

Investor Advisory Committee Investor as Owner Subcommittee

Proposed Resolution on Regulation FD and Board-Shareowner Dialogue

Feb. 22 2010

At its Dec. 21 2009 meeting, the IAC Investor as Owner Subcommittee unanimously recommended the following resolution to the Investor Advisory Committee. Background to the proposed resolution is attached.

Proposed IAC Resolution on Regulation FD

The IAC notes that some investors have experienced boards that have identified Regulation FD as a barrier to dialogue. Other investors have not found the issue to be a common problem in engagement. The IAC favors opportunities for dialogue between shareowners and corporate boards. Safeguarding channels for such dialogue is especially important in the context of changes to board election practices and the spread of advisory votes on executive compensation policies. In this context, SEC Chair Mary Schapiro made the following statement on July 15 2009 to the International Corporate Governance Network conference in Sydney. In response to a question as to whether Regulation FD may be used by some companies as an “excuse for not reaching out” to investors, she said in full:

“I would respond that Regulation FD does not restrict communications between companies and their shareholders. Rather, it restricts selective disclosures of material non-public information. Regulation FD was aimed at changing a practice that was universally regarded as unfair and damaging to our markets—namely, the selective or private disclosure of material non-public information to certain investors who can then use that information to make decisions to buy or sell stock ahead of other investors and the public. Regulation FD does not prevent companies from seeking out and listening to the views of investors. Indeed, the Commission encourages dialogue between companies and shareholders. I know of some investors who, prior to or at the beginning of individual meetings with company executives, clearly state that they do not want to receive material non-public information; this seems to be a strategy that can keep Regulation FD from becoming the focal point of discussion.”

In line with Chairman Schapiro’s statement, the IAC believes that Regulation FD should be understood as facilitating rather than preventing dialogue between investors, on the one hand, and corporations, including boards, on the other. The IAC recommends that the Commission issue staff interpretive guidance to suggest ways in which issuers can address Regulation FD compliance concerns about the selective disclosure of material corporate governance information in private meetings with investors. These suggestions

could include the use of confidentiality agreements or the use of other measures, such as in-house legal participation or pre-screening of discussion topics, that have developed as “best-practices” since Regulation FD was adopted. The IAC’s stance should not be construed as recommending dedication of major SEC staff resources, as the Committee believes that this should not be necessary to effect the Committee’s advice.

Background

At its physical October 5 2009 meeting in Washington, DC, the IAC's Investor as Owner Subcommittee considered the question of whether a recommendation is warranted to clarify the relevance of Regulation FD to board-shareowner communication. Advocates contended that corporations often cite restrictions under Reg FD to fend off investor efforts to enter into dialogue with board directors. The Subcommittee agreed by a two-thirds vote to pose a resolution on the matter to the full IAC. However, reservations remained in the Subcommittee and the full IAC voted to defer action on the matter until a subsequent meeting. A number of investors inside and outside the IAC have now pressed the IAC for action. In response, the chair engaged in bilateral discussions with several Subcommittee members and with the SEC staff to explore prospects for a formula that could facilitate board-shareowner communication while meeting concerns expressed at the October 5 session. This memorandum proposes such a resolution. In addition, the SEC staff kindly provided a background memorandum on the Reg FD matter. This is attached.

Reservations and responses

IAC members voiced four major reservations in respect to action on Reg FD:

1. Reg FD is not generally a barrier to board-shareowner communication;
2. SEC guidance could consume significant resources which could best be allocated for other work;
3. The issue does not rise to a level of importance that warrants singular IAC action;
4. SEC guidance on the matter would not prevent a board from using Reg FD as a reason to ward off dialogue with investors

Since the meeting, the Subcommittee has been provided with information that addresses these points, as follows.

1. Reg FD is not generally a barrier to board-shareowner communication.

The Subcommittee is composed of investors who contend that Reg FD is a common barrier to board-shareowner communication. The Subcommittee also includes investors who assert that they do not generally experience it as a problem, though they acknowledge that it has been for others. In this context it may be instructive to review evidence submitted to the Subcommittee in support of action.

- CalPERS's corporate governance executive Anne Simpson advised the chair that the fund would be strongly supportive of an IAC recommendation on Reg FD because the fund has often encountered arguments by boards that rules are barriers to dialogue.
- TIAA-CREF wrote the following: "There are two situations where we have encountered resistance from companies when we ask to meet with directors. First is at a company by company level when we ask to speak to board members regarding executive compensation or other governance issues. We recently had a very large company come in and talk to us about separating their

CEO and Chair. We had the corporate secretary and an internal lawyer at the meeting. They referred specifically to FD as a reason not to have the directors talk to shareholders, and this would be the case even if management were also in the room. This is not an isolated incidence. A number of companies have taken this same position. We do have precedent for successful direct meetings. We've had direct conversations with compensation committee members individually and collectively with other investors without any FD concerns being raised, so it can be done without discussing non-public material information. The other level is at conferences and other meetings on corporate governance. There is always someone who raises FD as a reason to be wary of director-shareholder dialogue. I can't tell you how many times this comes up – it comes up all the time. Companies are just very conservative or they simply do not understand that the discussions we ask for will not be on strategic issues but on governance and policy issues and are relying overly on advice from internal counsel, who tend to focus on technical compliance issues rather than on the broader governance and policy issues.”

