FORTRESS PARTNERS
E-Memo

TO: INVESTORS/MEMBERS/PARTNERS AND FRIENDS
FROM: Jon Bruss & Ed Depenbrok
DATE: August 20, 2018
SUBJECT: **"Stop quarterly reporting & go to a six month system. . .[t]hat would allow greater flexibility & save money. I have asked the SEC to study!"** *POTUS in a Twitter post at 6:30 AM, August 17, 2018.*

The subject tweet from the President stated he had spoken with some of the world's top business leaders asking them what would make business (jobs) even better in the US. So who are these top business leaders?

Well, according to multiple sources these top leaders include Warren Buffett and Jamie Dimon. Most recently the President spoke with the retiring CEO of PepsiCo, Inc., Indra Nooyi, who "urged" the President to look into six-month reporting.

Ms. Nooyi said in a statement Friday that many market participants "have been discussing how to better orient corporations to have a more long-term view. My comments were made in that broader context, and included a suggestion to explore the harmonization of the European system and the U.S. system of financial reporting" according to several reports.

The President said additionally, according to reports, that he's asked the SEC to study ending quarterly reporting for US businesses in order to ease regulations and spur growth.

I (Jon Bruss) think this would really be cool—absolutely the *right* thing for the SEC to explore and on which to rule *favorably*. That said, there are lots of arguments pro and con. We will try to be fair and balanced in our look at quarterly vs. semi-annual reporting of earnings. Here are some of those arguments:

Why does this make sense for all public companies?

- **It would**, as the President stated, **save money**. Each quarterly report for a company that is an SEC filer has to be filed as Form 10-Q. The 10-Q are run by the company's outside counsel and by its public accounting firm. Neither of those professions' hourly rates are inexpensive. A Wall Street law firm partner could charge around $1,000 per hour or more while an associate from the same firm may charge $500 per hour. In addition companies that release earnings to the public in the form of a press release must conform to a format reviewed by the company's law firm. SEC focused accountants are not inexpensive either. Local accounting offices may end up sending the 10-Q to their SEC review partner who will spend time reading the report to make sure no recent SEC regulations have been violated and if so, returned to the filer for correction and then back to the reviewer for a final sign-off. (Yes, this really does happen!) This process is undertaken four times per year.

  Reducing the frequency to semi-annual would reduce these outside costs significantly but not by half because the company's annual report cost is somewhat higher. Dean Anason, Managing Editor of **American Banker** said in a *Bankshot* blog on August 17 that "significant time and money are spent assembling voluminous quarterly reports and rehearsing for those earnings calls with analysts and reporters. **It is stunning how many corporate hands vet P&L statements, balance sheets**

and those pesky charts and footnotes before investors and reporters get their hands on them."

- It would **allow internal accounting functions to be focused more on productive planning and forecasting activities** rather than having to go through the repetitive drill of meeting a quarterly earnings deadline for public disclosure. Arguably internal finance department functions may even be able to reduce staff!

- It would **encourage more companies to become public** because the cost of being public would be reduced. We believe that for a small company, a *minimum* of $750,000 to $1,250,000 represents the cost of being public. For a company with $50 million in common equity, even after tax, $150,000 to $250,000 represents an annual improvement in ROE of 0.30% to 0.50% in the internal cost saves and you might drive the number to annual improvement average by 0.45% to 0.75%.

- "**Quarterly reporting breeds the worst kind of managing to the metrics in the corporate suite**: Forget down the road, let's set an earnings-per-share target that we can beat by just enough, cut some costs at the last moment, generously define terms like 'revenue,' practice some creative accounting, and, boom, live to tell about it for the next three months," according to Dean Anason who is *not* a friend of the President having called him "the Bomb Thrower in Chief" in this same blog.

Those who oppose this change in reporting frequency make important arguments as well.

- James Freeman of the Wall Street Journal said on Maria Bartriromo's Wall Steet on FBN on Saturday morning, August 18 said that **Trump has already caused significant earnings increases for companies with his Tax Act and the roll back of regulations**. No additional stimulus is needed!

- Harvey Pitt, former SEC Chairman in the early 2000s for George W. Bush said on August 18 on Maria Bartriromo's Wall Steet that he felt that **too much would occur in a 6 month period that would go *unreported* that would be important for investors to know such as trends in sales, expenses and earnings.**

- Anason again in **American Banker** said "[b]anks are a perfect example [of avoiding transparency]. It is very routine for banks, especially large, diversified ones, to post headline-grabbing, record profits. But a close study of the tables and footnotes and the presentations always reveals what about those is real, and what is hocus pocus. They allow us to separate the fundamentals like loan demand from distortions caused by M&A deals, tax cuts, short-term cost cuts and wider margins stemming from monetary policy changes."

- In the Wall Street Journal, online edition for Sunday August 19, Harvey Pitt, former SEC Chairman, said "**the regulator [SEC] could pare back quarterly reports if it required that investors**, in exchange, **get information more quickly about new trends that have emerged or old ones that have changed**." He said the aim of reducing costs is "something that investors should want as well."

What we find interesting is the short shrift given to community banks. In fact, we found virtually no mention of community banks in our research. We believe community banks are clearly an exception—something that is really clear for anyone who follows community banks and banking.

Also worth noting is that there is some talk about a "down-sized" version of the call report for the first and third quarters of each year. However, for the typical public community bank, there would be some relief in semi-annual Form 10 reporting, but it would be just as meaningful for banks as for other public companies if there were also reform to the call reporting process.

- **Banks are regulated** far more that most other publicly traded businesses.

- **Banks are required to report** in the form of detailed Call Reports [financial reports] **every quarter** regardless of size which are available immediately to Federal and state banking regulators and to the public at https://www.fdic.gov/regulations/resources/call/index.html.

- **Small bank holding companies, up to $1 billion in assets, are required to file an FR Y-9SP with the Federal Reserve semi-annually to provide basic financial data which becomes public record after filing.**

For banks and especially community banks reporting every quarter is something that is already done but not in anywhere near the detail the SEC feels necessary for the likes of JP Morgan Chase, B of A or CitiGroup. Unfortunately community banks reporting to the SEC don't get any break when it comes to complying with the detail required by the SEC. Call Reports are filed 30 days after each quarter and are then immediately made available to the public. The FR Y-9SP small bank holding company reports are filed and available to the public 45 days after June 30 and year-end. The only thing missing in the Call Report and the FR Y-9SP is some narrative which could be provided on a semi-annual basis in an SEC format.

We agree that changes can occur early in a six month period, but would not be reported for nearly six months. We think certain threshholds could be established by the SEC for changes in key trends. These could be established by the accounting profession to include insider accoutants and public accountants acting in an advisory role to the SEC.

A change to six month reporting is certainly a topic that the SEC should take up and examine. There needs to be a balance between adequate and timely disclosure to investors and the cost of compliance with a rigid and comprehensive reporting process.

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NOTE TO OUR READERS: ***This has turned out to be a controversial subject. Our readers are bankers and bank investors. We would like to know what you think and why. We will publish your responses of 75 words or less in an E-Memo Update. We will withhold your name if you wish. Also, please add to your 75 word response, your permission allowing us to use your reponses.***

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