Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

RE: File Number S7-26-18

March 21, 2019

Dear Mr. Fields:

The National Association of Corporate Directors (NACD), America's oldest and largest association for corporate directors and a founding member of the Global Network of Director Institutes, welcomes the opportunity to comment on the objectives and timing of the periodic financial disclosures required of US public companies beyond the annual report—specifically, quarterly reports and earnings guidance. The topic of periodic reporting is of keen interest to our more than 20,000 members, most of whom serve on US public company boards. Even our members serving on non-US public boards, or on the most aspirational boards of private and nonprofit organizations, view US public company disclosure requirements as a gold standard for disclosure practice.

We anticipate that you will receive a range of comments from the business community on the topic of interim financial reporting. Already, the comments that have come in represent a variety of views.[1]

- On the one hand, many investors are content with current practices, namely, the mandate of a detailed, audited quarterly financial report on Form 10-Q, preceded in many cases by an unaudited earnings projection on Form 8-K—so-called "earnings guidance." While some longer-term investors have a different view,[2] the comments now coming in to the SEC indicate that many shareholders want even *more* information in both of these documents, and/or would like to see them more frequently. There has even been a movement, since the rise of the Internet, for "real-time reporting," according to which companies would be issuing constant press releases concerning every development of potential interest to some shareholders, no matter how minute.[3]

- On the other hand, by contrast, many corporate directors, as well as corporate officers responsible for producing quarterly earnings reports, see risks in disclosure overload: frequent, mandated reporting of a highly detailed, purely financial nature focused on a short time period does not truly serve the needs of investors, as it drains resources that could be better used to understand and build long-term value for the ultimate benefit of all owners. Today, the quarterly reports for some companies exceed 50 pages. Some believe that for such reporting, twice per year is sufficient. As for earnings guidance, a number of corporate boards have voted to abandon the practice altogether, deeming it an agent of short-termism. Berkshire Hathaway chair Warren Buffet and JP Morgan chair and CEO Jamie Dimon, chair of the Business Roundtable, have publicly repudiated the practice, and NACD has expressed support for their positions.[4]

NACD believes that the views of shareholders wanting to receive more information, more often, and companies wanting to give more targeted information, possibly less often, can be reconciled by focusing on the quality and relevance of information—for that is what shareholders truly want to receive and companies truly want to give. Both the goal of providing necessary information and the goal of focusing on the long term can be reconciled, as described below in our more detailed comments on the SEC's four stated topics of interest.

1. The nature and timing of disclosures that reporting companies must provide in their quarterly Form 10-Q reports, including when the Form 10-Q disclosure requirements overlap with the disclosures such companies voluntarily provide to the public in earnings releases furnished on Form 8-K.

As for the ***nature*** of disclosures in the Form 10-Q, we are aware that the SEC is constantly working to revise disclosure requirements to remove requirements that are "redundant, duplicative, overlapping, outdated, or superseded, in light of other Commission disclosure requirements, US Generally Accepted Accounting Principles ('US GAAP'), or changes in the information environment." This was the stated purpose of your recent rule on Disclosure Update and Simplification, effective November 5, 2018.[5] The SEC's reforms have gone a long way in accomplishing this goal, and we encourage you to continue. As you do so, please consider amending the requirements of Form 10-Q to enable a quarterly report that includes disclosures the company deems most critical to its shareholder base, including progress made against a stated long-term strategic plan that may include nonfinancial results, such as meeting goals pertaining to human capital (e.g., diversity), intellectual capital (e.g., product innovation), or natural capital (e.g., carbon footprint reduction) that can drive long-term financial success.[6] This newly revised quarterly report could include one-year, three-year, and five-year projections, labeled as forward-looking information with the appropriate disclaimer. As for earnings guidance, NACD recommends that the SEC disallow earnings guidance effective January 1, 2020. Our economic reasons for this recommendation appear below under ***Topic 4.***

