



PROPOSED CHANGES TO PROVISIONAL STANDARDS

BASIS FOR CONCLUSIONS

Financials Sector

Commercial Banks

Investment Banking & Brokerage

Asset Management & Custody Activities

Consumer Finance

Mortgage Finance

Security & Commodity Exchanges

Insurance

Prepared by the
Sustainability Accounting Standards Board®

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Introduction

Robust and resilient sustainability accounting standards must not only address the sustainability-related risks and opportunities faced by reporting organizations, they must themselves be sustainable. That is, they must be designed to continually and systematically adapt to an ever-changing world. For this reason, the SASB engages in ongoing technical research and market consultation to ensure the maintenance of decision-useful, cost-effective standards. As changes occur in an industry's competitive context, in the broader sustainability landscape, or in the interests of the reasonable investor, this approach—bolstered by rigorous analysis and bottom-up, market-based input—is key to maintaining a set of standards that evolve to support market needs.

When potentially necessary or appropriate updates to the standards are identified by the SASB's own research or through engagement with corporate issuers, investors, or other subject matter experts, those items may be added to the SASB's Research Agenda or future Technical Agendas, indicating that such items are under review. For such items, the SASB staff prepares proposed updates intended to both incorporate its findings and to satisfy the essential concepts of sustainability accounting set forth in the [SASB Conceptual Framework](#). These updates are then proposed to the SASB Standards Board for review and approval.

The Basis for Conclusions for the proposed changes to provisional standards details the SASB staff's considerations in developing the updates included in the published 2017 Technical Agenda, helping users to better understand the updates and the reasoning behind them. The Basis for Conclusions go hand-in hand with the Exposure Draft of the standard, and highlight the specific proposed updates and associated changes per industry per sector. An explanation and rationale for each change is included herein.

About the SASB

Established in 2011, the Sustainability Accounting Standards Board (SASB) is the independent standards-setting organization for sustainability accounting standards that meet the needs of investors by fostering high-quality disclosure of material sustainability information. The standards focus on known trends and uncertainties that are reasonably likely to affect the financial condition or operating performance of a company and therefore would be required to be disclosed under Regulation S-K. The standards are designed to improve the effectiveness and comparability of corporate disclosure on material environmental, social, and governance (ESG) factors in SEC filings such as Forms 8-K, 10-K, 20-F, and 40-F. Based on a rigorous process that includes evidence-based research and broad, balanced stakeholder participation, the SASB currently maintains provisional standards for 79 industries across 11 sectors.¹

The SASB Standards Board, seated in 2017, comprises nine members, representing a diversity of key perspectives, including standards-setting, corporate reporting, and investing and financial analysis. The Standards Board is responsible for guiding the standard-setting process and for the quality of its outcomes. The SASB operates in accordance with its primary governance documents, the [SASB Rules of Procedure](#) and [SASB Conceptual Framework](#). The [SASB Conceptual Framework](#) sets out the basic concepts, principles, definitions, and objectives that guide the SASB in its approach to setting standards for sustainability-related matters. The [SASB Rules of Procedure](#) establish the

¹ Where traditional industry classification systems group companies by sources of revenue, the SASB's approach considers the resource intensity of firms, and groups industries with like sustainability characteristics, including risks and opportunities, within SASB's Sustainable Industry Classification System™ (SICS™) found at: <https://www.sasb.org/sics/>. SASB has proposed a number of amendments to SICS, and the revised classification system will go into effect when the standards are codified in early 2018. [Proposed changes](#) to SICS are on SASB's website and the Updates proposed herein are based on the amended classification.

processes and practices followed by the SASB in its standard-setting activities, and in its oversight of related work undertaken by the SASB staff. The following fundamental tenets underpin the SASB's efforts:

- **Materiality-Focused:** 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. In identifying sustainability topics that are reasonably likely to have material impacts, the SASB applies the definition of "materiality" established under the U.S. securities laws.² For more information, see the staff bulletin [SASB's Approach to Materiality for the Purpose of Standards Development](#).
- **Evidence-Based:** The SASB takes an evidence-based approach to assess whether sustainability topics are likely to be of interest to the reasonable investor, and whether they are reasonably likely to have material impacts on the financial condition or operating performance of a company. Evidence is drawn from both internal research and from credible external sources, such as financial filings, earnings calls, databases of U.S. government agencies, industry research products, and academic studies, among others.
- **Market-Informed:** The SASB standards are shaped in large part by feedback from participants in the capital markets—primarily corporate issuers and mainstream investors. The SASB actively solicits input and carefully weighs all stakeholder perspectives in considering which aspects of a sustainability topic warrant standardized disclosure and in determining how to frame, describe, and measure those aspects for the purposes of standardization. The SASB's consultation efforts have involved engagement through Industry Working Groups over a four-year period with more than 2,800 experts, representing \$23.4 trillion in assets under management and more than \$11 trillion market capitalization. Recently, deep consultation on the provisional standards included 141 companies (along with 19 industry associations, representing hundreds of companies) and 38 institutional investors (who consulted on 271 industries). Additionally, the SASB's Investor Advisory Group (IAG) comprises 28 organizations, representing more than \$20 trillion in assets under management, including BlackRock, California Public Employees' Retirement System (CalPERS), California State Teachers' Retirement System (CalSTRS), State Street Global Advisors, and others. This market feedback has played a significant role in shaping the SASB's 2017 Technical Agenda.

In its guidance and oversight role, the SASB operates in a sector committee structure, which assigns a minimum of three Standards Board members to each sector for review, discussion, and liaising with staff. The committees are structured as follows:

² TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976).

SASB Sector Committees		
<p>Health Care <u>Industries:</u> Biotechnology & Pharmaceuticals; Medical Equipment & Supplies; Health Care Delivery; Health Care Distributors; Managed Care; Drug Retailers <u>Committee Members:</u> Lloyd Kurtz*, Bob Hirth, Jean Rogers</p>	<p>Renewable Resources & Alternative Energy <u>Industries:</u> Biofuels; Solar Technology & Project Developers; Wind Technology & Project Developers; Fuel Cells & Industrial Batteries; Forestry Management; Pulp & Paper Products <u>Committee Members:</u> Stephanie Tang*, Jeff Hales, Kurt Kuehn</p>	<p>Food & Beverage (formerly Consumption I) <u>Industries:</u> Agricultural Products; Meat, Poultry, & Dairy; Processed Foods; Non-Alcoholic Beverages; Alcoholic Beverages; Tobacco; Food Retailers & Distributors; Restaurants <u>Committee Members:</u> Stephanie Tang*, Elizabeth Seeger, Lloyd Kurtz</p>
<p>Financials <u>Industries:</u> Commercial Banks; Investment Banking & Brokerage; Asset Management & Custody Activities; Consumer Finance; Mortgage Finance; Security & Commodity Exchanges; Insurance <u>Committee Members:</u> Jeff Hales*, Dan Goelzer, Verity Chegar</p>	<p>Transportation <u>Industries:</u> Automobiles; Auto Parts; Car Rental & Leasing; Airlines; Air Freight & Logistics; Marine Transportation; Cruise Lines; Rail Transportation; Road Transportation <u>Committee Members:</u> Kurt Kuehn*, Jean Rogers, Jeff Hales</p>	<p>Consumer Goods (formerly Consumption II) <u>Industries:</u> Apparel, Accessories & Footwear; Appliance Manufacturing; Household & Personal Products; Building Products & Furnishings; Toys & Sporting Goods; Multiline and Specialty Retailers & Distributors; E-commerce <u>Committee Members:</u> Elizabeth Seeger*, Stephanie Tang, Kurt Kuehn</p>
<p>Technology & Communications <u>Industries:</u> Electronic Manufacturing Services & Original Design Manufacturing; Software & IT Services; Hardware; Semiconductors; Telecommunication Services; Internet Media & Services <u>Committee Members:</u> Bob Hirth*, Lloyd Kurtz, Verity Chegar</p>	<p>Services <u>Industries:</u> Education; Professional & Commercial Services; Hotels & Lodging; Casinos & Gaming; Leisure Facilities; Advertising & Marketing; Media & Entertainment <u>Committee Members:</u> Dan Goelzer*, Jeff Hales, Bob Hirth</p>	<p>Infrastructure <u>Industries:</u> Electric Utilities & Power Generators; Gas Utilities & Distributors; Water Utilities & Services; Waste Management; Engineering & Construction Services; Home Builders; Real Estate; Real Estate Services <u>Committee Members:</u> Jean Rogers*, Kurt Kuehn, Verity Chegar</p>
<p>Extractives & Minerals Processing (formerly Non-Renewable Resources) <u>Industries:</u> Oil & Gas - Exploration & Production; Oil & Gas – Midstream; Oil & Gas - Refining & Marketing; Oil & Gas – Services; Coal Operations; Iron & Steel Producers; Metals & Mining; Construction Materials <u>Committee Members:</u> Verity Chegar*, Elizabeth Seeger, Bob Hirth</p>	<p>Resource Transformation <u>Industries:</u> Chemicals; Aerospace & Defense; Electrical & Electronic Equipment; Industrial Machinery & Goods; Containers & Packaging <u>Committee Members:</u> Lloyd Kurtz*, Dan Goelzer, Jean Rogers</p>	<p style="text-align: right;">* Sector chair</p>

The Standards Board sector committees have reviewed proposed changes to the provisional standards, based on the Technical Agenda, in anticipation of ratifying the standards in Q1 2018.

Commenting

The SASB has voted to release the Proposed Changes to Provisional Standards: Basis for Conclusions compendium and the Exposure Drafts of the standards, thus initiating a 90-day Public Comment Period. The Public Comment Period will occur from October 2, 2017, to December 31, 2017. During this time, the public may submit comments to the SASB on the proposed updates to the standards. Public comments will be evaluated in the process to ratify the standards, expected in early 2018. Further guidance on the Public Comment Period, including instructions to submit comments and accessing the Basis for Conclusions and Exposure Drafts, is available at: <http://www.sasb.org/public-comment>. Other questions on the SASB or the Public Comment Period may be sent to: info@sasb.org.

Proposed Changes to Provisional Standards: Basis for Conclusion Overview

The following provides a detailed description of—and rationale for—each change proposed to the SASB Provisional Standard for the industries within the Financials sector. Changes may be related to content, including adding, removing, or reframing a topic or adding, removing, or revising a metric. Changes may also be technical in nature, including updates to a metric's scope, definitions, third-party references, or harmonization across SASB's standards and/or with external initiatives. Typographical and other editorial changes have not been included below but can be provided to interested parties or reviewed in the redline Public Comment Standard.

Guidance Used to Determine Proposed Updates

In preparing its proposed updates, the SASB is guided by the *Fundamental Tenets of the SASB Approach to Standards-Setting*, which are designed to better achieve the *Core Objectives of the SASB*, as established by the *SASB Conceptual Framework*.

Topic-Level Proposed Updates

Proposed updates that relate to the addition, removal, or reframing of a topic are based on the following *Principles for Topic Selection* ("Principles"), as established by the *SASB Conceptual Framework*:

- **Potential to affect corporate value.** Through research and stakeholder input, the SASB identifies topics that can or do affect operational and financial performance through three channels of impact: (1) revenues and costs, (2) assets and liabilities, and (3) cost of capital or risk profile.
- **Of interest to investors.** The SASB addresses issues likely to be of interest to investors by assessing whether a topic emerges from the "total mix" of information available through the existence of, or potential for, impacts on five factors: (1) direct financial impacts and risk; (2) legal, regulatory, and policy drivers; (3) industry norms, best practices, and competitive drivers; (4) stakeholder concerns that could lead to financial impacts; and (5) opportunities for innovation.
- **Relevant across an industry.** The SASB addresses topics that are systemic to an industry and/or represent risks and opportunities unique to the industry and which, therefore, are likely to apply to many companies within the industry.

- **Actionable by companies.** The SASB assesses whether broad sustainability trends can be translated into industry-specific topics that are within the control or influence of individual companies.
- **Reflective of stakeholder (investor and issuer) consensus.** The SASB considers whether there is consensus among issuers and investors that each disclosure topic is reasonably likely to constitute material information for most companies in the industry.

Metric-Level Proposed Updates

Proposed updates that relate to the addition, removal, or revision of a metric are based on the following *Criteria for Accounting Metrics* (“Criteria”), as established by the *SASB Conceptual Framework*:

- **Fair Representation:** A metric adequately and accurately describes performance related to the aspect of the disclosure topic it is intended to address, or is a proxy for performance on that aspect of the disclosure topic.
- **Useful:** A metric will provide useful information to companies in managing operational performance on the associated topic and to investors in performing financial analysis.
- **Applicable:** Metrics are based on definitions, principles, and methodologies that are applicable to most companies in the industry based on their typical operating context.
- **Comparable:** Metrics will yield primarily (a) quantitative data that allow for peer-to-peer benchmarking within the industry and year-on-year benchmarking for an issuer, but also (b) qualitative information that facilitates comparison of disclosure.
- **Complete:** Individually, or as a set, the metrics provide enough data and information to understand and interpret performance associated with all aspects of the sustainability topic.
- **Verifiable:** Metrics are capable of supporting effective internal controls for the purposes of data verification and assurance.
- **Aligned:** Metrics are based on those already in use by issuers or are derived from standards, definitions, and concepts already in use by issuers, governments, industry associations, and others
- **Neutral:** Metrics are free from bias and value judgment on behalf of the SASB, so that they yield an objective disclosure of performance that investors can use regardless of their worldview or outlook.
- **Distributive:** Metrics are designed to yield a discernable range of data for companies within an industry or across industries allowing users to differentiate performance on the topic or an aspect of the topic.

Technical-Protocol Proposed Updates

Proposed updates that relate to the revision of technical protocols are based on the following attributes, designed to enable the technical protocols to serve as the basis for “suitable criteria,” as defined by the PCAOB’s AT Section 101³ and as referenced in the *SASB Conceptual Framework*:

- **Objectivity:** Criteria should be free from bias.
- **Measurability:** Criteria should permit reasonably consistent measurements, qualitative or quantitative, of subject matter.
- **Completeness:** Criteria should be sufficiently complete so that those relevant factors that would alter a conclusion about subject matter are not omitted.
- **Relevance:** Criteria should be relevant to the subject matter.

³ PCAOB, [AT Section 101](#) – Attest Engagements

Proposed Updates Related to Other Elements of Standardized Presentation

Each SASB standard is presented in a structured manner to ensure consistent application and to facilitate the cost-effective preparation of material, decision-useful information. These core objectives guide the preparation of proposed changes that involve the revision of specific elements of standardized presentation. Such revisions—including those made to general disclosure guidance, industry descriptions, topic descriptions, and activity metrics—are based on the stated objectives and key characteristics of the element, as established by the *SASB Conceptual Framework*.



FINANCIALS SECTOR

COMMERCIAL BANKS INDUSTRY

Sustainability Accounting Standard

Sustainable Industry Classification System™ (SICS™) #FN0101

Prepared by the
Sustainability Accounting Standards Board®

October 2017

Proposed Changes to Provisional Standard - Basis for Conclusion

Proposed Update #2-1 – **Industry:** Commercial Banks; **Topic Name:** Financial Inclusion & Capacity Building

2017 Technical Agenda Item #2-1 Description

SASB is evaluating the revision of metric FN0101-01⁴ to ensure the relevance, decision-usefulness, and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Revise Metric

The SASB proposes to remove metric:

- FN0101-01 Percentage of new accounts held by first-time account holders

and replace it with metric:

- Number of no-cost retail checking accounts provided to previously unbanked or underbanked customers

Note: Accounts that have contingencies such as the presence of a direct deposit, the minimum amount of funds transferred to or from the account, etc., would be excluded from disclosure as they are not relevant to the scope of the topic.

Adherence to Principles for Criteria for Accounting Metrics

The current Commercial Banks SASB industry standard includes a topic on Financial Inclusion & Capacity Building with five associated quantitative metrics to assess how banks balance their capacity building with risks associated with lending to unbanked, underbanked, or underserved customers. Companies that fail to manage performance in this area are likely to face challenges in expanding their product portfolios while minimizing portfolio exposure to non-performing loans. This could result in higher cost of capital.

The metric FN0101-01 currently includes disclosure of the percentage of new accounts opened in a year that are held by first-time account holders. In its current state, the metric does not directly address the risks associated with the topic noted above. While there may be some correlation between first-time account holders and previously unbanked/underbanked customers (as defined by the FDIC), the former is a broader measure that would encompass account holders who may not have been un- or underbanked. Thus, the current metric's scope is slightly broader than that of the topic.

While the provisional metric likely captures un- and underbanked individuals as a subset of the total numbers, the figure might not be sufficiently comparable and could be distorted by other factors, such as the age of account holders (e.g., young individuals opening their first account with a bank after getting their first job) and not be related to the financial inclusion rationale of the disclosure topic. The proposed revision to a more focused measure of financial inclusion improves comparability and representativeness of the information disclosed.

