The Future of Sustainability Disclosure: What Remains Unchanged in an Environment of Regulatory Uncertainty?

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Thank you, Jean, for that kind introduction. It has been an honor and a privilege to serve on the SASB Board, and it is a pleasure to be here with all of you, who come from so many different professions, different backgrounds, different regions, and different areas of expertise, but join together here today to help move our financial markets forward. It is exactly this kind of collective, collaborative effort that has characterized much of the significant progress our financial markets have made throughout history, and we hope to extend that tradition to the realm of sustainability reporting. SASB has brought us much closer to that goal; it is a shining example of what stellar results can be obtained when a group of smart, dedicated people come together.

This afternoon, I would like to talk with you about the history of sustainability disclosure, and about the fundamental principles that have long been central to the efficient functioning of our markets—concepts such as transparency, materiality, and, above all, the needs of investors. I believe it's important for all of us to understand where those ideas came from, how they gained currency and what lies ahead. But before we talk about the past, and about the future, let's consider where we are today.

This has been quite a day. We have heard about the Securities and Exchange Commission's disclosure effectiveness initiative. We have learned about a variety of emerging approaches to integrate sustainability information into financial analysis. We have been informed about the corporate perspective on sustainability-related risks, and we took a peek into the future of accounting. My thanks, and those of everyone at SASB, to all who took the time to participate in this inaugural conference.

Throughout all of the discussion today, one of the common refrains has been uncertainty. Of course, uncertainty is an everyday aspect of financial markets, but recently there seems to be a heightened sense of anxiety, which extends to the future of sustainability disclosure, and not just because it is still an emerging practice. There are, of course, a variety of reasons for this uneasiness, not the least of which is the fact that there will soon be three open seats at the SEC, where I spent much of my career. And, I know all of you are very busy people, so some of you may not be aware that the U.S. has elected a new president, and we do not yet fully know the policy directions of his administration.

But, there is one thing we know for certain. Change is inevitable. In the arena of what we refer to as "sustainability," that change could be dramatic. For example, the Environmental Protection Agency may change course, which could potentially and significantly move the goalposts for corporate performance. Likewise, we do not know

what the future holds for Dodd-Frank, including its controversial conflict minerals provision. Frankly, I could go on and on about what we do not know.

For better or worse—and it could be either one, depending on your perspective—change is on its way. But whatever happens politically, and however that affects policy and regulation, remember that SASB and this conference are about disclosure. And, the need for disclosure that conveys to investors the information they need to make informed investment decisions will remain.

Whatever the changes in policy, sustainability-related issues are significant to the financial future of companies that are publicly traded in our country. The policy changes that may be coming could alter the specific ways in which sustainability affects an industry or a particular company, and they may affect the outcome of the materiality analysis that the SASB framework calls on corporate management to make. However, the basic question will be the same: Is the sustainability issue material to investors in your company?

This, of course, brings us into the realm of securities regulation—my former world. As you know, even before the election, the SEC was considering a host of modifications intended to "modernize" Regulation S-K, which sets forth the non-financial-statement disclosure requirements for publicly-traded companies in the U.S. I'd like to stress that this is not, as some have said, an anti-disclosure initiative; it is intended to make U.S. rules more effective in eliciting disclosure for investors. Among many other topics, the Commission included in its release soliciting public feedback a section on sustainability information and the possibility of adopting specific new requirements for the disclosure of that information. Other aspects of the Commission's release are also relevant to our discussions today. For example, the Commission is also examining the content and focus of MD&A, including the threshold for disclosure of forward-looking information. I'll return to MD&A, which is a favorite topic of mine, in a few minutes.

I will not hazard a guess as to whether and how Regulation S-K will change. There are too many variables. Our newly elected President will appoint the 32d Chairman of the Commission. (Here, I must pause for an aside to congratulate Chair Mary Jo White for her outstanding leadership and thank her profusely for her service.) But also, much like the more frequently discussed Supreme Court, the SEC is not currently operating at full capacity. The incoming administration also will name two additional new Commissioners. Now, when I was an SEC staffer in the 70's, 80's and into the 90's, working first in the General Counsel's office and then in the Division of Corporation Finance, it was difficult to tell a Democratic commissioner from a Republican. These days, that is no longer the case. But it is important to remember that, as an independent agency, the Commission has balance built into its structure. No more than three Commissioners may belong to the same political party, regardless of which administration appoints them. And while the Chairperson has the authority to set the Commission's agenda, that person (as I remember well from my time as a Commissioner and Chairman) has only one vote; without a majority, much of the Chairman's agenda goes unexecuted. The Chairman cannot engage in unilateral rulemaking, or make enforcement decisions all by him or herself.

