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Concerning Regulation FD

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I appreciate the opportunity to convey my views on Regulation FD to the Committee in my capacity as a private individual engaged in the practice of securities analysis. My invitation to appear before the panel was fairly recent, so I have not been able to include as much supporting data as I would have liked, but I think you will get the flavor of my views.

My name is Perry Boyle. I am a founding partner of Thomas Weisel Partners and serve as the Deputy Director of Research. I have been an equity analyst since the middle of 1992, and I have covered a variety of sectors, including transportation stocks, business services stock and marketing services stocks. I currently supervise a department of 35 analysts covering primarily growth areas of the economy.

For those of you unfamiliar with Thomas Weisel Partners, we commenced operations on February 1, 1999. Our headquarters are in San Francisco, and we have offices in New York, Boston. Menlo Park and London. We have three major business lines: asset management, merger and acquisition advisory, and traditional broker dealer services focusing on equity and convertible securities. From a zero revenue base in 1998, we achieved revenues of just under $500mm in 2000.

To clarify my general position on Reg FD, and I believe you can view me as a typical analyst in this, I support the same ends as the Commission on selective disclosure. Good analysts favor a system that provides broad, non-discriminatory dissemination of quality information. I also note that, from a sell-side analyst position that Reg FD increases the value of "good analysts" in the marketplace, so it would be disingenuous of me to rail against the Regulation. However, from a public policy perspective, the Regulation does have costs that are probably not yet fully appreciated, and it is questionable whether the benefits of the Regulation merit those costs.

In the remainder of my testimony, I will address each of the questions posed by the Committee in its letter inviting me to testify.

Whether there was a need for Regulation Fair Disclosure (Reg. FD) prior to its promulgation.

With the advent of the Internet, a broadening of the investor base and the media's increased interest in the stock market, a greater flow of information to a broader range of people was occurring prior to Regulation FD.

I don't believe there was much of a need for the Regulation. Lawyers can debate about the extent to which the law reached selective dissemination prior to Regulation FD, but the simple fact is that, with a handful of exceptions, there was little evidence that selective disclosure was a problem for the markets. I do not recall reading in the popular press of a groundswell of public demand for a new fair disclosure regulation until the SEC raised the issue and a few media outlets whipped up e-mail writing campaigns. Indeed, I doubt that the vast majority of America's 90 million investors even know about the rule or have any practical use for it, given that almost all of them depend on professionals such as fund managers or stock brokers to manage their accounts.

To the degree that Reg FD has raised public confidence in the capital markets, it is laudatory. I have seen no study that supports that conclusion, but a reasonable person would likely presume that, at least on the margin, Reg FD would help raise public confidence in the market.

Reg FD does not change the fundamental role of an analyst nor does it introduce a new moral or ethical duty on selective dissemination. It merely creates more uncertainty about what the definitions surrounding selective dissemination are and how companies and analysts will be prosecuted for sharing information. It has injected uncertainty in the marketplace with an unreasonable definition of materiality and a lack of clarity on how the rule will be applied.

As a general rule, most of us involved in the capital markets believe that regulations that encourage efficient markets are good, and that regulations that impede market efficiency are not good. This is based on our education and experience that, over time, securities prices tend to reflect all the available information about that security.

The short term impact of Reg FD has been to reduce the flow of useful information from issuers to the investment community. Longer term, as we all learn how to live with it, that restrictive impact is likely to abate. In the information age with our plethora of media channels, it is hard to keep a lid on interesting news.

Prior to Reg FD, issuers took a wide variety of stances with the investment community vis a vis the amount of information they would share beyond the legally required disclosures. I have covered companies that released detailed monthly data regarding the volume and pricing of all their service lines; I have covered companies that had almost no communication with the investment community beyond the legally mandated disclosures. Prior to Reg FD there was no uniform standard of how much information an issuer shared with the investment community, and that has not changed post-Reg FD.