⁴ FN0101-01: Percentage of new accounts held by first-time account holders

Supporting Analysis

Disclosure analysis has not revealed existent disclosure of the first-time account holders from banks. At the same time, no-cost accounts is a metric often reported in SEC filings by a large number of U.S.-listed public banks. One publicly listed savings and loan holding company in its 8-K states, "...no- and low-cost checking deposit accounts represent 47 percent of total customer deposits at March 31, 2017." Several other banks state that no-cost checking accounts are one of the services they provide. On conference calls, a number of commercial banks highlight no-cost accounts as one of their offerings that enable them to grow their customer base. In its sell-side reports, a large integrated bank mentions no-cost checking accounts as one of the factors helping large commercial banks drive their cost of funds down. Therefore, narrowing the scope of the metric will improve its representativeness, as it is less likely to be distorted by individuals opening first-time accounts that may not be considered un- or underbanked (for example, children of individuals with adequate access to banking services). The narrower scope also improves comparability by diminishing the margin for the metric to be distorted by differing strategies on unrelated issues (for example, targeting children of current accountholders as potential new customers).

Stakeholder Consultation

Investors: None of the investors who provided feedback on metric FN0101-01 found it decision-useful, and all suggested dropping it. The metric on number and value of no-cost accounts was suggested by investors as decision-useful and commonly considered for the financial inclusion topic by financial analysts. The SASB further received feedback from multiple investors indicating decision-usefulness of the metric if provided with appropriate technical guidance highlighting the focus on financial inclusion.

Issuers: A number of large U.S.-listed commercial banks stated that the provisional metric is not a fair representation of performance on the disclosure topic. On the other hand, issuer feedback confirmed that no-cost accounts are commonly used to measure access to finance. Issuers stated that such metrics are disclosed by many companies in various SEC filings and ESG reports.

Benefits

Improves the SASB standard: The proposed revised metric will improve the quality of the information generated by the standard by offering investors a more representative view of issuer performance on the topic.

Improves cost-effectiveness: The proposed metric is currently measured and reported by some issuers. Alignment with existent disclosure improves cost-effectiveness of the standard, allowing issuers to collect and report data through existent channels.

Improves decision-usefulness: Feedback from investors suggests that the proposed metric would be a direct measure of financial inclusion, as no-cost accounts provide decision-useful information on companies' management of the level of access to their services.

Proposed Update #2-2 – **Industry:** Commercial Banks; **Topic Name:** Financial Inclusion & Capacity Building

2017 Technical Agenda Item #2-2 Description

SASB is evaluating the revision of metrics FN0101-02⁵ and FN0101-04⁶ to ensure the alignment, decision-usefulness, and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Revise Metrics

The SASB proposes to remove metrics:

- FN0101-02 Percentage of total domestic loans for underserved and underbanked business segments
- FN0101-04 Loan-to-deposit ratio for: (1) Overall domestic lending (2) Underserved and underbanked business segments

and replace them with metric:

- (1) Number and (2) amount of loans outstanding qualified to programs designed to promote small business and community development

Adherence to Criteria for Accounting Metrics

The current Commercial Banks SASB industry standard includes a topic Financial Inclusion & Capacity Building with associated metrics to describe how commercial banks enhance shareholder value through efforts to expand inclusion and build capacity through financial literacy initiatives as well as building a loan portfolio focused on community development. The proposed revised metric is intended to measure the size of lending focused on financial inclusion and community development. The proposed metric would replace two provisional metrics FN0101-02 and FN0101-04. While both provisional metrics are relevant, the proposed change would improve several criteria for metric selection from the *SASB Conceptual Framework* to improve decision-usefulness of information provided to investors. The technical protocol of the provisional metric FN0101-02 does not appropriately define the scope, as it groups overlapping loan categories that would prevent the data being reported in a format that is useful and/or verifiable. SASB further proposes to replace the focus on “underserved” and “underbanked” customers in the provisional metrics with references to clearly defined regulatory programs aimed to incentivize financial inclusion. Referencing these regulatory frameworks as the basis for computation of the proposed metric will improve their alignment with existing reporting requirements. Further, the proposed revision from ratios to absolute number and value of loans will improve usefulness of the metric as individual underlying elements of ratio calculation would be decision-useful to analyze. Activity metrics and/or data reported by companies in their financial filings would allow analysts to calculate ratios.

Supporting Analysis

The loan-to-deposit ratio for an overall portfolio can be currently derived from data reported on a commercial bank’s GAAP financial statements. When combined with currently reported GAAP metrics, the proposed revised metric would allow investors to calculate relevant ratios to understand company performance on the topic. Therefore, the

⁵ FN0101-02: Percentage of total domestic loans for underserved and underbanked business segments

⁶ FN0101-04: Loan-to-deposit ratio for: (1) Overall domestic lending (2) Underserved and underbanked business segments

SASB proposes to measure the number and value of applicable loans, which will improve the usefulness of the metric and its relevance to the financial inclusion issue.

The Community Reinvestment Act (CRA), which is a United States federal law enacted by the Congress in 1977 and enforced by the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision, states that “regulated financial institutions have continuing and affirmative obligations to help meet the credit needs of the local communities in which they are chartered.” Banks mention these requirements in their filings with the SEC. Institutions with at least \$1.2 billion in assets must collect and report data associated with CRA compliance. Data from Bloomberg Professional Services show that 95 percent of publicly listed companies in the industry are subject to the reporting requirements associated with the CRA. Analysis of SEC filings shows that more than 20 publicly listed large- and mid-cap commercial banks discuss the CRA and community lending in their annual reports.

The revision addresses multiple criteria for accounting metrics as outlined in the *SASB Conceptual Framework*. First, the proposed metric is closely aligned with the requirements of the CRA and covers the majority of registrants. Second, the proposed metric aligns both the scope of reporting and calculation methodology with the framework, which improves comparability and verifiability of reported data.

Performance on the proposed metric has a direct link to financial performance. For example, resultant disclosures could allow analysts to measure revenue growth opportunities from expanding to underserved communities. The metric would further be an indicator of regulatory compliance, as the vast majority of banks are subject to satisfying CRA performance requirements. Noncompliance with the CRA would prevent banks from expanding their operations. Therefore, the data generated by the SASB metric would be useful to both issuers and investors.

Stakeholder Consultation

Investors: Feedback from investors indicated that the number and value of deposits is unlikely to be a relevant measure of performance of financial inclusion and therefore unlikely to be decision-useful for financial analysis. Multiple investors that provided feedback on this topic stated that when they analyze companies’ management of financial inclusion in the Commercial Banks industry they focus on lending practices and specifically the amount of CRA lending.

Issuers: Issuers unanimously suggested changing the terminology from lending to “underserved” and “underbanked” consumers to lending as measured by categories recognized by the CRA. Issuer feedback indicated that the change would significantly improve cost-effectiveness of reporting because companies already collect this data per existing regulatory requirements.

Benefits

Improves the SASB standard: The proposed change improves materiality of the information generated by the standard, as the new metric is focused on the most relevant aspect of the topic, which is lending practices that promote financial inclusion.

Improves cost-effectiveness: SASB analysis of SEC filings suggests that the vast majority of commercial banks currently state in their SEC filings that they are required to collect and report the amount of originated CRA-qualified loans to regulators. Therefore, the change would align the disclosure with an existing regulatory framework and allow issuers to utilize existing channels for collection and reporting of this data.

Improves decision-usefulness: Performance on the proposed metric (both an absolute value and the change over time) can be converted to the financial performance of a commercial bank. The updated metric would provide decision-useful information in that it measures the magnitude of performance and financial impact through the number and value of loans and highlights the level of compliance with evolving CRA requirements.

Proposed Update #2-3 – **Industry:** Commercial Banks; **Topic Name:** Financial Inclusion & Capacity Building

2017 Technical Agenda Item #2-3 Description

SASB is evaluating the revision of metric FN0101-05⁷ to ensure the alignment, decision-usefulness, and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Revise Metric

The SASB proposes to remove metric:

- FN0101-05 Loan default rates for: (1) Overall domestic lending (2) Underserved and underbanked business segments

and replace it with metric:

- (1) Number and (2) amount of past due and nonaccrual loans qualified to programs designed to promote small business and community development

Adherence to Criteria for Accounting Metrics

The current Commercial Banks SASB industry includes the topic “Financial Inclusion & Capacity Building” with associated metrics to describe how commercial banks enhance shareholder value through efforts to expand inclusion and build capacity through financial literacy initiatives and building loan portfolios focused on community development. The proposed revised metric is intended to measure the performance of loans focused on financial inclusion and community development by indicating the number and amount of loans past due and on nonaccrual. The metric is also meant to be an indicator of origination practices, specifically aggressive and predatory lending practices. Combined with the metric proposed in Proposed Item #2-2, the proposed revision provides a complete picture of a company’s community development strategy.

The proposed metric would replace the provisional metric FN0101-05. While the provisional metric is relevant, the proposed change would improve several criteria for metric selection from the *SASB Conceptual Framework* to improve decision-usefulness of information provided to investors. The technical protocol of the provisional metric FN0101-05 uses insufficiently clear definitions of “underserved” and “underbanked” customers. SASB proposes to update the technical protocol with references to regulatory programs that aim to incentivize financial inclusion. Referencing these regulatory frameworks as the basis for computation of the proposed metric will improve its alignment with existing reporting requirements. Further, the SASB proposes to replace the potentially subjective term of “default rates” and the calculation provided by the SASB with terms and instructions included in the Consolidated Reports of Condition and Income (Call Reports). The change improves verifiability and comparability of the metric.

Supporting Analysis

The data associated with the existing, provisional metric—including overall default rates—can be calculated from data reported on financial statements and are not relevant to the topic of Financial Inclusion & Capacity Building. By focusing the proposed revised metric on performance on loans qualified to programs designed to promote small

⁷ FN0101-05: Loan default rates for: (1) Overall domestic lending (2) Underserved and underbanked business segments

business and community development, the revised standard will generate information that is more relevant to company performance on the “Financial Inclusion & Capacity Building” topic.

The CRA states that, “regulated financial institutions have continuing and affirmative obligations to help meet the credit needs of the local communities in which they are chartered.” Banks mention these requirements in their filings with the SEC. Institutions with at least \$1.2 billion in assets must collect and report data associated with CRA compliance. Data from Bloomberg Professional Services shows that over 95 percent of publicly listed companies in the industry are subject to the reporting requirements associated with the CRA. Analysis of SEC filings shows that more than 20 publicly listed large- and mid-cap commercial banks discuss the CRA and community lending in their annual reports. Second, the proposed metric aligns both the scope of reporting and the calculation methodology with the framework, which improves comparability and verifiability of reported data.

Performance on the proposed metric has both direct and indirect links to financial performance. Directly, it measures the amount of expected revenue lost due to customers missing loan payments. Indirectly, it could be a forward-looking indicator of risks associated with compliance with the CRA as well as the ability for banks to expand their community development portfolios. Holistically, it would allow analysts to measure the quality of loan origination focused on community development. Therefore, the data generated by the SASB metric would be useful to both issuers and investors.

Stakeholder Consultation

Investors: The metric was found to be a decision-useful measure of performance by investors involved in consultation.

Issuers: The SASB did not receive specific comments on the proposed change to metric FN0101-05 from issuers. Nevertheless, based on the feedback received on Proposed Item #2-2, the update to Proposed Item #2-3 is logical and appropriate to align with the criteria in the *SASB Conceptual Framework*. Issuers found the proposed metric to be decision-useful and cost-effective.

Benefits

Improves the SASB standard: The provisional metric was asking for the default rate of the overall lending portfolio, which is not a relevant indicator for the disclosure topic. The proposed metric is meant to measure performance of only a subset of loans that are relevant to financial inclusion and capacity building of banks.

Aligns with other metrics: The change would align the format of the default rates metric with the format in which loans qualified to programs designed to promote financial inclusion are proposed to be reported. The technical protocol of the proposed metric is aligned with that of the metric proposed in Proposed Item #2-2, which allows a direct assessment of the quality of loan origination covered in Proposed Item #2-2.

Improves decision-usefulness: The metric would improve decision-usefulness of disclosed information on the metric proposed in Proposed Item #2-2 (Number and amount of loans outstanding qualified to programs designed to promote small-business and community development). It would allow analysts to assess the quality of loans originated and determine whether long-term sustainability of business was taken into account at origination or whether aggressive lending practices were employed to boost short-term interest income.

Proposed Update #2-4 – **Industry:** Commercial Banks; **Topic Name:** Customer Privacy & Data Security

2017 Technical Agenda Item #2-4 Description

SASB is evaluating revisions to the topic, including the corresponding metrics FN0101-06⁸ and FN0101-07,⁹ due to its potential to affect corporate value, relevance across the industry, and level of investor interest.

Summary of Change – Revise Topic Name

The SASB proposes to rename the provisional disclosure topic from “Customer Privacy & Data Security” to “Data Security,” while retaining existent metrics FN0101-06 “Number of data security breaches and percentage involving customers’ personally identifiable information” (separately proposed to be revised in the Proposed Item #2-5) and FN0101-07 “Discussion of management approach to identifying and addressing vulnerabilities and threats to data security”, with minor changes to the technical protocols to improve their internal alignment with other SASB standards.

Rationale

The issue of customer privacy relates to the use of identifiable personal information for secondary purposes, internally or externally, by sharing it with affiliates and/or non-affiliates. Research conducted after the release of the provisional standards indicated that customer privacy is likely not material to companies in the Commercial Banks industry. This is because the scope of commercial banking activities addressed by the SASB standard includes issuing loans to and accepting deposits from institutions and individuals. Customer privacy refers to the responsible use of customer data. The SASB’s analysis, supported by feedback received from several large commercial banks, suggested that companies involved in providing bank accounts and loans to customers do not use proprietary client information for secondary marketing purposes. Therefore, few customer privacy risks are associated with commercial banking activities (as opposed to, for example, credit and pre-paid debit card activities addressed by SASB’s Consumer Finance standard).

On the other hand, evidence suggests that data security may represent a material risk to the operations of commercial banks. The industry ranks as one of the highest based on the average annualized cost of cybercrimes and abnormal churn rates.¹⁰

Companies in the industry allocate significant operating budgets to cybersecurity: “According to Homeland Security Research’s ‘U.S. Financial Services: Cybersecurity Systems & Services Market’ report, the U.S. financial institution[s]’ cybersecurity market is the largest and fastest growing in the private sector, predicted to grow to \$68 billion by 2020. [Four of the largest integrated banks] spend a collective \$1.5 billion on cybersecurity annually.”¹¹

Stakeholder Consultation

Issuers: Feedback from several large-cap issuers operating in both the Consumer Finance and Commercial Banks industries indicated that the topic was not relevant to the commercial banking segment. Companies stated that the

⁸ FN0101-06: Number of data security breaches and percentage involving customers’ personally identifiable information

⁹ FN0101-07: Discussion of management approach to identifying and addressing vulnerabilities and threats to data security

¹⁰ “2016 Cost of Cyber Crime Study & the Risk of Business Innovation,” Ponemon Institute, modified October 2016, accessed August 29, 2017, <https://www.ponemon.org/local/upload/file/2016%20HPE%20CCC%20GLOBAL%20REPORT%20FINAL%203.pdf>.

¹¹ “2016 Financial Industry Cybersecurity Report,” Security Scorecard R&D Department, modified August 2016, accessed August 29, 2017, https://cdn2.hubspot.net/hubfs/533449/SecurityScorecard_2016_Financial_Report.pdf.

use of identifiable customer information for secondary purposes may present material risks only in the credit card segment, which is addressed in the Consumer Finance industry.

Investors: All of the investors who provided feedback on the topic indicated that customer privacy is unlikely to be material and is currently not taken into consideration in their investment analysis of commercial banks.

Benefits

Improves the SASB standard: The proposed SASB standard improves materiality of the information generated by the standard by focusing only on relevant and applicable elements of disclosure.

Proposed Update #2-5 – **Industry:** Commercial Banks; **Topic Name:** Customer Privacy & Data Security

2017 Technical Agenda Item #2-5 Description

SASB is evaluating the revision of metric FN0101-06¹² to ensure the relevance and decision-usefulness of the metrics associated with the topic.

Summary of Change – Revise Metric

The SASB proposes revising provisional metric FN0101-06 from “Number of data security breaches and percentage involving customers’ personally identifiable information” to “Number of data security breaches, percentage involving customers’ personally identifiable information (PII), number of customers affected.”

Adherence to Criteria for Accounting Metrics

The Commercial Banks industry provisional standard includes a topic, Customer Privacy & Data Security, with associated metrics that describe a company’s management of risks related to the storage and protection of its users’ sensitive data. The provisional metric is ambiguous in terms of what data are being asked for. Specifically, the technical protocol of the provisional metric does not satisfy two technical protocol attributes, including measurability and completeness. The proposed revision will eliminate ambiguity regarding what data are being asked for by clarifying that the number of unique data security breaches shall be disclosed, thereby improving the measurability and completeness of the metric. Furthermore, the proposed revised metric will provide more useful information by including the number of customers affected by such data security breaches—a critical element to understanding the magnitude of breaches. The proposed metric benefits from being more aligned with current corporate disclosures on the topic than the current metric. Overall, the proposed metric will better accomplish the core objectives of the standard by clarifying that the number of unique incidents is to be disclosed, which improves the measurability and completeness of the associated technical protocol, as well as the inclusion of the number of customers affected by such incidents, which will improve the usefulness of the metric.

