

Regulation Fair Disclosure: An Analysis of SEC Enforcement Actions

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Abstract

This paper assesses the stock price impact of nine cases alleging a violation of Regulation FD. These cases comprise the population of actions taken since the SEC adopted the rule in August 2000. They relate primarily to situations where the company guides earnings for a small number of analysts or institutional investors without proper disclosure. While the average period of selective disclosure is small (one day only in three cases), we show that privileged investors who act promptly on this information can gain substantially, presumably at the expense of less informed, outside investors. The estimated gain to privileged investors in these nine cases amounts to more than \$260 million. SEC penalties, on the other hand, total only \$1.91 million. The SEC imposed no penalty in five cases, and one case (Siebel Systems) was recently dismissed. Our analysis offers new insights by documenting the gains (and losses avoided) by privileged investors during the selective disclosure period. We also calculate the average cost to the company of an alleged FD violation as a 4.19 percent drop in stock price on the day of the SEC announcement. Because the SEC penalties can explain only a small portion of the drop in the stock price, investors also suffer, in our view, from an increase in perceived information uncertainty, possibly because of allegations of breakdowns in disclosure controls.

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1. Introduction

This paper assesses the investor impact of nine cases brought against registrants by the Securities and Exchange Commission alleging a violation of Regulation Fair Disclosure (Regulation FD). These cases comprise the population of SEC actions taken since the adoption of the final rules on August 21, 2000 (SEC Release 33-7881, 2000). Effective for filings after October 23, 2000, FD was designed to level the disclosure playing field by making the same information available to all investors rather than just a few, such as securities analysts and institutional investors close to the company. Underpinning this regulation is the central idea that market confidence is threatened when one group of investors gains information unfairly based, for instance, on a privileged relationship rather than by effort or insight.

Regulation FD foresaw the need to address two situations—intentional selective disclosure and unintentional selective disclosure. In the first instance, when a company intentionally discloses non-public information to enumerated persons¹, FD requires that the information be offered simultaneously to all investors. On the other hand, when the disclosure is unintentional, FD simply requires that the disclosure be made promptly after discovery, which the SEC defines as within 24 hours of a senior officer first learning of the improper disclosure.

Thus, a failure to comply with FD could occur in two settings: (1) an intentional disclosure to an enumerated party not made simultaneously to all investors and (2) an unintentional disclosure not disclosed promptly once discovered. In either case, FD subjects a registrant to an SEC inquiry (e.g., a violation of section 13(a) or section 15(d)² of the Securities Exchange Act), whose consequence could be an enforcement action (e.g., an administrative cease and desist order or civil action seeking monetary

¹ Rule 100 (b) (1) of Regulation FD states four categories of enumerated person: (1) broker-dealer, (2) investment advisor, (3) investment company, and (4) all other persons for whom it is reasonably foreseeable that they would trade on non-public information.

² Sections 13a (1) through (17) and Sections 15d (1) through (17) regulate the general provisions for annual, quarterly, and 8-K reports of registered issuers.

penalties) or a finding or report of investigation (without further action). Regulation FD expressly disallows a violation to be the basis for a securities action under rule 10b-5. This “safe harbor” provision (Rule 102) removes what some viewed as a significant disincentive for issuers to comply with FD, although, as the regulation indicates, such safe harbor does not insure against 10b-5 liability on other grounds (e.g., insider trading, failure to update, or when the FD disclosure is false or misleading).

A considerable body of research has studied the behavior of stock prices, securities analysts, and disclosure mechanisms before and after FD to test propositions about the effects of the regulation. The results in these studies, reviewed in section 2, are mixed, however. In particular, most raise questions of control or attribution in that the effects alleged to be caused by FD could also be due to other factors. For example, during the time of FD adoption, in late 2000, the market was experiencing major changes in investor sentiment, trading infrastructure, investor technology, and cost of company information.³ These studies, by design, also tacitly assume that the SEC induced companies to act rapidly in response to FD, who found it in their interests to do so because the net benefit of compliance exceeded the net benefit of non-compliance.

However, if such companies viewed the net benefit of compliance as *less* than the net benefit of non-compliance, because of, for example, anticipated limited enforcement, probable low cost of violation, and significant uncertainty about the application of FD to specific issues, then why would one expect FD to induce rapid changes in company disclosure policy as implied by the research? Also, as noted earlier, an FD violation is shielded from 10b-5 liability, which further lowers the cost of violation. Yet none of the studies appears to recognize or incorporate the calculus of enforcement into their design. Indeed, what is the incentive to comply fully with FD when the consequences of non-compliance seem so limited? It may also be possible for some companies to comply with FD but at the same time to find other ways to communicate covered information on a selective basis not in violation of the regulation,

³ See, also, Francis et al. (2004).

for example, by exploiting differences in sophistication between institutions/analysts and less informed investors, or by re-characterizing public information, as occurred in the Siebel case (see below).