I should also mention that while Commissioners are coming and going, the bulk of the SEC staff will continue going about their day-to-day business. For example, the Division of Corporation Finance will still be reviewing disclosures and writing comment letters to registrants, which may, of course, include questions concerning the adequacy of sustainability-related disclosure.

While changes in direction do occur, they may not be as dramatic as you might think. Regardless of their political persuasion, all Commissioners and staff are driven by the agency's mission: to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. When Mary Schapiro and I served sequentially as Chairman of the Commission, there was a sign on the office door that read simply "How does it help investors?" It was a reminder that everything the Commission does should be focused on that common goal.

So let's talk about investors. At the SEC, I used to tell stories about my Aunt Millie, a typical retail investor whose retirement security depended on her modest portfolio. Aunt Millie was fictional, but her plight was—and still is—real to the millions of ordinary people who feel bewildered by our increasingly complex financial markets, but are nevertheless bound to them through pension plans, mutual funds, insurance premiums, and the like. The recent election in the U.S. and other so-called populist movements around the world have, in many ways, represented a referendum on public trust in our established institutions. This, of course, includes our financial markets. As institutional investors continue their rise and fiduciary capitalism plays an increasingly influential role in these markets, there is an increasingly close relationship between public trust and investor confidence. Investor confidence in the quality of financial disclosures is what makes our markets work.

Although this confidence is higher than it was five years ago, a growing number of investors are dissatisfied with the quality of the sustainability information being provided to them. In a recent PwC survey, for example, 79 percent of investors expressed dissatisfaction with the quality of sustainability data. Interestingly, many of the questions that arise today around the reliability of sustainability disclosures are the very same ones that made financial auditing an obligatory practice in the wake of the stock market crash of 1929. Questions such as:

- Is the underlying data accurate?
- Is the underlying data complete?
- Are there controls in place to mitigate risks and improve reliability in the data collection processes?

This comparison is instructive for at least a couple of key reasons. First, and most obviously, it recalls another period in our history during which reform and regulation of Wall Street served as an effective rallying cry for politicians. But what's equally important is the fact that independent audits became commonplace for large public companies several years before they were mandated by regulators. And this was true for a very simple reason: Because investors demanded it.

Investors, in fact, have been the driving force behind the development of much of our financial infrastructure. When the Securities Act was passed in 1933, and the Securities Exchange Act in '34, investor protection was their primary objective and disclosure was the primary tool they used to achieve it. Years earlier, in 1914, future Supreme Court Justice Louis Brandeis articulated the benefit of disclosure in a quote that all of you are likely familiar with:

> *Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.*

These views influenced President Franklin Delano Roosevelt's views about disclosure and the thinking of Felix Frankfurter, the future Supreme Court Justice who played a leading role in writing the Securities Act and guiding it through Congress.

The reforms of corporate disclosure practices that occurred during the Great Depression—including those that began as voluntary efforts—are analogous to what is happening now with the emergence and evolution of sustainability disclosure. The core principles that guided that reform—such as the importance of transparency, the primacy of investor protection, and the use of materiality as a moderator—are still relevant today and continue to guide SEC rulemaking.

As the saying goes, "The more things change, the more they remain the same." What appears on the surface to be dramatic change is often just the same old forces manifesting themselves in brand new ways.

The fundamental principles that guide securities regulation have now been in place for generations, and they are not likely to change any time soon. Nor are the macroeconomic trends that have brought sustainability matters slowly but surely to the forefront. Water availability will still present material risks to operations in a variety of industries. Customers, suppliers, employees and others will still prefer to do business with companies that effectively manage the material risks that data security presents.

So what does the future look like for sustainability disclosure? Like the rest of you, I do not own a crystal ball. But since years ago at the SEC, my colleagues and I asked registrants to look into the future in their MD&As, I would feel a bit hypocritical if I did not at least make an effort. In their SEC filings, we ask issuers to disclose known trends, demands, events, and uncertainties that are reasonably likely to have a material impact on the company's financial condition or results of operations. To state it in plainer

English, we ask what they know today that is likely to have a significant impact tomorrow.

We can apply this same approach to anticipate—at least to an extent—how the future of sustainability disclosure is likely to unfold. Certainly we can point to at least a couple of known trends that are relevant. First, investors are increasingly seeking out reliable sustainability information. Second, those investors are incorporating sustainability risks and information into their decision making. Third, as you can read in the Annual State of Disclosure report that SASB released today, more and more companies are attempting to supply that information, although they are not always doing so effectively.

In MD&A, we also ask that companies identify and discuss key performance indicators, including non-financial performance indicators that their management uses to run the business and are material to investors. So in that spirit, let's look at the KPIs, so to speak, that are available to measure the trajectory of sustainability disclosure.