Supporting Analysis

The technical protocol associated with the provisional metric does not satisfy the measurability and completeness attributes of a technical protocol, as it does not specify what is intended to be measured by “number of data security breaches.” This may include number of unique instances of breaches, or it may include the number of exposed customer records. For example, if a company faced two cyberattacks during the reporting period, with one exposing 200,000 customer records, and another exposing 50,000 customer records, the provisional metric is unclear as to whether the company would report this as “2” or “250,000.” Evidence shows that both the number of incidents and the number of customers affected are useful data points for understanding the frequency and magnitude of data security breaches.

Furthermore, an analysis of corporate disclosures demonstrates that, broadly speaking, this structure of disclosure that includes the number of incidents and the number of customers affected is a best practice for corporate disclosures. For example, after their own major breaches, some of the largest publicly listed companies¹³ in the Financials and

¹² FN0101-06: Number of data security breaches and percentage involving customers’ personally identifiable information

¹³ Brad Arkin, “Important Customer Security Announcement,” Adobe, October 3, 2013, accessed August 8, 2017, <https://blogs.adobe.com/conversations/2013/10/important-customer-security-announcement.html>.

Technology & Communications sectors revealed, for the respective incidents, the number of accounts affected. In greater detail, one company's public disclosure after a data breach that came to light in 2016 provides an illustrative example of the alignment of the proposed change with current corporate disclosures on the topic. In 2016, the company disclosed an unauthorized data breach associated with more than one billion user accounts, the largest known data breach to date. The firm's disclosure distinguished between unique incidents and number of records compromised, consistent with the proposed metric.¹⁴

Stakeholder Consultation

Investors: Many investors across multiple industries and sectors consistently communicated during the SASB's consultation period that clarification of this metric was necessary—and there was strong agreement for the proposed metric.

Issuers: Multiple issuers voiced confusion over the wording of the metric in its current version and communicated that it needed to be clarified in a manner similar to the proposed revision.

Benefits

Improves the SASB standard: The proposed revision will enhance the standardization of the metric by improving the measurability and the completeness of the technical protocol.

Improves decision-usefulness: The proposed revision will generate more useful information, given that both the number of unique cybersecurity data breaches and the number of customers affected are important elements needed to better understand corporate performance on the topic.

¹³ Tanya Agrawal, David Henry, and Jim Finkle, "JPMorgan Hack Exposed Data of 83 Million, Among Biggest Breaches in History," *Reuters*, October 2, 2014, <https://www.reuters.com/article/us-jpmorgan-cybersecurity-idUSKCN0HR23T20141003>; Cory Scott, "Protecting Our Members," LinkedIn, May 18, 2016, accessed August 8, 2017, <https://blog.linkedin.com/2016/05/18/protecting-our-members>; Keir Thomas, "Citigroup Hack Nabs Data from 210K Customers," *PCWorld*, June 9, 2011, accessed August 8, 2017, http://www.pcworld.com/article/229891/Citigroup_Hack_Nets_Over_200k_in_Stolen_Customer_Details.html; "Yahoo Security Notice December 14, 2016," Yahoo, December 14, 2016, accessed July 24, 2017, <https://help.yahoo.com/kb/SLN27925.html>.

¹⁴ Ibid.

Proposed Update #2-6 – **Industry:** Commercial Banks; **Topic Name:** Management of the Legal & Regulatory Environment

2017 Technical Agenda Item #2-6 Description

SASB is evaluating the revision of metric FN0101-08¹⁵ to ensure the relevance and decision-usefulness of the metrics associated with the topic.

Summary of Change – Add Metric and Revise Metric

The SASB proposes splitting metric:

- FN0101-08 Amount of legal and regulatory fines and settlements associated with financial industry regulation and percentage that resulted from whistleblowing actions

into its quantitative and qualitative components:

- Total amount of losses as a result of legal proceedings associated with fraud, anti-trust, anti-competitive, market manipulation, malpractice or other industry regulations

with a new metric subsequently created to capture whistleblower policies:

- Description of whistleblower policies and procedures

Adherence to Criteria for Accounting Metrics

The Commercial Banks industry provisional standard includes a topic, Management of the Legal & Regulatory Environment, which focuses on a company's management of risks related to the banking industry's legal and regulatory environment. Specifically, the topic and two associated quantitative metrics provide information to help analysts assess a company's internal control policies to prevent tax evasion, fraud, money laundering, and corruption. The provisional metric FN0101-08 currently measures the amount of legal and regulatory fines and settlements that resulted from whistleblowing actions. The current metric is unlikely to provide a fair representation and complete view of the topic and a company's efforts and abilities to institute a successful whistleblower program, which limits its decision-usefulness. The revision of the existing metric will eliminate the need to disclose the percentage of fines and settlements stemming from whistleblowers. To more adequately capture the nature of a company's whistleblower programs, the SASB proposes adding a qualitative metric that will facilitate disclosure of the unique characteristics of a company's whistleblower policies and practices in a more holistic manner. In tandem, both metrics would fairly represent the topic and improve the completeness of the standard.

Supporting Analysis

The provisional metric does not provide a complete picture of a company's whistleblower programs, which may reduce the decision-usefulness of the current provisional metric. During the consultation period (see Stakeholder Consultation), SASB received feedback noting that reporting on the issue generally includes the amount of fines and settlements related to violations of financial industry regulations plus a stand-alone discussion of whistleblower policies. This was confirmed by an analysis of current disclosure practices in SEC filings. As a set, the pair of proposed

¹⁵ FN0101-08: Amount of legal and regulatory fines and settlements associated with financial industry regulation and percentage that resulted from whistleblowing actions

metrics are more useful in measuring a company's performance on the topic because they provide a mix of quantitative and qualitative information, which is a characteristic that the provisional metric currently lacks. Reporting on the share of fines resulting from whistleblower action does not necessarily highlight the quality of a company's whistleblower policies. "For example," notes a report from Harvard Law, "Elements of an Effective Whistleblower Hotline," "a high volume of calls to a company's hotline (as compared to peers and its industry) may indicate that the company is experiencing significant compliance issues and potentially has an ineffective compliance and ethics program. Conversely, a high volume of hotline calls may suggest that the hotline is working as planned, that the company's compliance and ethics employee training program *is* effective, that there is greater awareness of the hotline and increased trust in the company's compliance department."¹⁶ The split of the metrics would consequently improve completeness of the metric by allowing investors to understand better the extent to which the volume of whistleblowing-related fines may be influenced by the registrant's policies regarding whistleblowing. The split improves the SASB criteria for fair representation and usefulness by making the links between whistleblowing policies and related fines clearer.

Stakeholder Consultation

Investors & others: A limited number of investors provided feedback on the proposed change. Nevertheless, those who did unanimously stated that the breakdown of regulatory fines and settlements resulting from whistleblowing actions is unlikely to yield additional decision-useful information, and is therefore unnecessary. Alternatively, these analysts and one subject matter expert recommended including a discussion of a company's whistleblower policies. This is because combined with other metrics proposed by SASB for this topic, it would provide a holistic view of the company's performance. Based on feedback from analysts, the share of fines resulting from whistleblower action does not necessarily highlight the quality of a company's whistleblower policies.

Issuers: Five of the largest issuers in the industry by market capitalization also suggested changing the metric and including a qualitative discussion and analysis on any whistleblower policies and procedures a company has.

Benefits

Improves decision-usefulness: Splitting the current provisional metric into two different metrics will improve the decision-usefulness of disclosure by providing a mix of quantitative and qualitative information. The quantitative metric on fines and settlements provides an indication of past performance on the topic, while a stand-alone qualitative discussion of whistleblower policies and practices sheds light on a company's unique whistleblower programs. In tandem, and compared to the previous requirement to report on the percentage of fines and settlements resulting from whistleblowing actions, both metrics fairly represent performance on the topic.

¹⁶ Bill Libit, Walt Draney, and Todd Freier, "Elements of an Effective Whistleblower Hotline," *Harvard Law School Forum on Corporate Governance and Financial Regulation*, October 25, 2014, accessed September 15, 2017, <https://corpgov.law.harvard.edu/2014/10/25/elements-of-an-effective-whistleblower-hotline/>.

Proposed Update #2-7 – **Industry:** Commercial Banks; **Topic Name:** Management of the Legal & Regulatory Environment

2017 Technical Agenda Item #2-7 Description

SASB is evaluating the revision of metric FN0101-09¹⁷ to ensure the relevance, decision-usefulness, and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Remove Metric

The SASB proposes to remove metric FN0101-09, “Number of inquiries, complaints, or issues received by the legal and compliance office through an internal monitoring or reporting system, and percentage that were substantiated.”

Adherence to Criteria for Accounting Metrics

The current Commercial Banks industry provisional standard includes a topic, Management of the Legal & Regulatory Environment, which focuses on a company’s management of risks related to the commercial banking industry’s legal and regulatory environment. Specifically, the topic and associated metrics provide information to help analysts assess a company’s internal control policies to prevent tax evasion, fraud, money laundering, and corruption. Other metrics in the topic include disclosure of the amount of legal and regulatory fines incurred that are associated with industry regulation and a description of the registrant’s policies and procedures regarding internal whistleblowing. The provisional metric FN0101-09 currently measures the number of inquiries, complaints, or issues received by the legal and compliance office through an internal monitoring or reporting system, and the percentage that were substantiated. This metric is meant to be an indicator of the effectiveness of a company’s internal compliance controls and a forward-looking proxy for potential violations and subsequent fines and penalties. Nonetheless, as indicated by feedback from issuers, the provisional metric is lacking in comparability if reported, as companies have different types of policies and procedures of internal controls, and therefore the number of inquiries could range significantly and not be indicative of actual performance on the topic. The removal of the metric will therefore retain the decision-usefulness of the disclosures contained in the remaining metrics (please refer to Proposed Item #2-6) on the topic, while reducing the cost burden of reporting and avoiding potential issues of comparability.

Supporting Analysis

The SASB’s analysis of company disclosures did not reveal instances where a company would disclose the number of inquiries, complaints, or issues received by the legal and compliance offices. These findings echo the feedback received from issuers highlighting the issue with the provisional metric FN0101-09 of not being comparable, affecting also its decision-usefulness and appropriateness as a measure of performance.

Stakeholder Consultation

Investors: Several investors stated that the metric would be challenging to interpret in a decision-useful manner.

Issuers: All three large issuers who provided comments on the disclosure topic unanimously expressed concerns with metric FN0101-09. Companies stated that it would not be cost-effective to obtain information comparable across issuers due to the fact that individual companies may have differences in their internal compliance processes. The current metric does not reference a recognized industry framework.

¹⁷ FN0101-09: Number of inquiries, complaints, or issues received by the legal and compliance office through an internal monitoring or reporting system, and percentage that were substantiated

Benefits

Improves the SASB standard: Removal of the metric improves comparability of the remaining set of disclosures. Given that each company has different approaches to internal controls and reporting issues to internal compliance departments, removal of the metric prevents disclosure comparability issues between registrants.

Improves cost-effectiveness: The provisional metric would be very cost-burdensome to standardize to ensure comparability, and therefore its removal improves cost-effectiveness.

Proposed Update #2-8 – **Industry:** Commercial Banks; **Topic Name:** Systemic Risk Management

2017 Technical Agenda Item #2-8 Description

SASB is evaluating the revision of metric FN0101-10¹⁸ to ensure the decision-usefulness and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Revise Metric

The SASB proposes to change metric FN0101-10:

- Results of stress tests under adverse economic scenarios, including the following measures (actual and projection): (1) Loan losses (2) Losses, revenue, and net income before taxes (3) Tier 1 common capital ratio (4) Tier 1 capital ratio (5) Total risk-based capital ratio (6) Tier 1 leverage ratio

to metric:

- Discussion of how results of mandatory and voluntary stress tests are integrated into capital adequacy planning, long-term corporate strategy, and other business activities

Adherence to Criteria for Accounting Metrics

The current Commercial Banks industry provisional standard includes a topic, Systemic Risk Management, which is focused on a financial institution's capacity to operate after economic shocks and the degree to which its operations may affect other companies and the broader economy. The need to preserve capital due to regulatory requirements means that any decisions on how to deploy the firm's financial capabilities should be carefully weighed against capital requirements. The provisional metric FN0101-10 includes reporting on results of regulatory stress tests under adverse economic scenarios using several actual and projected quantitative indicators. As these data are currently already disclosed in detail, the SASB disclosure is unlikely to add value to the total mix of information provided to investors. The proposed metric is meant to help analysts assess the alignment of performance on regulatory metrics with the company's long-term sustainability strategy by providing a discussion of how the stress tests drive corporate strategy and other business decisions. In particular, a discussion of how the integration of ESG factors in stress testing and the influence of stress test results on a company's ESG strategy (see Technical Protocol), provides information that can be decision-useful and is currently not disclosed.

Supporting Analysis

The "Dodd-Frank Act Stress Test: Supervisory Stress Test Methodology and Results" reports are published by the Federal Reserve, with the latest round consisting of 33 bank holding companies.¹⁹ The reports provide comparison tables with results for covered financial institutions on applicable Dodd-Frank metrics. The number of metrics disclosed in these reports is higher than that in the current metric FN0101-10. In Proposed Item #2-9, the SASB proposes to include a quantitative metric on registrants' Global Systemically Important Bank (G-SIB) score that provides a complete set of quantitative data points relevant to the topic. The G-SIB score, calculated with inputs collected by regulators in

¹⁸ FN0101-10: Results of stress tests under adverse economic scenarios, including the following measures (actual and projection): (1) Loan losses (2) Losses, revenue, and net income before taxes (3) Tier 1 common capital ratio (4) Tier 1 capital ratio (5) Total risk-based capital ratio (6) Tier 1 leverage ratio

¹⁹ "Dodd-Frank Act Stress Test 2016: Supervisory Stress Test Methodology and Results," Board of Governors of the Federal Reserve System, June 2016, accessed August 29, 2017, <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20160623a1.pdf>.

G-20 countries, assesses the systemic risk a financial institution poses through a composite of several metrics. As such, the proposed metric adds to the completeness of the SASB standard.

The proposed change to a qualitative discussion would be valuable to investors to understand how quantitative performance on regulatory metrics relates to companies' management of the material sustainability issue addressed in the SASB standard. Further, discussion of how ESG factors inform the quantitative and qualitative aspects of the stress tests' modeling and analysis, as well as how the stress test results inform its approach with respect to its ESG strategy, provides useful information to both issuers and investors. Such discussion ties back the regulatory and financial aspects of the topic to its sustainability aspects, improving the completeness of the standard.

Stakeholder Consultation

Investors: Feedback from multiple investors suggests that the amount of information related to results of stress tests, and the systemic risk in general, available through the Federal Reserve report, the Pillar 3 reports under Basel III, and other sources is sufficient to make informed investment decisions. Analysts suggest not to restate results of stress tests in the standard but rather to provide discussion of a long-term strategy to adapt to an evolving regulatory environment and to absorb shocks arising from financial and economic stress.

Issuers: All issuers support the change from results of SASB-specific stress tests to qualitative discussion and analysis. Issuers stated that the existent amount of quantitative data reported satisfy regulatory requirements and investor demand on the topic. As supported by feedback, the current amount of disclosure with respect to stress tests is sufficient and the provisional metric does not contribute to the completeness of information. Therefore, duplicating such disclosure would not be beneficial.

Benefits

Improves the SASB standard: Duplicating results of the stress tests, in this specific case, would not provide additional value to investors. The data investors can obtain from regulatory filings on results of stress tests is already complete and sufficient to make informed decisions. The proposed metric is likely to add value to the total mix of information rather than be duplicative. It allows companies to tie their regulatory performance with the sustainability topic that is found to be material for the industry.

Improves cost-effectiveness: By reducing the amount of data required from companies, SASB improves cost-effectiveness of the standard.

Improves decision-usefulness: As indicated by feedback from investors, discussion of companies' strategy would provide more additional decision-useful information than results of stress tests.

Proposed Update #2-9 – **Industry:** Commercial Banks; **Topic Name:** Systemic Risk Management

2017 Technical Agenda Item #2-9 Description

SASB is evaluating the revision of metrics FN0101-11,²⁰ FN0101-12,²¹ FN0101-13,²² and FN0101-14²³ to ensure the alignment, decision-usefulness, and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Revise Metrics

The SASB proposes removing the following provisional metrics:

- FN0101-11 – Basel III Liquidity Coverage Ratio (LCR)
- FN0101-12 – Net exposure to written credit derivatives
- FN0101-13 – Level 3 assets: (1) total value and (2) percentage of total assets
- FN0101-14 – Skewness and kurtosis of trading revenue

and replacing them with a new metric:

- Global Systemically Important Bank (G-SIB) score by category

Adherence to Criteria for Accounting Metrics

The Commercial Banks industry provisional standard includes a topic, Systemic Risk Management, which describes a financial institution’s capacity to operate after economic shocks and the degree to which its operations may affect other companies and the broader economy.

