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April 20, 2001

The Honorable Laura S. Unger  
Acting Chairman  
Securities and Exchange Commission  
450 Fifth Street, NW  
Washington, DC 20549

Re: April 24, 2001 Regulation FD Roundtable - Initial Experience with Regulation FD in the High-Yield Debt Market

Dear Chairman Unger:

The Bond Market Association (the "Association") is pleased to submit this letter to the Securities and Exchange Commission (the "Commission") in connection with the Commission's public roundtable to discuss the initial experiences of issuers, analysts and investors with Regulation FD.<sup>1</sup>

The Association appreciates the initiative that the Commission, and you personally, have taken to organize this roundtable discussion and to solicit the views of market participants regarding the impact of Regulation FD. In this connection, we are especially grateful for the Commission's willingness to consider our views and the views of the fixed income community on this important issue. The Association looks forward to continuing to work with you and the Commission to develop regulatory policies that improve the quality of publicly available information about reporting companies.

As noted in our comment letter on the Commission's original Regulation FD proposal, the Association opposes the practice of selectively disseminating material, non-public information where the purpose of the selective disclosure is to confer a benefit or preference.<sup>2</sup> At the same time, we expressed concern that the requirements of Regulation FD, as proposed, could adversely affect the flow of information in the high-yield debt markets, as well as create difficulties for issuers seeking to raise capital through private offerings of high-yield debt.

Our members' initial experience with Regulation FD suggests that the new disclosure requirement, while beneficial in some respects, has had generally negative consequences for the high-yield debt markets that merit continued careful monitoring by the Commission. In particular, the Association believes that, during the six months following the implementation of Regulation FD:

The volume and quality of the information made available by issuers in the high-yield marketplace has declined, and effective analysis of matters with particular relevance for high-yield debt investors has become more difficult as a result;

The volatility of certain segments of the market, especially of smaller high-yield debt issuers, may have increased, and the liquidity of certain issues may have decreased, as a result of changes in the flow of information to the marketplace; and

Private placements of high-yield debt securities have required increased time and expense, particularly in light of the impracticability of obtaining written confidentiality agreements as part of the offering process.

Part I of this letter provides a brief overview of the high-yield debt markets. Part II elaborates upon our members' initial experience regarding the impact of Regulation FD's disclosure requirements on the securities marketplace.

## I. Overview of the High-Yield Debt Markets

High-yield securities constitute a critical method of raising capital for corporate issuers that do not possess an investment grade rating from a rating agency and might not otherwise be able to access the debt markets.<sup>3</sup> The market for high-yield securities in the United States has tripled over the last ten years, increasing from \$200 billion in principal amount of securities outstanding in 1990 to approximately \$600 billion in principal amount outstanding in 2000.<sup>4</sup> Over 5,000 high-yield bonds have been issued in the last ten years. This growth reflects the significant capital needs of high-yield issuers, as well as the growing demand for and investor acceptance of this type of instrument.<sup>5</sup>

High-yield securities share several characteristics that distinguish them from both equities and investment grade bonds and raise particular issues of concern under Regulation FD. First, high-yield securities are significantly more sensitive to real or perceived changes in the issuer's capacity to service its obligations. By definition, issuers of high-yield securities demonstrate material levels of financial leverage and are therefore more susceptible to economic factors, such as increases in interest rates or a deterioration in the economic environment in their respective markets, that may affect their ability to repay principal and interest on their securities.

In particular, research analysts have suggested that credit concerns have contributed to the decline in the volume of new issues of high-yield bonds over the last two years. The volume of new issues of high-yield securities amounted to \$47.5 billion in the year 2000, as compared to \$143.9 billion in 1998.<sup>6</sup> The sensitivity of high-yield debt to such factors underscores the importance of maintaining an adequate, timely and consistent stream of high quality information about issuers in the high-yield sector. It is essential to the vitality of the high-yield market that high-yield analysts have access to the information necessary to be able to identify credit issues on a timely basis and place their significance in the proper context.<sup>7</sup>

Second, issuers of high-yield securities are generally smaller, in financial terms, than issuers in the investment grade debt market.<sup>8</sup> Such issuers often have considerable

competing demands on available financial resources and, as discussed in Part II.A below, may not have adequate staff or resources to communicate with the public on a regular basis. The quality and quantity of information an issuer can provide is consequently limited by the issuer's ability to make the legal and business determinations and stage the broad, public dissemination of information required by Regulation FD.

