CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

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July 17, 2019

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: **Roundtable on Short-Term / Long-Term Management of Public Companies, Our Periodic Reporting System and Regulatory Requirements**
File No. S7-26-18

Dear Secretary Countryman:

The U.S. Chamber of Commerce's Center for Capital Markets Competitiveness ("CCMC") appreciates the opportunity to comment on the notice issued by the Securities and Exchange Commission (the "SEC" or "Commission") relating to the Division of Corporation Finance's July 18 Roundtable on Short-Term / Long-Term Management of Public Companies, Our Periodic Reporting System and Regulatory Requirements (the "Roundtable").

The Chamber once again applauds the Commission for its ongoing commitment to review existing regulations that impact capital formation in the United States. As we have repeatedly noted, this issue is especially important in light of the declining number of public companies—in the past 20 years, the number of US public companies has been cut in half. We are confident that a careful reassessment of the SEC's overall approach to issues affecting the burdens on companies to go public and stay public will, over time and in the aggregate, make an impact.

<u>Encouraging Long-Term Thinking in our Markets</u>

We understand that the Roundtable is intended to focus on two general topics. First, it will explore concerns that have been raised about a short-term focus on our capital markets, seeking to identify potential market practices and regulatory changes that could encourage long-term thinking and investment. Second, the Roundtable will consider specific regulatory changes to the periodic reporting system that could be implemented to foster a longer-term focus on that system. We view these issues as two sides of the same coin.

The CCMC focused on many of these issues in our March 21, 2019 comment letter (the "March Comment Letter") in relation to the Commission's Request for Comment on Earnings Releases and Quarterly Reports.[1] The CCMC was also proud to partner with Nasdaq and several leading business associations to produce a report (the "Report") in 2018 entitled *Expanding the On-Ramp: Recommendations to Help More Companies Go and Stay Public*.[2] The Report includes 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. We urge the Commission to consider the Report more fully as it also touches on the issue of short-termism and the broader issue of making the public company model more attractive to growing businesses.

As part of our March Comment Letter, the CCMC considered whether quarterly or semi-annual reporting contribute to short-termism and concluded that arguments can be made both for and against each option. Critics of quarterly reporting note the attendant cost and compliance burden, as well as the distraction to management and incentives for management to focus on short-term results at the expense of greater long-term value creation. These factors undoubtedly discourage some companies from going public and may cause others to engage in sub-optimal decision-making such as postponing important strategic objectives. Those in favor of maintaining the status quo (a group that includes many prominent institutional investors) argue that quarterly reporting produces greater transparency results in a lower cost of capital and serves to discipline management.

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[1] The entire March Comment Letter is available at https://www.sec.gov/comments/s7-26-18/s72618-5177716-183506.pdf.

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

In the March Comment Letter, we also stated that assembling a Form 10-Q is an arduous task, even at the largest public companies. Time and attention of senior management and the board of directors that could be devoted to other pursuits are instead diverted to the preparation and review of the filing. The end product of the Form 10-Q is a lengthy document that often repeats information previously disclosed in prior reports or in the earnings release. Increasingly, public companies are also being asked to disclose information to investors that is not material to making an investment or voting decision, which further exacerbates these issues.

As the Commission is well aware, the guiding concept of "materiality," as laid out by the Supreme Court in seminal cases such as *TSC Industries v. Northway*[3] and *Basic Inc. v. Levinson*,[4] has played the central role in our American capital markets for decades and has contributed to the formation of the deepest, most diverse, most liquid markets the world has ever known. Materiality has long been the dividing line for determining what should be disclosed and what should not have to be disclosed under the federal securities laws. Therefore, 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 not representative of investors more broadly or that is looking to advance some special interest.[5]

The CCMC has repeatedly expressed its concern that, in recent years, there have been many efforts to erode the longstanding approach to materiality. This development has complicated and confused what materiality means and will further overload investors with information that few find to be useful when evaluating a company's financial and operational performance. Many special interests are, regrettably, advancing conceptions of materiality that would abandon altogether the traditional notion of materiality rooted in the Supreme Court's jurisprudence. These interest groups want to expand what businesses are mandated to disclose to advance

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[3] 426 U.S. 438 (1976).
[4] 485 U.S. 224 (1988).
[5] This approach to materiality mitigates the risk that SEC disclosure documents will become too dense and impenetrable for investors by seeking to be all things to all people. 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 overall and adheres to the agency's mission as the country's capital markets regulator.

the groups' own political and social agendas and to further goals that are extraneous and contrary to the SEC's mission.[6]

An undue emphasis on immaterial disclosure and short-term results has 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 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. In short, this system does not serve the needs of Main Street investors.