We raise these questions because in the approximately five years since the effective date of the regulation, the SEC has acted against only nine companies, including two with two alleged violations each (section 3 summarizes the individual cases).⁴ Assuming 10-K and 10-Q reports for, say, 15,000 non-SB issuers since fiscal 2000, this would amount to nine cases in approximately 300,000 filings, which would seem a rather low enforcement rate, particularly for a rule that was controversial at the time of adoption.⁵

The recent court order to dismiss the SEC's case against Siebel Systems' allegedly improper disclosures in April/May 2003, moreover, will unlikely make the SEC's enforcement task any easier. In Siebel, the court ruled against the SEC, concluding that a positive or negative characterization of public information given to a private party does not violate FD, even though such characterization could affect stock price. The court also chided the SEC for heightened scrutiny of Siebel's disclosures, noting that such position could lead companies to require the use of a "lexicologist to ensure that the proposed statement discloses the exact information in the same form as was publicly disclosed." (SEC v. Siebel Systems, et al., 2005).

This paper examines the impact of these FD enforcement actions on investor stock value. While the enforcement rate and direct costs of infraction seem minor, the stock price consequences may be more severe. For example, an SEC action could signal a problem with disclosure control and governance, which may trigger other kinds of investigations, either by the SEC or by private parties, since the 10b-5

⁴ We use the term "violation" for the eight cases of consent by the company and/or officers to the imposition of sanctions and penalties by the SEC without admission or denial of the disclosures prompting the SEC action. The ninth case, against Siebel Systems regarding events in April/May 2003, was dismissed on August 31, 2005 by the United States District Court for the Southern District of New York (SEC, 2005).

⁵ This rate would be even lower if analysts' recommendations and forecast announcements were included in the set of news possibly subject to selective disclosure. Shortly after the effective date of FD, however, the press did report that the SEC was investigating some possible violations although these were not pursued. Moreover, SEC officials around this time, indicated that only "cases of clear-cut violations involving unquestionably material information" would be investigated (Unger 2001).

safe harbor provision does not afford complete protection from securities fraud liability. Also, prior research on the market consequences of SEC enforcement actions (e.g., Dechow et al. 1996) documents that stock prices drop significantly at the time of an enforcement announcement, and investors could cue their responses to an FD announcement from this evidence (even though that research is based on actions involving improper accounting or auditing, not an FD violation). On the other hand, there may be little consequence for investors of an alleged FD violation, thus reinforcing the view that when non-compliance and enforcement costs are low, one should not expect substantive (and costly) changes in the flow of information to investors, as intended by the regulation and as tacitly assumed in the design of the research.

Our results are as follows. We find that the average period of selective disclosure is small. However, privileged investors appear to act promptly on this information and gain substantially at the expense of outside investors. Aggregate gains to privileged investors in the nine cases exceed \$260 million. The SEC penalties are much less, however, totaling only \$1.91 million; and in five cases, the SEC imposed no penalty at all. However, companies experienced an average stock price decrease of 4.19 percent on the day of the announcement of the *alleged* violation, which is far more significant than the penalties. These results contribute to the literature by documenting the investor costs associated with reported FD actions. In light of minor SEC penalties, these costs manifest themselves primarily as a wealth transfer from outside to privileged investors and as an increase in the registrant's cost of equity capital.⁶

The remainder of this paper is organized as follows. Section 2 discusses the related research, section 3 summarizes the nine cases of SEC enforcement, and section 4 analyzes these cases' impact on stock prices. Section 5 discusses the findings and raises questions for future research and policy.

2. Related research

Research on the effects of regulation FD builds upon the maintained hypothesis that companies'

⁶ We could find only one other study of FD enforcement actions. David and Holley (2004) describe five SEC enforcement cases from a legal perspective but offer no empirical analysis on the investor costs associated with reported actions.

disclosure environment changed beginning in late 2000 in response to FD. Most studies use a short post-FD window to observe such changes, either in the belief that companies changed rapidly in response to FD or because of a lack of post-FD data due to the recentness of the regulation. Several measures of change in the pre- and post-FD disclosure environment are examined. These include increases or decreases in (1) signed and unsigned stock price changes and/or stock price volatility around announcements of analyst forecasts/recommendations and earnings, (2) accuracy and dispersion of analysts' forecasts, (3) information asymmetry as measured by spreads, and (4) measures of information flow such as the frequency of conference calls and other public disclosures.⁷

With respect to the first category, Gintschel and Markov (2004) document that post-FD stock prices decreased relative to pre-FD levels, and decreased even more for those companies likely to have benefited from selective disclosure, such as those with optimistic analysts and analysts at favored firms. Shane, et al. (2001), Gadarowski and Sinha (2003), Heflin, et al. (2003), and Eleswarapu, et al. (2004) also find a decrease in stock volatility in the post-FD period. On the other hand, Bailey et al. (2003) find no decrease in volatility after controlling for the change to decimalization (minimum tick sizes reduced to one cent from one-sixteenth). More recently, Ke and Yu (2005) challenge the Gintschel and Markov (2004) result arguing that a part of the drop in informedness after FD can be linked to a decline in the research budgets of major brokerage houses due, in part, to public investigations of the brokerage industry.

