INVESTMENT COMPANY INSTITUTE

1401 H Street, NW, Washington, DC 20005-2148, USA
202/326-5800 www.ici.org

March 21, 2019

Vanessa Countryman
Acting Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Request for Comment on Earnings Releases and Quarterly Reports (File No. S7-26-18)

Dear Ms. Countryman:

The Investment Company Institute[1] appreciates the opportunity to provide the regulated fund industry's views regarding public company earnings releases and quarterly reports.[2] Regulated fund managers—including firms that are themselves public companies—strongly support the current system of quarterly reporting on Form 10-Q for all US public companies.

Regulated funds are significant investors in equity and fixed-income securities issued by US public companies. Mutual funds, for example, held approximately $8.6 trillion in such securities on December 31, 2018, representing 59 percent of their total net assets. Mutual fund holdings represent approximately 23 percent of all outstanding US equity securities and approximately 15 percent of all outstanding US corporate fixed-income securities. Regular, reliable and comparable information from public companies is absolutely essential to managers' investment decision-making on behalf of the more than 100 million Americans who invest in regulated funds.

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[1] The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US$21.9 trillion in the United States, serving more than 100 million US shareholders, and US$6.6 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

[2] SEC, Request for Comment on Earnings Releases and Quarterly Reports, 83 Fed. Reg. 65601 (Dec. 21, 2018), available at https://www.federalregister.gov/documents/2018/12/21/2018-27663/request-for-comment-on-earnings-releases-and-quarterly-reports.

ICI commends the Commission for seeking public comment on the nature, timing, format and frequency of public company reporting. These issues matter at the company level, because they may affect the willingness of investors to commit capital to a particular company and, in turn, the ability of that company to meet its capital needs. On a more macro level, these issues have implications for the overall level of participation in the US capital markets (widely regarded as the fairest, most efficient, and most competitive in the world), the returns that investors such as regulated funds earn on their invested capital, and public companies' contributions to US economic growth. We likewise concur with the Commission's stated goal of determining how it can "*enhance, or at a minimum maintain, the investor protection attributes of periodic disclosures* while reducing administrative and other burdens on reporting companies associated with quarterly reporting."[3] As the experience of the regulated fund industry demonstrates, strong protection of investor interests promotes investor confidence and, by extension, long-term investment.

In this letter, we discuss the importance of preserving the Form 10-Q filing requirement for all public companies and why substituting a less regulated form of information dissemination, such as an earnings release, would be detrimental to investors. We also offer our views on the issuance of quarterly earnings guidance, a voluntary practice by many public companies. We then explain why the Commission should maintain the current frequency of reporting for all public companies and not revise its rules to permit smaller companies to report on a less frequent (*e.g.*, semi-annual) basis. In closing, we note our support of regulatory efforts to increase the attractiveness of public capital markets, but we emphasize that reducing the frequency of reporting by public companies or moving to less regulated forms of reporting is not the answer.

The Commission should preserve a Form 10-Q filing requirement for all public companies

The public capital markets in the United States are the envy of the world. This is due in no small measure to investor confidence in the information being reported by public companies on Form 10-Q. That information is:

- Regular—quarterly for all public companies;

- Reliable— reviewed or audited by an independent accountant, certified by management as required by the Sarbanes-Oxley Act, filed with the Commission, and subject to securities law liability for material misstatements and omissions; and

- Comparable—containing specific disclosures mandated by the Commission and the Financial Accounting Standards Board.

[3] *Id.*

The SEC's request for comment seeks input on whether earnings releases could be used to satisfy the core financial disclosure requirements of Form 10-Q. We oppose this approach, because it would allow a company to highlight what it wished in an earnings release and relegate the rest of the information to the Form 10-Q. Although earnings releases are subject to the antifraud provisions of the securities laws, the Commission does not regulate their content or structure.[4] Thus, unlike with Form 10-Q, the information presented in earnings releases varies from issuer to issuer. Earnings releases also may omit information important to certain investors. For example, earnings releases often omit information relevant to fixed-income investors, such as a statement of financial position and a statement of cash flows. This approach would diminish the reliability and comparability of quarterly reporting, to the detriment of investors.[5]

Views on the practice of quarterly earnings guidance

The request for comment seeks input on whether forward-looking earnings guidance affects corporate decision making and strategic thinking. Some have suggested that the practice of providing forward-looking earnings guidance results in an undue focus on short-term financial results and thereby negatively affects the ability of companies to focus on long-term growth.[6] For example, after issuing earnings guidance, company management may feel compelled to satisfy earnings targets, even at the expense of investing in long-term opportunities (*e.g.*, research and development, marketing or other capital investments).

ICI believes that public companies should have the flexibility to determine whether and how to issue earnings guidance. At the same time, the Commission, investors and other stakeholders should encourage companies to move toward articulating longer-term financial and strategic goals that can be measured and reported.[7]

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[4] Moreover, earnings releases typically are considered to be "furnished" to the SEC and thus are not subject to liability under Section 18 of the Securities Exchange Act of 1934. Form 10-Q filings, on the other hand, are "filed" with the SEC and subject to Section 18 liability.

