Electronic Disclosure Venues and Regulation Fair Disclosure

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INTRODUCTION

Among U.S. corporations, Twitter, LinkedIn, Facebook, StockTwits, Instagram, YouTube, Google+, firm websites, and blogs are the most popular platforms for sharing information with stakeholders. As other chapters in this volume demonstrate, social media usage has significant benefits to participating firms. However, the executives and employees of SEC registrants should be aware that Regulation Fair Disclosure (Reg FD), which requires widespread public disclosure of investor information through recognized channels, also applies to disclosures through electronic platforms. A recent case sent shock waves through the investment community as the SEC took the position that a CEO's personal Facebook posts could violate Reg FD, potentially leading to injunctions or fines against the company and the executive.

On July 3, 2012, Netflix CEO Reed Hastings disclosed through his personal Facebook account that Netflix had streamed more than one billion hours for the first time during the preceding month of June. A simultaneous press release or an 8-K filing or a post on Netflix's own web site or Facebook page did not accompany this posting so this information was initially only available to Mr. Hastings Facebook followers. In December, the SEC alleged that Netflix violated Reg FD and issued a Wells Notice letter. A Wells Notice is a notification that the SEC intends to file civil action against a firm or a person and offers the respondent an opportunity to refute the charges by providing additional information.

Eventually, the SEC's Division of Enforcement did not pursue enforcement action against Netflix or CEO Hastings and chose to use this as an example of disclosure that would not satisfy Reg FD. In an SEC ruling on April 2, 2013, George Canellos, Acting Director of the Division of Enforcement, stated that communicating financial information through social media is acceptable as long as access to such outlets is unrestricted and that the investors are aware of them. The SEC report also made it clear that personal social media sites of corporate officers are unlikely to qualify as acceptable disclosure venues (Securities and Exchange Commission, 2013).

BACKGROUND

Use of electronic means to communicate with stakeholders has been on a consistent rise over the past decade. In a 2013 survey of social media use by Fortune 500 companies. Barnes, Lescault, and Wright (2013) report that seventy seven percent of firms have twitter accounts with a tweet in the past 30 days, seventy percent are on Facebook, sixty nine percent have corporate YouTube accounts, and thirty five

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percent have active Google+ accounts. In addition, fifty nine percent of the Fortune 500 firms provide social media links on their corporate homepages.

Increase in social media usage has its costs and benefits. Blankespoor, Miller, and White (2014) find that by tweeting market participants links to press releases, firms that are not highly visible experience a reduction in information asymmetry and increased market liquidity.[1] Investment advisers use Facebook, Twitter and LinkedIn to communicate with clients and prospects for new business (Henricks, 2013). In general, social media provides an opportunity for businesses to interact directly with investors, customers, suppliers, and other stakeholders.

However, such interaction if not carefully monitored and supervised can yield negative consequences. In November 2013, JPMorgan created hashtag, #AskJPM, and invited Twitter users to ask one of their executives anything they wanted. Given the turmoil JPMorgan had experienced being involved in everything from the mortgage fraud scandal to speculative trading to the 2008 Wall Street Crash, the response was overwhelmingly negative. By being aware of their brand reputation, JPMorgan's investment relations professionals should have seen this coming and altogether avoided setting themselves up in the first place ("Disaster! Social media screw-ups and how to avoid them," 2014).

Another potential cost associated with the persistent increase in social media usage is violating information dissemination guidelines required by regulatory agencies. In an attempt to level the playing field across all investors, the U.S. Securities and Exchange Commission passed Regulation Fair Disclosure (Reg FD) that continues to be applicable to all firms publicly traded on the U.S. stock exchanges. Since its passage back in 2000, Reg FD has been modified to adapt to changes in information dissemination venues. In the next section, we discuss Reg FD, why it was needed and what it encompasses, as well as academic research and survey findings on the Reg FD's impact on information dissemination. We then discuss the value relevance of social media and how it led to the evolution of Reg FD. We then close this chapter by providing recommendations for disseminating information through social media in an evolved Reg FD world.

REGULATION FAIR DISCLOSURE

Regulation FD was passed in 2000 in an effort to level the playing field for investors. The then-SEC Chairman Arthur Levitt was deeply concerned that shareholders might lose confidence in the markets as it became apparent that some investors were profiting from an information edge, rather than their investment skills. Levitt held out closed conference calls as an example of practices that allowed analysts to receive advance notice of important corporate information. These conference calls were hosted by firm executives and were open only to invited analysts. Information disclosed in closed conference calls affected the market price of the stock. Stock price movements, as large as twenty five percent, were observed following the conference calls but before the eventual public release of such information (The Los Angeles Times, 1999). In other cases, firms would offer tips or "whisper" to selected favored analysts prior to releasing information publicly. Often analysts felt pressure to make overly favorable recommendations on the firm stock, lest they jeopardize their invitation to hear financial results before the general public.

To prevent trading on quasi-inside information, Reg FD requires that when material information is disclosed to certain enumerated persons, this information must also be disclosed publicly. Enumerated persons include analysts, brokers and institutional investors. Customers, suppliers and others who receive information about a firm in the regular course of business would not be considered enumerated.

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