SEC Concept Release on Business and Financial Disclosure Required by Regulation S-K

Overview:

The Securities and Exchange Commission (SEC) issued **Release No. 33-10064; 34-77599; File No. S7-06-16, BUSINESS AND FINANCIAL DISCLOSURE REQUIRED BY REGULATION S-K** on April 22, 2016. The release—which seeks comment on virtually all Regulation S-K provisions applicable to U.S. reporting companies—includes 11 pages (pg. 204-215) of discussion on sustainability disclosure, and eight related questions. *A 90-day period of public comment on the release is open through July 21, 2016*. In addition to preparing a formal comment letter (under development), SASB has developed the following key messages.

Key Messages:

- **The information that is "material" to investors—much like the world around it—is rapidly changing.** Increasingly, management of ESG risks and opportunities influences corporate success and is therefore material to investors.[1] These factors affect the financial condition or operating performance of companies, and affect decisions on whether to buy, sell, or hold a security. Regulation S-K already requires the disclosure of material information. What the markets have lacked, until now, are accounting standards that guide companies in disclosing material sustainability information in a format that's decision-useful to investors. *(Maps to question 216, 220)*

- **To evaluate sustainability performance, an industry lens is needed.** Sustainability issues impact financial performance in specific ways that vary by topic and industry. As such, investors need guidance on which sustainability issues are material to which industries, and they need industry-specific metrics by which to evaluate and compare performance.[2] As analysts cover industries, not issues, the only way for them to understand and price risk is through an industry lens. *(Maps to question 223)*

- **Voluntary sustainability reports do not provide a balanced view of material risks and opportunities or suit investors' needs.** CSR, or sustainability reports, provide a broad overview of sustainability performance to broad stakeholders, including employees, customers, vendors, and community organizations. As such, these reports contain large amounts of immaterial information, data that is not standardized, and data that is not audited or reliable. Importantly, corporations produce voluntary reports because they can present a positively biased view of their situation, which is appealing from a marketing perspective. However, it is not a true and fair representation of performance on material factors, which is what investors need in order to understand and price risk.[3] For these reasons, voluntary sustainability reports do not meet investor needs. *(Maps to questions 218, 219)*

[1] 75% of institutional investors responding to a a 2015 CFA Institute survey of 1,322 institutional investors take ESG issues into account in their investment analysis and decisions.
According to the US SIF 2014 Trends Report, "the total US-domiciled assets under management using SRI strategies expanded from $3.74 trillion at the start of 2012 to $6.57 trillion at the start of 2014, an increase of 76 percent. These assets now account for more than one out of every six dollars under professional management in the United States."

[2] A 2015 EY survey of institutional investors found that "investors are especially eager to measure a company's nonfinancial performance against that of its sector peers and to link a company's nonfinancial information to its expected performance. Specifically, almost three-quarters of respondents consider sector-specific reporting criteria and key performance indicators (KPIs) to be very or somewhat beneficial to their investment decision making, and more than 70% see metrics that link nonfinancial risks to expected performance as equally beneficial.

[3] A 2013 study of GRI A and A+ reports in the Accounting, Auditing & Accountability Journal found that "90 percent of the significant negative corporate (social or environmental) events were not reported."

- **The practice of selective disclosure through ESG questionnaires is a market dysfunction.** Large-cap companies receive hundreds of information requests each year, leading to "questionnaire fatigue" and information asymmetry.[4] Because questionnaires and surveys lack a materiality focus, they yield largely immaterial information. Investors need standardized sustainability disclosure that is integrated into mandatory financial filings, so that the information is reliable and all investors have access to material information at the same time, without having to request it via a questionnaire. To achieve this goal, companies need a market standard for sustainability disclosure in the Form 10-K, which will alleviate the need to spend corporate resources on questionnaires. *(Maps to question 218)*

- **Line item requirements are not appropriate for sustainability issues.** Sustainability issues are not material for all companies, and when they are material, they manifest in unique ways and require industry-specific metrics. Requiring line item disclosures would result in corporate reporting burden and a large volume of information that is immaterial to investors. For example, SASB research shows that climate risk is present in 72 of 79 industries, or 93% of the capital markets[5]. However, what analysts need to know about climate risk is different from industry to industry. For apparel companies, analysts want to know the ability to source cotton, a crop that is vulnerable to shifting weather patterns. For commercial banks, analysts want to know about financed emissions—loans to Oil and Gas, Industrials, and Utilities companies. For automobile companies, analysts want to evaluate progress on developing alternative-fuel vehicles to curb use-phase emissions and capitalize on changing consumer preferences. A line item disclosure on climate risk would not capture the unique impacts of climate change across industries. *(Maps to questions 217, 219, 220, 222)*

