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Material Nonpublic Information What It Is and Why It Matters



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Disclaimer

The topic has many legal implications and I am not a lawyer. Today's discussion covers material nonpublic information generally. I strongly encourage including legal counsel in any discussion of specific circumstances or actions.

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When does it matter?

- For publicly traded companies:
 - Stock you can buy and sell through a broker
 - CINF, FITB, PG, GE
 - Many shareholders
 - Individuals from many walks of life, e.g., employees, agents, friends, neighbors, policyholders, professional investors
 - Entities such as pension funds, mutual funds, insurance companies
 - Regulated by Securities and Exchange Commission (SEC)

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From "The SEC's Mission:"

- The laws and rules that govern the securities industry in the United States derive from a simple and straightforward concept:
 - All investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it.
 - To achieve this, the SEC requires public companies to disclose meaningful financial and other information to the public.
 - This provides a common pool of knowledge for all investors to use to judge for themselves whether to buy, sell, or hold a particular security.
 - Only through the steady flow of timely, comprehensive, and accurate information can people make sound investment decisions.
- Find at <http://investor.gov> (the SEC's blog)

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SEC took action in 2000

- Regulation Fair Disclosure (FD)
 - Addresses the problem of "selective disclosure" of "material nonpublic information" by issuers of securities (*public companies*)
 - Leveled playing field

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What is selective disclosure?

- Providing **material nonpublic information** to certain people before disclosing this same information to the public
- SEC wanted Regulation FD to address:
 - Basic unfairness of providing a select few with a significant informational advantage over the rest of the market
 - Damages investor confidence in the integrity of our capital markets
 - Corporate management can treat material information as a commodity to be used to gain or maintain favor with particular analysts or investors

Source: Written Statement of the U.S. Securities And Exchange Commission Concerning Regulation FD ("Fair Disclosure") dated May 17, 2001.

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What is "material nonpublic information?"

- **Material:**
 - Information is "material" if "there is a substantial likelihood that a reasonable shareholder would **consider it important**" in making an investment decision
 - To be material there must be a substantial likelihood that a fact "would have been viewed by the reasonable investor as having significantly altered the `total mix' of information made available"
- **Nonpublic:**
 - Information is "nonpublic" if it has not been disseminated in a manner making it available to investors generally

Source: Written Statement of the U.S. Securities And Exchange Commission Concerning Regulation FD ("Fair Disclosure") dated May 17, 2001.

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What is important to shareholders?

- **Financial data, such as:**
 - Premiums
 - Losses (claims)
 - Expenses
 - Investments
 - Dividends
- **Business information, such as:**
 - Management changes
 - New products, services and geographies
 - Lawsuits

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Why does it matter?

- Under Regulation FD, whenever:
 - An issuer, or person acting on its behalf;
 - Discloses material nonpublic information;
 - To certain enumerated persons (in general, investment professionals or shareholders who may trade the stock on the basis of the information);
 - The issuer must make public disclosure of that same information:
 - simultaneously (for intentional disclosures), or
 - promptly (for non-intentional disclosures)
- Company and management can be penalized

Source: Written Statement of the U.S. Securities And Exchange Commission Concerning Regulation FD ("Fair Disclosure") dated May 17, 2001.

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When does Regulation FD apply?

- Disclosures made by a "person acting on behalf of an issuer."
- "Persons" usually are:
 - Senior management,
 - Investor relations professionals, and
 - Others who regularly interact with securities market professionals or security holders
- Particular officials can be designated as authorized spokespersons for purposes of the regulation

Source: Written Statement of the U.S. Securities And Exchange Commission Concerning Regulation FD ("Fair Disclosure") dated May 17, 2001.

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How is it "made generally available?"

- Investor relations
- Broadly disseminated news release
 - Earnings, dividends and special topics
 - Normally via newswire
- Filing a document with the SEC
 - 10-Ks, 10-Qs and 8-Ks
 - Proxy statement and other special purpose filings
- Widely available webcast audio
 - Conference calls
 - Annual meeting and other presentations
- Website
 - If preparatory steps are followed

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So, why does it matter to me?



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Because ...

- Reputation risk for the company
 - Avoid appearance of improprieties
 - Distractions (or worse) for management and business
- Other rules, e.g., Code of Conduct
 - “Insider” trading liability
- Just good business practice
 - Common sense

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A real life example:

- Cincinnati Financial’s Code of Conduct includes:
 - “We respect the privacy of our associates, policyholders, claimants, shareholders and agents, **and we protect our confidential and proprietary information**”
 - “We do not buy or sell the company’s securities while in possession of material information that has not been disclosed to the public, and we do not discuss such information with others”
 - “We obey the law in carrying out our duties”

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But is it okay to:

- Talk to customers/agents or other employees about business activities?
 - Yes -- Regulation FD does not apply to ordinary-course business communications
- Keep our family and friends up-to-date on happens at the office?
 - Yes – But use common sense
- Participate in industry groups, like this one?
 - Yes – But be aware of whether you are talking to members from other companies
- Gossip and speculate
 - No

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Background Information

- Regulation FD Final Rule, August 15, 2000
 - <http://www.sec.gov/rules/final/33-7881.htm>
- Written Statement of the U.S. Securities And Exchange Commission Concerning Regulation FD ("Fair Disclosure") before the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises Committee on Financial Services, United States House of Representatives, May 17, 2001
 - <http://www.sec.gov/news/testimony/051701wssec.htm>
- Fact Sheet: Regulation Fair Disclosure and New Insider Trading Rules, August 10, 2000
 - <http://www.sec.gov/news/extra/seldsfct.htm>
- Additional thoughts from the SEC on Selective Disclosure (Reg. FD), various dates
 - <http://www.sec.gov/hot/regfd.htm>
- Today's presentation, September 21, 2010
 - <http://www.InsuranceIR.com> on the blog.
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