Indeed, now that the commission has dealt with "fair" disclosure, perhaps their next priority should be on "full" disclosure. In the normal course of filings under SEC regulations using Generally Accepted Accounting Principles, issuers exclude massive amounts of information that could be presumed material in making an informed investment decision about a company. The simple fact is that investors will always be making investment decisions based on a combination of imperfect information, varying degrees of analysis, experience, intuition and luck. That's what makes a market.

The rule is designed to increase public confidence in the "fairness" of the market. I have not seen any study used by the SEC that measured the public's lack of confidence in the market prior to the rule. I would note that the US securities markets are globally considered to be the fairest in the world; issuers from around the globe flock to our markets along with countless investors.

I am also unaware of any cost/benefit analysis that was done prior to the promulgation of the regulation.

It is instructive to consider who wins and who loses under Reg FD. Winners include:

- the SEC for a positive public relations move,
- lawyers engaged by issuers to ensure compliance with the regulation,
- investor relations and public relations personnel who have much logistical work to do,
- those members of the public who were concerned about fairness of information disclosure,
- the financial media who have more press releases to make sound bites out of,
- the business wires and webcast services companies,
- day traders who have more press releases to trade off of,
- market makers who benefit from increased volatility,
- good analysts who have always cultivated sources of information other than top management of issuers.

Losers include:

- issuers and their shareholders who have to bear the costs of compliance,
- investors who bear the costs of increased volatility,
- bad analysts who merely reported what they heard from management.

From a selfish perspective, Reg FD is good for me. It makes the job of an analyst more difficult by reducing the flow of quality information. Thus the difference in the quality of work between good and bad analysts should only widen. As I pride myself on being a "good" analyst, the regulation can only work to my benefit.

From a public policy perspective however, I question whether the cost to the public is worth the benefit, and I urge the Committee to conduct some research on this.

Why would issuers want to communicate information to the market via the analyst community rather than in a press release, conference call, 8-K or other public disclosure? I believe it is in large part a liability arbitrage created by the disclosure regulations. The SIA in its testimony today gives a good example of that in its discussion of why safe harbors should be expanded under the Regulation. Simply put, issuer management has a higher liability standard for information disclosure than does the analyst community. By conveying information via the analyst community, issuers can convey a myriad of details about their business and their industry that they would not necessarily want attached to their name. Is that necessarily an "unfair" system? To the degree that one firm's clients benefit from the information to the detriment of other investors, perhaps it is. But that is hardly how Wall Street works.

On an institutional investor level, one investment bank's clients are pretty much the same as everyone else's client base. Everyone is fishing in the same pond. So to think that one investment bank's clients would benefit from selective dissemination over another investment bank's clients is not really accurate, and any benefit would be transitory. Everyone's clients benefit from a "good call" from a particular analyst. As the vast majority of individual investors hold their investment in institutionally managed portfolios, they are indirect beneficiaries.

And it has always been my understanding that it was not permissible under the pre-Reg FD system for one analyst's clients to benefit from selective dissemination. For selective dissemination of an issuer to an analyst to work to the detriment of the general investment community presumes another layer of selective dissemination on the part of that analyst to a favored group of investors. That is not the case.

The issue of selective dissemination of research to our clients is a moot one. All our research calls are published on the standard dissemination systems such as First Call, Multex, etc., which pretty all our institutional clients have access to. Some of our clients use our the research, other don't. Some use the research for one purpose, other clients for another purpose. The myriad of investment approaches of our client base is what makes for the trading activity of the market.

I believe that the SEC may not have a very rich view of the role of the analyst. While I am certainly not asking for sympathy, there are only three things that an analyst knows with complete certainty every day:

1. I am wrong. If I was right all the time, I would not be doing sell-side research, I would be trading my own account
2. I will upset someone today. I am paid to have an opinion. Often, that opinion will be contrary to the opinion of others, including my clients, which can be upsetting to them. If I do not have an opinion I am not doing my job.
3. I will be lied to all day by just about everyone I talk to, especially the management teams of the companies I cover.

