CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

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Mr. Steven Maijoor
Chair
European Securities and Markets Authority
103 rue de Grenelle
75345 Paris Cedex 07, France

Dear Chair Maijoor:

The U.S. Chamber of Commerce (the Chamber) Center for Capital Markets Competitiveness appreciates the opportunity to comment on the European Securities and Markets Authority (ESMA) survey regarding "short-termism" in financial markets (Survey).[1]

The Chamber appreciates the efforts of ESMA and the European Commission to review existing regulations and market developments to help promote long-term investment in global capital markets. The Survey occurs at a time when regulators in the United States are also examining whether undue short-term pressures are negatively impacting the performance of public companies: on July 18th, the Securities and Exchange Commission (SEC) held a public roundtable to gather input about the "impact of short-termism on our capital markets and whether our reporting system, or other aspects of regulation, should be modified to address these concerns."[2] The SEC also initiated a request for comment in late 2018 to examine the quarterly reporting regime and quarterly earnings guidance in the United States and whether those practices contribute to short-term thinking in the market.

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[1] Survey on collection of evidence on undue short-term pressure from the financial sector on corporations (June 24, 2019)
[2] Statement Announcing SEC Staff Roundtable on Short-Term / Long-Term Management of Public Companies, Our Periodic Reporting Systems, and Regulatory Requirements. SEC Chairman Jay Clayton, May 20th, 2019. Available at https://www.sec.gov/news/public-statement/clayton-announcement-short-long-term-management-roundtable

The Chamber has long noted our concern over the decline of public companies in the United States over the last twenty years. The U.S. is now home to roughly half the number of public companies than existed in the mid-1990's, and companies that are going public tend to be much larger at the time of their initial public offering ("IPO") than in years past. This has implications not only for growth and job creation, but also investment opportunities for low-and-middle income households that depend on strong public markets for their financial security.

In 2018, the Chamber – along with seven other organizations – released a report entitled *Expanding the On-Ramp: Recommendations to Help More Companies Go and Stay Public*[3] which included a number of policy recommendations on topics including corporate governance, financial reporting and disclosure, equity market structure and other regulatory requirements, each designed with the goal of improving the attractiveness of the public company business model.

The debate over what potentially drives short-termism encompasses a number of policy and regulatory issues including quarterly reporting, quarterly earnings guidance, pressure from special interest activists, the influence of proxy advisory firms, regulatory burdens for small public companies, and the voting rights and practices of certain activist investors. As part of a recent comment letter to the SEC, the CCMC considered whether shifting from quarterly to semi-annual reporting in the United States would mitigate concerns over short-termism, and ultimately concluded that valid arguments could be made for each option.[4] Critics of a quarterly reporting regime argue that it can incentivize management to focus on short-term results at the expense of long-term value creation, and often advocate for a shift to semi-annual reporting. Those in favor of maintaining quarterly reporting – including many prominent institutional investors – argue that quarterly reporting results in greater transparency and a lower cost of capital.

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[3] EXPANDING THE ON-RAMP: RECOMMENDATIONS TO HELP MORE COMPANIES GO AND STAY PUBLIC (Spring 2018), available at https://www.centerforcapitalmarkets.com/wpcontent/uploads/2018/05/CCMC_IPO-Report_v17.pdf.

[4] Chamber Comment on Request for on Earnings Releases and Quarterly Reports (March 21, 2019) Available at http://www.centerforcapitalmarkets.com/wp-content/uploads/2019/03/3.21.19-CCMC_Comments_QuarterlyReporting_SEC.pdf?#

Environmental, Social, and Governance Disclosures

The Survey raises a number of questions related to the disclosure of environmental, social, and governance (ESG) factors (particularly under the EU's Non-Financial Reporting Directive), and whether such disclosures enhance the long-term decision making of investors.

In the United States, the guiding concept of "materiality," as laid out by the U.S. Supreme Court in seminal cases such as TSC Industries v. Northway[5] and Basic Inc. v. Levinson,[6] has played a central role in the development of our capital markets for decades. The ability of businesses of all sizes—from young Main Street entrepreneurs to mature companies that have employed millions of Americans for generations—to seek appropriate forms of investment from investors of all walks of life within our disclosure-based regulatory system is the hallmark of American free enterprise.