There is also no clear consensus regarding the second category of research. For example, Shane, et al. (2001) and Heflin, et al. (2003) find no significant change in analyst forecast accuracy or forecast dispersion following FD, whereas Bailey et al. (2003) document a significant increase in dispersion but no increase in accuracy. Cornett et al. (2004) document changes in the differential accuracy of affiliated versus non-affiliate analysts after FD, and Mohanram and Sunder (2004) and Agrawal et al. (2006) find increases in dispersion and accuracy. Zitzewitz (2002), however, questions these results

⁷ The SEC and others, also, have used surveys to understand the impact of FD. See, for example, Unger (2001).

and finds that financial analysts had less private information after FD based on an increase in the days when analysts revised their forecasts based on common information relative to the days when they revised their forecast revisions based on private information. Also, Francis et al. (2004) examine several information content measures before and after FD compared to otherwise equivalent companies with American Depository Receipt (ADR) securities (which are exempted from FD). Francis et al. (2004) conclude that various information measures for FD and ADR companies are virtually indistinguishable before and after FD.

Regarding the third category, whereas Eleswarapu et al. (2004), Carnaghan and Sivakumar (2004), and Chiyachantana et al. (2004) find a decrease in spreads, especially for small or illiquid stocks, this result is not confirmed by Sidhu et al. (2004) who report an increase in spreads, and Mathew et al. (2002), Straser (2002), and Lee et al. (2004), who report no change.

The fourth category, perhaps, offers a more direct approach to the impact of FD but, still, the results are mixed. For example, according to Lee et al. (2004), the number of conference calls and number of companies hosting conference calls increased following FD; and Irani and Karamanou (2003) and Irani (2004) report that post FD conference calls have become more informative in terms of forecast consensus and accuracy. Conversely, Bushee et al. (2003, 2004) indicate that FD had a small negative impact on conference calls as measured by discontinuations or changes in conference call policy. Ke and Yu (2005) note further that while closed conference call companies revealed less bad news to analysts following FD relative to good news, the change in selective disclosure of bad news after FD was small relative to other sources of information available to analysts (e.g., due to effort, insight, costly analysis of public information).⁸

Finally, consider Gomes et al. (2004), who analyze FD in terms of four channels available to managers to communicate to investors: (1) company required reports, containing mandatory and voluntary

⁸ Also, Jorion et al. (2005) provides evidence to suggest that bond rating agencies may have gained an information advantage since they are not a covered party under the FD regulations, and Daske et al. (2005) conjecture that FD is one reason that short sellers appear to have lost their ability to predict significant bad news in recent years.

information, (2) selective disclosure, (3) analysts' reports, and (4) private information production. Regulation FD was meant to eliminate the second channel. Gomes et al. (2004) conclude that companies adjusted the other channels in response to FD, although the regulation may have affected small firms' cost of capital more than large firms, in that the latter adjust better to the loss of the second channel by using the other channels. Bailey et al. (2003) also report an increase in company disclosures per firm (i.e., an increased use of the first channel) after FD.

In sum, the studies so far offer no final consensus on whether regulation FD achieved its intended policy objective, and the mixed nature of the results also offers no firm pattern of empirical findings. This latter observation is surprising given that substantially similar research methods have been applied to a substantially similar set of companies (SEC registrants) before and after the adoption of FD. Some results may be linked to non-FD related changes in the financial markets, such as those surrounding the market downturn beginning in early 2000 and the market adjustments (and accounting scandals) that soon followed. These would include the Congressional investigations in 2001 that eventually lead to Sarbanes-Oxley and related regulations.

An alternative view, and one that would also be consistent with the above results (in particular, Francis et al. 2004), is that FD prompted few immediate, substantive changes in disclosure policy due to low expected enforcement and compliance costs and uncertainties about its implementation. Moreover, in those cases where registrants' disclosure policies might have changed—perhaps to signal compliance to regulators and investors—such companies were able to communicate the same information as before in other ways (e.g., via the other channels as suggested by Gomes et al. 2004) with no major differences in the timing, distribution, and quality of information for investors.

3. FD violation sample

Table 1 summarizes the nine cases brought by the SEC—as a civil action (3 cases), administrative release (5 cases), or as a report of an investigation (1 case). First, the table shows that the period of FD violation is quite short—in three cases, one day or less. Yet even in those cases, according to the SEC, the selective disclosure provided a financial advantage to certain privileged investors. Second, we note

only one case (Flowserve) where the violating company filed an 8-K report, which is one of the “non-exclusionary” methods of public disclosure required by FD on discovery of a selective disclosure (other methods include a wire service press release and an open conference call). Third, the main sanction used by the SEC is a cease and desist order (one of which was permanent); and only three cases involved a financial penalty on the company and/or officer. Schering-Plough paid the maximum of \$1,050,000. But, relative to the size of the companies, these are minor amounts. They may pale, moreover, in relation to the benefits conferred on certain investor groups, even after adjusting for the stock price decline upon disclosure of the alleged FD violation as an enforcement action. We also observe that the SEC describes all nine cases as intentional selective disclosures, with the possible exception of Motorola (where the disclosure was made on advice of legal counsel).

