreign governments and political subdivisions are exempt from Securities Act § 15(d), foreign governments and political subdivisions register debt securities under Section 12 of the Exchange Act in connection with their listing on a national securities exchange. We assume that there is no intention to subject such issuers to the requirements of Regulation FD and that their inclusion was simply an oversight.

2. Foreign Private Issuers. The attempt to apply Regulation FD to foreign private issuers is a serious mistake. The Commission would reach into the home office of every foreign private issuer that has chosen to list on a U.S. securities exchange or publicly offer its securities

here and tell it that, regardless of the legal requirements and customary practices in its own country, whenever it intentionally or unintentionally discloses any material information to an outsider anywhere in the world, it has to make public disclosure of it in the United States.

Over the years the Commission has made numerous accommodations to foreign private issuers to encourage them to use the American capital markets and have their equity securities listed or quoted here. This both increased business in the American capital markets and made those securities readily accessible to American investors. Foreign private issuers are completely exempt from the proxy rules, Section 16(b) insider trading provisions and Quarterly Reports on Form 10-Q and Current Reports on Form 8-K. Instead of Forms 10-Q and 8-K, they are only required to furnish to the Commission the information that they make publicly available in their home countries. Without any explanation or justification for a radical change in direction, the Commission would in Regulation FD completely undermine the information accommodation. Having worked for many years to encourage foreign issuers to come to the United States and having been very successful in doing so, the Commission would, for the first time and in a very serious way, change the ground rules under which these

issuers chose to enter the U.S. marketplace. This is just the kind of ex post facto changing the rules of the game the risk of which deters many foreign issuers from accessing the U.S. capital markets in the first place.

The Commission argues that foreign as well as domestic issuers whose securities are listed on the New York or American Stock Exchanges or quoted on NASDAQ are already subject to obligations to make timely disclosure of material information. The Commission overlooks the fact that the requirements are very general,¹⁷ are subject to exceptions susceptible of a whole range of interpretation and are

¹⁷ NYSE Listed Company Manual § 202.05 says that "A listed company is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for its securities". (Emphasis added.) Section 202.06 goes on to identify major events that "should be handled on an immediate release basis". (Emphasis added.) It then gives considerable guidance on how to handle disclosure. NASDAQ IM-4120-1 requires that "except in unusual circumstances, NASDAQ issuers disclose promptly to the public ... any material information which would reasonably be expected to affect the value of their securities or influence investors' decisions" (Emphasis added.) It goes on to say: "Under unusual circumstances issuers may not be required to make public disclosure of material events; for example, where it is possible to maintain confidentiality and immediate public disclosure would prejudice the ability of the company to pursue its corporate objectives". It then identifies events of an unusual and/or nonrecurrent nature. Neither the NYSE nor the NASDAQ requirement comes close to a requirement to make public disclosure concerning any material nonpublic fact that is communicated to an outsider.

administered in a very practical way. As a practical matter, they usually come into play only when the market asks an issuer for an explanation of unusual market movements, and the only practical sanction if an issuer refuses to respond is the rather extreme act of a suspension of trading. Obviously, the matter has to be very serious to take that action.

We believe that if the Commission wishes to address the issue of selective disclosure by non-U.S. issuers, it should do so through IOSCO.

3. Issuer or Person Acting on Its Behalf. By the terms of the rule, public disclosure is required when "an issuer, or any person acting on its behalf, discloses ..." (Emphasis added.) Since a corporate issuer can act only through agents and all its employees are its agents, the first reference to "issuer" should be deleted. The rule then defines person acting on behalf of the issuer to include any officer, director, employee or agent - essentially everyone in the organization. It then limits this somewhat ambiguously by saying "who discloses material nonpublic information while acting within the scope of his authority". As stated above, this is broad enough to cover the purchasing agent who tells suppliers of the kinds and quantities of things needed for an exciting new product or a

salesman who tells prospective customers of a great new product (e.g., a new medical drug) in the pipeline. On the other hand, the proposing release says that the Rule "would make an issuer responsible only for the disclosure of company officials, employees, or agents who are properly authorized or designated to speak to the media, the analyst community, and/or investors." If that is all that is really intended, it should be incorporated in the Rule itself.