The provisional metrics FN0101-11, FN0101-12, FN0101-13, and FN0101-14 include some, but not all, of the measures of systemic risk normally disclosed in regulatory stress test results. Consequently, they are insufficiently complete, according to the criteria for accounting metrics established in the *SASB Conceptual Framework*.

The SASB proposes to replace the aforementioned provisional metrics with one metric measuring Global Systemically Important Bank (G-SIB) score. The change would improve the completeness of the metrics associated with the topic while fairly representing a company’s performance, as it encompasses a broader view of systemic risk that can be condensed into a single indicator, rather than the multiple measures included in the provisional standard. It also would add to the comparability and alignment of the metrics associated with the topic, as data for the G-SIB score are calculated using standardized methodology and already collected by most industry participants and reported to regulators.

Supporting Analysis

The provisional metrics represent only individual elements of the relevant information investors need to assess a company’s performance on the topic. The replacement metric is meant to measure how a company manages its capital requirements and whether it is well positioned to absorb shocks arising from financial and economic stress. The G-SIB score is a measure of the degree to which a bank may pose a risk to the financial system. By measuring a bank’s

²⁰ FN0101-11: Basel III Liquidity Coverage Ratio (LCR)

²¹ FN0101-12: Net exposure to written credit derivatives

²² FN0101-13: Level 3 assets: (1) total value and (2) percentage of total assets

²³ FN0101-14: Skewness and kurtosis of trading revenue

relative score in five major categories (size, interconnectedness, complexity, cross-jurisdictional activity, and substitutability), the metric accounts for different factors that gauge the systemic risk that the institution poses. The data are already disclosed to national regulators and made public for most of the U.S.'s larger institutions, along with similar standards existing in other jurisdictions. By using a single metric, the proposed change would improve the completeness of data provided to investors while fairly representing performance on the topic. Banks with over \$50 billion in assets are required to collect and report the data underlying the calculation of G-SIB scores. The methodology for calculating the scores for each category takes into account performance on the provisional SASB metrics being replaced, as well as other applicable indicators that address the scope of the issue holistically.

G-SIB scores are calculated based on a global methodology that would ensure comparability and alignment of the SASB metric. The data used to calculate G-SIB scores, the methodology, and the scores themselves are publicly available on the Office of Financial Research's [website](#). Further, companies have established frameworks for collecting and reporting the underlying data, which makes reporting the proposed metric cost-effective.

Stakeholder Consultation

Investors: Multiple investors stated that the provisional metrics are relevant, but represent only a subset of all the relevant indicators. Therefore, the provisional metrics are not complete in measuring performance on the issue. Investor feedback indicated that the provisional metrics seemed to be chosen at random from the list of all metrics regulated under Dodd-Frank and Basel III. Analysts suggested either to go broader with metrics or not to duplicate measures at all. The G-SIB metric was recommended by one investor as the most decision-useful measure of systemic risk combined into a concise measure.

Issuers: The SASB did not receive feedback from issuers specifically related to the usefulness of the proposed metric.

Others: Subject matter experts confirmed the decision-usefulness and relevance of the G-SIB metric and its breakdown by five categories.

Benefits

Improves decision-usefulness: The G-SIB metric satisfies the SASB's goal of providing a minimal set of decision-useful metrics. The G-SIB sub-scores, such as interconnectedness, complexity, and substitutability, incorporate all the elements of the topic the SASB considers to be relevant from the sustainability point of view. As such, the revision improves the ability of the metrics associated with the topic to provide a complete and fair representation of performance in a way that is comparable among peers and aligned with industry practices.

Improves cost-effectiveness: By providing alignment with an existing methodology used by industry companies, the proposed metric would be more cost-effective to report.

Proposed Update #2-10 – **Industry:** Commercial Banks; **Topic Name:** Integration of Environmental, Social, and Governance Risk Factors in Credit Risk Analysis

2017 Technical Agenda Item #2-10 Description

SASB is evaluating the removal of metric FN0101-17²⁴ to ensure the relevance and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Remove Metric

The SASB proposes removing provisional metric FN0101-17, “Amount and percentage of lending and project finance that employs: (1) Integration of ESG factors (2) Sustainability themed lending or finance (3) Screening (exclusionary, inclusionary, or benchmarked) (4) Impact or community lending or finance.”

Adherence to Criteria for Accounting Metrics

The Commercial Banks industry provisional standard includes a topic, “Integration of Environmental, Social, and Governance Risk Factors in Credit Risk Analysis,” with associated metrics to describe a company’s understanding and management of its exposure to ESG risks and opportunities in its loan portfolio. Specifically, the topic and associated metrics are intended to help analysts assess a company’s approach to integrating ESG factors in credit risk analysis of borrowers at the stage of loan origination and servicing. Provisional metrics FN0101-15 and FN0101-16 capture a company’s approach to ESG integration and management’s view of the company’s ESG exposure. In addition to these qualitative provisional metrics, the metric revision proposed in Proposed Item #2-11 would provide a quantitative measure of ESG exposure by industry. The SASB proposes removing metric FN0101-17, as it is unlikely to provide additional marginal value over the other metrics included in the topic. The provisional metric FN0101-17 quantitatively measures the scope of ESG integration through various strategies such as screening, sustainability-themed lending, or impact and community investing. For these reasons, removal of the provisional metric FN0101-17 improves the applicability of the set of metrics associated with the topic, as well as their ability to present a fair representation of performance on the topic. Further, removal of the provisional metric does not impair the completeness of the metrics set retained in the disclosure topic. Metrics included in the topic provide complete information on a company’s performance to investors.

Supporting Analysis

Research and feedback from issuers and investors suggests that certain elements of metric FN0101-17 are not applicable to commercial banking activities. Specifically, sustainability-themed lending and finance are traditionally included in the investing and lending business segment covered in the Investment Banking & Brokerage industry. Furthermore, community lending and finance are covered in the Financial Inclusion & Capacity Building disclosure topic.

Stakeholder Consultation

Investors: Subject matter experts and analysts noted overlap between the provisional metric and the Financial Inclusion & Capacity Building topic, which also addresses impact and community lending and finance. Their feedback further suggested that sustainability-themed lending and finance are more relevant to the investment and lending business

²⁴ FN0101-17: Amount and percentage of lending and project finance that employs: (1) Integration of ESG factors (2) Sustainability themed lending or finance (3) Screening (exclusionary, inclusionary, or benchmarked) (4) Impact or community lending or finance

segment, which falls under the Investment Banking & Brokerage industry’s activities. No investors providing feedback on the topic found metric FN0101-17 to be relevant or decision-useful for Commercial Banks.

Issuers: Issuers agreed that focusing on a holistic integration of ESG risks in credit risk analysis rather than on various subgroups—such as sustainability-themed lending, screening, and other ESG-marketed portfolios—would “push the envelope” of ESG integration in the right direction. Issuers further agreed that disclosure topics focused on financial inclusion in the Commercial Banks industry and ESG integration in the Investment Banking & Brokerage industry unnecessarily overlapped with the metric, and they therefore suggested removing it from this topic.

Benefits

Improves the SASB standard: Remove the provisional metric, which was not found to be decision-useful by issuers or investors. The proposed update will improve the applicability of the set of metrics associated with the topic, as well as their ability to present a fair representation of performance on the topic.

Improves cost-effectiveness: By removing the provisional metric, the proposed update would improve the cost-effectiveness of disclosure on the topic.

Proposed Update #2-11 – **Industry:** Commercial Banks; **Topic Name:** Integration of Environmental, Social, and Governance Risk Factors in Credit Risk Analysis

2017 Technical Agenda Item #2-11 Description

SASB is evaluating the revision of metric FN0101-18²⁵ to ensure the relevance and decision-usefulness of the metrics associated with the topic.

Summary of Change – Revise Metric

The SASB proposes revising provisional metric FN0101-18 from “Total loans to companies in the following sectors/industries: Energy/Oil & Gas, Materials/Basic Materials, Industrials, and Utilities” to “Commercial and industrial credit exposure by industry.”

Adherence to Criteria for Accounting Metrics

The Commercial Banks industry provisional standard includes a topic, Integration of Environmental, Social, and Governance Risk Factors in Credit Risk Analysis, with four associated metrics to describe a company’s understanding and management of ESG risks and opportunities in its loan portfolio. Specifically, the topic and associated metrics should help analysts assess the company’s approach to integrating ESG risks in credit risk analysis of borrowers at the stage of loan origination and servicing. Provisional qualitative metrics FN0101-15 and FN0101-16 capture the extent of a company’s ESG integration practices and the level of its understanding of ESG exposure. The provisional metric FN0101-18 is proposed to be removed (please refer to Proposed Item #2-10). The provisional metric FN0101-18 measures a bank’s exposure to the most carbon-intensive industries, which therefore highlights concentration of climate-related risk on the loan portfolio. The SASB proposes revising this metric, as exposure to carbon is only one aspect of climate-related risk and climate risk is just one of many ESG factors to which borrowers may be exposed. Therefore, in accordance with the criteria for accounting metrics set forth in the *SASB Conceptual Framework*, the proposed revision would enhance the completeness and neutrality of the information yielded by the set of metrics associated with this topic.

To improve verifiability and comparability of the provisional metric, the SASB proposes to provide a reference to a well-recognized classification system that would be used to classify borrowers. Additionally, the proposed change improves usefulness of the metric by providing a holistic view on ESG risk exposure of borrowers.

Supporting Analysis

In researching and developing sustainability accounting standards for 79 industries, the SASB identified various sustainability issues that are reasonably likely to materially impact the financial condition and operations of companies in each industry of the economy. These sustainability (or ESG) factors range from environmental to human and social capital and beyond, and can impact the risk profile of companies. As debt is considered one of the primary sources of finance, companies transfer some of these risks to the banks from which they obtain loans. Therefore, when making lending decisions, it is important for banks to understand and manage the universe of ESG risks and opportunities to which borrowers may be exposed.

²⁵ FN0101-18: Total loans to companies in the following sectors/industries: Energy/Oil & Gas, Materials/Basic Materials, Industrials, and Utilities

Analysis of corporate disclosures shows that many of the largest companies in the industry, including three of the ten largest integrated banks, report their corporate credit portfolio by industry or sector in Form 10-K. Such information is useful in assessing portfolio exposure to financial and economic risk factors. Combined with the other metrics related to this topic, the industry exposure metric would further yield information useful to assessing the ESG exposure of borrowers.

However, current disclosure of portfolio exposure by industry is not standardized. For example, issuers do not disclose the systems used to classify borrowers into one industry versus another. Companies may also report their exposure at various levels (e.g., sector versus industry versus sub-industry), further hindering comparability. To address this issue, the SASB references a well-recognized classification system in the guidance for the proposed metric. This approach improves the verifiability and comparability of the SASB metric.

Stakeholder Consultation

Investors: Investors generally recommended that metrics for this topic reflect a more holistic approach to ESG integration rather than a focus on specific risks (e.g., climate). All analysts that provided feedback on this metric found it helpful and would like to see companies report credit portfolio exposure in a standardized manner. Along with qualitative discussion of ESG risks and strategies companies employ to account for the risks when they issue loans to borrowers, this metric would provide them with a holistic picture of ESG credit risk on banks' books.

Issuers: Several large-cap issuers stated that providing a breakdown by industry rather than explicitly asking for exposure to energy-related industries is more appropriate. Otherwise, the SASB would be making a judgment as to what industries are exposed to more ESG risks. Issuers stated that banks do track borrower industry exposure at originations that would not create a significant cost in collecting and reporting the data. During the SASB's consultation period, issuers confirmed that there is a lack of comparability and recommended that the SASB identify a well-recognized classification system to be referenced in the technical protocol. Issuers also stated that the banking industry as a whole, as well as investors, would benefit from a standardized approach to reporting on ESG integration in credit risk analysis.

Benefits

Improves the SASB standard: The proposed revision improves the standard by shifting its focus from only a subset of ESG risks to a more holistic approach to analyzing credit risks associated with sustainability factors. The proposal addresses completeness, neutrality, and usefulness of SASB metrics.

Improves decision-usefulness: As highlighted by the feedback received from investors, the overall industry-level exposure provides decision-useful information that allows for a more holistic investment analysis than exposure to only a small subset of industries and related ESG risks.

Proposed Update #2-12 – **Industry:** Commercial Banks; **Topic Name:** Activity Metrics

2017 Technical Agenda Item #2-12 Description

The SASB proposes to include activity metrics for the Commercial Banks industry.

Summary of Change – Add Activity Metrics

The SASB proposes adding the following activity metrics:

- (1) Number and (2) value of checking and savings accounts by segment: (a) personal and (b) small business
- (1) Number and (2) value of loans by segment: (a) personal, (b) small business, and (c) corporate

Note: Mortgage loans as well as revolving credit loans would be excluded from the scope of disclosure as they are addressed in the Mortgage Finance and Consumer Finance industries.

Rationale

The SASB proposes adding activity metrics to its standards for industries in the Financials sector, including the Commercial Banks industry. At the time of release of the provisional standards, the SASB had not incorporated the concept of activity metrics into the industry standards. Activity metrics are useful for measuring the scope and scale of a company's operations, providing normalization factors for the performance metrics included in the disclosure topics.

Supporting Analysis

The proposed activity metrics are aligned with information that is commonly disclosed in SEC filings by industry firms. The Bloomberg Professional Services software includes dedicated data fields for number of checking accounts, consumer loans, corporate loans, etc. Aggregate [data by the Federal Reserve](#) show that as of the end of June 2017, deposits represented just below 81 percent of total liabilities on a seasonally adjusted basis. Loans represented 57 percent of the aggregate assets on banks' balance sheets. The SASB analysis of corporate disclosure suggests that value of accounts is commonly reported by banks, unlike the number of accounts, which is only reported by two out of the top five U.S. banks by market capitalization. Similarly, banks report the value of loans originated, but none report the number.

Both number and value of loans are useful indicators, as one or the other activity metric can be used to normalize reported information, depending on the topic and associated accounting metrics. For example, in the case of data security risks, assessing the scope of exposure in terms of the number of individual customer accounts may be a more appropriate indicator of cybersecurity risk than the total value of those accounts.

Stakeholder Consultation

Investors: Consultation on the activity metrics was not a priority for the SASB. Nevertheless, the SASB received feedback from a number of investors (all analysts who commented on the proposed activity metrics) that the proposed activity metrics are relevant, decision-useful, and partially disclosed already.

Issuers: The SASB received feedback from one of the largest integrated banks that the proposed metrics are cost-effective to report as they are aligned with internally collected information and, for the most part, are already disclosed.

Benefits

Improves the SASB standard: Activity metrics provide investors with normalization factors to ensure the comparability of performance metrics across issuers.

Improves decision-usefulness: The proposed metrics improve the decision-usefulness of all quantitative metrics included in the standard by allowing investors to convert them from absolute to relative measures of performance.



FINANCIALS SECTOR

INVESTMENT BANKING & BROKERAGE INDUSTRY

Sustainability Accounting Standard

Sustainable Industry Classification System™ (SICS™) #FN0102

Prepared by the
Sustainability Accounting Standards Board®

October 2017

Proposed Changes to Provisional Standard - Basis for Conclusion

Proposed Update #2-13 – **Industry:** Investment Banking & Brokerage; **Topic Name:** Employee Incentives & Risk Taking

2017 Technical Agenda Item #2-13 Description

SASB is evaluating the revision of metrics FN0102-01,²⁶ FN0102-02,²⁷ FN0102-03²⁸, and FN0102-04²⁹ to ensure the relevance, decision-usefulness, and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Revise Metrics

The SASB proposes removing the following provisional metrics:

- FN0102-01 Discussion of variable compensation policies and practices
- FN0102-03 Percentage of variable compensation that is equity for: (1) executives and (2) all others

The SASB also proposes replacing the following provisional metrics:

- FN0102-02 Percentage of total compensation that is variable for: (1) executives and (2) all others
- FN0102-04 Percentage of employee compensation which includes ex post adjustments for: (1) executives and (2) all others

with these new metrics:

- Percentage of total remuneration that is variable for Material Risk Takers (MRTs)
- Percentage of variable remuneration of Material Risk Takers (MRTs) to which malus or clawback provisions were applied

Adherence to Criteria for Accounting Metrics

The Investment Banking & Brokerage industry provisional standard includes a topic, Employee Incentives & Risk Taking, with associated metrics to describe how incentives embedded in the compensation structure for employees contribute to the overall risk profile of an organization. Structures that focus on the short term are likely to encourage excessive risk taking and present adverse implications for long-term corporate value. Concern over this issue has led to increased regulatory and shareholder scrutiny since the financial crisis. The topic and associated metrics measure the breakdown between fixed and variable remuneration of relevant employees as well as policies around clawback provisions.