- Hermes Equity Ownership Services, which represents Hermes and other funds, advised the IAC through governance analyst Bess Joffe: “I so often have companies refuse to provide me with board-level access on the basis of Reg FD. As you know, the conversations EOS strives to have with boards are high-level and broad in nature, testing directors on issues such as accountability, risk oversight and governance practices. Often board-level insight provides us with exactly the window into decision-making dynamics that we are seeking to uncover. From my understanding, Reg FD was never intended to stand in the way of this kind of dialogue and it is frustrating to have our engagement efforts in the US market stilted because of it.”
- A memo was circulated on Dec. 11 to 10 large US and non-resident funds launching a new initiative on Reg FD. It read: “A number of us have been discussing that Reg FD is often a barrier to gaining access to boards of directors in the US. We all know that it is not meant to prevent shareholders from having discussions regarding governance practices with directors or senior management. However, a number of us have encountered this from time to time as an excuse for not being granted the access we're requesting. As you may know, Mary Schapiro, has said a few times publicly that Reg FD should not be a barrier to these kinds of conversations - she made this comment when she spoke at the CII last April, and again in September at the SEC-hosted Transatlantic Corporate Governance Dialogue. In conversations with various people at the SEC, we have requested that such guidance be drafted and released in writing by the SEC to clarify its position on this, with the hope that this will prevent companies from using it as an excuse to deny us board-level access. The SEC is a bit between a rock and a hard place on this issue, not wanting to state in writing that governance discussions are not ‘material.’ But we all know that there are various definitions of ‘material.’ We are now hoping to make some headway on this issue ahead of the next proxy season.”

2. SEC guidance could consumer significant resources which could best be allocated for other work.

The chair sought advice on this matter from SEC staff so that the IAC could make an informed judgment. Resources required for interpretive guidance, if so requested by the IAC and endorsed by the SEC, would vary particularly according to whether it would come in the form of a Commission release or a staff interpretation. A staff interpretive guidance statement is thought to be something that would not require a substantial investment of resources, and in any case this route would involve an estimated 40% less time than a full Commission release.

3. The issue does not rise to a level of importance that warrants singular IAC action.

Concerns were widely shared on October 5 that a series of more immediate and bigger issues demand the attention of the IAC, and that focusing on Reg FD on its own would send a suboptimal signal to the market about the Committee's mission. On the other hand, proponents of action on the matter see an IAC stance on Reg FD as a practical and important measure to ease board-shareowner dialogue as a means of promoting sustainable corporate performance. To address both positions, the Subcommittee has the option of taking up the resolution on Reg FD along with a package of other measures.

4. SEC guidance on the matter would not prevent a board from using Reg FD as a reason to ward off dialogue with investors.

There is consensus that even if the SEC were to issue guidance on the relevance of Reg FD to board-shareowner communication, it would be unable to prevent certain companies from citing the regulation to ward off dialogue with investors. The staff memo below makes just this point:

Although this type of guidance might result in a reduction of what some Subcommittee members believe are unnecessary restrictions on communications between company representatives and investors, there would be no guarantee of that desired outcome. Whether particular corporate governance information is "material" and the provisions of Regulation FD have been complied with will remain a determination based on facts and circumstances.

Advocates nonetheless contend that guidance would serve to assist investors as they seek such dialogue at many companies.

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**SECURITIES AND EXCHANGE COMMISSION
INVESTOR ADVISORY COMMITTEE—INVESTOR AS SHAREOWNER SUBCOMMITTEE**

Application of Regulation FD to Corporate Governance Matters

Introduction

The Investor as Shareowner Subcommittee of the Commission's Investor Advisory Committee decided at its meeting in October 2009 to recommend to the full Committee that a resolution be approved requesting that the Commission issue guidance as to whether Regulation FD (Fair Disclosure) restricts discussions between companies and shareholders on corporate governance matters. In particular, the Subcommittee members discussed the possibility of the Commission issuing a statement confirming remarks of Chairman Schapiro in response to a question at the 2009 International Corporate Governance Network annual meeting.¹ The proposed resolution was considered by the full Committee, but the decision was made to defer action on the Subcommittee's recommendations pending additional information.