Our job is to anticipate market trends and figure out which companies will best capitalize on those trends to the benefit of their shareholders over long periods of time.
Analysts should not be day traders. We don't change our investment opinion on a stock based on every press release. That's called "whipsawing" your opinion. Indeed, if we are reacting to news in press releases, we are following stocks, not leading them.

I believe the Supreme Court got it right in the Dirks case:

> "It is commonplace for analysts to 'ferret out and analyze information' [citing SEC statement] 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 or 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."

By reducing information flow to the analyst community through poor definitions of materiality and liability, with few safe harbors for the analyst community, the value of the analyst community, "which the SEC itself recognizes as necessary to the preservation of a healthy market" is diminished.

Was the SEC responsive to commentary regarding the rule?

I had no interaction with the SEC on Reg FD, and therefore have no opinion on this question. Based on my reading of the SEC's commentary on the regulation, it would appear that they were very responsive to the input of the media. I would also note that individual analysts generally have little interaction with the SEC, and it is my belief based on listening to the comments of several commissioners that the commissioners had relatively little direct interaction with practicing analysts in the formulation of the regulation.

How are those affected by Reg. FD adjusting to the Reg. FD regime in terms of policies, practices, and trends?

From an analyst perspective, Reg FD has had both positive and negative influences on how we conduct our business.

<u>Increased emphasis on primary research</u>
On the positive side, it has created a renewed commitment to what we call primary research. That is where we gather input from customers, vendors, competitors, employees, etc. to create a flow of information regarding a company's prospects.

<u>Increased adversarial relationships between management and analyst</u>
On the negative side, it has increased the adversarial relationship between managements and analysts. Many issuers now believe they need to protect themselves from analyst interactions. Many issuers are not particularly happy that analysts are poking more deeply into their relationships with customers, suppliers and even their lower level employees. Not all of these sources can replace the lost quality of information that was often available from direct interactions with top management, particularly surrounding longer-term strategies and estimate guidance.

In the post Reg FD world, analyst interaction with top management is far more likely to occur in a highly scripted manner, with management only discussing information that has been scrubbed and sanitized by lawyers and investor relations personnel. These interactions lack spontaneity and the depth of color that existed pre-Reg FD.

In some instances, management will only meet with analysts in large group meetings. Analysts are a competitive lot, and by their nature are reluctant to ask probing questions in front of their competition. We simply don't want our competitors to have the benefit of divining our "angle" on the stock from the kinds of questions we ask management.

<u>Inconsistencies in what kinds of information companies release mid-quarter</u>
On page C1 of *The Wall Street Journal* on May 11th, there was an article entitled "After Reg FD, Progressive Sets Bold Move." Here is a situation in which Reg FD can be interpreted as having its desired influence on issuer disclosure. Instead of publishing operating statistics only at quarter end, Progressive will now issue monthly statistics. This may force its competitors to do the same. That is clearly positive. But still, the data provided by Progressive is historical. They still refuse to give forward guidance on how they believe the company will perform. And even prior to Reg FD, Progressive had moved toward having quarterly earnings conference calls. The article also mentions how Progressive is not giving any commentary or analysis on their operating statistics and won't report investment income and tax rates—crucial data in evaluating a company.

The same article notes that Gillete announced earlier this year that it would no longer provide short-term earnings guidance. And a *New York Times* article on Saturday talked about how Wal-Mart will no longer share its detailed sales data with third-parties.

The *Journal* article states: "… many companies are puzzled buy just what 'material' means, and what Reg FD does and doesn't allow them to say. Many are uncertain of how best to deal with analysts are fearful they might overstep the bounds of the rule and incur the wrath of the SEC." I agree that the biggest problem with the regulation is the lack of clarity on what is material versus non-material information. In the absence of that clarity and with a new degree of liability, many issuers have chosen to take the safe road of reducing the quality of information. So while the Regulation may have positive impact on the "fairness" of information dissemination, I believe it has had a negative impact on the "fullness" of information dissemination.