As for ***timing of disclosures,*** we are aware that in some markets, the mandatory minimum for detailed financial reports is twice per year, as in Australia, the United Kingdom, and Europe, where issuers produce one annual report and one mid-year report.[7] One of our members who experienced a change from quarterly to semi-annual reporting told us that semi-annual reporting did not diminish financial focus, monitoring, or internal reporting, but it did eliminate complexity each quarter and enabled time to be spent on other strategic and long term topics. Attorney David Benoit of Wachtell, Lipton, Rosen & Katz has called for an end to quarterly reports, noting that these are a relatively recent invention in America. Mandatory annual reporting did not begin until 1934, semiannual reporting began in 1955, and quarterly reporting began in 1970.[8] One recent study of the transition of US firms from annual reporting to semiannual reporting and then to quarterly reporting before, during, and after these changes

(1950–1970) showed that "companies that reported *annually,* when compared to those that report *quarterly,* had an average of 10% greater annual sales as a percentage of assets, an annual sales growth almost 3.5% greater, and 1.5 greater return on assets."[9] Another study published in the *Accounting Review* showed that in Europe, a past (2007) mandate for quarterly reporting (discontinued in 2014) led to "higher managerial short-termism resulting from increased reporting frequency requirements."[10]

Even considering arguments for less frequent reporting, NACD recognizes that a change from quarterly to semiannual reports might be acceptable to issuers, but would meet with strong shareholder resistance. Therefore, our recommendations here center on improving the content of quarterly reporting on Form 10-Q, and disallowing earnings guidance on Form 8-K.

2. How the Commission can promote efficiency in periodic reporting by reducing unnecessary duplication in the information that reporting companies disclose and how any such changes could affect capital formation, while enhancing, or at a minimum maintaining, appropriate investor protection.

We believe that the changes we proposed in ***Topic 1*** will have a positive effect on capital markets. The world of equity investment has changed dramatically in recent years. The investor population itself has shifted, with the advent of day traders focused on the ultimate short term: this minute. As for longer-term investors, we have seen a shift from active "value" investing based on analysis of specific company fundamentals to passive investing tied to an index. And finally, we have witnessed the rise of algorithmic trading—automated trading based on algorithms that force buy-sell-hold decisions based on market patterns. In determining a way forward, it may be useful to ask what percentage of investors actually base their trades on financial reports from companies in the first place. J.P. Morgan has estimated that it may be as low as 10 percent.[11] As stated in a J.P. Morgan research report released November 30, 2018, "Today most micro-level trading decisions in equities and electronic future contracts are made by algorithms: they define where to trade, at what price, and what quantity."[12] The SEC should do what it can to reduce the kinds of disclosures that may send false signals to the automated traders, creating volatility that reflects no meaningful economic reality and serves no good economic purpose.

3. Whether Commission rules should allow reporting companies, or certain classes of reporting companies, flexibility as to the frequency of their periodic reporting.

As mentioned above, the SEC should ban use of the Form 8-K for earnings guidance. The SEC should also consider the special disclosure needs of particular industries—not only with respect to timing but also content. We note that Alison Staloch, chief accountant, Division of Investment Management of the SEC, granted "no action" assurance on September 28, 2018, in response to a request from a life insurance company to report on interim financial results using statutory accounting principles rather than generally accepted accounting principles.[13]

4. How the existing periodic reporting system, earnings releases, and earnings guidance (either standing alone or in combination with other factors) may affect corporate decision making

and strategic thinking, including whether these factors foster an inefficient outlook among reporting companies and market participants by focusing on short-term results.

NACD has spoken against the practice of earnings guidance. Our 2015 *Report of the NACD Blue Ribbon Commission on the Board and Long-Term Value Creation* recommended that "boards should consider recommending a move away from quarterly earnings guidance in favor of broader guidance parameters tied to long-term performance and strategic objectives."[14] The report noted that "the business media echo-chamber can amplify a one- or two-cent difference between a company's actual results and the company's published guidance . . . into predictions of imminent success or failure." To avoid this fate, noted the report, some companies sacrifice value to make their earnings targets—that is, to fulfill the prophecy made in their earnings guidance.

Since the publication of this report, the problem has not disappeared. In one recent survey, researchers asked respondents if their firms had a long-term culture, and most (63%) said no. And in those firms, most (55%) said that they would sacrifice a value-creating project to make their earnings targets.[15] This short-term fixation harms the ability of American firms to pursue long-term innovation and development, undermining their competitive advantage in the global economy. Obviously, anything that can be done to move investor behavior from short-term focus to long-term focus will be beneficial.