The provisional metrics FN0102-02 and FN0102-04 focus on these two aspects, variable remuneration and ex post adjustments. While these provisional metrics are relevant to the disclosure topic, their scope was found to be too broad, covering categories of employees whose work and decisions are unlikely to impact the risk profile of the whole organization. The SASB proposes revising the metric by narrowing the scope of disclosure to employees who are classified as Material Risk Takers (MRTs). This change improves fair representation, usefulness, and completeness of accounting metrics and, therefore, also improves the decision-usefulness of information provided to investors. In defining material risk takers, the SASB references the Commission Delegated Regulation (EU) No 604/2014 of March

²⁶ FN0102-01: Discussion of variable compensation policies and practices

²⁷ FN0102-02: Percentage of total compensation that is variable for: (1) executives and (2) all others

²⁸ FN0102-03: Percentage of variable compensation that is equity for: (1) executives and (2) all others

²⁹ FN0102-04: Percentage of employee compensation which includes ex post adjustments for: (1) executives and (2) all others

4, 2014, supplementing Directive 2013/36/EU of the European Parliament. Reference to the directive improves the alignment of the accounting metrics that also ensures their cost-effectiveness.

The SASB further proposes to remove the provisional metrics FN0102-01 and FN0102-03, which, as highlighted by research and feedback received, are unlikely to provide additional value to the overall disclosure on the topic. The discussion of variable remuneration policies and practices required by the technical protocol of the updated metric FN0102-02 would eliminate the need for a stand-alone discussion metric. Meanwhile, the share of variable remuneration that is equity, as suggested by analysts, may not provide valuable information beyond the fixed versus variable breakdown. Feedback suggested the proposed set of metrics would be complete, satisfying the criteria for accounting metrics established in the *SASB Conceptual Framework*.

Supporting Analysis

Analysis of disclosure in the SEC filings of companies in the industry shows that when large financial institutions discuss how employee incentives impact riskiness of the firm, they do it in the context of employees classified as MRTs, often described in SEC filings as “employees who, as part of their role or function, can take or influence risk that is material to a business unit or Firm.” This finding supports the proposal to adopt a more narrowly defined scope of disclosure. Investment banks may employ a significant number of support staff and other categories of employees whose daily work does not include making material decisions that may impact riskiness of the organization. Therefore, a clearer definition of the scope of disclosure proposed by the SASB addresses these concerns and enhances the fair representation criterion of the accounting metric. Disclosure analysis on the Bloomberg Professional Service shows a significant number of large, publicly listed banks, primarily those with operations in the E.U., that report the incentive compensation structure for their MRTs.

The definition of MRTs was developed by the European Banking Authority under the Basel III requirements for the variable component of total remuneration of employees. Regulatory Technical Standards (RTS) set out process and criteria for the identification of categories of staff who have a material impact on the institution’s risk profile. For example, according to Deutsche Bank, its “MRTs are identified at a Group level and also at a single legal entity level for significant institutions.”³⁰

The criteria apply globally, as stated in the RTS: “The criteria aim to identify staff whose professional activities have a material impact on the institution’s risk profile, independent of the actual location of the staff member. The criteria, when applied at group level, take into account the scope of consolidation, including subsidiaries and branches in third countries.”³¹

Stakeholder Consultation

Investors: Investors indicated that they would find disclosure on the proposed metric decision-useful and were supportive of limiting the scope of disclosure to MRTs. Feedback suggested that remuneration of key employees, such as MRTs, is particularly important in the Investment Banking industry, as compared to Commercial Banks, Asset Management & Custody Activities, and Consumer Finance. Analysts also agreed that the share of compensation represented by equity is not decision-useful on its own and should be discussed holistically as part of an overall incentives structure.

³⁰ Deutsche Bank, *Annual Report 2016*, pages 215 and 243,

https://annualreport.deutsche-bank.com/2016/ar/servicepages/downloads/files/dbfy2016_entire.pdf.

³¹ European Banking Authority, *EBA Final Draft Regulatory Technical Standards*, December 16, 2013, accessed September 11, 2017,

<https://www.eba.europa.eu/documents/10180/526386/EBA-RTS-2013-11+%28On+identified+staff%29.pdf/c313a671-269b-45be-a748-29e1c772ee0e>.

Issuers: Issuers agreed on the approach of focusing disclosure on MRTs. Companies stated that for operations where a regulatory environment covering material risk takers applies they currently provide disclosure. The proposed metric on clawback provisions was found to be relevant, and many companies said they currently disclose this information in qualitative format.

Benefits

Improves cost-effectiveness: Focusing disclosure on a particular category of employees with clearly defined criteria reduces the burden of collecting and preparing the data.

Improves decision-usefulness: By focusing the metric on MRTs, SASB is likely to provide investors with data that is decision-useful in assessing riskiness of companies in the industry by improving fair representation, usefulness, and alignment criteria for metric selection defined in the *SASB Conceptual Framework*.

Proposed Update #2-14 – **Industry:** Investment Banking & Brokerage; **Topic Name:** Employee Incentives & Risk Taking

2017 Technical Agenda Item #2-14 Description

SASB is evaluating the revision of metric FN0102-05³² to ensure the relevance, decision-usefulness, and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Revise Metrics

The SASB proposes revising provisional metric FN0102-05 from “Number of instances when risk limits were breached and number and percentage by response: (1) position reduced, (2) risk limit temporarily increased, (3) risk limit permanently increased, (4) other” with “Discussion of the company’s policies around supervision, control, and validation of traders’ pricing of Level 3 assets and liabilities.”

Note: The metric would include a note asking issuers to discuss incentive-based compensation of employees responsible for pricing of Level 3 assets and liabilities.

Adherence to Criteria for Accounting Metrics

The Investment Banking & Brokerage industry provisional standard includes a topic, Employee Incentives & Risk Taking, with associated metrics to describe a financial institution’s approach to linking the structure of employee incentives to the firm’s desired level and time horizon of risk taking. Specifically, provisional metric FN0102-05 asks registrants for the number of breaches of trading risk limits and the actions taken to address the breaches. Although the indicator would be helpful to illustrate at what level the bank has been breaching self-determined risk levels and how it resolves those breaches, measures of what constitutes a breach vary significantly among institutions. Therefore, the provisional metric fails to satisfy the comparability and verifiability criteria of accounting metrics. The proposed revision would take a more informative approach to disclosure on the subject by asking firms to describe their policies toward supervision, control, and validation of traders’ pricing of Level 3 assets and liabilities. According to the Financial Industry Regulatory Authority (FINRA), a clearer understanding of the registrant’s policies on supervision, control and validation of pricing of Level 3 assets and liabilities would help investors better understand whether traders or managers engage in “non-bona fide” valuations to enhance compensation or other benefits.³³ A lack of control over how assets are priced may incentivize employees to misrepresent them in order to boost short-term compensation. The proposed change will improve fair representation, relevance, and completeness of the metrics included in the disclosure topic by providing decision-useful information for assessing registrant performance on the topic. Aligning the disclosure with the FINRA rules also improves alignment and comparability of the proposed metric.

Supporting Analysis

FINRA highlights the policies around supervision, control, and validation of traders’ pricing of Level 3 assets in the ‘Supervision, Risk Management and Controls, Management of Conflicts of Interest’ section of the ‘2016 Regulatory and Examination Priorities Letter’.³⁴ The policies specifically address the incentive-compensation structure of

³² FN0102-05: Number of instances when risk limits were breached and number and percentage by response: (1) position reduced, (2) risk limit temporarily increased, (3) risk limit permanently increased, (4) other

³³ Rick Ketchum, “2016 Regulatory and Examination Priorities Letter,” Financial Industry Regulatory Authority, January 5, 2016, accessed August 29, 2017,

<http://www.finra.org/industry/2016-regulatory-and-examination-priorities-letter>.

³⁴ Ibid.

proprietary traders. This fact highlights the importance of the issue to the stakeholders and the capital market overall. Therefore, aligning the disclosure with the FINRA rules improves alignment and comparability of the proposed metric.

Analysis of disclosures made by industry firms shows that at least five of the 20 publicly listed investment banks provide discussion related to the proposed metric in SEC filings, while all discuss compliance with the FINRA guidance and provide disclosure of their Level 3 assets. The SASB analysis of corporate filings found no instances of quantitative or qualitative disclosures related to the provisional metric FN0102-05. On the other hand, several large investment banks mention the FINRA rules related to pricing of Level 3 assets in the SEC filings. Consequently, the changes in the metric should contribute to the fair representation and relevance criteria for SASB accounting metrics, while remaining cost-effective due to their alignment, comparability, and verifiability.

Stakeholder Consultation

Issuers: Some of the largest issuers in the industry stated that reporting on provisional metric FN0102-05 would be extremely difficult to standardize as companies could have significantly different definitions of “risk-limit breaches” as well as significant differences in the nature of activities involved and implications of breaches. Companies felt strongly that reporting on the provisional metric would be unlikely, as such disclosure would be easily misinterpreted by shareholders and company clients. The revised metric was found to be relevant by a few large investment banks.

Investors: While conceptually investors saw the relevance and value in provisional metric FN0102-05, they did not expect companies to disclose such data. The revised metric was found to be relevant, decision-useful, and advantageous, as it aligns with the FINRA framework, which would generate comparable data among companies.

Benefits

Improves decision-usefulness: As the proposed metric provides alignment with the FINRA framework as to incentive compensation and riskiness, it satisfies the criteria of fair representation and relevance and, therefore, improves its decision-usefulness.

Improves alignment and cost-effectiveness: As disclosure analysis suggests, some companies already provide disclosure on the proposed metric in their SEC filings. These companies cite FINRA requirements with which they must comply. By aligning the proposed metric with the FINRA, the SASB improves alignment, comparability, and verifiability of the metrics, ensuring its cost-effectiveness.

Proposed Update #2-15 – **Industry:** Investment Banking & Brokerage; **Topic Name:** Employee Inclusion

2017 Technical Agenda Item #2-15 Description

SASB is evaluating the revision of metric FN0102-06³⁵ to ensure the alignment, decision-usefulness, and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Add Metric and Revise Metric

The SASB proposes revising metric FN0102-06 from “Percentage of gender and racial/ethnic group representation for: (1) executives and (2) all others” to “Percentage of gender and racial/ethnic group representation for: (1) decision-makers and (2) all other employees,” where decision-makers include (a) Executives/Senior Officers & Managers, (b) First/Mid Officers & Managers, and (c) Professionals.

Note: For integrated banks, the guidance would be to report employees of the investment banking segment. If the company is also involved in asset/wealth management, where the same metric is included, disclosure should include reporting by segment, not be aggregated at the corporate level.

Adherence to Criteria for Accounting Metrics

The Investment Banking & Brokerage industry provisional standard includes a topic, Employee Inclusion, with an associated quantitative metric meant to measure how companies in the industry manage their human capital and ensure attraction and retention of talent by hiring diverse candidates. Investment banking companies face a high degree of competition for skilled employees, and the ability of companies to attract and retain them is likely to become increasingly material. By ensuring gender and racial diversity throughout the organization, companies are likely to expand their candidate pool. Further, evidence suggests that diverse groups of employees at investment banking and brokerage companies may reduce risk.

The provisional metric FN0102-06 provides a breakdown of gender/racial diversity at only two general levels: executives versus non-executives. The SASB proposes revising the metric to include a more decision-useful breakdown of employee categories. Specifically, the revised metric would separate employees involved in decision making, which could directly impact the value of an organization from all other employees. The “decision-makers” include the following categories from the U.S. Equal Employment Opportunity Commission’s (EEOC’s) EEO-1 Job Classification Guide: (1) Executives/Senior Officers & Managers, (2) First/Mid Officers & Managers, and (3) Professionals. Although the provisional metric provides a picture of the company’s overall workforce diversity, it fails to separate employees into categories where diversity may be a driver of corporate value, i.e., decision makers. As highlighted by issuers and investors and supported by the evidence discussed below, diversity among employees involved in decision-making processes (e.g., portfolio managers, investment analysts, and traders) at financial institutions may improve the risk-return profile of organizations. Therefore, the proposed breakdown would provide more decision-useful information.

The proposed metric references the U.S. EEOC’s EEO-1 Job Classification Guide, which would enhance the alignment of the metric with standard practice, as well as the comparability and verifiability of the reported data. As supported by market feedback, the proposed change would also improve the fair representation, usefulness, and completeness of information disclosed in line with the metric, as the proposed breakdown would reveal additional relevant information that is decision-useful in assessing companies’ performance on the disclosure topic.

³⁵ FN0102-06: Percentage of gender and racial/ethnic group representation for: (1) executives and (2) all others

Supporting Analysis

Research suggests that diversity may be of particular importance within individual departments of investment banks, such as trading desks, research teams, and sales, where diverse groups show better performance on metrics such as return on investment, risk, and client attraction and retention. Diversity within those groups of employees, as shown by evidence, can have a material impact on an investment bank. For example, one study shows that men are 2.5 times more likely to break rules, which can lead to excessive risk taking and losses to the firm.³⁶

The provisional metric may obscure diversity levels within specific employee categories by grouping them together across the organization, as highlighted by market feedback (see Stakeholder Consultation).

Analysis of corporate disclosure suggests that large financial institutions, including diversified banks with investment banking operations, report diversity metrics referencing categories defined by the EEOC. Some of the largest companies in the industry, including four of the ten largest investment banks, provide disclosure using the EEOC categories proposed by the revision.

There are several challenges related to reporting racial/ethnic data outside of the United States. First, classification categories vary significantly country-by-country and region-by-region; therefore, it would not be practical or necessarily representative of racial/ethnic diversity for companies to aggregate their global number of employees by EEO-1 categories. Second, data are typically only available in some countries (e.g., Canada, Brazil) due to privacy laws preventing disclosure. Finally, some countries also look at age, disability, gender identity, sexual orientation, or other aspects of diversity, but these categories may be defined differently by each country.

The updated metric addresses these concerns by requiring gender breakdown globally but racial/ethnic breakdown per the EEO-1 categories only in the United States. Companies will describe their policies for promoting inclusivity and preventing the development of a homogenous workforce outside the U.S. that is not representative of the local populations. They can also disclose racial/ethnic or other breakdowns by region or country-specific categories, if they choose. This update recognizes that a perfectly representative workforce would mirror population demographics but that regional demographics and ideal representation may vary widely. Thus, it improves the representativeness and the usefulness of the metric.

Stakeholder Consultation

Investors: Investors and issuers across sectors, including analysts covering investment banks and asset managers, consistently communicated that while a gender breakdown is relevant globally, a racial/ethnic group breakdown by EEO-1 categories is feasible only in the United States. In addition, some stated that the provisional metric is overly U.S.-centric and would not provide meaningful information for large multinational companies that operate in different countries.

Issuers: Several banks and asset management companies noted that aggregating diversity across an organization may hinder its comparability, as companies reporting the data at the enterprise level while having a large retail banking presence would likely appear more diverse. The vast majority of banks and asset management companies, as well as issuers across sectors, consistently communicated that while a gender breakdown is relevant globally, a racial/ethnic group breakdown by EEO-1 categories is feasible only in the United States. In addition, some stated that the

³⁶ Sarah Butcher, "New Figures Show Women Make Better Traders than Men on Every Metric Imaginable," eFinancialCareers, modified January 26, 2015, accessed August 29, 2017, <http://news.efinancialcareers.com/us-en/197066/exclusive-figures-show-women-make-far-better-traders-men/>.

provisional metric is overly U.S.-centric and would not provide meaningful information for large multinational companies that operate in different countries.

Benefits

Improves decision-usefulness: Additional breakdown by EEOC categories, as well as reporting by segment improves fair representation, usefulness, and completeness of the proposed metric, and therefore provides more relevant information about performance and improves comparability across companies that may have different exposures to various segments.

Improves cost-effectiveness: As stated by issuers, the proposed metric is aligned with the framework used by human resources departments and thus improves the alignment, comparability, and verifiability criteria of the metric, which makes it cost-effective to collect and report. By limiting the required quantitative disclosure on race/ethnicity to U.S. operations, the proposal further improves cost-effectiveness.

Improves the SASB standard: This change improves cost-effectiveness by limiting the required quantitative disclosure on race/ethnicity to U.S. operations, which are measurable and complete. It also improves decision-usefulness by only requiring the aggregation of gender data, which is more likely to be comparable across issuers in different industries and geographies.

Proposed Update #2-16 – **Industry:** Investment Banking & Brokerage; **Topic Name:** Management of the Legal & Regulatory Environment

2017 Technical Agenda Item #2-16 Description

SASB is evaluating the revision of metric FN0102-07³⁷ to ensure the relevance and decision-usefulness of the metrics associated with the topic.