4. Stock price adjustment to selective disclosure and FD enforcement

4.1. Selective Disclosure

Each FD action states the period during which privileged investors may have benefited from the selective disclosure, either by buying before a price increase or selling before a price decrease. We measure this benefit as the abnormal return from the start of the FD violation period (from the previous day’s close) to the close as of the end of the violation period multiplied by the shares traded in the violation period. We measure abnormal return as the raw return less the return on the S&P 500 stock index. Next, we categorize each selective disclosure as positive or negative news based on the implications of the revision of earnings for stock price. We also calculate abnormal trading volume as actual volume on a given day divided by the average volume over a prior period.

Table 2 presents the initial results. This table shows the abnormal return and volume for days -10 to 10, relative to the start of the FD violation period (day 0). For positive news, panel A shows that stock prices gain steadily from days 0 to 4. At day 4, for example, the mean abnormal return is 19.19 (1.1919-1.0) percent, assuming an initial investment at the close of trading on day -1. Similarly, for negative news, the mean abnormal return is -6.24 (0.9376-1.0) percent relative to an initial investment at the close of day -1. Table 2 also shows abnormally higher average trading volume, especially on

days 1 to 4, relative to “normal” trading volume in a prior period (defined below). We do not observe abnormal volume on day 0, however, in part because the privileged information at that point is unlikely to have fully reached the broader market. Figures 1a and 1b plot the results, and show a clear separation of positive and negative news starting on day 0.

These average gains and losses, however, do not adjust for differences in the length of time a company allegedly violated FD. Table 3, column 2, shows the individual stock price increases and decreases for each FD violation. Note that abnormal return is calculated from day -1 to the end of the FD violation period, because the FD violations start on day 0 (usually in the morning). We then multiply the abnormal return during the violation period by two measures of trading volume on those days to provide a measure of the aggregate gain or loss to those investors with the privileged information. First, we use raw volume, multiplied by 50 percent to adjust for inter-dealer trading for the NASDAQ stocks (column 3). Second, we calculate abnormal volume in the violation period as actual volume in the violation period in excess of average volume over days -15 to -10 (column 4). Columns 5 and 6 show the calculations. These amounts are also initial measures of the damages suffered by non-privileged investors, assuming, in the first case (column 5), that each share that trades in the FD violation period comes from a non-privileged investor and, in the second case, that only each share of abnormal volume in the FD violation period comes from a non-privileged investor (column 6).⁹ We also assume no trading costs. The total gain to and/or loss avoided by privileged investors under this methodology ranges from \$259.8 million to \$657.1 million, although, as table 3 indicates, much of the overall gain/loss avoided relates to Schering-Plough and Motorola. SEC penalties (column 7), by contrast, total \$1.91 million, or less than one percent of privileged investors’ benefits.

⁹ Our measure of abnormal volume, potentially, understates the gains/losses avoided by privileged investors, since it assumes that in four cases the abnormal volume is zero. Also, an outside investor could be damaged by normal trading if the shares normally traded were sold too low or purchased too high because of a lack of privileged information.

4.2. FD Enforcement Action

In addition to an SEC penalty, a company that violates Regulation FD may be subject to a stock price adjustment upon the announcement of the FD violation. We, therefore, calculate the abnormal stock return for each company around the date of the SEC release. A negative response would be evidence of a market-imposed consequence, which would not only reflect the SEC penalty but also any additional investor concerns such as those relating to corporate governance or, more specifically, to the effectiveness of the company's disclosure controls. For example, under sections 302 and 404 of Sarbanes-Oxley, a company must certify to and report material weaknesses in its disclosure controls (and other aspects of internal control also); and an FD violation would almost certainly be viewed by an investor as pertaining to the disclosure control system.

Table 4 presents the results. This table reports that FD violator companies lose on average 4.19 (1.0-0.9581) percent of their market capitalization from the close on day -1 to the close on day 0; and lose 5.79 (1.0-0.9421) percent over days -1 to 4.¹⁰ Applied to registrants' market capitalization before the SEC action, these percentages represent well over a one billion dollar loss of market value. Average trading volume, also, spikes on day 0 at 43.26 percent above average prior levels, presumably as the market assimilates news of the alleged violations, and this volume increase occurs for six of the nine companies. (The unusual volume increase on day 6 is due solely to Siebel Systems). This evidence is consistent with the view that the market assesses a significant "penalty" on alleged FD violators as a group. Since the SEC monetary penalties (and other cash flow effects) are minor, we posit that this stock price decrease is due to additional perceived risk factors, for example, a reassessment of risk based on concerns about a company's disclosure controls (and related aspects of corporate

¹⁰ Sloan et al. (1996) report a 4.30% average decline in stock price (for 25 companies) on the day of announcement of an SEC Accounting and Auditing Enforcement Release (AAER). While this percentage decline is comparable to the day 0 decline at the time of an alleged FD violation announcement in this study (4.19%), we note that most AAERs represent an *alleged* securities law violation, whereas in this study the SEC release reports on a violation that is recognized by the company and its officers who assent to sanctions, though usually it is without admitting or denying the violation. A recent study of announcements of internal control weaknesses also indicates a significant negative reaction following the announcement, e.g., a 1.96% drop after 30 days (Glass, Lewis & Co. 2005).

governance).¹¹ Investors, also, might assess a higher litigation risk, as an FD violation is not fully insured against outside private party lawsuits.

