

# What Can Managers Privately Disclose to Investors?

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*Regulators have long been aware that differential access to information can undermine the efficiency and fairness of financial markets. In an effort to place investors on equal footing, the Securities and Exchange Commission in 2000 created Regulation Fair Disclosure (Reg FD), which prohibits public firms from disclosing material information to certain parties but not others. Nevertheless, managers have continued to meet privately with select investors, possibly sharing information in violation of Reg FD. A key weakness of Reg FD is that its definition of materiality remains unclear. Using a series of vignettes based on actual private investor meetings, I investigate how managers and regulators understand Reg FD. I find considerable uncertainty and disagreement among both managers and regulators as to what kind of information may be lawfully communicated. Many managers interpret Reg FD subjectively, often relying on individual industry norms to decide where to draw the line. Ultimately, the ambiguity of Reg FD leads to considerable variation in the information managers privately provide to investors, undermining the notion of a level playing field in financial markets.*

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## I. Leveling the Playing Field

Well-functioning equity markets are predicated on investors' ability to acquire accurate and timely information about firms. This information is gathered from a variety of sources, including press releases, regulatory filings, conference calls, and private meetings with management. Historically,

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executives provided information selectively, sharing it with certain investors during private meetings. To the extent that only some investors had access to certain material information (e.g., advance knowledge of earnings-related information), it placed these investors in a more favorable trading position.<sup>1</sup> Notably, the prohibition against insider trading did not restrict managers from providing information during private meetings with investors, since the information was neither being misappropriated nor traded upon for personal gain by insiders.<sup>2</sup>

Out of concern that the selective disclosure of news by managers could undermine investor confidence and the integrity of financial markets, the Securities and Exchange Commission (SEC) implemented Regulation Fair Disclosure (Reg FD) in October 2000. Reg FD requires any material information disclosed by managers to be released publicly so that all investors may consume it.<sup>3</sup> The regulation effectively closed the gap that existed around insider trading restrictions that permitted managers to convey some non-public, material information legitimately to outsider parties.

When Reg FD was promulgated, some commenters raised concerns that the regulation could sharply curtail or even eliminate private dialogue between managers and investors.<sup>4</sup> However, in the years since, private meetings have flourished despite the apparent restrictions on what may be conveyed during these offline interactions. For example, Brown, Call, Clement, and Sharp (2018) recently surveyed hundreds of investor relations officers and found that seventy percent of firms granted investors offline access to senior executives.<sup>5</sup>

Researchers have tried to understand how private meetings persisted in the wake of Reg FD. One explanation is that managers merely provide immaterial information to investors during meetings, which is permitted under the regulation. An alternative hypothesis is that managers commonly disclose material information, but that these violations are difficult to enforce because the meetings are private. Indeed, these private meetings appear to be quite valuable: Academic papers have found that those in attendance make more

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1. See, e.g., Lauren Cohen et al., *Sell-Side School Ties*, 65 J. FIN. 1409 (2010) (showing that prior to Reg FD, sell-side analysts outperformed their predictions by nearly ten percent a year on average when they shared an educational background with members of senior management at a firm); Andreas Gintschel & Stanimir Markov, *The Effectiveness of Regulation FD*, 37 J. ACCT. & ECON. 293 (2004) (showing that after Reg FD, the impact of analyst reports on stock prices diminished by 28%).

2. See 17 C.F.R. § 240.10b-5 (2018).

3. See Regulation FD, 17 C.F.R. § 243 (2018).

4. See, e.g., Joanna E. Barnes, *Regulation FD Will Result in Poorer Disclosure and Increased Market Volatility*, 29 PEPP. L. REV. 3 (2002).

5. Lawrence D. Brown et al., *Managing the Narrative: Investor Relations Officers and Corporate Disclosure*, J. ACCT. & ECON. (forthcoming 2018).

informed trading decisions—buying before the stock rises and selling before it falls.<sup>6</sup>

To better understand how both managers and regulators view the appropriateness of information disclosed during private meetings, I present a series of vignettes of private meeting interactions to managers and regulators to ascertain what types of dialogues they view as appropriate. As will be shown, the answers by both managers and regulators suggest that there is considerable uncertainty about what is acceptable. Managers operate in the penumbra of regulatory ambiguity when they privately meet with investors.

## II. Assessing Managerial and Regulatory Views of Acceptable Private Dialogue

Reg FD requires that whenever a firm seeks to disclose material information, the information must be disclosed publicly (e.g., via press release, conference call, etc.). The regulation does not explicitly prohibit managers from speaking privately with investors and analysts, but restricts them to communicating information that is immaterial. However, Reg FD does not define what is meant by material information.<sup>7</sup> In its preamble to the final rule, the SEC explicitly noted that Reg FD relies on existing definitions of materiality in the case law—i.e., “[i]nformation is material if ‘there is a substantial likelihood that a reasonable shareholder would consider it important’ in making an investment decision.”<sup>8</sup> Numerous law firms have noted the uncertainty in the interpretation of the regulation and the difficult position it places managers in,<sup>9</sup> and ultimately no clear guidance about what information could be conveyed privately under the regulation was provided.<sup>10</sup> Adding to the ambiguity, the SEC considers some information immaterial even if it can be used by investors and analysts in conjunction with their other information to make material insights.<sup>11</sup>

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6. See Brian J. Bushee et al., *Do Investors Benefit from Selective Access to Management?*, 2 J. FIN. REPORTING, no. 1, 2017, at 31; David Solomon & Eugene Soltes, *What Are We Meeting For? The Consequences of Private Meetings with Investors*, 58 J.L. & ECON. 325 (2015).

7. See 17 C.F.R. § 243.101 (2018).

8. Selective Disclosure and Insider Trading, 60 FED. REG. 51,716, 51,721 (August 24, 2000) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

9. See, e.g., LATHAM & WATKINS, *THE SEC’S REGULATION FD—FAIR DISCLOSURE* (2000), [https://www.lw.com/upload/pubContent/\\_pdf/pub302.pdf](https://www.lw.com/upload/pubContent/_pdf/pub302.pdf) [<https://perma.cc/BUZ8-BCPG>]; MORRISON & FOERSTER, *FREQUENTLY ASKED QUESTIONS ABOUT REGULATION FD* (2017), <https://media2.mofo.com/documents/faqs-regulation-fd.pdf> [<https://perma.cc/DF52-D6X3>].

