The Disclosure Paradigm

Prof. Adam J. Levitin

Georgetown University Law Center

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Why Disclosure Regulation?

1. Enables efficient risk pricing ('33 Act)
   - Informing of particular risks (dolphin-safe labeling)
   - Informing of potential risks (risk-factors in prospectus)

2. Enables comparison shopping (TILA, auto safety star ratings)

3. Levels informational asymmetries between buyers and sellers (lemon laws)

4. Levels playing field among buyers (Reg FD)

5. Enables private monitoring of market (HMDA)

6. Shaming encourages better market behavior (restaurant hygiene)

7. Fosters market confidence and hence depth and liquidity

8. Politically easier than substantive regulation

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Does Disclosure Work?

- Short answer: it depends.
  - Scant empirical work on disclosure efficacy.
- Some obvious successes
  - Flammable gas odorization
  - Railway crossings
  - Williams Act (takeover warning)
- Some obvious failures
  - GLBA privacy notices
  - WARN Act

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K.I.S.S.

- Efficacy is negatively correlated with complexity of information disclosed.
  - Amount of data (number of variables)
  - Amount of data (number of data points)
  - Format of data (analyzability)
  - Timing of disclosure (pre- or post-transaction)

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Australian ATM Fees

- Fees for using ATMs from other banks (“foreign ATMs”)
  - Prior to Mar. 2009, foreign ATM fees not disclosed at ATM.
    - Only disclosed on bank statement up to one month later.
  - As of Mar. 2009, fees must be disclosed at ATM before transaction.
- Effect?

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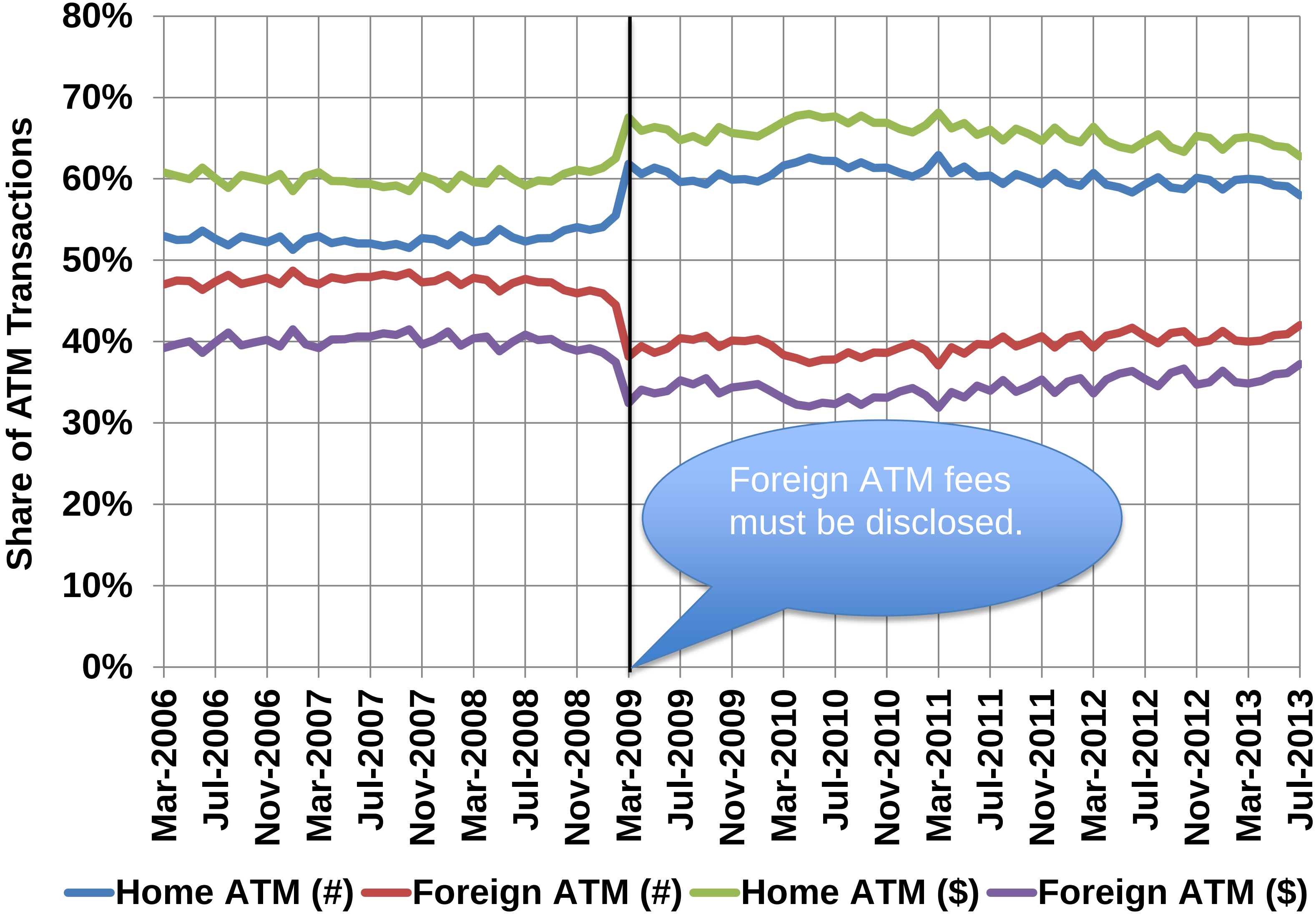
Australian ATM Fee Disclosure