5. Discussion

This paper examines nine SEC enforcement actions regarding a violation of Regulation FD. These cases merit investigation as an initial study of all cases brought by the SEC since the adoption of FD in late 1990. These cases also reflect an historically low rate of enforcement, particularly for a regulation that, with few exceptions, denies the use of private litigation as a supplement to SEC enforcement. The small number of enforcement actions, of course, could reflect the fact that registrants found it in their interests to comply fully and immediately with FD because the net benefits of adoption exceed those of non-adoption.¹² However, without clear and significant costs of non-compliance (consistent with low enforcement) and clear and significant benefits of compliance (as suggested by the mixed research), we question why the underlying calculus should lead to such “full compliance” outcome.¹³ For example, if one assumes that companies operated efficient and optimal methods of dissemination prior to FD, then the adoption of FD without further adjustment would no longer be an optimal strategy, unless of course the net cost of adoption was low.

Consistent with this view, some research indicates that certain forms of *low cost* information dissemination did indeed change soon after FD, for example, an increase in financial statement disclosure. Companies, also, may have found ways to communicate selectively to certain investors in ways not in violation of FD, such as by releasing (complex) information that is more useful to informed

¹¹ The court in Siebel Systems (SEC 2005), however, found there were no grounds for the SEC cause of action based on a failure to maintain adequate disclosure controls.

¹² Several of the empirical papers (reviewed in section 2) embrace this view as a maintained hypothesis by adopting a relatively short post FD period, often of one year or less.

¹³ A complete analysis would also consider the incentives of privileged investors before and after FD, particularly possible actions on their part to continue to gain from preferential treatment, but in ways not in violation of FD. For example, what if a small group of investors encouraged management to release certain information to all investors (in compliance with FD) that was truly useful only to the small group, for example, key inputs to a particular earnings forecasting model? Information can also be conveyed in allowable communications with rating agencies and in private securities offerings (where potential investors are required to commit not to trade until a public disclosure is made).

and well-resourced groups than to investors in general. On the other hand, the small number of cases could also be consistent with a rule whose consequences could be quite limited and, possibly, were intended to be such for most companies even under non-compliance.¹⁴ What are those consequences?

The empirical analysis in this paper addresses three consequences of an FD violation. First, we document that, on average, the few FD violations targeted by the SEC involve significant information in the selective disclosure period. Stock prices increase beginning on the day of selective disclosure of positive information and, similarly decrease following selective disclosure of negative information. Second, in the nine cases, privileged investors gain (or avoid losses) by a total of more than \$260 million from the selective information. These gains, however, cannot be claimed as damages by the non-privileged investors; for example, an FD violation cannot in general be grounds for a 10b-5 class action lawsuit. We, therefore, have a situation where privileged investors apparently gain at the expense of the less informed with little financial consequence. These gains, moreover, according to the court in the Siebel decision (SEC 2005) cannot be considered as grounds for an FD violation.

There is, however, one consequence of FD, in addition to the penalties and sanctions, which would appear to impose a significant cost on investors. On the day of an SEC announcement of an action, the average stock price of an alleged FD violator falls by 4.19 percent, or well over \$1 billion in terms of aggregate market value. Since the SEC penalties and other cash flow effects are small or zero, this drop in stock price must, therefore, reflect a risk adjustment from the perceived effects of the allegations; for example, concerns about the adequacy of disclosure controls and the possibility of future litigation.

Finally, this paper raises several unanswered questions. For example, how does the SEC select its cases for investigation? Why have there been so few cases of enforcement, assuming the SEC does not

¹⁴ The SEC, also, may have adopted a strategy of acting on violations of FD only under the most egregious circumstances. This too limits the costs and consequences of non-compliance. In this regard, Cox and Thomas (2003) explore the role of private suits in the enforcement of securities laws and examine the characteristics of enforcement actions and their overlap with private class action suits. They find that the SEC targets smaller capitalization issuers than those targeted by private suits, with no evidence of relative provable losses as driving the SEC's action. Considering the limited resources of the SEC and the fact that FD explicitly excludes private litigation, it is not surprising to see few enforcement actions and quite reasonable, at least to us, to assume limited compliance. The SEC's resources, enforcement, staffing, and filings review goals in recent years are discussed in Cox and Thomas (2003;757-760).

pursue other less formal means of FD compliance and enforcement not disclosed as an SEC release? As we noted earlier, the small number of reported actions under FD stands in contrast to the hundreds of thousands of *potential* FD situations, which in our view could arise almost anytime a company discloses, or anticipates disclosing, significant information to investors. Are we to believe then, in this post FD era, that *all* incremental return to informed investors is now the result of effort and insight, and none is from preferential access? Or has the SEC simply taken a “hands off” approach to the enforcement of this particular regulation?