10. There have been only thirteen enforcement cases since the enactment of Reg FD. See Martin Bengtzen, *Private Investor Meetings in Public Firms: The Case for Increasing Transparency*, 22 FORDHAM J. CORP. & FIN. L. 33, (2017). For a discussion of the ambiguity of Reg FD, see also John L. Campbell et. al., *Selective Disclosure After Regulation Fair Disclosure: More than Simply ‘Completing the Mosaic’?* (Kelley School of Business, Research Paper No. 16-52, 2017), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2803308](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2803308) [<https://perma.cc/SK7Y-5Z7Z>].

11. See Selective Disclosure and Insider Trading, 60 FED. REG. 51,716, 51,722 (August 24, 2000) (“At the same time, an issuer is not prohibited from disclosing a non-material piece

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The continued ubiquity of private investor meetings suggests that some norms have developed about what information managers may convey. However, it is uncertain whether these practices comport with the expectations of regulators. To better ascertain the boundaries of permissible private dialogue under Reg FD, I asked both managers and regulators to evaluate a series of vignettes depicting private meetings between investors and managers.

To design the vignettes, I relied on a dataset collected by observing and recording the private interactions between investors and managers at nearly seventy private meetings at two publicly traded companies.<sup>12</sup> During these meetings, investors posed more than 1,200 questions to executives. I focused on questions that asked information about management impressions of the firm and those that sought more timely information since these inquiries raise the most salient concerns with potentially conveying material information. I sought to also select questions that not only raised challenging issues, but ideally also ones that were routinely asked by investors. For instance, twenty-six different investors in the database asked managers of a biotechnology firm for an update on the firm's cash position and cash burn rate.<sup>13</sup> I worked with two investor relations officers (who have more than fifteen years of experience each and have collectively attended hundreds of private investor meetings) to script representative investor-manager conversations based on these questions.<sup>14</sup> In each vignette, the investor asks for a certain kind of information about the company, and the manager offers an answer (all seven vignettes are provided in the Appendix). Survey respondents read the vignettes and were asked: "Would you consider the information the investor received during the meeting with COMPANY to be a violation of Reg FD?"

Participating managers were randomly selected from a list of chief financial officers and investor relations officers of large publicly traded firms.<sup>15</sup> Participating "regulators"—specifically, individuals charged with investigating possible violations of the securities laws and helping enforce those laws—were

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of information to an analyst, even if, unbeknownst to the issuer, that piece helps the analyst complete a "mosaic" of information that, taken together, is material.")

12. See Jihwon Park & Eugene Soltes, *What Do Investors Ask Managers Privately?* (April 9, 2018) (unpublished manuscript), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3087369](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3087369) [<https://perma.cc/99GG-FJMC>].

13. The cash questions served as the basis for the Situation C vignette shown in the Appendix.

14. To protect firm managers, the dataset recorded the investors' questions but not the managers' answers. Thus, the manager responses provided in each vignette are plausible answers that reflect the experience of the investor relations officers who helped design the vignettes, rather than the literal response of managers in the Park and Soltes (2018) field work.

15. Firms were selected from the CRSP/Compustat database if they met all of the following criteria: They held at least one earnings conference call in 2016, had a share price of greater than \$5, were an operating firm (i.e., not a holding firm or REIT), and were incorporated in the United States. From these 2,695 firms, I randomly selected 150 firms and went to each firm's website to find an e-mail contact for their investor relations officer or chief financial officer, of which I found 134 direct e-mail addresses.

shown the vignettes during an annual training conference.<sup>16</sup> The order of the vignettes was randomized to avoid rank-order effects. I received completed surveys from thirty managers and seventy regulators.<sup>17</sup> The responses for each of the seven vignettes are provided in Figure 1.

Managers responded to every vignette with significant disagreement, some seeing the disclosure as a potential violation of Reg FD and others deeming the information immaterial. In every case there were some managers who believed the disclosure was unambiguously illegal, while others found it “likely not” or “not” a violation of Reg FD. On average, 65% of the managers responding to each vignette stated that the depicted disclosure likely or certainly violated Reg FD. Even for the vignette that the most managers found acceptable (Situation A: expressing sell-side analyst interest), a significant minority—38%—still believed the information violated or likely would violate Reg FD. The aggregated responses for all the vignettes are shown in Table 1.

Perhaps even more notable is that regulators had equally mixed responses to the vignettes. Although these respondents are charged with supporting the enforcement of securities regulation like Reg FD, there was considerable heterogeneity in what regulators viewed as appropriate under the policy. On average, 62% of the regulators responding to a vignette stated that it likely or certainly violated Reg FD—a level nearly identical to the manager respondents. Regulators were not consistently more strict about finding Reg FD violations. In three of the seven vignettes, regulators were more prone than managers to view the dialogue as acceptable under Reg FD. None of the differences in responses between managers and regulators in the vignettes are statistically significant (as shown in last two columns of Table 1 through the  $\chi^2$  test statistic).

The qualitative responses provide insight into how managers interpret Reg FD. Consider Situation A, where the hypothetical CFO tells investors that that additional analysts had expressed interest in covering the company. Here, 38% of managers and 48% of regulators said such a disclosure would likely or certainly violate Reg FD. Managers who believed this to be a violation of Reg FD explained that they felt the CFO’s disclosure would influence the company’s share price.

“Learning that specific analysts may initiate coverage on a company is insider information.”

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16. Under the terms of confidentiality that were agreed to in order to distribute this survey at the training conference, the author is not permitted to publicly disclose the name of the agency whose employees responded to the vignettes.

17. The study was submitted to Harvard University’s Committee on the Use of Human Subjects (IRB). Harvard’s IRB exempted the study under 45 C.F.R. 46.101(b)(2). For the managers, twenty-nine completed all seven vignettes while one manager completed only the Situation B vignette (i.e., Describe Contract Proposals After Election). While this manager did not complete the survey in its entirety, I included this manager in the relevant analysis of Situation B.

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“Launch of coverage can significantly impact the share price and is material information that an investor shouldn’t know. It’s a bad form of management to share that info, not to mention illegal under FD.”

In contrast, the 62% of managers who did not believe that Situation A violated Reg FD explained why they felt the information was immaterial:

“Additional sell-side coverage does not guarantee additional liquidity, neither does it indicate any movement in the company’s value up or down.”

“To allege a violation of Reg FD assumes coverage by the new analysts is both positive and differentiated from the existing analysts as to cause a material appreciation in share price.”