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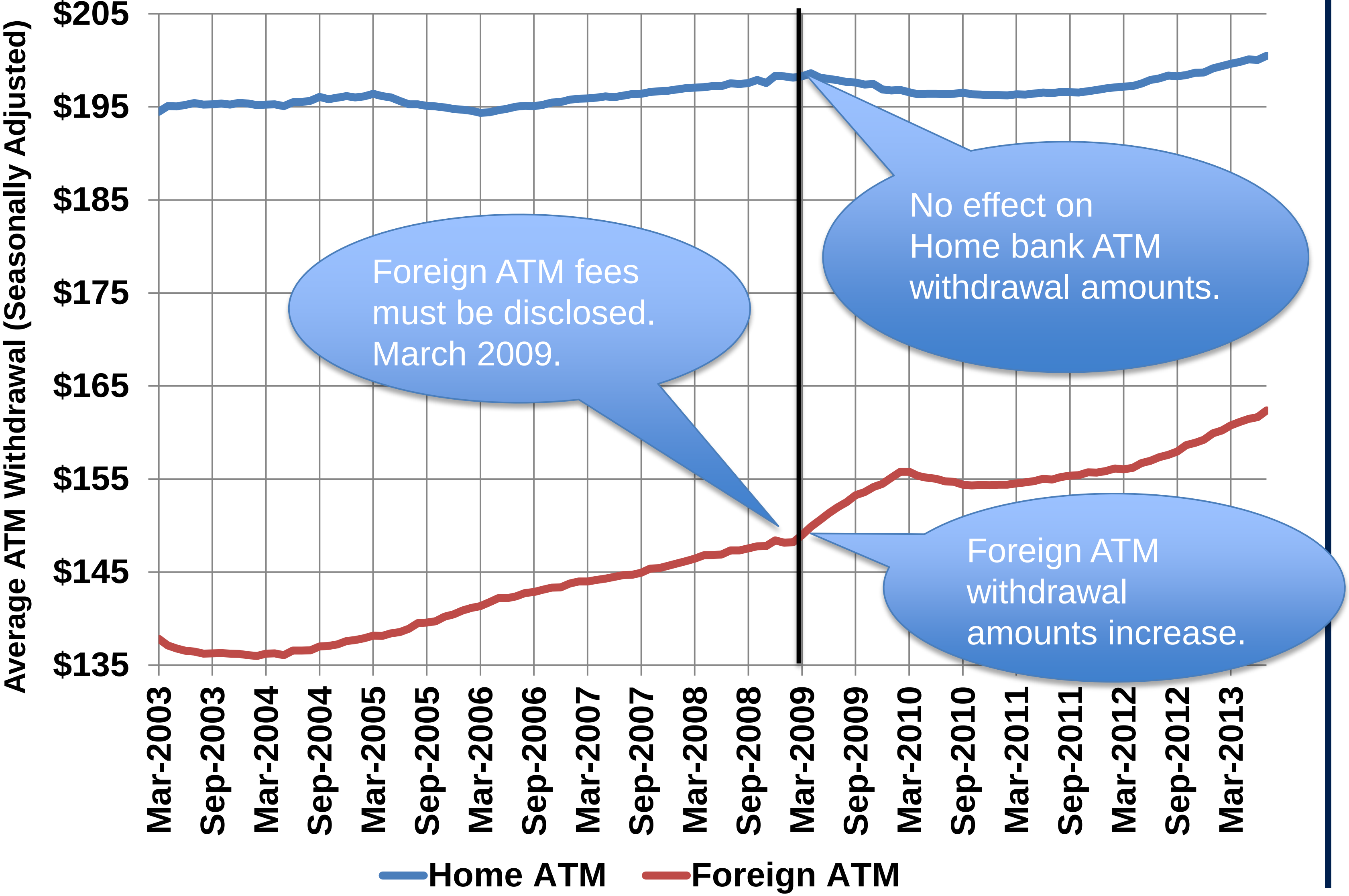
Australian ATM Fee Disclosure



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Unit Price per Ounce

$6.23/oz.

$4.98/oz.

$5.97/oz.

$4.54/oz.

$4.45/oz.

$6.29/oz.

$5.31/oz.

$7.56/oz.

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Consumer vs. Institutional

- Consumer paradigm may be appropriate for many institutional investors *and* issuers.

- Institutional sophistication varies.
  - Goldman Sachs vs. muni bond issuer
  - Quant hedge fund vs. Landesbank

- No one wants to admit to lack of sophistication.
  - But least sophisticated parties are often managing funds for even less sophisticated entities (non-profits, local gov't, individuals)

- Limits on third-party bonding.
  - Accuracy of rating agency ratings.
  - Ratings not available on all products.

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Adapting the Consumer Paradigm to Institutions

- Effective disclosure requires substantive term regulation to standardize non-negotiated terms.

- Existing standardization requirements.
  - Trust Indenture Act mandatory terms.
  - Blue Sky Law mandatory terms.

- Proposed standardization requirements.
  - Mortgage securitization documentation.

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Is Disclosure Enough

- Disclosure can be improved via standardization.
- But it might not be enough to protected less sophisticated investors.
  - Non-waiveable duties for transactions involving public funds, non-profits, ERISA-qualified plans (trustee-like parties).
- Investor protection may require disclosure + standardization + duties.
- Will any of this matter without better enforcement?