Shareholder Proposals

Although the shareholder proposal system was designed to allow investors to put forth constructive ideas on improving a company's governance and performance, the guardrails put in place to protect investors have steadily weakened. As a result, a small subset of investors (many of whom hold only trivial amounts of shares) has come to dominate the system, while a vast majority of investors bear the costs, and more and more U.S. companies feel the unnecessary weight of going public.

We have offered numerous recommendations to the SEC for reforming Rule 14a-8 of the Securities Exchange Act. These recommendations include amending the Resubmission Rule to raise the thresholds for support that proposals must receive in order to be eligible for resubmission; offering more transparency to investors by requiring proponents to provide sufficient disclosure regarding their economic interests and objectives; providing market participants with more certainty regarding the SEC's policing of a provision dealing with proposals that relate to a redress of a personal claim or grievance; and allowing for the exclusion of proposals that include

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[6] We discuss materiality further in our white paper, ESSENTIAL INFORMATION: MODERNIZING OUR CORPORATE DISCLOSURE SYSTEM (Winter 2017), *available at* https://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/U.S.-Chamber-Essential-Information_Materiality-Report-W_FINAL-1.pdf.

materially false or misleading statements, among many others. Any effort to address short-termism should include an analysis of SEC rules such as Rule 14a-8 that, regrettably, tilt the scales in favor of a small subset of activists at the expense of investors as a whole. [7]

Shareholder Activism

The topic of economic shareholder activism more generally has become a common one in boardroom discussions. Shareholder activists are often the very embodiment of short-termism, cajoling companies into undertaking short-term actions, such as returning capital or divesting businesses, that may be contrary to an enterprise's long term strategic plan. While the problems associated with shareholder activism do not lend themselves solely to regulatory solutions, our members would certainly welcome a fresh look by the Commission at the disclosure regime around shareholder activists who acquire equity positions, beneficially or synthetically, with a view towards influencing management.

In sum, materiality should continue to be the lodestar for any efforts at disclosure reform. While we do not necessarily advocate for the elimination of all quarterly reporting, we believe a scaled approach that gives companies greater flexibility to tailor the frequency of disclosure to meet the demands of their own investors may be warranted. Accordingly, in the March Comment Letter, we urged the Commission to consider ways to streamline and simplify disclosures in the Form 10-Q, particularly those that are repeated each quarter.

Presentation of Information

In the March Comment Letter we expressed our belief that any effort at improving the efficiency of periodic reporting should consider not just what is disclosed, but also how information is presented and delivered to investors. Then and now, we urge the Commission to rethink the format of public company reports and

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[7] Our full white paper details these recommendations further. *See generally* SHAREHOLDER PROPOSAL REFORM: THE NEED TO PROTECT INVESTORS AND PROMOTE THE LONG-TERM VALUE OF PUBLIC COMPANIES (Summer 2017), *available at* http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/023270_CCMC-SEC-Shareholder-Proposal-Reform-Report_Online_Report.pdf?x48633.

the fundamentals of how information is delivered to investors, with the goal of enhancing the usability and value of public company disclosures for investors in the modern technological era. Other than migrating the archive of issuers' periodic reports from a nationwide network of physical SEC public reference rooms to an electronic database with the adoption of Edgar in the 1990s, and from time to time expanding the categories of reportable events under Form 8-K, the basic delivery of information to investors remains largely unchanged since 1970. Investors still receive issuer periodic reports in seriatim fashion much the same way they have for nearly fifty years.