This variation in responses relies on the respondents’ assessments of whether additional analyst coverage is enough to move the price of a stock. Studies on analyst initiation decisions support the view that new analyst coverage is sufficient to generate changes in prices and liquidity, suggesting that the information could be viewed as material.<sup>18</sup> At the same time, this does not resolve the question of a potential violation since these academic studies are not known to most investors. The regulation is based on the beliefs of “reasonable investors,” not academic researchers. Thus if analysts’ initiations are believed to be inconsequential to the average investor (despite academic research to the contrary), then under a strict interpretation of the regulation, it ought not be a violation. The variation in responses by managers reflects the ambiguity of what a “reasonable investor” understands about sell-side coverage and therefore what is material.

Others vignettes generated considerably higher percentages of respondents identifying a Reg FD violation. In Situation D, the hypothetical CEO discloses that she is likely to continue purchasing additional shares in the firm. Comporting with evidence that a CEO’s desire to purchase shares is a significant signal of a firm’s prospects, 69% of manager respondents judged that this was material information that had been disclosed in violation of Reg FD. However, some argued that a CEO’s personal views about the company stock are not material.

“Just because the CEO thinks the stock is worth purchasing doesn’t mean it will perform well.”

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18. See Bruce C. Branson et al., *Information Conveyed in Announcements of Analyst Coverage*, 15 CONTEMP. ACCT. RES. 119 (1998); Cem Demiroglu & Michael Ryngaert, *The First Analyst Coverage of Neglected Stocks*, 39 FIN. MGMT. 555 (2010); Paul J. Irvine, *The Incremental Impact of Analyst Initiation of Coverage*, 9 J. CORP. FIN. 431 (2003); Kevin K. Li & Haifeng You, *What is the Value of Sell-side Analysts? Evidence from Coverage Initiations and Terminations*, 60 J. ACCT. & ECON. 141 (2015).

“I don’t feel like the intention to buy shares personally is significant enough to materially move the stock beyond what a track record of purchases would do.”

Notably, the second respondent stated, as did others, that the disclosure was not material because of how the situation “felt.” Thus, it appears that some managers evaluate the acceptability of providing a piece of information not by some well-defined definition of materiality or prior evidence of the impact of a particular action, but rather subjectively based on their intuitive impression of whether the information “feels” material.<sup>19</sup> One respondent also stated that:

“If you flipped the question to say he told the investor he would very likely be selling shares I would have said yes, a violation of Reg FD.”

Prior research finds that insider purchases tend to be more informative about future stock returns than sales because insider sales arise for both information and liquidity reasons.<sup>20</sup> Thus, this manager appeared to rely on a different set of beliefs (i.e., sales occur for information, rather than liquidity reasons) to form his or her views of what conduct would be viewed as material.

In other instances, responses appear largely unguided by the regulation, but instead by what is perceived to be acceptable practice based on norms in the industry. This was most clear with Situation F, where the CEO discloses that there have been informal discussions about potentially selling the firm. Here, 72% of managers saw a likely violation of Reg FD. The 28% of managers who disagreed cited the commonplace nature of such takeover discussions.

“M&A discussions between firms are common and disclosing that discussions have been held should not be considered material for disclosure purposes.”

“Most CEOs think their company is worth more than where it is trading . . . Informal meetings with competitors and strategic partners are not uncommon.”

Merger and acquisition (“M&A”) discussions are one of the few areas where the SEC has offered specific guidance related to Reg FD, suggesting that such information “should be reviewed carefully” because it is “more likely to be considered material.”<sup>21</sup> But the guidance also includes the explicit warning that information about mergers is not *per se* material, and that determinations

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19. For a discussion of how intuition can contribute to the decision to engage in misconduct, see EUGENE SOLTES, *WHY THEY DO IT: INSIDE THE MIND OF THE WHITE-COLLAR CRIMINAL* (2016).

20. See, e.g., Josef Lakonishok & Inmoo Lee, *Are Insider Trades Informative?*, 14 *REV FIN. STUD.* 79 (2001).

21. Selective Disclosure and Insider Trading, 60 *FED. REG.* 51,716, 51,721 (August 24, 2000).

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must still be made case by case.<sup>22</sup> This vagueness may explain why even 24% of regulators said the M&A information conveyed in Situation F was unlikely to violate Reg FD.

In this situation, the guidance might have confused more than it clarified. One manager, an investment relations officer, strongly believed that the information discussed in the vignette would be a clear violation of Reg FD:

“Discussing M&A suitors, meetings, or discussions would be material non-public information. Period.”

Here, the IRO seems to be misinterpreting the SEC’s guidance by divining a bright-line rule where one does not actually exist.

The differences in perspectives suggest that there are discrepancies between how the regulation is written, how it is interpreted and, and how it is complied with by managers in practice. Managers may believe that some disclosures violate Reg FD, but still view it as acceptable behavior because it has become a widespread practice in their industry. In particular, several respondents explicitly discussed the divergence of Reg FD in practice from Reg FD “in theory.”

“By the letter of the law, if management is discussing anything they haven’t said publicly before about their strategy, it’s a violation of Reg FD. But realistically, management is going to answer strategic questions when asked.”

“Speaking from experience, investor relations and management routinely say things like ‘we have more analysts interested in us’ or ‘we’ve talked to this sell-side guy or that one’ in private investor meetings. It’s not best practice, but it’s also a reasonable assumption that anyone might make.”

One manager respondent suggested that how much information would be conveyed was less a function of what regulation guided, but more of a matter of who they were speaking with. In response to one vignette where the respondent believes the executive’s answer violated Reg FD, the respondent stated:

“I can say that the exact situation described here happens every day, and management typically wants to answer it. How clearly and how detailed they answer the question depends on who that investor is. If it’s Wellington or Fidelity, or a long-only type shop that they’d love to have as long-term investors, he’s going to bend over backwards and divulge information. If it’s a high-turnover hedge fund, he’ll be very careful. If it’s a no-name investment firm, the meeting wouldn’t even be happening.”

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22. *Id.*

In practice, based on the few administrative proceedings that the SEC has initiated against firms for violating Reg FD, the SEC seems to take note of large, unexplained swings in the stock price.<sup>23</sup> However, relying on stock price changes to identify Reg FD violations raises the problem of defining fraud by hindsight.<sup>24</sup> Courts have consistently rejected the notion that information has to necessarily change an investor's mind to be viewed as material. For instance, in *SEC v. Mayhew*, the court reasoned that "to be material, the information need not be such that a reasonable investor would necessarily change his investment decision."<sup>25</sup>

None of the disclosures described in the vignettes would be considered *per se* material by a court. As the Supreme Court held in *TSC Industries, Inc. v. Northway, Inc.*, "only if the established omissions are 'so obviously important to an investor that reasonable minds cannot differ on the question of materiality' is the ultimate issue of materiality appropriately resolved 'as a matter of law.'"<sup>26</sup> Since both managers and regulators found the information disclosed as material in each vignette, none of the disclosures in the vignettes could be described as unambiguously material or immaterial.