Summary of Change – Add Metric and Revise Metric

The SASB proposes splitting metric:

- FN0102-07 Amount of legal and regulatory fines and settlements associated with financial industry regulation and percentage that resulted from whistleblowing actions

into its quantitative and qualitative components:

- Total amount of losses as a result of legal proceedings associated with fraud, anti-trust, anti-competitive, market manipulation, malpractice or other industry regulations

with a new metric subsequently created to capture whistleblower policies:

- Description of the whistleblower policies and procedures

Adherence to Criteria for Accounting Metrics

The current Investment Banking & Brokerage SASB industry standard includes a topic for Management of the Legal & Regulatory Environment with associated metrics to describe a company's management of risks related to the legal and regulatory environment. Specifically, the topic and two associated quantitative metrics provide information to help analysts assess a company's internal control policies to prevent tax evasion, fraud, money laundering, and corruption. The provisional metric FN0102-07 currently measures the amount of legal and regulatory fines and settlements that resulted from whistleblowing actions. The current metric is unlikely to provide a fair representation and complete view of the topic and a company's efforts and abilities to institute a successful whistleblower program, limiting its decision-usefulness. The revision of the existing metric will eliminate the need to disclose the percentage of fines and settlements stemming from whistleblowers. To more adequately capture the nature of a company's whistleblower program, the SASB proposes adding a qualitative metric that will facilitate disclosure of the unique characteristics of a company's whistleblower policies and practices in a more holistic manner. In tandem, both metrics would fairly represent the topic and improve the completeness of the standard.

Supporting Analysis

The provisional metric does not provide a complete picture of a company's whistleblower program, which may reduce the decision-usefulness of the current provisional metric. During the consultation period (see Stakeholder Consultation), the SASB received feedback noting that reporting on the issue generally includes the amount of fines and settlements related to violations of financial industry regulations plus a stand-alone discussion of whistleblower

³⁷ FN0102-07: Amount of legal and regulatory fines and settlements associated with financial industry regulation and percentage that resulted from whistleblowing actions

policies. This was confirmed by an analysis of current disclosure practices in SEC filings. As a set, the pair of proposed metrics are more useful in measuring a company's performance on the topic because they provide a mix of quantitative and qualitative information, which is a characteristic that the provisional metric currently lacks. Reporting on the share of fines resulting from whistleblower action does not necessarily highlight the quality of a company's whistleblower policies. "For example," notes a report from Harvard Law, "Elements of an Effective Whistleblower Hotline," "a high volume of calls to a company's hotline (as compared to peers and its industry) may indicate that the company is experiencing significant compliance issues and potentially has an ineffective compliance and ethics program. Conversely, a high volume of hotline calls may suggest that the hotline is working as planned, that the company's compliance and ethics employee training program is effective, that there is greater awareness of the hotline and increased trust in the company's compliance department."³⁸ The split of the metrics would consequently improve completeness by allowing investors to understand better the extent to which the volume of whistleblowing-related fines may be influenced by the registrant's policies regarding whistleblowing. The split improves the SASB criteria for fair representation and usefulness by making the links between whistleblowing policies and related fines clearer.

Stakeholder Consultation

Investors & others: A limited number of investors provided feedback on the proposed change. Nevertheless, those who did unanimously stated that the breakdown of regulatory fines and settlements resulting from whistleblowing actions is unlikely to yield additional decision-useful information, and is therefore unnecessary. Alternatively, these analysts and one subject matter expert recommended including a discussion of a company's whistleblower policies because combined with other metrics proposed by the SASB for this topic, it would provide a holistic view of the company's performance. Based on feedback from analysts, the share of fines resulting from whistleblower action does not necessarily highlight the quality of a company's whistleblower policies.

Issuers: Five of the largest issuers in the industry by market capitalization also suggested changing the metric and including a qualitative discussion and analysis on a company's whistleblower policies and procedures.

Benefits

Improves decision-usefulness: Splitting the current provisional metric into two different metrics will improve the decision-usefulness of disclosure by providing a mix of quantitative and qualitative information. The quantitative metric on fines and settlements provides an indication of past performance on the topic, while a stand-alone qualitative discussion of whistleblower policies and practices sheds light on a company's unique whistleblower programs. In tandem, and compared to the previous need to report on the percentage of fines and settlements resulting from whistleblowing actions, both metrics fairly represent performance on the topic.

³⁸ Bill Libit, Walt Draney, and Todd Freier, "Elements of an Effective Whistleblower Hotline," *Harvard Law School Forum on Corporate Governance and Financial Regulation*, October 25, 2014, accessed September 15, 2017, <https://corpgov.law.harvard.edu/2014/10/25/elements-of-an-effective-whistleblower-hotline/>.

Proposed Update #2-17 – **Industry:** Investment Banking & Brokerage; **Topic Name:** Management of the Legal & Regulatory Environment

2017 Technical Agenda Item #2-17 Description

SASB is evaluating the revision of metric FN0102-08³⁹ to ensure the relevance and decision-usefulness of the metrics associated with the topic.

Summary of Change – Remove Metric

The SASB proposes removing provisional metric FN0102-08, “Number of inquiries, complaints, or issues received by the legal and compliance office through an internal monitoring or reporting system, and percentage that were substantiated.”

Adherence to Criteria for Accounting Metrics

The current Investment Banking & Brokerage industry provisional standard includes a topic, Management of the Legal & Regulatory Environment, that is focused on a company’s management of risks related to the investment banking industry’s legal and regulatory environment. Specifically, the topic and associated metrics provide information to help analysts to assess a company’s internal control policies to prevent tax evasion, fraud, money laundering, and corruption. The two other metrics proposed for inclusion in the topic cover disclosure of the amount of legal and regulatory fines incurred that are associated with industry regulation and a description of the registrant’s policies and procedures regarding internal whistleblowing. The provisional metric FN0102-08 currently measures the number of inquiries, complaints, or issues received by the legal and compliance office through an internal monitoring or reporting system, and the percentage that were substantiated. This metric is meant to be an indicator of the effectiveness of a company’s internal compliance controls and a forward-looking proxy for potential violations and subsequent fines and penalties. The provisional metric is lacking in comparability if reported, as companies have different types of policies and procedures of internal controls, and therefore, the number of inquiries could range significantly and not be indicative of actual performance on the topic. The removal of the metric will therefore retain the decision-usefulness of the disclosures contained in the remaining metrics (please refer to Proposed Item #2-16) on the topic, while reducing the cost burden of reporting and avoiding potential issues in terms of comparability.

Supporting Analysis

The SASB analysis of disclosures from all U.S.-listed public companies has not revealed instances where a company disclosed the number of inquiries, complaints, or issues received by the legal and compliance offices.

Stakeholder Consultation

Issuers: All three large issuers who provided comments on the disclosure topic unanimously expressed concerns with metric FN0102-08. Companies stated that it would not be cost-effective to obtain information comparable across issuers due to the fact that individual companies may have differences in their internal compliance processes. The current metric does not reference a recognized industry framework.

Investors: Several investors stated that the metric would be challenging to interpret in a decision-useful manner.

³⁹ FN0102-08: Number of inquiries, complaints, or issues received by the legal and compliance office through an internal monitoring or reporting system, and percentage that were substantiated

Benefits

Improves the SASB standard: Removal of the metric improves comparability of the remaining set of disclosures. Given that each company has different approaches to internal controls and reporting issues to internal compliance departments, removal of the metric prevents disclosure comparability issues between registrants.

Improves cost-effectiveness: The provisional metric would be very cost-burdensome to standardize to ensure comparability, and therefore its removal improves cost-effectiveness.

Proposed Update #2-18 – **Industry:** Investment Banking & Brokerage; **Topic Name:** Management of the Legal & Regulatory Environment

2017 Technical Agenda Item #2-18 Description

SASB is evaluating the removal of metric FN0102-09⁴⁰ to ensure the relevance and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Remove Metric

The SASB proposes removing provisional metric FN0102-09, “Number of conflicts of interest disclosed to clients, customers, and/or counterparties.”

Adherence to Criteria for Accounting Metrics

The Investment Banking & Brokerage industry provisional standard includes a topic, Management of the Legal & Regulatory Environment, that is focused on a company’s management of risks related to the complex and, at times, inconsistent set of national and international rules that may apply to industry activities. Specifically, the topic and associated metrics provide information to help analysts assess a company’s internal control policies to prevent tax evasion, fraud, money laundering, conflicted advice, and corruption. Other metrics associated with the topic include disclosure of the amount of legal and regulatory fines incurred that are associated with industry regulation and a description of the registrant’s policies and procedures regarding internal whistleblowing. The provisional metric FN0102-09 measures the number of conflicts of interest involving the registrant and/or its representatives that are disclosed to clients, customers, and/or counterparties. This metric is intended to be an indicator of a company’s transparency regarding potentially conflicted advice that could be given to its customers and that could run afoul of industry ethical standards and/or result in regulatory scrutiny. However, the provisional metric is insufficient, as it only captures a small and potentially not relevant aspect of a registrants’ approach to the professional integrity of services provided, which itself represents a related but fundamentally unique offshoot of the broader topic of a company’s management of the legal and regulatory environment. Further, as supported by the SASB analysis, the provisional metric is not discussed by companies either directly or conceptually, which may be indicative of the lack of relevance and fair representation of performance. The proposed removal of the metric, along with the proposed addition of a separate topic on professional integrity (please refer to Proposed Item #2-19), which would include a different set of metrics, would improve the fair representation of disclosure related to this topic.

Supporting Analysis

An analysis of disclosures from listed companies in the industry revealed no cases of issuers discussing the concepts addressed in the metric (instances of conflict of interest disclosed to clients). The concept of conflict of interest is strictly regulated in the financial services sector overall, and traditionally is discussed in the context of fiduciary duty and policies around providing transparent information and fair advice to clients. To improve the fair representation and relevance of the approach addressing conflicts of interest in the Investment Banking & Brokerage industry, the SASB also proposes adding a stand-alone “Professional Integrity” topic (refer to Proposed Item #2-19) with associated metrics, which would address fiduciary duty to clients and conflicts of interest. The inclusion of the topic of “Professional Integrity” and associated metrics should lead to a more informative set of metrics and render metric FN0102-09 of little relevance. Consequently, removal of the metric (along with the proposed change associated with

⁴⁰ FN0102-09: Number of conflicts of interest disclosed to clients, customers, and/or counterparties

Proposed Item #2-19) would improve the fair representation and relevance of the sets of metrics included in both the Management of the Legal & Regulatory Environment and Professional Integrity topics.

Stakeholder Consultation

Investors: Multiple investors consistently found the inclusion of the Professional Integrity topic with proposed metrics, where fiduciary duty and potential conflict of interest are addressed, to be appropriate to improve decision-usefulness of disclosure in the SASB standard. Therefore, the removal of the provisional metric FN0102-09 from the current disclosure topic is justified.

Issuers: All of the large investment banks that provided feedback on the proposal stated that adding a stand-alone Professional Integrity topic and covering conflicts of interest within it is a relevant approach to measuring performance of companies in the industry.

Benefits

Improves the SASB standard: The proposed change to remove the provisional metric and address the concept of conflict of interest in a stand-alone disclosure topic improves relevance and fair representation of accounting metrics included in each of the topic. Furthermore, the sets of metrics included in individual topics ensure completeness of data reported to investors to assess performance on the topics.

Proposed Update #2-19 – **Industry:** Investment Banking & Brokerage; **Topic Name:** Professional Integrity

2017 Technical Agenda Item #2-19 Description

SASB is evaluating the addition of the topic, including corresponding metrics, based on investor interest and its potential to affect corporate value.

Summary of Change – Add Topic

The SASB proposes adding the disclosure topic “Professional Integrity,” including the corresponding metrics:

- (1) Number and (2) percentage of the registrant’s covered employees with record of investment-related investigations, consumer-initiated complaints, private civil litigations, or other regulatory proceedings
- Number of mediation and arbitration cases associated with professional integrity and duty of care
- Total amount of losses as a result of legal proceedings associated with professional integrity and duty of care
- Description of management approach to assuring professional integrity and duty of care

Description of Topic

The business model of investment banking and brokerage companies is dependent on the development of trust and loyalty with clients. To ensure long-term, mutually beneficial relationships, companies need to provide services that satisfy the highest professional standards of the industry, which makes professional integrity an important governance issue. Therefore, companies in this industry should take measures to avoid conflicts of interest, misrepresentation, and negligence, including training employees adequately and implementing policies and procedures to ensure employees provide advice and distribute data free from bias and error. At the same time, professional integrity pertains to following a code of ethics with respect to transparency and disclosure. These measures are important both for strengthening a company’s license to operate as well as for attracting and retaining clients.

Companies in the industry have a fiduciary or agency relationship, where the professional owes the client a duty of loyalty and care, whereby a client can expect a level of professionalism and standard of conduct commonly upheld by those in the profession. In some segments of the industry, companies have the potential to influence the decisions and judgment of their clients. Because of the potential for social or harm from malpractice, professional integrity is not only a material business issue, but also a sustainability issue, and therefore falls under the umbrella of topics covered by the SASB. In cases where a fiduciary relationship is present, the influence on clients’ decisions may result in environmental and social externalities indirectly created by the registrant, which implies that operating at the highest levels of professional responsibility is important for companies to maintain their formal or social licenses to operate.

Failure to comply with professional standards can harm not only the clients who rely on the advice, data, and key services these companies provide, but may also hurt shareholders. Investment banking and brokerage companies could not only face legal penalties related to such actions, but could also incur significant negative impact on revenue from reputational damage.

To maintain professional integrity, investment banking and brokerage companies need to ensure that employees have adequate training as well as know and adhere to applicable financial industry regulations. To comply with the Financial Industry Regulatory Authority (FINRA) rules, employers need to ensure that they are aware of any past record

of violation of their employees who are involved in communications and providing advice to clients. Companies need to provide clients with transparent and complete information regardless of the products sold or services provided. Therefore, a description of management’s approach to assuring professional integrity and duty of care would help investors understand risk exposure as well as any processes in place to avoid misconduct. Additionally, disclosure of the company’s amount of legal and regulatory fines and settlements would provide a clearer picture of the extent to which financial institutions are adhering to regulatory norms. More specifically, company performance in this area can be analyzed in a cost-beneficial way through the following direct or indirect performance metrics:

- (1) Number and (2) percentage of the registrant’s covered employees with record of investment-related investigations, consumer-initiated complaints, private civil litigations, and other regulatory proceedings
- Number of mediation and arbitration cases associated with professional integrity and duty of care
- Total amount of losses as a result of legal proceedings associated with professional integrity and duty of care
- Description of management approach to assuring professional integrity and duty of care

Supporting Analysis

Research conducted after the release of the provisional standards suggests that management of the client relationship—specifically, the fiduciary duty investment banks owe to their clients—should be addressed as a stand-alone disclosure topic rather than as a component of the existing “Management of the Legal & Regulatory Environment” topic. Evidence shows that investment banks may be financially impacted by failing to disclose conflicts of interest or to provide clients with transparent and complete information as part of advisory services.

In recent years, there have been multiple cases of violations related to professional integrity and duty to clients involving some of the largest U.S.-listed financial institutions. In fact, in the aftermath of the financial crisis, some of the largest U.S. and international investment banks paid billions of dollars in regulatory fines and settlements to compensate their clients in cases related to sales of financial products. The instances related to cases in which companies failed to disclose the conflict of interest to clients when representing both counterparties on an underwriting transaction or having an undisclosed incentive to overstate the value or understate the risk of financial products and investment projects. The magnitude of these fines had a significant impact on the value of banks, and it took several years to recover. Further material impact resulted from the damaged reputations of these companies, which may be even more difficult to recover.

A study found that data from BrokerCheck, “including disciplinary records, financial disclosures, and employment history of brokers has significant power to predict investor harm.”⁴¹ Percentage of employees with record of violation could be a forward-looking indicator for client-initiated litigations and fines and settlements.

Stakeholder Consultation

Investors: Multiple investors consistently found the proposed metrics to be decision-useful measures of performance if reported by companies.

⁴¹ Hammad Qureshi and Jonathan S. Sokobin, “Do Investors Have Valuable Information About Brokers?” FINRA Office of the Chief Economist Working Paper, August 20, 2015, accessed August 29, 2017, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2652535.

Issuers: All five large investment banks that provided feedback on the topic stated that it is relevant to companies in the industry. Companies stated that it is appropriate to address the issue in a stand-alone topic rather than as a part of the Management of the Legal & Regulatory Environment topic. Issuers stated that metrics are relevant to measuring performance on professional integrity.

Benefits

Improves the SASB standard: The proposed topic would highlight a very important sustainability issue in the Investment Banking & Brokerage industry, where a company's management—or mismanagement—of the issue is reasonably likely to have a material financial impact on companies.

Improves decision-usefulness: As highlighted by feedback, the proposed metrics would provide decision-useful information to analysts to assess performance of investment banks.