[5] *See, e.g.,* Comment letter responding to this release from Jack T. Ciesielski, CPA, CFA and President, R.G. Associates, Inc., dated Feb. 24, 2019 ("When an investor prints a 10-Q, he or she knows what to expect for every company. If companies are allowed to omit information from the 10-Q because it's reported in an 8-K, it downgrades the 10-Q information package. It's unclear how this serves investors better.").

[6] *See, e.g.,* Jamie Dimon and Warren E. Buffett, Short-Termism is Harming the Economy (June 6, 2018), available at https://www.wsj.com/articles/short-termism-is-harming-the-economy-1528336801 ("In our experience, quarterly earnings guidance often leads to an unhealthy focus on short-term profits at the expense of long-term strategy, growth, and sustainability."); Business Roundtable Supports Move Away from Short-Term Guidance (June 7, 2018) available at: https://www.businessroundtable.org/business-roundtable-supports-move-away-from-short-term-guidance.

[7] Appropriately designed executive compensation programs also can play an important role in focusing management on long-term value creation rather than short-term earnings goals. Such programs should include meaningful stock ownership combined with long-term holding requirements.

The Commission should continue to require all public companies to report on a quarterly basis

Regulated fund managers rely on quarterly financial reporting to manage fund portfolio investments. Specifically, managers use the information to assess the performance and financial position of the companies in which they invest and make judgments about the relative risk and reward associated with investment in a company's securities. Changing from quarterly to semi-annual reporting would diminish the amount and timeliness of information available to fund managers, thereby hindering their ability to analyze company performance and make informed investment decisions.

We also are concerned that semi-annual reporting would impede price discovery and contribute to increased volatility in security prices. The interaction of buyers and sellers based on informed judgments on the value of securities is critical to price discovery and the resulting accuracy of security prices. Semi-annual reporting would diminish the amount and timeliness of information available to investors and inhibit their ability assess the fundamental value of securities. Others share these concerns.[8]

A change to semi-annual reporting also may increase the cost of equity capital for public companies and thereby diminish their long-term prospects. A recent academic study examined the effects on the cost of equity capital associated with reporting frequency.[9] From 1955 through 1970, the SEC required semi-annual reporting. During that time, however, many companies voluntarily reported their results on a quarterly basis. The study examined the cost of equity capital for these two groups of reporting companies and concluded that the cost of equity capital decreased significantly for those companies that adopted quarterly reporting.

As noted at the outset of this letter, ICI supports quarterly reporting for all public companies, regardless of size. Investors need to be able to compare the performance of companies, large and small, across a given industry (*e.g.*, in the technology sector). Any move toward greater "flexibility" in reporting frequency, such as allowing semi-annual reporting by smaller companies, would frustrate such comparisons and even create disincentives for investors to invest their capital in smaller companies. If anything,

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[8] *See, e.g.,* Robert C. Pozen and Mark Roe, *Keep Quarterly Reporting* (Sept. 5, 2018), available at https://www.brookings.edu/opinions/keep-quarterly-reporting/ ("With corporate results disseminated less frequently, stock prices would be less accurate as investors struggled to assess the financial effects of material developments without the company's numbers. Small bits of information loom larger in stock price valuations when investors are in the dark as to the actual earnings implications of such bits.").

[9] *See* Financial Reporting Frequency, Information Asymmetry, and the Cost of Equity; Renhui Fu, Rotterdam School of Management, Erasmus University; Arthur Kraft, Sir John Cass Business School, City University of London; and Huai Zhang, Nanyang Business School, Nanyang Technological University, available at: https://pdfs.semanticscholar.org/6a2d/be34a31acfd4f8a5841719656a4727a385f3.pdf.

investors are likely to want *more* frequent reporting by smaller companies because their business prospects are less certain and likely to change more quickly over time as compared to larger companies.

The Commission should explore other ways to alleviate burdens on companies seeking to become (or remain) public

ICI applauds the Commission's efforts, under the leadership of Chairman Clayton, to explore ways to alleviate regulatory burdens on public companies. A vibrant public market lies at the core of healthy capital markets, but data showing a long-term decline in the number of US-listed companies suggest that our public markets are becoming increasingly less attractive than private markets.

In congressional testimony last June, I emphasized that concerns associated with the declining number of public companies are particularly serious for individual investors trying to build wealth and meet other financial goals. Most individuals are ineligible to participate directly in the private markets, and few mutual funds invest in private companies. Consequently, the returns generated by promising new companies increasingly have accrued to investors in private markets and not to the millions of retail investors that mutual funds serve.[10]

More can and should be done to encourage participation in the public markets. But, as I hope our comments above have underscored, reducing the frequency of reporting or moving to less regulated forms of reporting is not the answer.

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If you have any questions regarding our comments or would like additional information, please contact me at [redacted] or [redacted]; Rachel H. Graham, Associate General Counsel, at [redacted] or [redacted]; or Greg Smith, Senior Director, Operations, at [redacted] or [redacted].

Sincerely,

/s/ Paul Schott Stevens

Paul Schott Stevens
President & CEO
Investment Company Institute

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[10] *See* Statement of Paul Schott Stevens, President & CEO, ICI, Before the US House of Representatives Committee on Financial Services on Empowering a Pro-Growth Economy by Cutting Taxes and Regulatory Red Tape (June 20, 2018), available at https://www.ici.org/pdf/18_house_fsc_growth.pdf.