- **Most existing sustainability disclosure in the Form 10-K is boilerplate, which is not useful to investors.** Although SASB research shows that nearly three-quarters of SASB disclosure topics are already addressed by issuers in their SEC filings, the information being disclosed is rarely decision-useful to investors. More than 40 percent of all disclosures on sustainability topics contain boilerplate language, while only about 15 percent of such disclosures use metrics. Even then, companies use different metrics and/or calculation methods, which hinders comparability. In order to evaluate performance of companies within an industry, analysts need full data sets of comparable metrics. Research shows that more detailed disclosures enhance analysts' understanding and impact investors' decision making.[6] Industry-specific accounting standards will reduce the proliferation of boilerplate language in the Form 10-K. *(Maps to questions 216, 218)*

- **The disclosure of material sustainability information strengthens competitiveness.** Disclosing and managing the sustainability issues most likely to have a financial impact helps business mitigate risk and identify innovation opportunities. Not driving performance on material sustainability issues leaves value unrealized or unprotected. New Harvard research confirms companies that perform well on *material* sustainability factors—as identified by SASB

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[4] For example, at GE, responding to over 650 ESG questionnaires involved more than 75 people at GE and took several months, "with virtually no value to (GE's) customers or shareholders and even less impact on the environment." Ann R. Klee, The Environmental Forum, May/June 2015, p. 18

[5] See SASB's Technical Bulletin 2016-01—Climate Risk for an in-depth analysis of how the systemic risk of climate change manifests itself differently across industries.

[6] One study, The Benefits of More Detailed Risk-Factor Disclosures, which focused on 10-K Risk Factor disclosures—those required by Item 503(c) of Regulation S-K—found that analysts are better able to assess fundamental risk when firms' risk-factor disclosures are more detailed and avoid vague, abstract, or "boilerplate" language. It also found that the market more readily incorporates detailed information into stock prices, suggesting that such non-financial disclosures help investors better assess firms' financial statements.

standards—enjoy enhanced market returns over firms that perform poorly on them.[7] A market standard drives competitiveness by helping companies improve performance on the most important issues for their industry. (*Maps to question 221)*

- **The capital markets need a market standard for the disclosure of sustainability factors.** SASB standards are created by the market, specific to industry, and compatible with U.S. securities law. The SEC has an opportunity to reduce boilerplate information, reduce corporate disclosure fatigue, eliminate selective disclosure, and improve investor decision making by referencing use of SASB standards as a way for companies to comply with the disclosure requirements of US securities law. *(Maps to questions 216, 217, 219, 220)*

- **The capital markets need sustainability accounting standards that are created by the market, specific to industry, and compatible with U.S. securities law**. Via the disclosure effectiveness initiative, the SEC has an opportunity to eliminate selective disclosure and reduce boilerplate information. By pointing to sustainability accounting standards, the SEC can reduce corporate disclosure fatigue and improve investor decision-making, which will build trust and facilitate capital formation. *(Maps to questions 216, 217, 219)*

- **SASB standards should be used as the market standard for sustainability accounting.** SASB standards were designed specifically for use in mandatory SEC filings, such as the 10-K and 20-F, to improve the quality of MD&A and risk factor disclosures on sustainability-related matters. SASB standards – for 79 industries in 10 sectors – are focused on sustainability disclosure topics and related metrics that are material to financial performance, decision-useful to investors. They ease the burden of questionnaire fatigue, reduce disclosure of immaterial information and are cost-effective for companies. SASB's evidence-based, inclusive and transparent standards development process is modelled after the process used to develop U.S. accounting standards. SASB recommends that the SEC reference use of SASB standards as a way for companies to comply with the disclosure requirements of U.S. securities law.