We know that the signatories to the UN's Principles for Responsible Investment now manage about $60 trillion in global assets, and that figure has been steadily growing every year. We also know, from a recent report by the Forum for Sustainable and Responsible Investment, that sustainable, responsible, and impact investing assets have expanded to $8.72 trillion in the U.S. alone, up 33 percent from just two years ago. We know, from a 2015 CFA Institute survey, that 73 percent of institutional investors take environmental, social ESG issues into account in their investment analysis and decisions, to help manage investment risks. And, perhaps more importantly, we know that these investors are generally unsatisfied with the comparability and quality of the sustainability information they are being provided. As I mentioned earlier and as others discussed this morning, the SEC recently sought public feedback on sustainability disclosure requirements, and received 276 non-form letters in response. Of those, two-thirds addressed sustainability matters, 80 percent of which called for improved disclosure of this type of information.

Meanwhile, on the corporate side, we know that, in their SEC filings, 69 percent of companies are already addressing at least three-quarters of the sustainability topics included in their industry's SASB standards, and 38 percent are already providing disclosure on every SASB topic. So, companies acknowledge the potential for material impacts related to the sustainability factors identified by SASB.

On the other hand, we also know that less than 24 percent of reported sustainability topics are being disclosed using metrics, while more than half use boilerplate language, which is nearly useless to investors. As Jean often points out, even in those cases where metrics are being used, they are non-standardized, and therefore lack comparability across industry peers. The new SASB report I mentioned provides a baseline against which investors will be able to measure progress on this front in coming years.

Thus, using our MD&A approach, these “known trends” seem to represent a long-term market movement, and point to the future of sustainability disclosure. Although there is obviously plenty of room for improvement, demand is strong--demand for sustainability performance data that is comparable and trustworthy--and the supply side appears to be working to catch up. The question is no longer whether or not companies should disclose information on material sustainability risks and opportunities; it is how they can improve the effectiveness of the disclosures they are already making. In short, it is not about more disclosure; it is about better disclosure.

Now MD&A calls for both discussion *and* analysis, and our analysis would not be complete without considering the broader context for these developments. Again, when we survey the landscape, a number of other “known trends” stand out. For example, businesses increasingly compete in a global marketplace, and multinational corporations operate in many countries with strong government support for action on—as well as disclosure about—climate change, human rights, ethical governance, and other sustainability factors. And, according to a recent Deloitte survey, 87 percent of millennials—who are now America’s largest generation—believe “the success of a business should be measured in terms of more than just its financial performance.” Shifting consumer preferences require companies to increasingly provide products and services that promote sustainability through protection of natural resources, attention to personal health and fitness, advancement of social and economic equality, and an emphasis on ethical sourcing and production.

In large part because of these changing market dynamics, evolving population demographics, and shifting consumer demand patterns, companies have embraced sustainability even where regulation does not compel them to do so. Simply put, sustainability issues are business issues. They can have material impacts on the financial condition or operating performance of a company, or an entire industry. We heard this afternoon that many firms are approaching sustainability from a risk-management perspective, and that is important. A growing body of research, including a well-known paper out of Harvard Business School, is also emerging to support the idea that by focusing on the most crucial sustainability factors—in other words, those that are reasonably likely to have material impacts—companies can achieve higher risk-adjusted returns for shareholders.

SASB’s approach to disclosure of sustainability information is tied to traditional financial drivers. By viewing sustainability through the lens of materiality, as SASB suggests, corporations can measure and manage what matters most—and by that I mean the subset of sustainability factors that are important to business outcomes and to long-term shareholder value. This recognition—that sustainability performance and financial performance are intertwined—is why dozens of industry-leading companies, representing over $7 trillion in combined market capitalization, signed the American Business Act on Climate Pledge to demonstrate their support for the Paris agreement on global climate action. It is why food companies are pouring resources into the organic market, where growth is outpacing conventional foods by 300 percent. And it is why,

according to an Accenture survey, 80 percent of CEOs think their company is approaching sustainability as a route to competitive advantage: They are cutting costs, they are disrupting markets with innovative inputs, processes, and products, they are attracting top talent, and they are strengthening their brands.

My point here is that, regardless of what happens from a policy standpoint or regulatory perspective, powerful market forces are already in motion that will play a major role in shaping the future of both corporate sustainability performance and the disclosure of material information about that performance. The users and providers of financial capital are engaged around these issues, and they are finding common ground.

Let me emphasize that last idea, because it is, in large part, why I chose to join SASB's board of directors in 2014. Companies and their investors are working together on these issues, and SASB's standard-setting process has provided a forum in which they can bring their interests into alignment. This approach addresses some of the problems I have seen with government rulemaking over the years. Coming from the SEC, I know full well the strictures placed on government rulemaking, which is a cumbersome process.