Third, liquidity in the secondary market for high-yield securities is not maintained as readily as in the market for investment grade securities and is therefore more susceptible to disruption - for example, by the lack of current information about the issuer.<sup>9</sup> In addition, many high-yield issues are of a relatively small size, and are therefore likely to be followed by a smaller group of analysts. As a result, the amount of information produced by analysts with respect to these issues has fewer points of origin and may be less extensive than is the case for other issues.<sup>10</sup>

## II. Initial Experience with Regulation FD

### A. Regulation FD Has Generally Had an Adverse Impact on the Information Available in the High-Yield Debt Marketplace

Based on our members' experience to date, Regulation FD has generally had an adverse impact on the volume and quality of information that issuers provide to the public. While improving access to material information in some respects, Regulation FD has imposed significant constraints on the discourse between issuers and analysts, both by limiting the venues in which discussions tend to occur and by narrowing the range of information made available to the public - e.g., regarding issues of concern to the high-yield debt market. In addition, a number of issuers (particularly smaller issuers that maintain less extensive investor relations staff) appear to have reduced the amount of information, as well as the frequency with which they disseminate information, to avoid the cost of making the difficult materiality assessments required by Regulation FD. As a result, the ability of high-yield debt analysts to collect and disseminate information to the marketplace has been significantly impaired.

**Impact of Regulation FD on the Dialogue Between Issuers and Analysts.** The adoption of Regulation FD has markedly altered the quality of information available to analysts by limiting opportunities for in-depth dialogue with issuers - particularly on matters that are relevant to the high-yield market.

Many issuers have sought to minimize the need to make materiality assessments under Regulation FD - as well as to avoid the appearance of providing selective disclosure to analysts - by conducting the vast majority of significant communications with analysts and investors in public venues, such as through their websites, teleconferences, or regulatory filings. These changes have, of course, resulted in some improvements in the ability of investors and market professionals to obtain access to material information disseminated by an issuer. For example, following the implementation of Regulation FD,

there has been a significant improvement in the amount of statistical and other relevant information provided by issuers on their websites. Moreover, Regulation FD has in this respect leveled the playing field for high-yield analysts and other market professionals who traditionally have been excluded from conference calls with an issuer's favored equity sell-side analysts.

While the Association strongly favors the use of public venues and innovative technologies to communicate with investors, these venues suffer from numerous limitations and therefore cannot serve as an effective substitute for ongoing substantive dialogue between issuers and analysts. Publicly conducted webcasts and conference calls do not typically afford the same opportunities to develop information essential to effective analysis of fixed income instruments. Large public settings render it more difficult to draw out the depth and nuance that can be elicited by the third, fourth or fifth follow-up question - questions that can only be asked in the one-on-one context. Moreover, issuers may find it easier in a public meeting to avoid insightful questions or to resist elaboration of specific issues of interest, particularly where the questions do not relate directly to financial forecasts. To draw an analogy from public life, consider the differences between a press conference and a one-on-one "60 minutes" interview with a political candidate: even though both are broadcast publicly, the nature of the information elicited in the one-on-one context generally will differ from the information made available in the press conference (especially on issues the candidate would rather not discuss).

Regulation FD has created particular problems for analysts that focus on issues of relevance to a particular market segment - such as high-yield debt. Analysts in the high-yield market have a significant interest in issues that generally are not of interest to shareholders and equity analysts, such as covenant packages and related features of specific securities or financing. As a result of Regulation FD, high-yield debt analysts must now compete with equity analysts and others for the limited "air time" allotted for issuer conference calls and webcasts. In the context of such conference calls and webcasts, high-yield and other debt analysts generally have had less opportunity to explore issues of concern to debt holders in detail, as well as to ask multiple follow-up questions, probe assertions made by issuers, or otherwise engage issuers and their representatives in substantive discussions of issues uniquely important to the debt markets.

Impact of Regulation FD on the Information Available to Investors and Analysts. The experience of the Association's members to date also suggests that, as widely anticipated, Regulation FD has reduced the frequency of issuer communications and the amount of information made available to investors and analysts. The impact, however, has varied from issuer to issuer and appears to reflect a range of factors.

First, smaller issuers - with less extensive investor relations, finance and legal staff and resources - have experienced greater difficulty in arranging for frequent discussions with analysts in light of the application of Regulation FD. All issuers, in considering whether to disseminate information, must balance the benefits of disclosure against the legal

expense associated with difficult materiality decisions, the cost of making disclosure in a public setting or filing, and the demand for scarce management time. In the case of smaller companies, this assessment has tended to lead to less frequent and extensive disclosure opportunities (often only in connection with periodic filings and related announcements).

Second, in many cases, issuers are sensitive to the potential for competitors to benefit from information disclosed to analysts in a public setting. Thus, competitively sensitive information no longer tends to be disclosed, except to the extent necessary to satisfy public filing requirements with the Commission. Given the justifiable conservatism of issuers in applying the qualitative and judgmental legal standard of "materiality," the impact of this non-disclosure extends even to information that, standing alone, would be immaterial but that could prove important to effective analysis of a company's position.