Given the difficulty that managers—and regulators—seemingly have in assessing materiality in a consistent manner across the vignettes, one potential concern is that the vignettes themselves are unusually vague. Put differently, the concern is that there would be greater agreement among respondents if the vignettes included more specific information and facts.

There are two considerations which help mitigate this concern and support the premise that the responses accurately reflect the inability of individuals to consistently assess what is appropriate under Reg FD. First, although these vignettes were invented, they are representative of actual conversations as observed by two experienced investor relations officers and the author. Their realism was further confirmed by several of the surveyed managers. For example, one respondent commented:

"I've personally experienced this many times as an analyst and as an IRO. Of course, the investor is going to ask the question. And, of course, this is exactly how most management teams would answer the question."

Thus the vignettes accurately reflected casual and vague nature of these private investor conversations in the real world. Any examination of how individuals interpret the restrictions created by Reg FD needs to be under

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23. Yvonne Ching Lee Lee, *The Elusive Concept of "Materiality" Under U.S. Federal Securities Laws*, 40 WILLAMETTE L. REV. 661, 677 (2004).

24. For a discussion of fraud by hindsight, see G. Mitu Gulati et al., *Fraud by Hindsight*, 98 NW. U.L. REV. 773 (2004).

25. 121 F.3d 44, 52 (2d Cir. 1997).

26. 426 U.S. 438, 450 (1976) (quoting *Johns Hopkins Univ. v. Hutton*, 422 F.2d 1124, 1129 (C.A.4 1970)).

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representative circumstances as they arise in practice, rather than a more clinical and artificial context where any ambiguity has been removed. While greater information may help regulators resolve whether particular information ought to be conveyed under Reg FD, such detail is simply not representative of how most information is conveyed by managers during actual private meetings.

A second observation which suggests that managers' inability to consistently ascertain what information can be provided under Reg FD is a function of the regulation and not the design of these particular vignettes is the conviction in managers responses which is unrelated to the specific information provided by firms. For example, the manager who wrote that "discussing M&A suitors, meetings, or discussions would be material non-public information. Period." indicates that he/she felt that any conversation related to M&A was inappropriate. The specific information in the conversation about the M&A conversation was not pertinent to this manager's determination (i.e., the only appropriate managerial response to an investor question about M&A is "no comment"). Perhaps even more significantly, numerous managers explicitly stated that the amount of detail that would be appropriate to provide in response was not guided by Reg FD restrictions, but instead by who they were speaking with (e.g., "[h]ow clearly and how detailed they answer the question depends on who that investor is"). In this way, the determining factor such managers consider in practice about what to convey is "who" the investor is, not what material information is formally restricted under Reg FD. Thus, even if more specific information was provided in each vignette, it is not clear that this would alter managers' judgments since managers' assessments of the appropriateness of the information conveyed is often divorced from the notion of materiality.

### III. Clearer Expectations

The lack of agreement among managers leads to divergent practices that undermine Reg FD's objective of creating a more level playing field where all investors have access to the same material information. As indicated by the survey responses, managers often confront this ambiguity by devising their own regulatory interpretations. For example, if managers observe competitors providing cash updates privately to investors during meetings, then such disclosures become tacitly accepted practice even when communicating such information violates both the spirit and literal reading of the regulation.

Managers also appear to decide how much information to convey based on who they are meeting with and whether providing the information is likely to benefit their relationship with the investor. Such decisions appear to more deliberately ignore regulatory restrictions, but the lack of enforcement limits the risk of such practices. Problematically, this means that Reg FD creates a greater burden on firms that more faithfully and conservatively adhere to the

regulation, while posing little downside to managers who, at least in part, ignore it.

Private discussions have the opportunity to improve investors' ability to more effectively allocate capital, thereby improving market efficiency. Yet, when some managers feel less constrained by the regulation than others, this creates a heterogeneous disclosure environment where some managers are providing more information to investors than others. To the extent that investors value this more privileged access, this can benefit managers and implicitly reward firms for violating the regulation. Moreover, to the extent that managers continue to provide quasi-material or material information to select investors they meet privately with, market participants as a whole gain a misleading impression that they are operating on a "level" information playing field—undermining the impetus for creating Reg FD.

In the eighteen years since the passage of the regulation, there have been thirteen Reg FD enforcement cases.<sup>27</sup> One explanation for lack of cases, given the nearly ten million estimated private interactions that have occurred since Reg FD's passage,<sup>28</sup> is that managers largely abide by Reg FD's restrictions, thereby creating few opportunities for SEC enforcement. Yet, in light of managers' responses to the vignettes in this study, a more plausible explanation for the paucity of enforcement is that the SEC is effectively unable to "police" markets for Reg FD violations. Offline manager-investor meetings are, by definition, private. Thus, without any disclosure requirement on the part of firms, regulators cannot ascertain where or when such interactions occur, let alone the specifics of the discussion, unless information leaks out of a meeting. Lacking the ability to observe such interactions, the SEC is neither capable of evaluating such dialogue for its appropriateness (in contrast to public securities filings) nor capable of sanctioning private manager-investor communications that violate Reg FD.

A regulation that is heterogeneously interpreted by market participants and unable to be effectively enforced by regulators undermines rather than enhances market integrity. The heterogeneity in responses by both managers and regulators suggest that the regulation is failing to fulfill its original objective of creating a more level playing field with respect to information access. To amend the regulation and help it further achieve its original goal, four considerations must be taken into account. First, changes that would prevent or curtail institutional investors' private access to senior executives

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27. Martin Bengtzen, *Private Investor Meetings in Public Firms: The Case for Increasing Transparency*, 22 FORDHAM J. CORP. & FIN. L. 33 (2017).

28. According to an informal survey conducted by Ipreo, the average firm conducted 114 private, one-on-one investor meetings in 2015. IPREO, CORPORATE ACCESS SURVEY (2016), <https://ipreo.com/blog/corporate-access-survey-2016/> [<https://perma.cc/TBA2-KHW9>]. On average, there were 4,640 publicly traded operating firms (i.e., non-REIT) each year since the passage of Reg FD, according to author calculations from CRSP data. Thus, there have been an estimated 9.5 million private meetings between managers and investors in the eighteen years since the passage of Reg FD.