This scope of the proposed regulation is flawed in another way. What happens if an employee without authority to speak deliberately or accidentally discloses material nonpublic information under circumstances not resulting in insider trading? Literally, public disclosure is not required. What if a lower echelon employee in the finance or public relations department with apparent authority to speak deliberately or accidentally discloses material nonpublic information (e.g., concerning a possible acquisition or disposition) in violation of an express order not to talk about the subject? Is this with or without authority?

4. Senior Official. Prompt disclosure is required after a "senior official" knows (or is reckless in not knowing) of a non-intentional disclosure of material nonpublic information to an outsider. Senior official is

defined to include directors. We believe that it is inappropriate to put outside directors in this position and to subject issuers to adverse consequences by reason of directors' failure to recognize or report such information. Rather, we believe that "senior official" should be restricted to the chief executive officer, chief financial officer or any other officer responsible for speaking for the issuer with respect to financial matters.

5. Prompt Disclosure. Public disclosure is required as soon as reasonably practicable (but no later than 24 hours) after a senior official knows (or is reckless in not knowing) of a non-intentional disclosure. For purposes of measuring the 24 hours, at what moment in time is a senior official reckless in not knowing of the disclosure? The time when a person learns something, or is reckless in not knowing sooner, are both not workable as bases for triggering a disclosure or filing requirement.

6. Governmental Recipients. Issuers frequently provide nonpublic material to regulators, enforcement agencies and courts or arbitrators. Do any or all of them owe a duty of trust or confidence to the issuers? If not, will they be prepared to expressly agree to maintain such information in confidence? They should be deleted from the definition of outsiders. This illustrates the risk that the

Commission has not thought of all the situations in which nonpublic information is legitimately communicated "selectively" to outsiders.

B. Eligibility for Shelf Registration and Rule 144

As described above under "II. General Comments - B. Issuers' Perspective," the prospect of loss of eligibility to use Form S-3 will have a very chilling effect on issuers and their relationships with all kinds of third parties, not just securities analysts. The problem will not be solved as a practical matter by suspending eligibility during the time an issuer is in noncompliance with Regulation FD because of the difficulty in determining whether an issuer is in noncompliance. Accordingly, if the Commission adopts Regulation FD, we believe it should amend Forms S-2 and S-3 to state that eligibility to use such forms is not affected by noncompliance with Regulation FD.

Rule 144 is available for sales of "control" and "restricted" securities if the issuer of such securities has been subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act for at least 90 days and "has filed all the reports required to be filed thereunder during the 12 months preceding such sale". The seller is entitled to rely upon the issuer's statement, in its most recent

report on Form 10-K or 10-Q, that it has filed all reports required to be filed during the preceding 12 months, unless the seller knows or has reason to believe that the issuer has not complied with such requirements. Under Regulation FD an issuer would find it difficult to know whether it has complied with its filing requirement. If it determines that it has not and corrects the deficiency, presumably Rule 144 has been satisfied since there is no requirement of timely filings. In the meanwhile, however, holders of control or restricted securities may be unable to take advantage of Rule 144. We believe that this is unduly harsh to such holders and, accordingly, that Rule 144 should be amended to state that eligibility to use such rule is not affected by noncompliance with Regulation FD.

C. Confidentiality Agreements

Given the broad reach of the rule, we understand the need to carve out information delivered to someone who agrees to maintain it in confidence.¹⁸ Assuming that some issuers would desire to document the agreement, we foresee a multiplicity of competing forms. Each party will for

¹⁸ The use of the word "express" gives rise to some ambiguity. We conclude from the other language of proposed Rule 101(a) and the language of the release that the agreement need not be in writing.

legitimate reasons want to have a single form of agreement covering all its employees. Issuers will prepare a form of confidentiality agreement complete with indemnities for breach. The firm of each analyst will have its own form, slightly different from the forms of other firms and certainly different from issuers' forms by reason of the absence of any indemnity. Whether through a "battle of the forms" or in connection with a specific communication, it seems obvious that negotiations of confidentiality agreements alone will lead to delays in the communication of information or, in many cases, abandonment of the attempt to communicate.

If issuers succeed in imposing their forms on analysts, will the issuers have succeeded in transferring their risk to the analyst? Then, who determines which of the information communicated by the issuer is material, non-public and, therefore, subject to the agreement? Does that depend on whether the Commission subsequently brings an enforcement action and succeeds - or the plaintiffs' bar succeeds in making something of the information? What are the damages to the issuer if the analyst intentionally discloses the covered information in violation of the agreement, accidentally discloses it, makes a mistake as to what is material or nonpublic or discloses something else

from which a clever reader deduces (or guesses correctly) the covered information?