Third, the incentives for disclosure of information important to holders of high-yield debt securities often will not outweigh the additional compliance burdens resulting from Regulation FD. Company management, whose principal fiduciary duty is to shareholders, typically has a substantially greater interest in ensuring marketplace disclosure on issues affecting an issuer's equity securities than on those affecting solely its debt securities. Companies thus appear less likely to create opportunities to permit high-yield analysts to obtain the specialized information that may be essential to the performance of their job (and in some cases, may have selectively invoked Regulation FD itself as a shield to avoid discussions with high-yield analysts). This problem is particularly acute, moreover, in cases where a company's only publicly traded securities are debt and not equity - since high-yield analysts cannot avail themselves of information that might otherwise be provided for the benefit of the equity security holders.

#### B. Regulation FD May Have Increased Volatility and Decreased Liquidity for Certain High-Yield Issues

Although a definitive assessment cannot yet be offered, our experience to date suggests that the changes in the flow of information resulting from Regulation FD may have had a negative impact on the volatility of high-yield debt securities, as well as on the liquidity of smaller issues. In the Association's view, accordingly, it is essential for the Commission to assess carefully the potential for longer-term adverse consequences for the efficiency of the high-yield debt market.

As discussed above, Regulation FD has in many cases made it more difficult for high-yield analysts to develop in-depth, ongoing research that can be made available to the market. In addition, the rule appears to have resulted in the dissemination of less extensive information on a more infrequent basis - particularly with respect to those issuers whose equity securities are not publicly traded - thereby creating the potential for more pronounced earnings surprises or other unanticipated business developments. Moreover, when such information is disclosed, the issuer must communicate it directly to

the public, without affording analysts and other market commentators an opportunity to consider, interpret and explain the significance of particular items disclosed.

These changes in information flow appear to have led market participants to concentrate trading activity around particular disclosures, as investors react immediately to the news being disseminated without opportunity for reflection. High-yield debt securities may be particularly prone to significant price fluctuations following such disclosures. Similarly, liquidity has tended to decrease during periods when issuers disseminate relatively little information to the marketplace, since investors lack access to current information about the issuer.

Increased volatility is particularly problematic in the high-yield markets, which have not yet achieved the liquidity of the government and investment-grade securities markets. In the case of less liquid securities (particularly of smaller issuers), the absence of ongoing disclosure can decrease investor interest in trading between periodic disclosures, thereby reducing liquidity further and heightening the risk of greater volatility. While empirical data have not yet emerged, these risks could result in wider spreads or a reduction in the number of market makers for particular instruments, which may negatively affect the availability and cost of capital for high-yield issuers.

### C. Regulation FD Has Added Burdens to the Private Placement Process

Regulation FD has increased the burdens on issuers conducting private placements, particularly for small-cap companies that typically issue high-yield debt. Regulation FD is widely perceived to have heightened the importance of avoiding disclosure of nonpublic information in the context of a private placement that might be regarded as material in hindsight. Because issuers have generally found it impracticable to obtain confidentiality agreements from prospective investors, issuers have deemed it necessary to adopt more stringent procedures for "sanitizing" private placement memoranda and ensuring that prospective purchasers receive no material information that is not simultaneously disclosed to the public.<sup>11</sup>

These additional procedures have proven costly and have introduced considerable delays in the private placement process without appreciably improving the information made available to the public.<sup>12</sup> For example, counsel must review private offering documents and assess the materiality of the disclosures made therein, while question-and-answer sessions and other meetings with prospective investors must be carefully structured to avoid inadvertent disclosure of material information that will not have been simultaneously published.<sup>13</sup> Issuers and their counsel must also make certain that all public disclosures (e.g., on Form 8-K) are drafted in a manner that does not violate the prohibition against general solicitations under Section 5 of the Securities Act of 1933.<sup>14</sup> These additional steps, moreover, address a policy issue of only marginal concern, since issuers in most instances refrained from disclosing material, nonpublic information to investors in the context of private placements even before Regulation FD was adopted.

## Conclusion

While Regulation FD was designed to encourage issuers to make full and fair disclosure of material information, it appears that the rule may have had a significant negative impact on the volume and quality of information that issuers disseminate to the public. In particular, analysts have encountered significant difficulties in eliciting information - especially regarding issues of concern to the high-yield debt markets - from those issuers who have come to rely on the use of public venues for the dissemination of material information to avoid making the materiality assessments required by Regulation FD.