Proposed Update #2-20 – **Industry:** Investment Banking & Brokerage; **Topic Name:** Systemic Risk Management

2017 Technical Agenda Item #2-20 Description

SASB is evaluating the revision of metric FN0102-10⁴² to ensure the decision-usefulness and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Revise Metrics

The SASB proposes to change metric FN0102-10, “Results of stress tests under adverse economic scenarios, including the following measures (actual and projection): (1) Loan losses (2) Losses, revenue, and net income before taxes (3) Tier 1 common capital ratio (4) Tier 1 capital ratio (5) Total risk-based capital ratio (6) Tier 1 leverage ratio” to metric “Discussion of how results of mandatory and voluntary stress tests are integrated into capital adequacy planning, long-term corporate strategy, and other business activities.”

Adherence to Criteria for Accounting Metrics

The current Investment Banking & Brokerage industry standard includes a topic for Systemic Risk Management with associated metrics to describe a financial institution’s capacity to operate after economic shocks and the degree to which its operations may affect other companies and the broader economy. The need to preserve capital due to regulatory requirements means that any decisions on how to deploy the firm’s financial capabilities should be carefully weighed against capital requirements. The provisional metric includes reporting on results of regulatory stress tests under adverse economic scenarios using several actual and projected quantitative indicators. As these data are currently already disclosed in detail, SASB disclosure is unlikely to add value to the total mix of information provided to investors. The proposed metric is meant to help analysts assess the alignment of performance on regulatory metrics with the company’s long-term sustainability strategy by providing a discussion of how the stress tests drive corporate strategy and other business decisions. In particular, a discussion of how the integration of ESG factors in stress testing and the influence of stress test results on a company’s ESG strategy, as requested in the technical protocol, provides information currently not disclosed that can be decision-useful to investors.

Supporting Analysis

The “Dodd-Frank Act Stress Test: Supervisory Stress Test Methodology and Results” reports are published by the Federal Reserve, with the 2016 round consisting of 33 bank holding companies.⁴³ The reports provide comparison tables with results for covered financial institutions on applicable Dodd-Frank metrics. The number of metrics disclosed in these reports is higher than that in the current metric FN0102-10. In Proposed Item #2-21, the SASB proposes to include a quantitative metric of registrants’ Global Systemic Important Bank (G-SIB) scores, which provide a complete set of quantitative data points relevant to the topic. The G-SIB score, calculated with inputs collected by regulators in G-20 countries, assesses the systemic risk a financial institution poses through a composite of several metrics. As such, the proposed metric adds to the completeness of the SASB standard.

The proposed change to a qualitative discussion would be valuable to investors to understand how quantitative performance on regulatory metrics relates to a company’s management of the material sustainability issue addressed

⁴² FN0102-10: Results of stress tests under adverse economic scenarios, including the following measures (actual and projection): (1) Loan losses (2) Losses, revenue, and net income before taxes (3) Tier 1 common capital ratio (4) Tier 1 capital ratio (5) Total risk-based capital ratio (6) Tier 1 leverage ratio

⁴³ “Dodd-Frank Act Stress Test 2016: Supervisory Stress Test Methodology and Results,” June 2016, accessed August 24, 2017, <https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20160623a1.pdf>.

in the SASB standard. Further, discussion of how ESG factors inform the quantitative and qualitative aspects of the stress tests' modeling and analysis, as well as how the stress test results inform its approach with respect to its ESG strategy, provide useful information to both issuers and investors. Such discussion ties the regulatory and financial aspects of the topic back to its sustainability aspects, improving the completeness of the standard.

Stakeholder Consultation

Investors: Feedback from multiple investors suggests that the amount of information related to results of stress tests, and the systemic risk in general, available through the Federal Reserve report, Pillar 3 reports under Basel III, and other sources is sufficient to make informed investment decisions. Analysts suggest not to restate results of stress tests in the standard but rather to provide discussion of a long-term strategy to adapt to the evolving regulatory environment and absorb shocks arising from financial and economic stress.

Issuers: All issuers support the change from results of SASB-specific stress tests to qualitative discussion and analysis. Issuers stated that the existent amount of quantitative data reported satisfy regulatory requirements and investor demand on the topic. As supported by feedback, the current amount of disclosure with respect to stress tests is sufficient and the provisional metric does not contribute to the completeness of information. Therefore, duplicating such disclosure would not be beneficial.

Benefits

Improves the SASB standard: Duplicating results of the stress tests, in this specific case, would not provide additional value to investors. The data investors can obtain from regulatory filings on results of stress tests is already complete and sufficient to make informed decisions. The proposed metric is likely to add value to the total mix of information rather than be duplicative. It allows companies to tie their regulatory performance with the sustainability topic through the language in the technical protocol.

Improves cost-effectiveness: By reducing the amount of data required from companies, SASB improves cost-effectiveness of the standard.

Improves decision-usefulness: As indicated by feedback from investors, discussion of a company's strategy would provide more additional decision-useful information than results of stress tests.

Proposed Update #2-21 – **Industry:** Investment Banking & Brokerage; **Topic Name:** Systemic Risk Management

2017 Technical Agenda Item #2-21 Description

SASB is evaluating the revision of metrics FN0102-11,⁴⁴ FN0102-12,⁴⁵ FN0102-13,⁴⁶ and FN0102-14⁴⁷ to ensure the alignment, decision-usefulness, and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Revise Metrics

The SASB proposes removing the following provisional metrics:

- FN0102-11 Basel III Liquidity Coverage Ratio (LCR)
- FN0102-12 Net exposure to written credit derivatives
- FN0102-13 Level 3 assets: (1) total value and (2) percentage of total assets
- FN0102-14 Skewness and kurtosis of trading revenue

and replacing them with a new metric:

- Global Systemically Important Bank (G-SIB) score by category

Adherence to Criteria for Accounting Metrics

The Investment Banking & Brokerage industry provisional standard includes a topic, Systemic Risk Management, with associated metrics to describe a financial institution’s capacity to operate after economic shocks and the degree to which its operations may affect other companies and the broader economy.

The provisional metrics FN0102-11, FN0102-12, FN0102-13, and FN0102-14 include some of but not all the measures of systemic risk normally disclosed in regulatory stress test results. Consequently, they are not complete, according to the criteria for accounting metrics established in the *SASB Conceptual Framework*.

The SASB proposes to replace the aforementioned provisional metrics with one metric measuring Global Systemically Important Bank (G-SIB) score. The change would improve the completeness of the metrics associated with the topic while fairly representing a company’s performance, as it encompasses a broader view of systemic risk that can be condensed into a single indicator, rather than the multiple measures included in the provisional standard. It also would add to the comparability and alignment of the metrics associated with the topic, as data for the G-SIB score are calculated using standardized methodology and already collected by most industry participants and reported to regulators.

Supporting Analysis

The provisional metrics represent only individual elements of the relevant information investors need to assess a company’s performance on the topic. The replacement metric is meant to measure how a company manages its capital requirements and whether it is well positioned to absorb shocks arising from financial and economic stress. The G-SIB score is a measure of the degree to which a bank may pose a risk to the financial system. By measuring a bank’s

⁴⁴ FN0102-11: Basel III Liquidity Coverage Ratio (LCR)

⁴⁵ FN0102-12: Net exposure to written credit derivatives

⁴⁶ FN0102-13: Level 3 assets: (1) total value and (2) percentage of total assets

⁴⁷ FN0102-14: Skewness and kurtosis of trading revenue

relative score in five major categories (size, interconnectedness, complexity, cross-jurisdictional activity, and substitutability), the metric accounts for different factors that gauge the systemic risk that the institution poses. The data are already disclosed to national regulators and made public for most of the U.S.'s larger institutions, with similar standards existing in other jurisdictions. By using a single metric, the proposed change would improve the completeness of data provided to investors while fairly representing performance on the topic. Banks with over \$50 billion in assets are required to collect and report the data underlying the calculation of G-SIB scores. The methodology for calculating the scores for each category takes into account performance on indicators captured by the provisional SASB metrics being replaced, as well as other applicable indicators, which addresses the scope of the issue holistically.

G-SIB scores are calculated based on a global methodology, which would ensure comparability and alignment of the SASB metric. The data used to calculate G-SIB scores, the methodology, and the scores themselves are publicly available on the Office of Financial Research's [website](#). Further, companies have established frameworks for collecting and reporting the underlying data, which makes reporting the proposed metric cost-effective.

Stakeholder Consultation

Investors: Multiple investors stated that the provisional metrics are relevant, but are only a subset of all the relevant indicators. Investor feedback indicated that the provisional metrics seemed to be chosen at random from the list of all metrics regulated under Dodd-Frank and Basel III. Analysts suggested either to go broader with metrics or not to duplicate measures at all. The G-SIB metric was recommended by one investor as the most decision-useful measure of systemic risk combined into a concise measure.

Issuers: The SASB did not receive feedback from issuers specifically related to the usefulness of the proposed metric.

Others: Subject matter experts confirmed the decision-usefulness and relevance of the G-SIB metric and its breakdown by five categories.

Benefits

Improves decision-usefulness: The G-SIB metric satisfies the SASB's goal of providing a minimal set of decision-useful metrics. The G-SIB sub-scores, such as interconnectedness, complexity, and substitutability, incorporate all the elements of the topic the SASB considers to be relevant from the sustainability point of view. As such, the revision improves the ability of the metrics associated with the topic to provide a complete and fair representation of performance in a way that is comparable among peers and aligned with industry practices.

Improves cost-effectiveness: By aligning with an existing methodology used by industry companies, the proposed metric would be more cost-effective to report.

Proposed Update #2-22 – **Industry:** Investment Banking & Brokerage; **Topic Name:** Integration of Environmental, Social, and Governance Risk Factors in Advisory, Underwriting, and Brokerage Activities

2017 Technical Agenda Item #2-22 Description

SASB is evaluating the suitability of the topic name.

Summary of Change – Revise Topic Name

The SASB proposes renaming the provisional topic “Integration of Environmental, Social, and Governance Risk Factors in Advisory, Underwriting, and Brokerage Activities” to “Integration of Environmental, Social, and Governance Factors in Investment Banking & Brokerage Activities.”

Rationale

Several stakeholders highlighted that it would be beneficial to streamline the topic name to make it encompass all investment banking activities.

The proposed name would be inclusive of all investment banking and brokerage activities. The SASB proposes to add an additional metric focused on ESG integration in proprietary investing and lending (which is currently not addressed in the name). Please refer to Proposed Item #2-24. Further, ESG factors can be both risk and opportunity factors, therefore the focus should be ESG factors holistically not only on the risk side of managing performance.

The SASB also proposes removing the term “Risk” from the title, as ESG factors may present both risks and opportunities related to investment banking and brokerage activities. The proposed change improves neutrality of the disclosure topic.

Benefits

Improves the SASB standard: The proposed revision improves the completeness, neutrality, and fair representation of the disclosure topic name.

Proposed Update #2-23 – **Industry:** Investment Banking & Brokerage; **Topic Name:** Integration of Environmental, Social and Governance Risk Factors in Advisory, Underwriting, and Brokerage Activities

2017 Technical Agenda Item #2-23 Description

SASB is evaluating the revision of metrics FN0102-16⁴⁸ and FN0102-17⁴⁹ to ensure the relevance, decision-usefulness, and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Revise Metrics

The SASB proposes removing the following provisional metrics:

- FN0102-16 Amount of sustainability-focused services, activities, and products, broken down by: (1) origination, (2) market making, and (3) advisory and underwriting
- FN0102-17 Deal size of advisory and underwriting transactions for companies in the following sectors/industries: Energy/Oil & Gas, Materials/Basic Materials, Industrials, and Utilities

and adding a new metric:

- (1) Number and (2) total value of (a) underwriting, (b) advisory, and (c) securitization transactions incorporating integration of environmental, social, and governance (ESG) factors by industry

Adherence to Criteria for Accounting Metrics

The Investment Banking & Brokerage industry provisional standard includes a topic, Integration of Environmental, Social, and Governance Risk Factors in Advisory, Underwriting, and Brokerage Activities, with three associated metrics to describe how and the extent to which investment banks manage their exposure to ESG risks and opportunities through key business activities. The provisional metrics call for a description of the registrant’s approach to ESG integration as well as for additional quantitative data. Specifically, provisional metric FN0102-16 calls for the disclosure of the registrant’s portfolio of ESG products in underwriting, origination, and market making. Meanwhile, provisional metric FN0102-17 asks for the registrant to provide data on its exposure to carbon-intensive industries such as Oil & Gas and Utilities.

The SASB proposes addressing the concepts captured in both of these quantitative provisional metrics (exposure within a range of investment banking activities and industry-specific ESG risks) with a single new metric. With respect to provisional metric FN0102-16, replacing the terminology “sustainability-focused services, activities, and products” with a measure of products and services “incorporating integration of environmental, social, and governance (ESG) factors” is likely to remove subjectivity. For example, market feedback suggests that the labeling of a product or service as “sustainability-focused” may not be consistently applied by registrants, therefore limiting its comparability. Moreover, the provisional metric, as written, fails to ensure the fair representation of the aspect of the topic it is intended to measure. Specifically, in addition to being subjective, “sustainability-focused” products and services would

⁴⁸ FN0102-16: Amount of sustainability-focused services, activities, and products, broken down by: (1) origination, (2) market making, and (3) advisory and underwriting

⁴⁹ FN0102-17: Deal size of advisory and underwriting transactions for companies in the following sectors/industries: Energy/Oil & Gas, Materials/Basic Materials, Industrials, and Utilities

constitute only a subset of products and services provided by investment banks that incorporate ESG factors. This is because investment banks often take into account ESG factors in their advisory, underwriting, and origination activities, even when those services may not necessarily be labeled as ESG- or sustainability-focused. Finally, as investors increasingly encourage material ESG factors to be holistically integrated into traditional business activities, measuring ESG-focused products and services in isolation may contradict that objective by incentivizing companies to view ESG as an add-on to traditional business activities rather than an integral part of them.

With respect to provisional metric FN0102-17, the SASB proposes removing the focus on carbon exposure from the metrics and instead incorporating a general breakdown of exposure by industry. ESG risks and opportunities are present in all industries in the economy and the SASB does not make a judgment as to which issues are more or less important than others. Therefore, the proposed metric includes a breakdown of exposure through key business activities by industry, improving the neutrality of the metric. Investment banks provide underwriting, advisory, and securitization services to clients in various industries of the economy. Taking into account the ESG factors to which their clients are exposed—or failing to do so—may have material impacts on investment banks. Such impacts may be both direct, through the risk profile of the client, and reputational. Therefore, from a bank’s perspective, it is extremely important to understand and consider the whole universe of ESG risks and opportunities to which its clients are exposed, rather than only those applicable to carbon-intensive industries.

Therefore, in expanding the scope of disclosure to include ESG integration that banks may incorporate outside of their “sustainability-focused” products or services as well as across the entire economy, the proposed revision would improve the completeness, fair representation, and neutrality of the metrics associated with this topic, as defined by the *SASB Conceptual Framework*.

Supporting Analysis

A review of ESG disclosure from investment banks suggests that companies report quantitative and qualitative data inconsistently. One of the most consistently reported ESG metrics is the amount of green bond underwriting. Nevertheless, analysts pointed out that even when the amount of green bond underwriting is disclosed by peers, the data is unlikely to be comparable, as some companies report the value of the syndicate underwriting while others only disclose the amount for which they were accountable. Further, the scope of projects/products that companies include in the disclosure differs significantly. Companies also fail to provide clear definitions of certain ESG integration efforts or product offerings. Feedback from issuers echoed these findings and confirmed that a consistent definition of ESG integration is needed. Aligning the format of disclosure per investment banking activity improves comparability of the metric. Further, a holistic approach to integration of ESG factors rather than a focus on specific risks improves completeness and neutrality of the metric.

Several large investment banks, including two of the ten largest by market capitalization, mention in their sustainability reports that they perform Environmental and Social Risk Management (ESRM) reviews of their transactions and investments. For example, a large investment bank states, “In 2015, 782 deals across 12 industries and three regions (Americas, EMEA, and Asia Pacific) were referred for environmental and social due diligence.” A significant share of these deals may not necessarily fall under the definition of “sustainability-focused,” which supports the proposal to revise the metric to cover those that incorporate integration of ESG. Moreover, several large investment banks disclose exposure to a broad set of industries rather than focusing on carbon-intensive ones. This highlights the fact that, in addition to the proposed SASB metric providing a more holistic view on exposure to ESG risks and opportunities, it is also in line with industry practice.

Stakeholder Consultation

Investors: Investors generally recommended that metrics for this topic reflect a more holistic approach to ESG integration rather than focusing on specific risks (e.g., climate). All the analysts that provided feedback on this metric found the proposed revision very helpful and would like to see companies report their exposure to products such as green bonds in a standardized manner. Along with the qualitative discussion of ESG risks and the strategies companies employ to account for those risks when providing investment banking services (FN0102-15), this additional quantitative metric would provide users with a holistic view of a bank's ESG exposure.

Issuers: Large U.S.-listed, integrated banks provided extensive feedback on this topic. Issuers stated that while most of them report on their ESG integration strategies, such reporting is not consistent and not comparable across the industry. All companies saw the benefit in standardizing disclosure by providing common categories of reporting. The feedback confirmed that the focus should be on holistic integration of ESG factors rather than on highlighting exposure to a few carbon-intensive industries, as individual companies may be integrating ESG factors differently and have different levels of exposure due to their business decisions.

