

ALERTS

SEC Brings Rare Regulation FD Enforcement Case — Implications for Private Fund Managers and Broker-Dealers

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On March 5, 2021, the Securities and Exchange Commission charged AT&T with violating Regulation FD (“Reg FD”) for selectively disclosing material nonpublic information (“MNPI”) to research analysts.[1] The SEC has brought only a handful of Reg FD cases since its enactment in 2000, and this case may have significant implications for investment professionals.

Regulation FD prohibits issuers, or persons acting on their behalf, from disclosing MNPI to certain third parties without disclosing that same information to the general public. Reg FD was enacted, primarily, to prevent public companies from selectively providing nonpublic earnings information to securities analysts and certain shareholders. The goal of Reg FD was to level the playing field between individual and institutional investors following publicized reports of institutional investors profiting in advance of corporate earnings announcements. Final Rule: Selective Disclosure and Insider Trading, Exchange Act Rel. No. 43154, 65 Fed. Reg. 51, 721 (Aug. 15, 2000) (<https://www.sec.gov/rules/final/33-7881.htm>).

According to the SEC’s complaint filed against AT&T last week, AT&T had experienced an unanticipated decline in its first quarter 2016 smartphone sales. To avoid falling short of Wall Street’s consensus revenue estimate, the SEC alleged that AT&T investor relations executives made private, one-on-one phone calls to equity analysts at approximately 20 different sell-side firms during which they disclosed the disappointing sales

data. The SEC contends that these calls were made in an effort to lower Wall Street's expectations such that AT&T would avoid missing the consensus estimate for the third consecutive quarter. According to the SEC, the disclosures were material and not shared with the general public. Notably, the case was not settled at the time of its filing, indicating AT&T's intent to defend itself against the SEC's charges.

Clear guidelines under Reg FD, and strict adherence to those rules, are essential to safeguard against the potential misuse of material nonpublic information. Most investment professionals, particularly private investment funds and broker-dealers, frequently communicate with senior management and investor relations personnel at public companies as part of their research process. Market participants generally rely on public company executives to know and follow Reg FD, and assume that statements made during these management meetings do not include MNPI. If broker-dealers or investment advisers receive MNPI from company management, they may violate insider trading laws by purchasing or selling securities or sharing the information with another party that buys or sells securities. This is true even though the public company executives themselves might have breached their own independent obligations under Reg FD.

Compliance Implications for Private Fund Managers and Broker-Dealers

The SEC's case against AT&T and its investor relations personnel serves as an important reminder that investment professionals cannot simply assume corporate executives understand and comply with Reg FD, and that private fund managers and broker-dealers need to have policies and procedures in place that take into consideration the specific risks presented by meetings with corporate executives.

For example, it is important to carefully monitor communications with corporate executives and to independently confirm that all of the information conveyed in calls and meetings is either not material or is otherwise publicly available. Effective policies and procedures also should require that contemporaneous notes be prepared of meetings with management and that compliance take an active role in monitoring and taking notes at such meetings.

Of course, investment professionals also should be trained to recognize MNPI and understand it is their responsibility to ensure that they have not received MNPI. Other protective measures, such as reviews of meeting materials, should be employed as appropriate.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

[1] The SEC also charged three AT&T investor relations employees with aiding and abetting AT&T's violations.

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