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could have negative externalities (e.g., hinder capital allocation decisions in the United States by large institutional investors) and face considerable political obstacles to passage. Practically speaking, some investors will continue to gain considerable private, one-on-one time with executives. Second, creating regulations that the SEC cannot effectively police is unsatisfactory policy. Therefore, changes to the regulations should recognize the impediments that the SEC currently faces in evaluating whether managers are providing information that violates Reg FD. Third, as the SEC itself acknowledged in its original rule, bright-line standards about what information is and is not material are unlikely to be effective and exhaustive. At the same time, for each vignette, at least some regulators found the dialogue appropriate and others inappropriate, suggesting a potential degree of arbitrariness depending on the individual characteristics of the specific regulator looking at the case. Creating a more consistent and rigorous set of guidelines of what can be appropriately disclosed, while avoiding bright-line standards, would help reduce ambiguity both among managers and regulators. Finally, in line with the original goal of the regulation, all investors should have access to information that may be viewed as material (i.e., that at least some investors see as material).

In line with these expectations, regulators could create a requirement that firms publicly disclose records of their private discussions shortly after each meeting in the form of detailed minutes or transcripts.<sup>29</sup> Such a proposal would acknowledge the potential value of private interactions, but also provide for the fact that some information that managers convey to investors may be material to other investors. This disclosure requirement would also remedy regulators' current inability to observe potential violations by making private material disclosure effectively moot.<sup>30</sup> By disclosing all meeting contents, material information, even if privately communicated to an investor during a meeting, would be disseminated to all market participants. Regulatory enforcement could focus on firms that fail to disclose or do not adequately disclose their private interactions, rather than trying to assess whether a specific piece of information is material or not. This proposal would bolster transparency by providing investors access to all information disclosed by managers and place the SEC in a more effective position to enforce its policies.

There are several potential criticisms to the idea of requiring firms to publicly release meetings data in a timely manner. First, historically some institutional investors have conveyed proprietary insights during their private dialogue with executives. Timely public disclosure of an investor's strategy

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29. An earlier precedent is with quarterly earnings conference calls. For background of the environment, see Brian J. Bushee et al., *Open Versus Closed Conference Calls: The Determinants and Effects of Broadening Access to Disclosure*, 34 J. ACCT. & ECON. 149 (2003).

30. Other markets have required disclosure of private meetings. Although there are questions about the quality of disclosure, beginning in 2009, listed firms on the Shenzhen Stock Exchange in China were required to disclose investor meetings within two days of their occurrence. See Qiang Cheng, *Seeing is Believing: Analysts' Corporate Site Visits*, 21 REV. ACCT STUD. 1245 (2016)

could hinder an investor's ability to capitalize on their plan. Investors could respond by becoming more nuanced in the information they convey to management to avoid its dissemination, or the investor could simply participate in public conversations (e.g., earnings conference call). Exceptions to public disclosure could also be made in some limited circumstances (e.g., private placement negotiation) where its immediate public disclosure could adversely impact firms. Second, between the time of the meeting and the public disclosure of the meeting conversation, investors who attended the meeting could be placed at an information advantage. Although this time could be short (perhaps less than 24 hours), other market participants would be at an information disadvantage during this time. One solution would be to prohibit investors who attend private meetings from trading until the records are publicly released. Alternatively, firms could publicly disclose when meetings are planned to occur so that other investors could choose to avoid trading during that time. While there are different externalities associated with each of these considerations, further analysis could seek to design policy to minimize any adverse effects. Finally, some firms are likely to object on the basis of the cost of preparing and releasing such records. However, many firms already prepare informal logs of questions that are frequently asked by investors during private meetings. The regulatory disclosure would simply be a more complete and rigorous compilation of the meeting dialogue. The monetary outlay associated with preparing minutes/transcripts would additionally not be a material expenditure for firms. Overall, it is possible to address many of the preceding concerns in designing an updated disclosure policy.

#### IV. Conclusions

Managers should not be forced to play a game of roulette when privately meeting with investors. While managers could take a conservative approach and either not engage in private meetings or not provide any information that any investor could view as material, such a choice would likely prove detrimental to both the firm and the efficiency of capital allocation within capital markets. At the same time, managers who divulge information risk violating Reg FD, albeit without necessarily intending or even appreciating that they are doing so.

Although Reg FD operates in a civil context, the constitutional doctrine of vagueness, which prohibits ambiguous criminal codes, offers an apt warning to regulators. The Supreme Court has held that it violates the Fifth Amendment to "take[] away someone's life, liberty, or property under a criminal law so vague that it fails to give ordinary people fair notice of the conduct it punishes, or so standardless that it invites arbitrary enforcement."<sup>31</sup> It is not clear why securities regulations such as Reg FD, which have sweeping personal

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31. *Johnson v. United States*, 135 S. Ct. 2551, 2557 (2015).

## What Can Managers Privately Disclose to Investors?

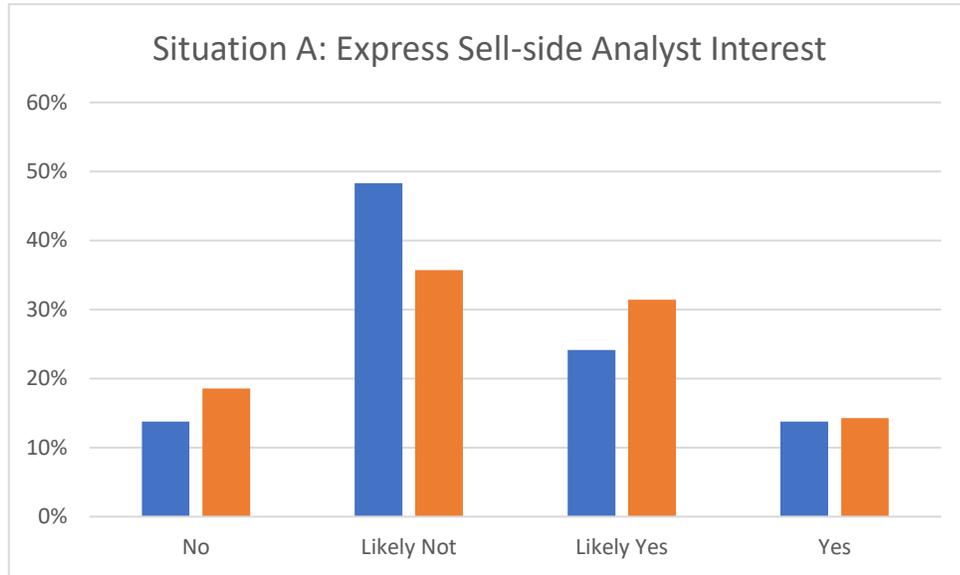
consequences for individuals and firms who are sanctioned, should be held to a lesser standard.<sup>32</sup> When both regulators and the regulated disagree vehemently among themselves and between each other over the appropriate interpretation of a rule, it verges on being “standardless.” Such arbitrariness should give all parties pause.