Table 1: Summary of FD Violations (11/25/02 to 3/24/05)

#	Company	Release Date	Violation Start	Violation End	Days	Nature of Violation	Form 8-K
1	Flowserve Corporation	03/24/05	11/19/02	11/21/02	2	Selective disclosure took place at a private meeting held November 19, 2002 with four analysts during which CEO reaffirmed earnings guidance and provided additional nonpublic information to those analysts. Those analysts issued a positive report the next day.	Yes
2	Senetek PLC-I	09/16/04	06/06/02	06/11/02	5	Company hired an outside firm for consulting services. This firm, however, submitted a research report to management for review. Management corrected the revenue and earnings projections in the draft report. The firm published the research report on June 11, 2002.	No
3	Senetek PLC-II	09/16/04	09/26/02	09/30/02	4	Company hired an outside firm for research services. This firm submitted a research report to management for review. Management corrected the revenue and earnings projections in the draft report. Firm published the research report on September 30, 2002.	No
4	Siebel Systems-II	06/29/04	04/30/03	05/01/03	1	Company on April 30, 2003 disclosed nonpublic information to certain analysts and institutional investors in a private meeting in New York, who acted on this information the next day. CFO failed to develop proper disclosure controls to prevent selective disclosure, which had occurred earlier (Siebel-I). Aiding and abetting charges also filed.	No
5	Schering-Plough Corporation	09/09/03	09/30/02	10/03/02	3	CEO met with analysts and portfolio managers for four select institutional investors (Putnam, Fidelity, Wellington, MFS) and indicated that Wall Street earnings estimates were too high. Late on October 3, 2002, Schering issued a press release providing earnings guidance for 2002 and 2003 that was materially below analysts' consensus estimates.	No
6	Motorola Corporation	11/25/02	03/06/01	03/12/01	6	Motorola disclosed information about the company's quarterly sales and orders during private telephone calls with sell-side analysts in March 2001. These calls interpreted the meaning of "significant" used in an earlier public communication as meaning 25% or more. Management relied on counsel to provide the private interpretation to select sell-side analysts.	No.
7	Raytheon Company	11/25/02	02/15/01	03/05/01	18	CFO selectively disclosed information about Raytheon's expected quarterly distribution of earnings per share for 2001 in general, and for the first quarter in particular. Specifically, the CFO communicated to the analysts that the first quarter EPS estimates were too high.	No
8	Siebel Systems-I	11/25/02	11/04/01	11/05/01	1	Company on November 5, 2001 disclosed favorable nonpublic information to a group of invitation-only analysts. This differed from unfavorable information disclosed in a public conference three weeks earlier.	No
9	Secure Computing	11/25/02	03/06/02	03/07/02	1	Company disclosed material non-public information about a significant software contract to two portfolio managers at two institutional advisers. Company announced the contract to the public in a press release issued after the close the same day.	No

Table 1, continued

#	Company	Form 8-K Filed	Formal Enforcement Action	SEC statement about effects of violation on price change and volume	Fiscal Period	Total Penalty
1	Flowserve Corporation	Yes	Civil penalty paid of \$350,000 by company, \$50,000 by CEO; Charges settled without admission of liability; Investor relations director consents to cease and desist order.	On November 21 st , closing stock price was approximately 6% higher than the closing price the day before. Trading volume increased by 75%, from 379,500 shares traded on November 20th to 658,300 shares traded on November 21st, after the dissemination of the analyst's report.	Fiscal year 2002	\$400,000
2	Senetek PLC-I	No.	Company consents to cease and desist order; No penalties, No admission of liability.	None	Fiscal year 2002	\$-
3	Senetek PLC-II	No.	Company consents to cease and desist order; No penalties; No admission of liability.	None	Fiscal year 2002	\$-
4	Siebel Systems-II	No.	Judgment requested for cease and desist order, civil penalties, and permanent injunction; More serious because a second violation.	On May 1, 2003, the day following the private meetings, the company's stock price closed approximately 8% higher than the prior day's close, and the trading volume was nearly twice the average daily volume for the preceding year.	Second quarter 2003	\$- (Dismissed September 1, 2005)
5	Schering-Plough Corporation	No.	Company consents to cease and desist order; CEO pays civil penalty of \$50,000; Company pays \$1,000,000 civil penalty.	From October 1 through October 3, 2002, Schering's stock price fell by more than 17 percent, from \$21.32 to \$17.64 per share, with volume each day averaging more than four times the stock's typical daily volume (<i>i.e.</i> , over 20 million shares per day compared to an average of less than 5 million).	Third quarter 2002	\$1,050,000
6	Motorola Corporation	No.	Report of an investigation that determined a violation of FD; No penalties imposed or orders issued.	Between March 6 and March 12 - the period of the phone calls at issue - the price of Motorola stock declined from \$17.70 to \$15.00, a drop of more than 15%. There were also significant increases in trading volume of Motorola stock at most of the firms where analysts were contacted.	First quarter 2001	\$-
7	Raytheon Company	No.	Cease and order on company and CFO; No penalties imposed.	After the March 1, 2001 morning call, the price of Raytheon B stock fell approximately 6%, from \$32.80 to \$30.84, and the price of Raytheon A stock fell approximately 3%, from \$31.30 to \$30.50.	First quarter 2001 and 2001 overall.	\$-
8	Siebel Systems-I	No.	Company consents to cease and desist order; Civil penalty of \$250,000; Permanent injunction.	On the day of the conference, the company's stock price closed approximately 20% higher than the prior day's close and the trading volume was more than twice the average daily volume.	Fiscal year 2002	\$250,000
9	Secure Computing	No.	Cease and order on company and CEO; No penalties imposed.	Secure's stock price closed at \$18.55 per share on March 7, a 7% rise from March 6 on volume that was 130% higher.	Fiscal year 2002	\$-