Materiality has also long been the dividing line for determining what must be disclosed under the federal securities laws. To that end, considering materiality through the eyes of a "reasonable investor" is a critical feature of the Supreme Court's test. Materiality does not turn on the needs of an investor that is looking to advance in idiosyncratic agenda. This approach mitigates the risk that investors become subject to the short-term whims and demands of particular activists that may have goals other than long-term value creation. It also helps ensure that the SEC, in fashioning and enforcing the disclosure regime under the federal securities laws, focuses on what is best for investors long-term and adheres to the agency's mission as the country's capital markets regulator.

The Chamber has repeatedly expressed its concern that, in recent years, there have been many efforts across the globe to erode the longstanding approach to materiality. This development has complicated and confused what materiality means and will further overload investors with information and make long-term decision making more difficult. Many special interests are, regrettably, advancing shadow disclosure regimes that would abandon altogether the traditional notion of materiality. The ever-growing number of ESG standard setters, ratings firms, and the increased presence by proxy advisory firms on ESG matters has only served to create confusion and costs for companies and shareholders. These entities frequently and suddenly shift their expectations for companies without any clear explanation as to why, a

[5] 426 U.S. 438 (1976).
[6] 485 U.S. 224 (1988).

practice that in no way enhances long-term thinking amongst businesses or shareholders.

An undue emphasis on immaterial disclosure and short-term results has indeed helped spawn an entire corporate governance "industry." Chief among them are proxy advisors, and the two dominant firms in that industry harbor conflicts of interest that are well-documented. Moreover, various ratings services purport to evaluate, rank, and grade companies based on uncertain subjective criteria. These rating services – many of them specifically focused on ESG issues - are not regulated, and because there are no standardized metrics or methodologies, they often come to very different idiosyncratic conclusions. Nevertheless, these actors have cultivated a growing customer base who rely on them for investment advice, and while they attempt to portray their work product as unbiased, it is instead often one-sided, factually flawed and intended to advance a particular ideological point of view. Put simply, this system does not serve the long-term interests of investors particularly well and its influence should be included as in any discussion related to concerns over short-termism in the capital markets.

Engagement by Institutional Investors

The Survey also seeks input regarding engagement practices of asset managers with publicly traded companies. The Chamber has long viewed ongoing, proactive engagement between companies and shareholders as a critical component of good corporate governance.

For the last four years, the Chamber and Nasdaq have conducted an annual survey of public companies regarding their interactions with proxy advisory firms and institutional investors during the previous proxy season. The 2018 proxy season survey found that nearly 80% of public companies have in place a year-round regular communication program with institutional investors.[7] The PwC 2018 Annual Corporate Directors Survey also found that 49% of public company board members engaged directly with shareholders, a number that has steadily increased over the years.[8]

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[7] 2018 Chamber / Nasdaq Proxy Season Survey, available at https://www.centerforcapitalmarkets.com/resource/2018-proxy-season-survey/

[8] The Evolving Board Room: Signs of Change (PwC) Available at https://www.pwc.es/es/publicaciones/consejos-y-buen-gobierno/pwc-annual-corporate-directors-survey-2018.pdf

There is an important link between the importance of company/shareholder engagement and the increasing attention paid to ESG issues. In the United States, nearly 80% of S&P 500 companies publish some type of annual corporate responsibility report where companies are able to communicate with investors and other constituencies their unique approach to ESG and related matters. The growing number of companies publishing such reports reflects the positive outcomes that arise from increased engagement and demonstrates that voluntary and tailored reporting on issues that do not meet the test of materiality is preferable to one-size-fits-all mandated disclosure.

Conclusion

The Chamber appreciates the opportunity to comment on these issues of critical importance. We look forward to working with ESMA and other regulators as they review existing regulations and find ways to modernize global capital markets for the 21st Century.

Sincerely,

Tom Quaadman