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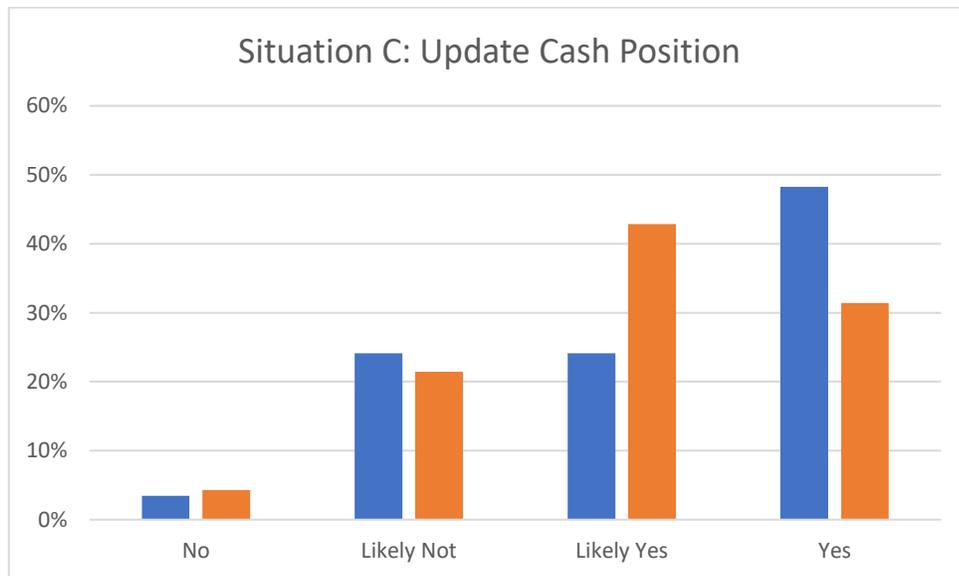
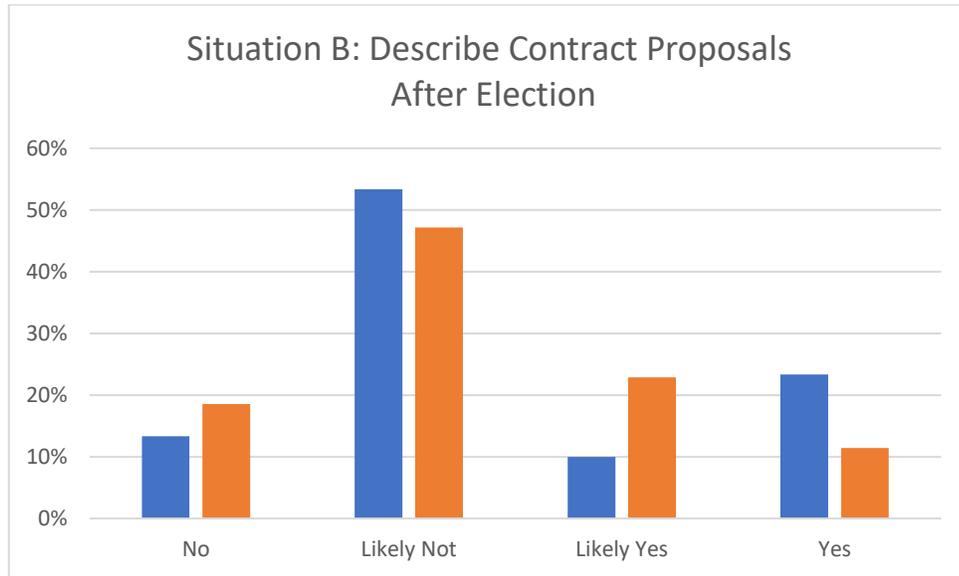
32. See Nicholas Kappas, *A Question of Materiality: Why the Securities and Exchange Commission's Regulation Fair Disclosure is Unconstitutionally Vague*, Note, 45 N.Y.L. Sch. L. Rev. 651 (2001).

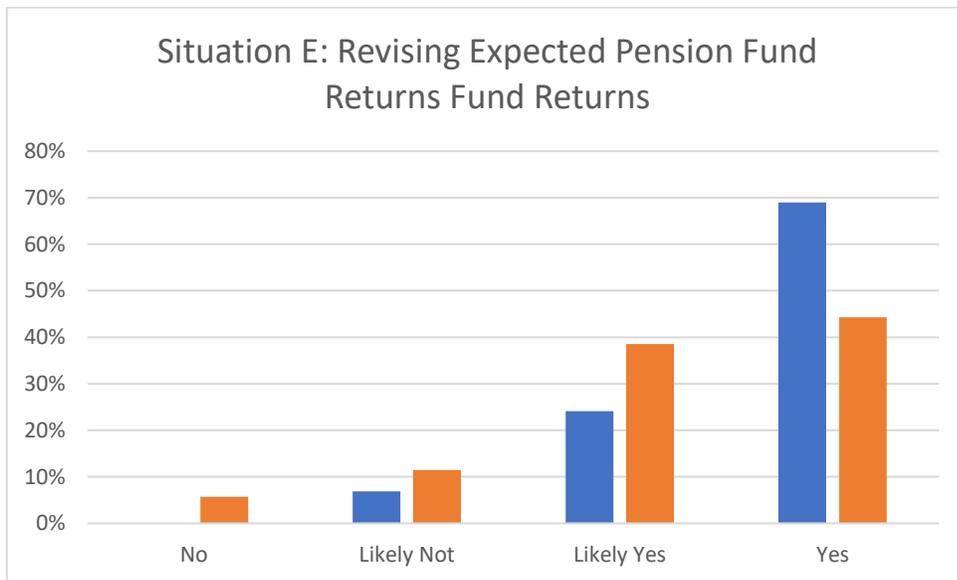
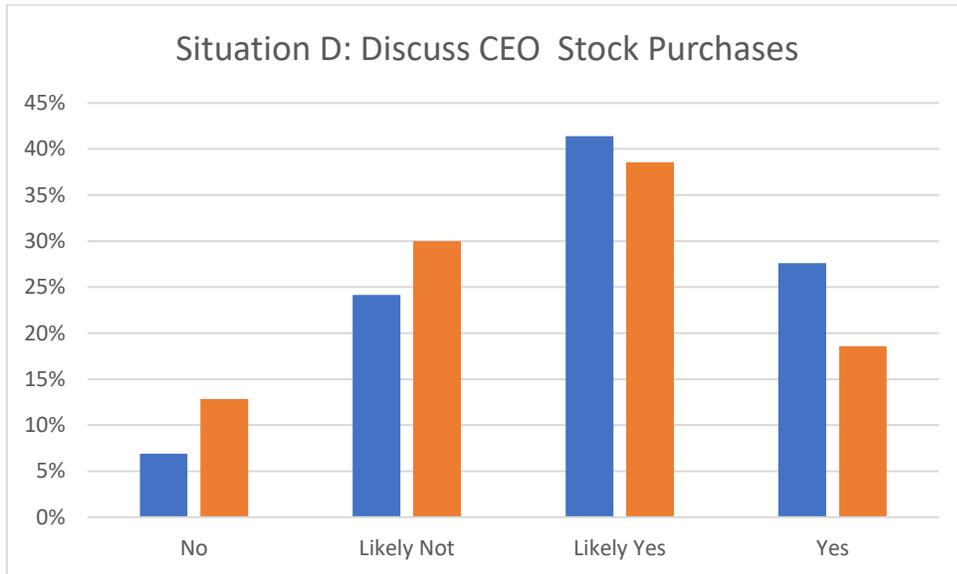
Figure 1: Vignettes Responses