Public Comment
Public comments can be submitted through July 21, 2016 by one of the following four methods:

1. **Online: https://www.sec.gov/cgi-bin/ruling-comments**

2. **Email: rule-comments@sec.gov**
   The subject line of your message must include File No. S7-06-16. If you attach a document, indicate the format or software used (e.g., PDF, Word Perfect, MS Word, ASCII text, etc.) to

[7] The 2015 HBS working paper "Corporate Sustainability: First Evidence on Materiality" was the first significant study to differentiate between those sustainability factors that are likely to have material impacts and those that are not, and it used the SASB standards to make this determination. Using historical data, the study tracked the performance of 2,307 unique firms over 13,397 unique firm-years across 6 sectors and 45 industries, and found that firms enjoyed significantly higher accounting and market returns when they addressed material sustainability factors, and significantly higher returns still when they efficiently concentrated on material sustainability factors to the exclusion of immaterial sustainability factors.

create the attachment. DO NOT submit attachments as HTML, GIF, TIFF, PIF, ZIP, or EXE.

3. **Regulations.gov**
   www.regulations.gov is an integrated federal resource for researching and commenting on rulemaking. At this site you can search, view and comment on proposed federal regulations open for comment. Once you have located the document you want to comment on, click on the *"Comment Now"* button, and follow the instructions to complete the online form.

4. **Paper**
   Send 3 copies of your paper comment letter to:
   Brent Fields, Secretary
   Securities and Exchange Commission
   100 F Street, NE
   Washington, DC 20549-0609
   Each copy must list File No. S7-06-16.

Appendix A:

Background:
The Sustainability Accounting Standards Board (SASB)

The Sustainability Accounting Standards Board (SASB) is an independent 501(c)(3) nonprofit organization and is an American National Standards Institute (ANSI) accredited standards developer. SASB's mission is to develop and disseminate sustainability accounting standards that help public corporations disclose material, decision-useful information to investors. That mission is accomplished through a rigorous process that includes evidence-based research and broad, balanced stakeholder participation.

- SASB standards address the sustainability topics that are reasonably likely to have material impacts on the financial condition or operating performance of companies in an industry. Provisional standards are available for 79 industries in 10 major sectors. SASB standards are cost-effective for issuers—on average, each standard has 5 disclosure topics and 13 metrics. Because SASB standards are industry-based, the information is immediately useful to analysts and investors, who are able to benchmark and evaluate the performance of securities in an industry context.

- SASB standards are developed using the definition of "materiality" applied under the U.S. federal securities laws. That definition, set forth by the U.S. Supreme Court in TSC Industries v. Northway, 426 U.S. 438 (1976), is that a fact is material if "there is a substantial likelihood" that a "reasonable investor" would view its omission or misstatement as "having significantly altered the total mix of information." Every topic in the SASB standards is substantiated by evidence that performance on the topic can have a material financial impact on the financial condition or operating performance of a company, and that it is of interest to investors. On average, 75% of the topics in SASB standards are already acknowledged by companies in their mandatory filings as being material, but boiler plate language is heavily relied upon, making disclosure ineffective. SASB standards provide an effective way for companies to disclose these material risks to investors.

- SASB standards are designed to be integrated into the MD&A and other relevant sections of mandatory SEC filings such as the Form S-1, 10-K and 20-F, so that information is reliable and all investors have access to material, comparable information without the need to source it from questionnaires or purchase it from commercial vendors. This will alleviate the current burden of disclosure fatigue—companies now routinely prepare hundreds of investor ESG questionnaires, a costly practice for both companies and investors. SASB is committed to keeping immaterial information out of the Form 10-K, and ensuring material information does not have to change hands between issuers and investors outside of the regulated, controlled disclosure processes via questionnaires.

- SASB's standards development process is evidence-based and market-informed in order to ensure the standards are focused on information that is material, are cost-effective for companies and are decision-useful for investors. Over 2,800 individuals affiliated with investors with $23.4 T AUM and companies with $11 T in market capitalization participated in SASB's industry working groups. The process of identifying and prioritizing material factors ensures that the SEC does not have to promulgate "line item" standards for topics that are not likely to be material for all registrants. On average, over 82% of issuers and investors in SASB's working groups agreed that the topics in the standards were reasonably likely to be material.

- SASB's rigorous process is designed to elicit the sustainability topics that are likely to be material for each industry. This ensures that issuers only need to address a small number of material topics in their mandatory filings (on average just 5 topics per industry), and can focus on the quality of those disclosures: i.e. risk management, performance, and business strategy related to the topic. Because SASB standards address a small set of financially material ESG factors, the reporting burden is minimized and the usefulness of the information is maximized.

- SASB standards provide financial analysts with a view of material ESG risks and opportunities by industry, enabling investors to understand their exposure to ESG risk across a diversified portfolio and shape appropriate investment strategies to manage and price risk for the long term.