Another trend affecting rulemaking is the diversity of investors in the market. From retail to large institutional, active to passive, growth to value, today's investors are more diverse—in sophistication, methodology, and motive—than ever before. This richly populated continuum of investors creates challenges for securities regulation. More than 50% of members responding to a 2016 CFA Institute survey believe there is too much regulation in the U.S. financial markets. While, as a life-long regulator, I continue to believe in the value of regulation, I also believe that regulation is not always the answer. And, a market standard is, in my opinion, the right answer for sustainability disclosure. A market standard can more efficiently meet diverse investor needs; it can evolve more quickly and thus address emerging issues in a more effective way than governmental regulation.

Like the SEC, SASB has become the target of unfair accusations of "capture." I often heard from issuers, investors, auditors, and other groups that we at the SEC were catering to someone else's special interests. Because it is not a governmental body, SASB is better able to bring those parties together to work out their differences. SASB's approach is open and inclusive. It allows everyone to take a seat at the table and have their voice heard. And, as a result, it produces outcomes that, we believe, strike an appropriate balance. That is, the standards will provide information investors need and are entitled to by law, but they do so in a way that does not create an undue burden on corporations.

A focus on financial materiality is what makes this shared understanding possible. And it is also what makes SASB's approach to sustainability disclosure so elegant: By operating under the framework of the existing securities laws, SASB's approach requires no new regulation.

In 2010, the SEC issued guidance to registrants on how existing law and regulations applied to climate change. As you might guess, many people reacted as if our interpretation had changed the law in a radical, and dreadful, way. My answer to them was always the same, "Have you read it?" Usually, they had not. The reality is that our guidance did not change the law one iota. It was not intended to, nor did it need to.

The same is true of disclosure of sustainability issues using SASB's approach. There is no need for companies to spend time and resources on learning complex new rules, or on decoding unfamiliar legal jargon. The disclosure requirements involved are, as they say, the same-old same-old.

This is because existing regulation, which is focused on delivering full, accurate, and intelligible information to investors, already provides for the disclosure of information on sustainability factors when they are reasonably likely to have material impacts on a company's business. Management's Discussion and Analysis, or MD&A, was first introduced in 1968, and the SEC adopted the current framework for MD&A in 1980. For 35-plus years, companies have been using this section of their statutory filings to explain financial statements from management's perspective, to enhance financial disclosure and provide context for its analysis, and to describe not just the "what?" and "how much?" but the "why?" so that investors can better understand whether past performance is indicative of future results. This is the core of what SEC-mandated disclosure is all about.

As I mentioned earlier, companies have already begun addressing key sustainability issues in their Form 10-K and 20-F filings, including in MD&A. But, as SASB's new report shows, they are taking a minimalist's approach to these topics, often describing them in vague, non-specific language that could apply to virtually any firm. I maintain that issuers should not view sustainability disclosure as an obligation, but rather as an opportunity to tell their full value-creation story.

Given the lackluster quality of sustainability disclosure currently finding its way into SEC filings, what we have, to quote *Cool Hand Luke,* is failure to communicate. To me, this is a missed opportunity. Studies have shown a correlation between high-quality investor relations, which naturally involves effective communication, and increased market valuation and lowered cost of capital. So why, then, do we have investors getting their sustainability information from ad hoc reports that are neither comparable nor, in many cases, focused on the issues that really matter to that company? Or from unfocused questionnaires that are costly and time-consuming to prepare and respond to? Or from direct engagement, where the potential for "selective disclosure" raises red flags with regulators?

These are not the hallmarks of an efficient market. But there is a solution, and it does not require SEC action. It requires only that all of us—investors, corporate professionals, auditors, securities lawyers, regulators, and so on—work together to establish and maintain a market standard for the disclosure of this important information. After all, business exists to create value for society, and financial markets exist so that business

has access to the funding necessary to do so. That puts investors in the driver's seat. And just as the needs of investors once precipitated the establishment of the Securities acts, of generally accepted accounting principles, and of auditing standards, those needs today must fuel our efforts to bring disclosure into the 21st century. Investor demand for material sustainability information has reached a critical mass, and the time has come for companies, their advisors, our regulators, and the market at large to respond. Investor demand should—and, I believe will—once again be the catalyst for change.

If we hope to move sustainability disclosure forward, we should focus on making steady progress that balances the needs of all stakeholders. Today, we have come together to join in that conversation. But as Henry Ford said, "Coming together is a beginning; keeping together is progress; working together is success." As you return to the day-to-day grind, I encourage you to keep together and work together to realize a future in which financial fundamentals and sustainability fundamentals sit side-by-side. As we move boldly into an uncertain time ahead, let's not fear change, because progress is impossible without it.

Thank you.