During this discussion, some Committee members expressed uncertainty about whether Regulation FD is, in fact, being used extensively to curtail governance-related communications between shareholder and company representatives, including members of the board. Some Committee members believe that concerns about complying with Regulation FD may be unnecessarily restricting these communications. Other Committee members questioned whether Commission guidance alone could adequately address the issue and, if so, whether such guidance would possibly be viewed as a statement about the materiality of all corporate governance matters.

¹ It was reported by Stephen Davis & Jon Lukomnik in Compliance Week on September 15, 2009 that the Chairman responded as follows to a question about whether Regulation FD restricts communications between companies and their shareholders:

I would respond that Regulation FD does not restrict communications between companies and their shareholders. Rather, it restricts selective disclosures of material non-public information. Regulation FD was aimed at changing a practice that was universally regarded as unfair and damaging to our markets—namely, the selective or private disclosure of material non-public information to certain investors who can then use that information to make decisions to buy or sell stock ahead of other investors and the public. Regulation FD does not prevent companies from seeking out and listening to the views of investors. Indeed, the Commission encourages dialogue between companies and shareholders. I know of some investors who, prior to or at the beginning of individual meetings with company executives, clearly state that they do not want to receive material non-public information; this seems to be a strategy that can keep Regulation FD from becoming the focal point of discussion.

Regulation FD

Regulation FD restricts the selective disclosure of material, non-public information to certain market professionals and security holders. While Regulation FD does not define the term “material,” courts have identified information as material if there is a substantial likelihood that a reasonable investor would consider the information important to his or her investment or voting decision, and disclosure of the information would have significantly altered the total mix of information available to the investor.

Regulation FD applies to communications by an issuer and any person acting on its behalf, including senior management, directors and others who regularly interact with securities market professionals or security holders. Selective disclosure may not be made to specific categories of persons, absent a specified exclusion. The categories of persons covered by Regulation FD include holders of the issuer’s securities, under circumstances in which it is reasonably foreseeable that those persons will trade on the information, broker-dealers, and investment companies. Regulation FD does not apply to disclosures made to certain other persons, including anyone who expressly agrees to maintain the information in confidence and the media.

In an effort to avoid inadvertent violations of Regulation FD, especially given the fact-dependent nature of the definition of “material,” most companies have implemented policies and procedures designed to control how they disclose information to investors. As part of these controls and procedures, many have imposed restrictions on communications between company representatives, including directors, and persons to whom communications are restricted by Regulation FD, including investors.

The Commission is responsible for the enforcement of the provisions of Regulation FD. The Commission has brought a number of actions for violations of Regulation FD. Those actions have generally addressed selective disclosure of earnings guidance and financial projections.

Current Commission and Staff Guidance

In addition to the Regulation FD adopting release and the Chairman’s statement noted above, the Commission and its staff have provided further interpretive guidance on Regulation FD.² The Regulation FD guidance issued by the Commission and the staff of the Commission has not specifically addressed corporate governance matters.³

² Following are links to Commission releases and staff interpretations regarding Regulation FD:

<http://www.sec.gov/rules/final/33-7881.htm>; <http://www.sec.gov/rules/interp/2008/34-58288.pdf>;
<http://www.sec.gov/rules/final/33-8591.pdf>; <http://www.sec.gov/divisions/corpfin/guidance/regfd-interp.htm>

³ The Commission issued an interpretive release in 2008 that provided guidance as to the circumstances under which information posted on a company web site would be considered “public” for purposes of Regulation FD. In connection with reforms of the Securities Act regulations, the Commission amended Regulation FD and provided additional Regulation FD guidance—including guidance about communications made in connection with registered securities offerings—to address the impact of the new regulations on Regulation FD. The Division of Corporation

Potential Commission or Staff Action

In the event the Investor Advisory Committee concludes that a recommendation should be made to the Commission to address the Regulation FD concerns raised by the Subcommittee, the Committee could suggest a way for the Commission to proceed. For example, a recommendation could be made for the Commission to consider issuing interpretive guidance, in the form of a Commission release or a staff interpretation, to suggest ways in which issuers can address Regulation FD compliance concerns about the selective disclosure of material corporate governance information in private meetings with investors. These suggestions could include the use of confidentiality agreements or the use of other measures, such as in-house legal participation or pre-screening of discussion topics, that have developed as “best-practices” since Regulation FD was adopted. Although this type of guidance might result in a reduction of what some Subcommittee members believe are unnecessary restrictions on communications between company representatives and investors, there would be no guarantee of that desired outcome. Whether particular corporate governance information is “material” and the provisions of Regulation FD have been complied with will remain a determination based on facts and circumstances.