Table 2
Stock Market Response Relative to Start of FD Violation Period

Event Day ¹	Mean Abnormal	Mean Abnormal	Mean Abnormal
	Return Index ²	Return Index ²	Volume Index ³
	Positive News	Negative News	
-10	1.0284	1.0098	0.9129
-9	1.0334	1.0067	1.0217
-8	1.0182	1.0039	0.8412
-7	1.0472	1.0018	1.0928
-6	1.0423	0.9929	1.2182
-5	1.0422	0.9793	0.9527
-4	1.0516	0.9754	0.8424
-3	1.0365	0.9664	0.8359
-2	1.0344	0.9672	0.9362
-1	1.0000	1.0000	0.7355
0	1.0700	1.0015	1.0022
1	1.1124	0.9986	1.6902
2	1.1543	0.9565	1.6611
3	1.1942	0.9705	1.5751
4	1.1919	0.9376	1.8068
5	1.2005	0.9624	1.1160
6	1.2263	0.9347	1.3429
7	1.1882	0.9453	1.2162
8	1.1659	0.9335	1.1035
9	1.1642	0.9414	0.9576
10	1.1471	0.9130	0.9476

Notes to table 2.

1. Event day relative to start of FD violation period (see table 1)
2. Abnormal return index relative to S&P stock index; set arbitrarily to 1 on day -1.
3. Abnormal volume relative to average volume over days -15 to -10.

Table 3
Market Response to FD Violation, Adjusted for FD Violation Period

Company	Predicted Effect ¹	Abnormal Return ²	Trading Volume ³	Abnormal Trading Volume ⁴	Trading Volume Change in Mkt. Capitalization ⁵	Abnormal Trading Volume Change in Mkt. Capitalization ⁵	SEC Penalty Combined
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Flowserve Corporation	P	2.16%	1,310,200	-18,050	\$1,231,588	\$-	\$400,000
Motorola Corporation	N	-10.42%	73,248,900	17,908,150	\$197,772,030	\$48,352,005	\$-
Raytheon Company	N	-4.48%	14,457,900	606,900	\$46,988,175	\$1,972,425	\$-
Schering-Plough Corporation	N	-19.28%	52,282,800	39,483,850	\$192,400,704	\$145,300,568	\$1,050,000
Senetek PLC-I	N	-8.52%	108,116	-26,349	\$12,866	\$-	\$-
Senetek PLC-II	N	1.42%	38,397	-9,643	\$384	\$-	\$-
Secure Computing	P	8.41%	394,550	-40,408	\$453,733	\$-	\$-
Siebel Systems-I	P	22.13%	28,737,750	7,045,383	\$129,032,498	\$31,633,771	na
Siebel Systems-II	P	9.31%	15,674,500	6,069,117	\$12,382,855	\$4,794,602	\$250,000
Mean response		9.57%	20,694,790	7,890,994	\$64,474,981	\$25,783,708	\$212,500
Median response		8.52%	14,457,900	606,900	\$12,382,855	\$1,972,425	\$-
Total					\$657,132,668	\$259,809,504	\$1,912,500

Notes to table 3.

1. Based on impact of selective disclosure on earnings or forecasted earnings (P=positive news, N=negative news).
2. Abnormal return over FD violation period (from close of day -1 to close of end of FD violation period).
3. Trading volume over FD violation period x 50% for inter-dealer trading for NASDAQ listed companies.
4. Relative to average trading volume over days -15 to -10 relative to start of FD violation period.
5. Abnormal price change from close of day -1 to close of end of FD violation period times trading volume/abnormal trading volume).