Reduction in quality information from management in 1-on-1 meetings and conversations

One of the ways issuers have responded to Reg FD is by avoiding have any discussion with analysts that could be remotely construed as having a bearing on earnings guidance. For example, the simple question "how's business?" often elicits the response "we have no new guidance from our previous press release." The very text of the SEC renders conversations with management difficult:

> "When an issuer official engages in a private discussion with an analyst who is seeking guidance about earnings estimates, he or she takes on a high degree of risk under Regulation FD. If the issuer official communicates selectively to the analyst nonpublic information that the company's anticipated earnings will be higher than, lower than, or even the same as what analysts have been forecasting, the issuer likely will have violated Regulation FD." 65 Fed. Register at 51721 (August 24, 2000).

That language pretty much precludes all private conversations with an analyst, because an analyst who is any good at his or her job is always seeking information to go into their earnings estimates. It puts the issuer official in a predicament, because he or she cannot be sure what kernal of information will ex post facto be interpreted as material. What is perceived as a material fact to one analyst may be immaterial to another.

Any information that goes into an analyst's estimates under this language is material. And I have to tell you that essentially all information about a company, from how full the parking lot is, to how clean the CEOs desk is compared to how it normally is, to who signed the guest register to where a CFO is flying to can become material as the one piece of information that solidifies an analyst's view on the earnings outlook for the company. Any private meeting is by definition selective. If the consensus estimate for a quarter is higher than the guidance issued by an issuer in a previous press release, and the issuer merely says "we are comfortable with our previous guidance" they have technically violated the regulation by implying that their earnings will be lower than consensus.

Lack of insight on models and reports

Prior to Reg FD, it was a common but not universal practice for an analyst to send a preview copy of a research report to the issuer. The intent was to give the issuer a chance to comment on factual errors and to rebut any unflattering arguments made by the analyst. Of course, a good analyst used any management feedback only as one source of information. The preview also enabled management to be prepared for any inbound grief they might have gotten from investors. It was a courtesy.

Post Reg FD, many issuers will refuse to comment in any way on a preview report. I personally know of one issuer who refuses to even have an analyst fax him a report or model, because he doesn't want anyone to even try to assert that he ever commented on one. This is a small issuer who does not want to spend a lot of money trying to comply with Reg FD. Why would they take this position? I cite the following from the SEC website.

7. Can an issuer ever review and comment on an analyst's model privately without triggering Regulation FD's disclosure requirements?

Yes. It depends on whether, in so doing, the issuer communicates material nonpublic information. For example, an issuer ordinarily would not be conveying material nonpublic information if it corrected historical facts that were a matter of public record. An issuer also would not be conveying such information if it shared seemingly inconsequential data which, pieced together with public information by a skilled analyst with knowledge of the issuer and the industry, helps form a mosaic that reveals material nonpublic information. It would not violate Regulation FD to reveal this type of data even if, when added to the analyst's own fund of knowledge, it is used to construct his or her ultimate judgments about the issuer. An issuer may not, however, use the discussion of an analyst's model as a vehicle for selectively communicating – either expressly or in code – material nonpublic information.

