For Regulation FD, Is There Life After 20?

Updated 28 October 2020

This October marks 20 years since Regulation Fair Disclosure (“Reg FD”) went into effect. Amid a global pandemic and economic recession, it might seem odd to focus on the legacy of SEC rules implemented so long ago. But Reg FD dramatically reshaped the investor relations practice of giving forward-looking business guidance, which is again being reshaped by COVID-19.

Reg FD mandates broad public disclosure of any material, non-public information. In practice, this has mostly related to earnings guidance when, in fact, its intent is far broader.

Reg FD went into effect toward the end of the “dotcom” bubble, a time when the sell-side analyst was an indispensable part of the financial community ecosystem, and accurate quarterly earnings estimates separated the best analysts from the rest. Understandably, there was enormous pressure for companies to hit their numbers and for analysts to accurately predict them. Some companies had privately guided analysts to estimates that were closer to what would be reported, depriving the general investing public of these advance insights. One of the SEC’s principal goals for Reg FD was to rein in these back-door conversations and thereby ensure that all investors had “a level playing field.”

While some expressed concern at the time that Reg FD would cause companies to provide less information, most responded by providing more – and more frequent – public earnings guidance. According to studies by the National Investor Relations Institute, by 2003 nearly 75% of public companies provided quarterly earnings guidance, compared to just over 36% prior to Reg FD.

The irony, of course, is that the trend toward providing quarterly earnings guidance drove an obsession with short-term results by momentum-oriented investors. No one questioned if this was helpful or not, until recently.

Since 2003, the proportion of companies providing earnings guidance has been in decline among the largest companies. By late 2019, according to FactSet, the five-year average of S&P 500 companies providing quarterly earnings guidance was down to around 20%, significantly lower than before Reg FD opened the floodgates.

The extraordinary uncertainty surrounding the COVID-19 pandemic drastically changed the guidance landscape yet again. During the first and second quarters of 2020, approximately 850 companies withdrew or suspended earnings guidance of any kind, according to *The Wall Street Journal* or 60% of respondents in a recent survey by The Conference Board.[1] Many corporate executives now openly predict that earnings guidance may eventually disappear.

This raises an important question: do sophisticated, fundamentals-driven, long-term investors value (or even need) near-term earnings guidance from the companies they own? If they do not, what does that mean for how companies guide toward their future results?

One axiom of long-term investing is that most of a company's value is related to cash flows three or more years out, which could render guidance for the next quarter – or even the next year – largely irrelevant to investment decision-making. While this axiom has always applied, there was a seductive dynamic around the market's fascination with trading on quarterly results, and the feedback loop of earnings guidance that fueled it. But that is changing, as accurate earnings guidance for the next quarter or year becomes all but impossible during COVID-19. So, for most companies, their long-term outlook is the most reliable perspective they can offer.

The short-termism that brought us Reg FD so many years ago may finally be evolving into a longer-term focus by companies and their investors. If that new perspective survives the current uncertainty, for Reg FD there is indeed "life after 20," and its legacy may be that it mandated the equal treatment of all investors, even if in a very different era where near-term earnings were far more important than they are today. In the face of an ongoing global pandemic, the disclosure of future expectations is again being reshaped, now toward longer-term performance benchmarks and strategic plans, under circumstances that no one could have predicted twenty years ago.

This means that companies – and their regulators – still need to view disclosures on factors affecting long-term performance (including so-called ESG issues) through the lens of Reg FD – perhaps even more than in the past. If past is prologue, then this should not stifle the provision of such information and, instead, may lead to more attention being paid to it, both by companies and their investors.

---

[1] Corporate Governance Challenges in the COVID-19 Crisis: Findings from a Survey of 236 US Public Companies, The Conference Board, June 2020.

AUTHORS

Alan Oshiki

Executive Vice President
Abernathy MacGregor

The Conference Board is the Member-driven think tank that delivers ***Trusted Insights for What's Ahead®***. Founded in 1916, we are a nonpartisan, not-for-profit entity holding 501(c)(3) tax-exempt status in the United States.