Figure 1 presents histograms showing the percentage of respondents that answered “no,” “likely not,” “likely yes,” or “yes” to the question “Would you consider the information the investor received during the meeting with COMPANY to be a violation of Reg FD?” after reading each vignette. The blue bar represents the frequency of responses by managers (n=29 except in Situation B where n=30) and the orange bar represents the frequency of responses by regulators (n=70). The seven vignettes (labeled Situation A through Situation G) are presented in the Appendix.



## What Can Managers Privately Disclose to Investors?





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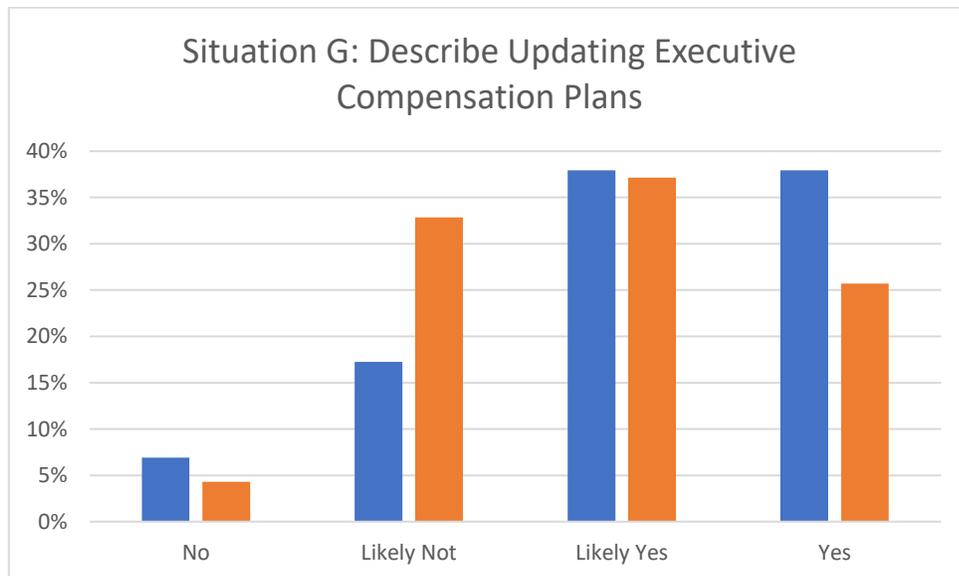
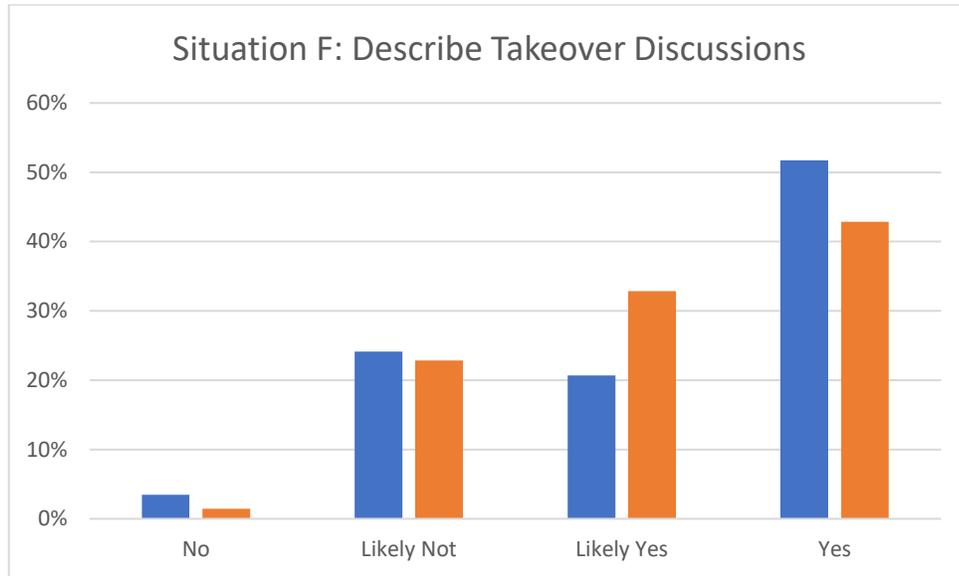


Table 1: Vignettes Responses Aggregated by “Yes” and “No” Responses

Table 1 shows the responses of both managers and regulators to the question “Would you consider the information the investor received during the meeting with COMPANY to be a violation of Reg FD?” after reading each vignette. The No column aggregates the “No” and “Likely Not” responses, and the Yes column aggregates the “Yes” and “Likely Yes” responses. The Pearson Chi-square test ( $\chi^2$  test) evaluates observed differences between aggregated Yes and No responses between managers (n=29 except in Situation B where n=30) and regulators (n=70). The table shows the Pearson  $\chi^2$  test statistic and the associated p-value. The seven vignettes (labeled Situation A through Situation G) are presented in the Appendix.