As the March Comment Letter noted, efforts at modernizing the presentation and delivery of public company reports have been discussed before. For example, more than ten years ago the SEC's 21st Century Disclosure Initiative published a report that sought to explore "the possibility of using modern technology to move from a document-based disclosure system that requires the repeated filing of the same information in often lengthy static documents to an interactive data disclosure system that avoids redundancies and makes the information more accessible."[8] The report made a number of recommendations for moving forward, most notably by advocating for the further exploration of what it described as a centralized "company file" to replace the current process for delivering investor information.

Under this type of system, after providing baseline disclosure companies would not be required to repeat prior disclosures on a regular basis as they do under the current regime, but would instead only be required to discuss additional developments that are material.[9] Disclosure affected in this manner would make it easier for investors to identify the most current material information about a company without having to wade through reams of historical information to ferret out what is most relevant. As an additional benefit to capital formation, issuers of all sizes making use

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[8] Staff Report of 21st Century Disclosure Initiative, "Towards Greater Transparency: Modernizing the Securities and Exchange Commission's Disclosure System" (Jan. 2009), at 4, available at http://www.sec.gov/spotlight/disclosureinitiative/report.pdf. The events of the financial crisis overtook this initiative and little progress has since been made on the company file format since 2009.

[9] A variation of the company file concept would be to allow companies to satisfy certain disclosure obligations—such as those describing the business, the management team, and the board—by cross-referencing the company's website.

of a company file would also spend less time preparing offering documents and could go to market more quickly.

A company file system would provide additional benefits to investors as well. Again, rather than flipping manually through a series of filings to find relevant information, everything would be available in a single integrated report at a central location. Not only would placing the information in a single, central location reduce potential informational asymmetries, but it may also entice more retail investors to invest in individual equities by making it easier for them to track information about individual stocks.[10]

Quarterly Reporting

Additionally, our March Comment Letter discussed how the existing periodic reporting system, earnings releases, and earnings guidance may affect corporate decision making and strategic thinking. For example, the distraction to management that accompanies quarterly reporting and the attendant focus on short-term results often comes at the expense of greater long-term value creation. Providing an explicit target often motivates executives to manage to those targets, as investors expect management to meet or exceed those targets, penalizing firms that do not.

Even many advocates for maintaining the status quo with respect to quarterly reporting on Form 10-Q would prefer to see less emphasis placed on quarterly guidance.[11] In the March Comment Letter we expressed our belief that quarterly earnings guidance may be a greater concern than quarterly reporting, and itself contributes to an overemphasis on short-term thinking at some companies.

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[10] The March Comment Letter also repeated our request for the Commission to reassess the burdens, including cost, personnel, additional liability, and increased time and documentation associated with the requirement that issuers submit certain information in XBRL format.

[11] Nevertheless, Commission rules neither prohibit nor require companies to set periodic earnings targets or publish other operational metrics (such as same-store sales or EBITDA), though Regulation FD and the Commission's rules on the presentation of non-GAAP financial measures may impact the manner in which such information is disclosed. Whatever route the Commission takes in the future on the reporting of information under Form 10-Q, we do not believe it should further regulate the dissemination of earnings guidance.

To be sure, companies are proactively addressing many of the issues associated with short-termism. Board involvement and independence are at all-time highs, and boards have become more sophisticated in their capital allocation policies. Investor engagement has become common and regular. Further, boards are employing a more thoughtful process in CEO succession planning and in setting executive compensation for the entire executive team in a way that discourages short-term thinking. In addition, boards are laser-focused on regulatory and compliance issues. Nevertheless, despite this much-needed shift in corporate governance, without changes to the regulatory environment in which public companies operate, short-termism will continue to prevail.

Conclusion

We hope to see a realignment of the balance between short-term vision and long-term performance at America's public companies. Relatedly, we believe our 1930s disclosure regime should finally begin to function more like one for 2020 and beyond, which will also mitigate the impact of short-termism. We appreciate your consideration of these comments, and we are available to discuss them further with the Commissioners or Staff at your convenience.

Sincerely,

Tom Quaadman

cc: The Honorable Jay Clayton
The Honorable Robert J. Jackson, Jr.
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman
The Honorable Allison Herren Lee