Source: http://www.sec.gov/interps/telephone/phonesupplement4.htm

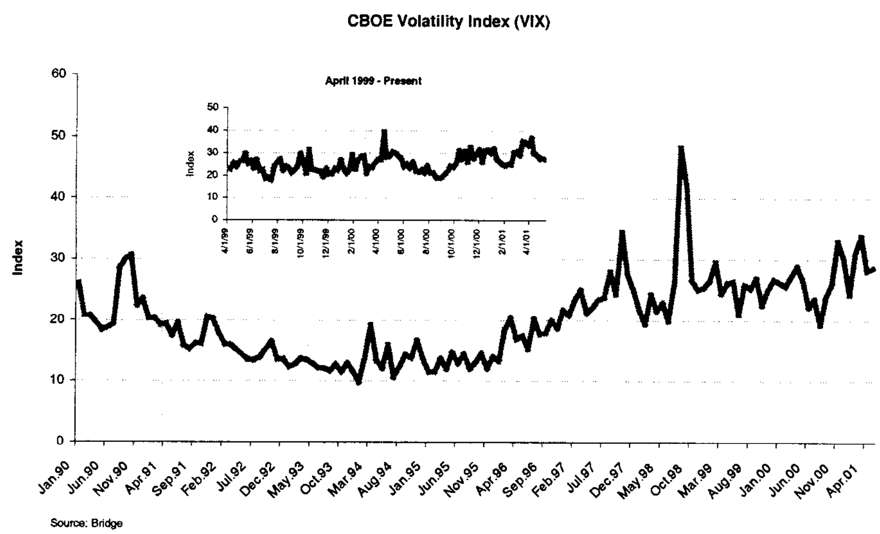
I would posit that it is impossible for an issuer to determine what the Commission means by "seemingly inconsequential data. When in doubt, it is safer just to say nothing. That is probably the advice they are getting from their attorneys. So analysts are lacking the nuance and color that they may have previously gotten.

In your view, has Reg FD impacted volatility in the marketplace, and if so, how?

I believe that, in addition to the costs of compliance, a primary cost of the Regulation has been increased volatility of the market. "Fairer" dissemination has reduced the "fullness" of dissemination. So the cost of fairness has been volatility. It is up to higher powers than me to determine whether the cost is worth the benefit, but I have been surprised by the lack of attention to this point.

While many factors go into creating more or less market volatility, I believe the volatility cost of Reg FD is something that can and should be studied and determined. Reg FD was implemented at an inflection point in the market. It also coincided with decimalization of stock quotes. Most stocks are down significantly from the date of its effectiveness. While the correction in the stock market is the result of declining fundamentals in the economy, not Reg FD, I do believe that the regulation contributed to volatility during this period, as the investing community has been deprived of information flows that could have injected a bit more certainty surrounding earnings estimates and business prospects.

One commonly used measure of market volatility is the CBOE Volatility Index, or VIX. This index clearly indicates an increase in the trend of market volatility since the introduction of the prospects of Reg FD in the summer of 2000. One might argue that since the VIX is based on the volatility of options on stocks, there are probably better measures of volatility and I would agree. It would take a more detailed study of individual stock price movements to get a real sense of true market volatility. This would make for a fine thesis for a doctoral candidate.



From my experience and study of economics, I have noticed that a reduced quality of information has reduced analysts' confidence in their estimates and interpretations. I note that while the range of street earnings estimates for the next quarter appear to have tightened up as analysts get more detailed near term information from the companies, the range of out year estimates has widened. Out year estimates are far more important to valuation determinations than just the next quarter. This situation implies much less confidence in the earnings outlook for a company and leads to more volatility.

What impact has Reg. FD had upon the quality and quantity of information being provided to the capital markets about issuer companies?

As previously noted, quantity is up and quality is down. Reg FD has not really changed the practices of professional investors in terms of what they read or which calls they listen to. On the margin, some individual investors appear to be taking advantage of new information conduits, but not in large numbers. I have found it ironic how few investors seem to be interested in all the incremental data that is now presumably available post Reg FD. Conference calls and webcasts for many, indeed most, companies are sparsely attended. This is particularly true for smaller issuers.

The sad fact is that most individual investors, when trading individual stocks, rely on the media for their investing data. Given that company press releases and conference calls are now lacking a level of analysis and color that they previously included, the investing public is left to get its information filtered by a reporter who is often selected more for on camera ratings potential than the depth or insight of their analysis. Do these financial reporters have degrees in economics, accounting or financial analysis? Have they passed the Series 7 exam? Are they Chartered Financial Analysts?

To the degree that Reg FD has reduced the insight available to the media in interpreting information, the public may be getting the short end of the stick.

What particular benefits or problems is your industry group experiencing as a result of Reg. FD?