Situation	Violation? (Managers)		Violation (Regulators)		$\chi^2$ test: difference between managers and regulations	p-value
	No	Yes	No	Yes		
A: Express Sell-side Analyst Interest	62%	38%	54%	46%	0.51	0.48
B: Describe Contract Proposals After Election	67%	33%	66%	34%	0.01	0.93
C: Update Cash Position	28%	72%	26%	74%	0.04	0.85
D: Discuss CEO Stock Purchases	31%	69%	43%	57%	1.20	0.27
E: Revising Expected Pension Fund Returns	7%	93%	17%	83%	1.77	0.18
F: Describe Takeover Discussions	28%	72%	24%	76%	0.12	0.73
G: Describe Updating Executive Compensation Plans	24%	76%	37%	63%	1.56	0.21

## What Can Managers Privately Disclose to Investors?

### Appendix: Investor-Management Interaction Survey

An investor is potentially interested in purchasing stock in a publicly traded firm, COMPANY. After reviewing the information about the firm from its regulatory filings, conference calls, and news releases, the investor has the opportunity to meet privately with senior executives of COMPANY to ask additional questions. The questions the investor asks are about information that may be potentially useful, but is not found in other regulatory filings or news releases. Management does not have plans to disclose its responses in a public news release in the immediate aftermath of privately meeting with the investor.

According to Regulation Fair Disclosure (Reg FD), managers cannot provide material non-public information to investors during such private interactions. Information is considered material if there is a substantial likelihood that a reasonable shareholder would consider it important in making an investment decision.

You will be given 7 different situations. In each situation, an investor makes a query to senior management during a private meeting. After management's response, you are asked whether in your opinion the information provided by management in response to the investor's question would violate Reg FD.

#### Situation A

The investor recently viewed the number of sell-side analysts covering COMPANY and saw that only four analysts covered the firm— a number lower than some of COMPANY's similarly sized competitors. Additional positive coverage by analysts can improve the liquidity and raise the price of COMPANY's stock, but the investor does not know if other analysts are potentially planning on initiating coverage of COMPANY.

During a private meeting with COMPANY's management, the investor asks the CFO of COMPANY if he knows of any additional analyst planning to cover COMPANY. The CFO responds that he recently had several conversations with two analysts at large banks that do not currently cover the firm. The CFO mentions that several of the analysts expressed interest in beginning coverage and provides the investor with their names.

Question: Would you consider the information the investor received during the meeting with COMPANY to be a violation of Reg FD?

#### Situation B

On November 9th, two days after the presidential election, the investor has a planned private meeting with senior executives of COMPANY, a defense contractor. Unexpectedly, the presidential candidate who campaigned on a

desire to increase military engagement in a volatile part of Africa won the election. As a leading defense contractor, COMPANY is well situated to financially benefit from greater engagement in the conflict.

During the meeting, the investor asks executives how COMPANY plans to capitalize on the potential opportunities under the new political leadership. Executives from COMPANY describe the types of contracts that they plan to propose to defense leaders to help support expected military operations.

Question: Would you consider the information the investor received during the meeting with COMPANY to be a violation of Reg FD?

#### Situation C

The investor is considering buying stock in a new biotechnology firm, COMPANY, which has several promising drugs under development. The extensive testing process needed to gain governmental approval is very costly and the investor is concerned about the firm's cash levels and whether it is sufficient to continue its tests without raising additional funds. The last time the executives spoke publicly about their cash position and their cash burn rate was in a conference call that accompanied the quarterly earnings release almost two months ago.

During a private one-on-one meeting with the CFO of COMPANY the investor asks him to provide an update on the firm's cash position and expected burn rate. The CFO responds that management re-examined the cash needed to bring their two most promising products through the next stage of testing and found several additional opportunities to more efficiently manage the process thereby likely helping to slow the rate COMPANY burns through its cash reserves.

Question: Would you consider the information the investor received during the meeting with COMPANY to be a violation of Reg FD?

#### Situation D

Over the prior month, the investor noticed that the CEO of COMPANY began purchasing a large number of shares in COMPANY on the open market which was publicly reported in regulatory filings.

During a one-on-one meeting with the CEO, the investor asks the CEO whether he plans to continue purchasing shares in COMPANY. The CEO responds that he is very likely to continue buying more shares in the coming month.

Question: Would you consider the information the investor received during the meeting with COMPANY to be a violation of Reg FD?

#### Situation E

As the investor is reviewing COMPANY's financial statements he notices that the firm has noted the expected rate of return for the assets in its defined benefit pension fund is 7%. This expected return is higher than some reports

## What Can Managers Privately Disclose to Investors?

suggest is sustainable. The investor knows that if COMPANY revises the expected rate of return downwards, the company will be required to significantly increase its pension liabilities to reflect the underfunding of the pension plan.

During a private meeting with the CFO of COMPANY, the investor asks the CFO whether he expects COMPANY's rate of return on its pension return to remain stable or potentially change in the coming year. The CFO responds that they are currently reevaluating the rate and are likely to revise it downwards to reflect changes in future market expectations.

Question: Would you consider the information the investor received during the meeting with COMPANY to be a violation of Reg FD?

### Situation F

A rapidly growing, but still small, technology company named COMPANY has a new mobile communication tool that the investor believes is likely to be of interest to larger social media firms.

During a private meeting with firm management, the investor asks whether the CEO has been approached by any larger social media firms about potential takeover discussions. The CEO of COMPANY responds that he has had several informal discussions with the heads of the larger social media firms and he has told them that COMPANY is worth significantly more than the valuation currently indicated by the firm's stock price. The CEO tells you that COMPANY will not accept a takeover offer at a valuation near the current trading price, but he will continue meeting with executives at other firms who express potential interest in COMPANY.

Question: Would you consider the information the investor received during the meeting with COMPANY to be a violation of Reg FD?

### Situation G

In the prior several years, COMPANY has encountered growing resistance from the media and Institutional Shareholder Services to the size of its stock option grants, which are considerably larger than others in the industry. At this year's annual meeting, the executive stock compensation plan is up for renewal.

During a one-on-one meeting, the investor asks the CEO whether COMPANY is considering making any changes to the compensation plan given the potential resistance and public scrutiny. The CEO responds that they are planning on adjusting the number of options granted to make it more in line with COMPANY's peer firms in its industry.

Question: Would you consider the information the investor received during the meeting with COMPANY to be a violation of Reg FD?