In summary, the SEC should continue to require quarterly reports, but in a revised format that would enable reporting on issues of long-term value. The Commission should continue to educate issuers and investors alike on the downsides of attention focused on quarterly performance. Finally, the SEC can consider appointing a committee to study the disclosure requirements of the Form 10-Q. NACD would be honored to participate in such a study.

Sincerely,

Karen Horn

Dr. Karen Horn, Chair
National Association of Corporate Directors

Peter R. Gleason, CEO
National Association of Corporate Directors

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[1] Most comments advocated keeping quarterly reporting but some want less frequent reporting. For all comments see: https://www.sec.gov/comments/s7-26-18/s72618.htm. For positions favoring more flexibility in timing, see https://www.sec.gov/comments/s7-26-18/s72618-178366.htm and https://www.sec.gov/comments/s7-26-18/s72618-176970.htm.

[2] Robert Pozen, former chair, MFS Investment Management, has compared them to outdated "telephone books," and has suggested a streamlining of their disclosure requirements in connection with biannual reporting (detailed reporting would occur twice a year, with short-form reporting in between). See "Six Months Isn't Long Term," by Robert C. Pozen and Mark J. Roe, *Wall Street Journal*, August 20, 2018.

[3] "Real-Time Disclosure of Securities Information Via The Internet: Real-Time Or Not Right Now?" by Aaron J. VanGetson, *Illinois Journal of Law, Technology & Policy*, Vol. 2003, No. 2.

[4] For an NACD press release supporting the Business Roundtable's position, see "NACD CEO Peter Gleason Comments on Business Roundtable's Support of Companies Moving Away from Providing Quarterly Earnings Guidance," June 7, 2018.
[5] https://www.sec.gov/rules/final/2018/33-10532.pdf.
[6] A leader among many champions of these kinds of disclosures is the International Integrated Reporting Council. See, for example, "From Monocapitalism to Multicapitalism: 21st Century System Value Creation," by Richard Howitt and Ralph Thurm, June 12, 2018.
[7] The European regulation appears here.
[8] David Benoit, "Time to End Quarterly Reports, Law Firm Says," *Wall Street Journal*, August 19, 2015.
[9] Cited in "Why Unilever Stopped Issuing Quarterly Reports," by Geoffrey James, *Inc.*, January 23, 2018, and in "Should We Lose the 10-Qs," *The Corporate Counsel*, February 15, 2018. The full article, which is not available for download, is "Frequent Financial Reporting and Managerial Myopia," by Arthur G. Kraft, Rahul Vashishtha, and Mohan Venkatachalam, posted as "Forthcoming in the Accounting Review."
[10] Jürgen Ernstberger, Benedikt Link, Michael Stich, and Oliver Vogler, "The Real Effects of Mandatory Quarterly Reporting," *The Accounting Review*, September 2017, Vol. 92, No. 5.
For Peter Gleason's blog following comments by Warren Buffet and Jamie Dimon, see "As Bells Toll for Earnings Guidance, We Ponder Progress," by Peter Gleason, *NACD BoardTalk* (blog), June 18, 2018.
[11] Evelyn Cheng, "Just 10% of trading is regular stock picking, JPMorgan estimates," CNBC, June 14, 2017.
[12] "Idiosyncrasies and challenges of data driven learning in electronic trading," by Vangelis Bacoyannis et alia, J.P. Morgan (a paper presented at the NIPS 2018 Workshop on Challenges and Opportunities for AI in Financial Services: the Impact of Fairness, Explainability, Accuracy, and Privacy, in Montréal, Canada, November 30, 2018).
[13] No Action Letter of Alison Staloch, chief accountant, Division of Investment Management, on September 28, 2018, to Stewart Gregg Allianz Life Insurance Company of North America.
[14] *Report of the NACD Blue Ribbon Commission on the Board and Long-Term Value Creation* (Washington, DC: NACD, 2015), p. 18 and p. 9.
[15] *Rising to the challenge of short-termism*, by Dominic Barton, Jonathan Bailey, and Joshua Zoffer, FCLT Global, 2016. See also *Quarterly Earnings Guidance: A Corporate Relic?*, by Ariel Fromer Babcock and Sarah Williamson, The Conference Board, March 2018.