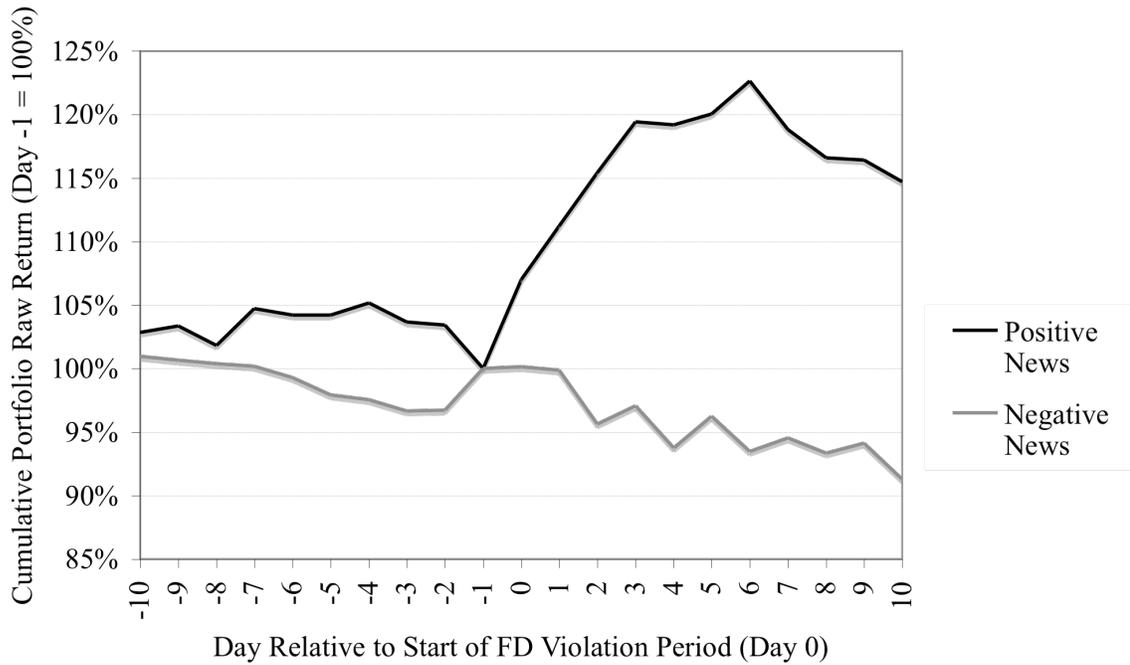
Table 4
Stock Market Response Relative to SEC Enforcement Action Date

Event Day ¹	Mean Abnormal Return Index ²	Mean Abnormal Return Index ²	Mean Abnormal Return Index ²	Mean Abnormal Volume Index ³
	Positive News	Negative News	Combined	
-10	0.8908	0.9585	0.9133	0.8436
-9	0.9170	0.9764	0.9090	1.0022
-8	0.9138	0.9694	0.9171	0.9070
-7	0.9189	0.9501	0.9347	1.0724
-6	0.9443	0.9520	0.9503	0.9178
-5	0.9656	0.9677	0.9381	0.9316
-4	0.9558	0.9530	0.9589	0.9483
-3	0.9705	0.9603	0.9987	0.9937
-2	1.0004	0.9934	1.0008	1.2638
-1	1.0000	1.0000	1.0000	1.0858
0	0.9653	0.9783	0.9581	1.4326
1	0.9200	0.9512	0.9346	0.9402
2	0.9236	0.9681	0.9441	0.9893
3	0.8965	0.9719	0.9271	0.7768
4	0.9203	0.9900	0.9421	1.1072
5	0.8974	0.9988	0.9292	1.2067
6	0.8931	1.0208	0.9319	2.3973
7	0.8990	1.0192	0.9382	1.3445
8	0.8710	1.0040	0.9027	1.1061
9	0.8574	0.9820	0.8927	1.1222
10	0.8609	0.9545	0.8814	0.8254

Notes to table 4.

1. Event day relative to SEC Enforcement Action date (see table 1)
2. Abnormal return relative to S&P 500 stock index; set arbitrarily to 1.0 on day -1.
3. Abnormal trading volume relative to average volume over days -15 to -10.

Panel A: Market Reaction Around Start of FD Violation Period



Panel B: Trading Volume Around Start of FD Violation Period

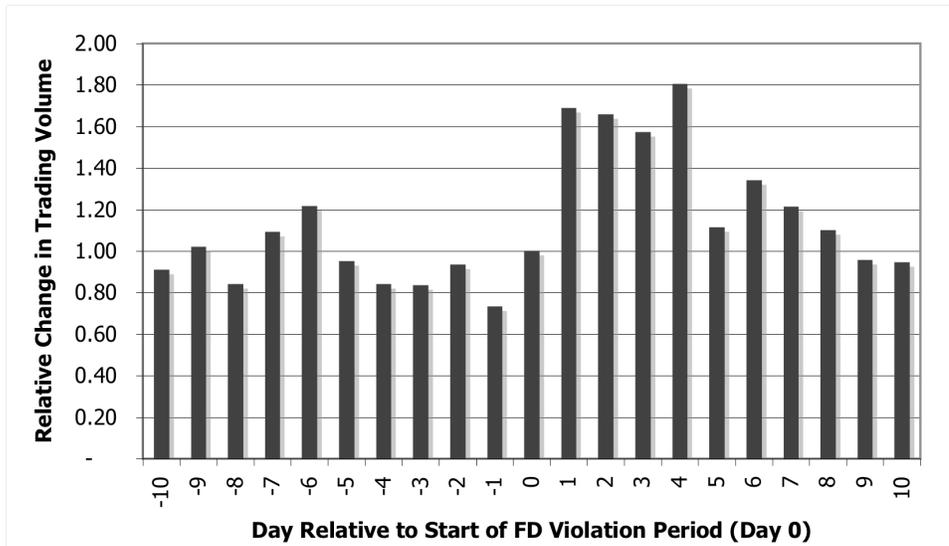


Figure 1: Stock Market Response Relative to Start of FD Violation Period

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