Addressed above.

Are there any specific ways that Reg. FD can be improved?

In my view the regulation could be improved in the following ways:

- clarification regarding what is considered "material" information to end the ex post facto nature of the definition—particularly as it relates to earnings guidance by issuers
- a carve out for analysts on any derivative liability

Materiality

In general, reducing liability for disseminating information should improve the quality of information disseminated. Therefore, clarification on the definition of materiality would be helpful. The current definition of materiality in the rule is ex post facto (i.e., the information is material if it moved the stock price.) This is tautological and impossible to accurately anticipate. It brings to mind the comment "I don't know what art is, but I know it when I see it." In the absence of clarity, the natural impulse is to reduce information flow to the minimum disclosure required by law.

From this it follows that the definition of materiality should be as narrow as possible. In my view, this would encourage the broadest dissemination of the many pieces of information that analysts piece together in a mosaic to create our investment recommendations.

Enforcement

It is also very unclear as to how the Regulation will be enforced. I participated in an SEC sponsored round table in New York in April where one of the commissioners was emphatic that interpretations of materiality under the regulation would not be determined by enforcement cases. I also participated in a roundtable on the subject sponsored earlier in the year by Business Wire, where another commissioner said that the SEC did not intend to aggressively enforce the rule. Yet even as we speak the enforcement division of the SEC is making inquiries of a number of issuers and analysts about who told who what when. What is the investment community to believe? Actions speak louder than words.

I believe there should be a safe harbor for securities analysts to protect them from derivative liability under Reg FD. Such protection should apply as long as an analyst is in compliance with the Chinese Wall procedures required by Exchange Act Section 15(f), and that information did not improperly influence the broker-dealer's proprietary trading.

As noted in the SIA's testimony, the Commission staff has suggested that it would only seek to charge a recipient, such as a securities analyst, if he or she threatened or cajoled an issuer or corporate official into divulging material nonpublic information. In the words of a senior SEC official, "it is okay to be persistent and dogged; it is not okay to be abusive and threatening." What is "abusive"? What is "threatening"? If an analyst is "abusive and threatening" to an issuer official, he or she is likely to have bigger problem that penalties under Reg FD. These kind of stretches by the Commission are just further examples that enforcement of Reg FD against securities analysts is impractical from any reasonability standard and could border on the farcical. Nevertheless, no analyst wants to risk having any sort of run in with the SEC on his or her U4. Having exposure to the risk of persecution under Reg FD for what many analyst see as their ethical duty to their clients does not encourage analysts to be determined in their probing.

I would note that the exclusion of the media from Reg FD puts them at an advantage over the analyst community in getting information from issuers. It is ironical that under Reg FD, instead of the supposedly "favored analyst" using unfairly garnered material information to favor their preferred clients, now favored media outlets and reporters can deliver material information to their preferred clients in what could be construed as a violation of the spirit of Reg FD. Reg FD has encouraged issuers to curry favor with the financial media.

Why not give analysts the same protections—the liability for Reg FD violations should remain with the issuer, not the analyst.

<u>Dissemination</u>
In my opinion, the dissemination requirements of the Regulation put small companies at a disadvantage. Until the SEC starts sending a synopsis of 8-K filings to the news wire services, most analysts and investors will rely on the media for timely dissemination of press releases. Media companies have little incentive to cover the press releases of small companies. Perhaps there should be an exclusion for the rule for issuer below a certain size or shareholder base.

Conclusion

In conclusion, it is my opinion that Reg FD has had a mildly positive impact on the public's perception of market fairness surrounding selective dissemination. However, I do not believe that selective dissemination was a significant problem prior to the regulation, and that the cost of the regulation has been high in terms of compliance costs and increased market volatility from the increased quantity/reduced quality of information available to professional investors.

I believe the Regulation should be modified to provide more clarity on the issues of materiality and enforcement in order to mitigate at least the volatility issue.

I thank the Committee for its invitation to testify.