If an analyst were to enter into a confidentiality agreement and receive very negative non-public information, such as the fact that the issuer is in serious financial trouble, what is he or she to do? Maintain an out-of-date recommendation? For how long? Suspend coverage - with whatever information that conveys to the marketplace? Change his or her recommendation based on the information received? Analysts cannot let themselves be put in this position.

In the end we believe that there will be very few confidentiality agreements between issuers and investors or between issuers and analysts.

D. Proposed Rule 181

This proposed rule simply highlights the problems of mandating broad public disclosure of all material nonpublic information that is otherwise disclosed. The issuer is caught in the cross-fire of Securities Act § 5 and proposed Regulation FD. We believe the problems are the same whether public disclosure is required before or after a registration statement is filed. Accordingly, we believe that any Regulation FD disclosure that constitutes an

"offer" or "prospectus" should be exempted from Section 5(c) as well as Section 5(b).

If a Regulation FD-required public disclosure might be an offer for purposes of Section 5, then don't we also have to worry whether it is a "public offering" for purposes of Section 4(2), a "general solicitation" for purposes of Regulation D, an "offer" to non-QIBs for purposes of Rule 144A and or a "directed selling effort" for purposes of Regulation S?

These problems are very serious when one considers that the penalty for violation is rescission. They also illustrate the difficulties in trying to control information in the electronic age that we addressed in our letter, dated May 12, 1999, commenting on the proposed Aircraft Carrier.

By its terms the protection of Rule 181 is available only if (1) the public disclosure is "used only as required under Rule 100(a) of Regulation FD" and (2) the "registrant otherwise complies with the requirements of Regulation FD". We assume that clause (1) means that the information is made public only in the manner contemplated by Rule 101(e) (not (a)) and that, notwithstanding the way in which paragraph (e) is drafted, an issuer may distribute the information concurrently in all three of the ways specified in paragraph (e), namely, the filing of a

Form 8-K, dissemination of a press release through a widely available news or wire service and dissemination through any other method of disclosure that is reasonably designed to provide broad public access to the information and does not exclude members of the public from access. Presumably, the language of clause (1) is designed to preclude use of the Form 8-K press release etc. to actually offer and sell the securities.

As to clause (2) of Rule 181, we are puzzled at the meaning of "otherwise complies with" Regulation FD. This cannot mean that the exemption is not available if the information was not filed "simultaneously" in the case of intentional disclosure and "promptly" in the case of non-intentional disclosure. It must mean that the information, when disclosed in the required manner (even if late), will be exempt. The Commission should clarify that this is the case.

IV. Conclusion

We share the Commission's goal of encouraging greater disclosure of information to the marketplace. Our disagreement with proposed Regulation FD is its practical effect.

We have tried to present a ground-level view of the practical problems involved in trying to comply with the requirements of proposed Regulation FD in real-world situations. We believe that the majority of issuers will curtail the current level of communications with securities analysts and the media. This widespread informational "brown-out" will be far more damaging than the relatively small number of abusive selective disclosures under existing law. Other issuers might decide to live with the rule by taking a narrow view of what is material, but their attitude may change as they consult with counsel about the difficulty of making materiality assessments and the many circumstances that may lead to enforcement investigations and private actions.

A governmental regulation is a blunt instrument when it tries to impose legal obligations to act arising out of ordinary course day-to-day communications of millions of

persons. Regulation FD cannot and will not work as intended.

The Commission should seek other remedies for what it perceives as abuses of selective disclosure. NIRI has published a booklet, Standards of Practice for Investor Relations (Apr. 1998), that at pp. 27-37 contains constructive recommendations as to how to avoid the problems of selective disclosure. Rather than adopt Regulation FD, the Commission should consider whether it is satisfied with such recommendations and, if not, discuss with NIRI proposed changes therein. When satisfied, the Commission should promote the adoption of such principles by all reporting issuers and monitor what happens. The Commission could also address more directly the specific abuses that concern it, including the vigorous enforcement of existing insider trading prohibitions. This approach would be far preferable to imposing an oppressive regulation on all issuers in order to get at a relatively small number of abusive cases.

The SIA very much appreciates this opportunity to present its views. Should you have any questions, please feel free to communicate with George R. Kramer of the SIA's staff at (202) 296-9410.

Very truly yours,

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