In light of these developments, it is essential, in the Association's view, that the Commission continue to assess the progress of the issuer and analyst community in implementing Regulation FD and vigilantly monitor the impact of the regulation on the market for high-yield and other fixed income securities. In particular, the Commission should strongly consider approaches to alleviating the legal and administrative burdens of complying with Regulation FD, such as:

Reducing the need for issuers to make difficult materiality assessments in discussions with analysts or other market professionals - particularly with respect to issues that concern only a limited segment of the market; and

Encouraging greater communication between issuers and investors in the context of Rule 144A and similar private placement offerings (e.g., during question-and-answer sessions or roadshows with prospective institutional investors).

In this connection, the Association encourages the Commission to explore a wide range of alternatives that could address issuer concerns.<sup>15</sup>

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We appreciate the Commission's initiative in seeking the views of issuers, analysts and investors in connection with its forthcoming roundtable discussion regarding Regulation FD, and look forward to working with the Commission to find ways to continue to ensure fair disclosure to all investors while improving the quality and efficiency of the fixed income markets.

If it would be helpful to the Commission or members of its Staff, we are available to meet and discuss any points raised in this letter. Please address any questions or requests for additional information to Michel de Konkoly Thege, Vice President and Associate General Counsel of the Association, at (212) 440-9476, or to Giovanni P. Prezioso or Onnig H. Dombalagian of Cleary, Gottlieb, Steen & Hamilton at (202) 974-1500, special counsel to the Association in this matter.

Sincerely,

/s/ Matthew W. Quigley

Matthew W. Quigley  
Credit Suisse First Boston Corporation  
Vice-Chair, High Yield Bond Committee  
The Bond Market Association

cc: The Honorable Isaac C. Hunt, Commissioner  
The Honorable Paul R. Carey, Commissioner  
David Becker, General Counsel, Office of the General Counsel  
Stephen M. Cutler, Deputy Director, Division of Enforcement  
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#### Notes

The Association represents securities firms and banks that underwrite, trade and sell debt securities, both domestically and internationally. The Association's member firms collectively represent in excess of ninety-five percent of the initial distribution and secondary market trading of corporate debt securities and other fixed income securities. More information about the Association is available at [www.bondmarkets.com](http://www.bondmarkets.com). This letter was prepared in consultation with the Association's High Yield Bond Committee and Corporate Bond Legal Advisory Committee.

Letter from Irshad Karim, Chair, Corporate Bond Legal Advisory Committee, The Bond Market Association to Jonathan G. Katz, Secretary, Securities and Exchange Commission (Apr. 28, 2000).

For purposes of this letter, a high-yield security is one that is rated by at least one nationally recognized statistical rating organization and that does not possess at least one investment grade rating (i.e., a rating of BBB-/Baa3 or higher).

The Bond Market Association Research Group.

According to the Investment Company Institute, the net assets of high-yield bond mutual funds increased from \$45.1 billion in 1994 to \$116.9 billion in 1999.

The Bond Market Association Research Quarterly, Feb. 2001, page 5.

Unlike bond rating agencies, which evaluate solely the ability of an issuer to meet its obligations when and as they become due, high-yield analysts additionally provide "relative value" analysis of high-yield issues - i.e., using established relationships based on criteria such as maturity, seniority, and industry prospects to identify situations in which certain issues may offer a better yield to investors vis-à-vis similarly situated issues.

The Bond Market Association Research Group.

Id.

This factor may be exacerbated in the case of high-yield issuers that have not issued publicly traded equity and are therefore followed only by fixed income analysts.

Prospective purchasers, typically large institutions, have almost uniformly been unwilling to agree to any confidentiality undertakings that might restrict their right to trade securities. This has proven especially true in the context of Rule 144A offerings, which play a central role in the high-yield securities markets, because of purchasers' desire to preserve complete flexibility to engage in resales.

The Association understands that similar problems have been experienced in other fixed income market sectors, including mortgage-backed and asset-backed securities offerings conducted pursuant to Rule 144A.

Material information that may be disseminated during roadshows for many registered offerings, by contrast, is not covered by Regulation FD. See Rule 100(b)(2)(iv) of Regulation FD.

In the Regulation FD adopting release, the Commission acknowledged that Regulation FD requires public disclosure of material information provided to an investor in an unregistered offering "even if, as a result of such disclosure, the availability of the Securities Act registration exemption may be in question." Securities Act Release No. 7881 (Aug. 15, 2000), 65 Fed. Reg. 51,716, 51,725 (Aug. 24, 2000).

These could include, for example, an exemption for small issuers or high-yield issuers with no publicly traded equity, or for communications made in connection with Rule 144A private placement transactions. The Association notes that these suggestions have not necessarily been endorsed by its members at this stage.