Benefits

Improves the SASB standard: The proposed change improves the completeness of the metrics associated with the topic, as it shifts the focus from only a small subset of ESG risks and opportunities to investment banks to a more holistic approach for analyzing integration of ESG factors in the portfolio of services. The proposal also improves the fair representation and neutrality of the metrics.

Improves decision-usefulness: As highlighted by the feedback received from investors, the overall industry-level exposure through the portfolio of investment banking services provides decision-useful information and allows for a more holistic analysis.

Proposed Update #2-24 – **Industry:** Investment Banking & Brokerage; **Topic Name:** Integration of Environmental, Social, and Governance Risk Factors in Advisory, Underwriting, and Brokerage Activities

2017 Technical Agenda Item #2-24 Description

SASB is evaluating the addition of a metric to ensure the relevance and decision-usefulness of the metrics associated with the topic.

Summary of Change – Add Metric

The SASB proposes adding a metric: “(1) Number and (2) total value of investments and loans incorporating integration of environmental, social, and governance (ESG) factors by industry.”

Adherence to Criteria for Accounting Metrics

The Investment Banking & Brokerage industry provisional standard includes a topic, Integration of Environmental, Social, and Governance Risk Factors in Advisory, Underwriting and Brokerage Activities, with associated metrics to describe how and the extent to which investment banks manage their exposure to ESG risks and opportunities through key business activities. The provisional metrics call for a description of the registrant’s approach to ESG integration as well as for additional quantitative data around the portfolio ESG products in underwriting, origination, and market making.

The proposed revision would add a metric to capture the registrant’s level of integration of ESG factors in the investing and lending business segment. As highlighted by research and feedback from issuers and investors, investing and lending are among the key business activities of investment banks; however, such activities are not addressed in the provisional standard. Companies in the industry may be exposed to ESG risks and opportunities when they provide proprietary investments and loans to various projects. Therefore, the inclusion of the proposed metric would improve the completeness and usefulness of reported information, enabling investors to better assess the registrant’s performance on the disclosure topic.

Supporting Analysis

Analysis of corporate disclosure suggests that proprietary investing and lending are some of the primary activities of investment banks in which integration of ESG factors is currently occurring and where related financial impacts are most prominent. In their corporate filings, some of the largest investment banks by market cap discuss their integration of ESG factors into investing and lending activities. For example, a review of disclosure by the top 10 investment banks shows that several of the largest companies provide quantitative disclosure on the amount they have invested in sustainability-focused projects, such as those related to renewable energy, water efficiency, sustainable infrastructure and transportation, and others. Most companies disclose these activities in their corporate social responsibility (CSR) reports, while several banks also include disclosure in their Form 10-K or 20-F filings. This evidence highlights that the investing and lending is one of the key business activities of investment banks through which exposure to ESG risks and opportunities may materially impact corporate performance. Therefore, addressing this business segment with a stand-alone metric would improve the completeness of the accounting metrics associated with the disclosure topic. As a result, the proposal would improve decision-usefulness of the information reported on the topic by providing a more holistic view of the quality of management.

Stakeholder Consultation

Investors: Investors suggested that this segment should be addressed in the Investment Banking & Brokerage industry and indicated that the ESG integration topic is particularly relevant to investing and lending activities.

Issuers: A number of companies raised the point that investing and lending activities did not seem to be adequately addressed in the disclosure topic, and that current disclosure from companies lacks comparability. Issuers stated that a metric focused on ESG integration through the investing and lending segment should be included to supplement the existing metrics associated with the topic. Issuers also stated that they already collect and report data on such activities, specifically addressing ESG-focused products and services, so they thought the proposed metric would be cost-effective to report.

Benefits

Improves the SASB standard: The proposed metric is likely to provide information that would be material to companies and decision-useful to investors in analyzing investment banks' integration of ESG factors holistically. The proposal would enhance the completeness and usefulness of the data reported to investors.

Proposed Update #2-25 – **Industry:** Investment Banking & Brokerage; **Topic Name:** Activity Metrics

2017 Technical Agenda Item #2-25 Description

The SASB proposes to include activity metrics for the Investment Banking & Brokerage industry.

Summary of Change – Add Activity Metrics

The SASB proposes adding the following activity metrics:

- (1) Number and (2) value of (a) underwriting, (b) advisory, and (c) securitization transactions
- (1) Number and (2) value of proprietary investments and loans by sector
- (1) Number and (2) total value of market making transactions in (a) fixed income, (b) equity, (c) currency, (d) derivatives, and (e) commodity products

Adherence to Criteria for Accounting Metrics

The SASB proposes adding activity metrics as a new element of the Investment Banking & Brokerage standard. At the time of release of the provisional standards for the Financials sector, the SASB had not incorporated the concept of activity metrics into the industry standards. Activity metrics are useful for measuring the scope and scale of a company's operations, providing normalization factors for the performance metrics included in the disclosure topics.

Supporting Analysis

The proposed metrics measure the scope of key business activities of three key segments as disclosed in companies' SEC filings (Investment Banking, Investing & Lending, and Institutional Client Services activities). The metrics are aligned with those used to measure performance in these segments in the league tables published by third-party data providers.

Stakeholder Consultation

Investors: The SASB received feedback from a limited number of investors on activity metrics. Analysts providing comments stated that the proposed metrics are relevant, decision-useful, and partially disclosed already through third-party data providers. Investors would see value in this information coming from companies directly.

Issuers: Feedback from four of the largest investment banks indicates that the proposed metrics are cost-effective to report as they are aligned with internally collected information and, for the most part, are already disclosed in league tables.

Benefits

Improves the SASB standard: Activity metrics provide investors with normalization factors to ensure comparability of SASB metrics across issuers.

Improves decision-usefulness: The proposed metrics improve decision-usefulness of all quantitative SASB metrics included in the standard by allowing investors to convert them from absolute to relative measures of performance.



FINANCIALS SECTOR

ASSET MANAGEMENT & CUSTODY ACTIVITIES INDUSTRY

Sustainability Accounting Standard

Sustainable Industry Classification System™ (SICS™) #FN0103

Prepared by the
Sustainability Accounting Standards Board®

October 2017

Proposed Changes to Provisional Standard - Basis for Conclusion

Proposed Update #2-26 – **Industry:** Asset Management & Custody Activities; **Topic Name:** Employee Incentives & Risk Taking

2017 Technical Agenda Item #2-26 Description

SASB is evaluating the removal of the topic, including the corresponding metrics FN0103-01,⁵⁰ FN0103-02,⁵¹ FN0103-03,⁵² and FN0103-04⁵³ based on investor interest and its potential to affect corporate value.

Summary of Change – Remove Topic and Metrics

The SASB proposes removing the topic Employee Incentives & Risk Taking, including the corresponding metrics:

- FN0103-01 Discussion of variable compensation policies and practices
- FN0103-02 Percentage of total compensation that is variable for: (1) executives and (2) all others
- FN0103-03 Percentage of variable compensation that is equity for: (1) executives and (2) all others
- FN0103-04 Percentage of employee compensation which includes ex-post adjustments for: (1) executives and (2) all others

Adherence to Principles for Topic Selection

This topic, included in the provisional standard for the Asset Management & Custody Activities industry, relates to how compensation can incentivize short-term or long-term firm performance. Structures that focus on short-term performance or allow managers to share in investors' upside gains can encourage risk taking and lead to a concentration of investments in certain asset classes or securities. The proposal to remove the topic and the corresponding metrics is based on a lack of evidence to demonstrate the issue's relevance across the industry, as well as on stakeholder input.

Supporting Analysis

The SASB's analysis shows that incentives and compensation structures for employees involved in asset and wealth management are unlikely to have a material impact on the performance of a company. Therefore, disclosure on this topic is unlikely to provide decision-useful information to a reasonable investor.

According to the *SASB Conceptual Framework*, the evidence of financial impact is sufficient to consider the topic material to the industry as a whole when, "information provides an overall picture of whether the management or mismanagement of the topic has the potential to affect the valuation or operational and financial performance of most companies in an industry." The rationale for including the topic in the provisional standard was based on studies showing that, in a hedge fund setting, failure to generate performance fees may incentivize managers to take on tail risk. However, hedge funds represent a small percentage of the overall asset management industry and a negligible share when only publicly listed asset managers are considered (approximately 1.7 percent of global industry revenue, according to Bloomberg Professional as of June 5, 2017).

⁵⁰ FN0103-01: Discussion of variable compensation policies and practices

⁵¹ FN0103-02: Percentage of total compensation that is variable for: (1) executives and (2) all others

⁵² FN0103-03: Percentage of variable compensation that is equity for: (1) executives and (2) all others

⁵³ FN0103-04: Percentage of employee compensation which includes ex-post adjustments for: (1) executives and (2) all others

For a traditional asset manager, there is no evidence that the incentive compensation structure of individual employees or the fee structure of individual funds incentivizes excess risk-taking, which could impact the risk profile or financial condition of the company. Furthermore, the SASB's analysis of industry disclosure shows that less than seven percent of publicly listed asset management companies discuss employee compensation and risk taking in their annual filings with the SEC.

Stakeholder Consultation

Investors: While a relatively small number of analysts provided feedback on the topic, they unanimously stated that the topic is less applicable to the Asset Management & Custody Activities industry than to the Investment Banking & Brokerage industry, as the risk of moral hazard from compensation is less prevalent in the former.

Issuers: Issuers were not opposed to removing the topic. One of the largest issuers in the industry stated that compensation of sales employees would be of interest, in the context of it being an incentive for selling more products to clients. The link between the amount of compensation and the type of products sold may create a hazardous incentive for selling products that generate higher commissions rather than those suitable to clients. The compensation of sales employees is proposed to be addressed in the disclosure topic "Transparent Information & Fair Advice for Customers" (See Proposed Item #2-29) as it better fits the angles covered in that disclosure topic. The topic of "Employee Incentives & Risk Taking" has a different rationale, where compensation would have an impact on the riskiness of investment decision making rather than on the suitability of products sold to clients. Therefore, the issuers were in general agreement about the removal of the topic.

Benefits

Improves the SASB standard: The proposal would ensure that the standard includes only disclosure topics that are reasonably likely to have a material impact on industry companies, thereby minimizing the amount of reported information that would not be decision-useful to a reasonable investor.

Improves cost-effectiveness: The proposal would reduce the amount of new and unnecessary disclosure from issuers. The SASB's analysis of disclosure shows that 93.5 percent of U.S.-listed public issuers do not currently mention the topic in their SEC filings.

Proposed Update #2-27 – **Industry:** Asset Management & Custody Activities; **Topic Name:** Employee Inclusion

2017 Technical Agenda Item #2-27 Description

SASB is evaluating the revision of metric FN0103-05⁵⁴ to ensure the decision-usefulness of the metrics associated with the topic.

Summary of Change – Add Metric and Revise Metric

The SASB proposes revising provisional metric FN0103-05 from “Percentage of gender and racial/ethnic group representation for: (1) executives and (2) all others” to “Percentage of gender and racial/ethnic group representation for: (1) decision-makers and (2) all other employees,” where decision-makers include (a) Executives/Senior Officers & Managers, (b) First/Mid Officers & Managers, and (c) Professionals.

Note: For integrated banks, the guidance would be to report employees of the asset management segment. If the company is also involved in asset/wealth management, where the same metric is included, disclosure should include reporting by segment, not aggregated at the corporate level.

Adherence to Criteria for Accounting Metrics

The Asset Management & Custody Activities industry provisional standard includes a topic, Employee Inclusion, with an associated metric intended to measure how companies in the industry manage their human capital and ensure attraction and retention of talent by hiring diverse candidates. Asset management and custody companies face a high degree of competition for skilled employees, and the ability of companies to attract and retain them is likely to become increasingly material. By ensuring gender and racial diversity throughout the organization, companies are likely to expand their candidate pool. Further, evidence suggests that diverse groups of employees at asset management companies may increase portfolio return and reduce risk.

The provisional metric FN0103-05 provides a breakdown of gender/racial diversity at only two general levels: executives versus non-executives. The SASB proposes revising the metric to include a more decision-useful breakdown of employee categories. Specifically, the revised metric would separate employees involved in decision-making, which could directly impact the value of an organization, and all other employees. The “decision-makers” include the following categories from the U.S. Equal Employment Opportunity Commission’s (EEOC’s) EEO-1 Job Classification Guide: (1) Executives/Senior Officers & Managers, (2) First/Mid Officers & Managers, and (3) Professionals. Although the provisional metric provides a picture of the company’s overall workforce diversity, it fails to separate employees into categories where diversity may be a driver of the corporate value, i.e., decision makers. As highlighted by issuers and investors and supported by the evidence discussed below, diversity among employees involved in decision-making processes (e.g., portfolio managers, investment analysts, and traders) at financial institutions may improve the risk-return profile of organizations. Therefore, the proposed breakdown would provide more decision-useful information.

The proposed metric references the U.S. EEOC’s EEO-1 Job Classification Guide, which would enhance the alignment of the metric with standard practice, as well as the comparability and verifiability of the reported data. As supported by market feedback, the proposed change would also improve the fair representation, usefulness, and completeness of information disclosed in line with the metric, as the proposed breakdown would reveal additional relevant information that is decision-useful in assessing companies’ performance on the disclosure topic.

⁵⁴ FN0103-05: Percentage of gender and racial/ethnic group representation for: (1) executives and (2) all others

Supporting Analysis

Research suggests that diversity may be of particular importance within individual departments of investment banks and asset managers, such as trading desks, research and portfolio management teams, and sales, where diverse groups show better performance on metrics such as return on investment, risk, and client attraction and retention. Diversity within those groups of employees, as shown by evidence, can have a material impact on an asset manager. For example, one study shows that men are 2.5 times more likely to break rules, which can lead to excessive risk-taking and losses to the firm.⁵⁵ Further, a 2015 study by Morningstar found that funds run by mixed-gender teams of analysts and portfolio managers outperformed those run by only men or only women.⁵⁶ In order to understand a firm's diversity at the decision-useful level (as was done for the studies above), the metric should look at a breakdown deeper than simply executives versus non-executives, as asset managers and investment banks have a large number of staff not involved in investment decision-making, and whose activities do not impact the company's risk-return profile.

The provisional metric may obscure diversity levels within specific employee categories by grouping them together across the organization, as highlighted by market feedback (see Stakeholder Consultation).

Analysis of corporate disclosure suggests that large financial institutions report diversity metrics referencing categories defined by the EEOC. Some of the largest companies in the sector, including four of the ten largest integrated banks, for which the Asset Management & Custody Activities industry standard applies, provide disclosure using the EEOC categories proposed by the revision.

There are several challenges related to reporting racial/ethnic data outside of the United States. First, classification categories vary significantly country-by-country and region-by-region; therefore, it would not be practical or necessarily representative of racial/ethnic diversity for companies to aggregate their global number of employees by EEO-1 categories. Second, data are typically only available in some countries (e.g., Canada, Brazil) due to privacy laws preventing disclosure. Finally, some countries also look at age, disability, gender identity, sexual orientation, or other aspects of diversity, but these categories may be defined differently by each country.

The updated metric addresses these concerns by requiring gender breakdown globally but racial/ethnic breakdown per the EEO-1 categories only in the United States. Companies will describe their policies for promoting inclusivity and preventing the development of a homogenous workforce outside the U.S. that is not representative of local populations. They can also disclose racial/ethnic or other breakdowns by region or country-specific categories, if they choose. This update recognizes that a perfectly representative workforce would mirror population demographics but that regional demographics and ideal representation may vary widely. Thus, it improves the representativeness and the usefulness of the metric.

Stakeholder Consultation

Investors: Investors and issuers across sectors, including analysts covering investment banks and asset managers, consistently communicated that while a gender breakdown is relevant globally, a racial/ethnic group breakdown by EEO-1 categories is feasible only in the United States. In addition, some stated that the provisional metric is overly U.S.-centric and would not provide meaningful information for large multinational companies that operate in different countries.

⁵⁵ Sarah Butcher, "New Figures Show Women Make Better Traders than Men on Every Metric Imaginable," eFinancialCareers, January 26, 2015, accessed September 11, 2017, <http://news.efinancialcareers.com/us-en/197066/exclusive-figures-show-women-make-far-better-traders-men/>.

⁵⁶ "Morningstar Research Report: Fund Managers by Gender," Morningstar, June 2015, accessed September 11, 2017, <http://corporate.morningstar.com/US/documents/ResearchPapers/Fund-Managers-by-Gender.pdf>.

Issuers: Several banks and asset management companies noted that aggregating diversity across an organization may hinder its comparability, as companies reporting the data at the enterprise level while having a large retail banking presence would likely appear more diverse. Several companies raised concerns that segregating the data only at executive versus non-executive level masks the “true performance” when seemingly diverse companies overall may still have very poor diversity when the data is sliced at the department or seniority level. Companies from the Investment Banking & Brokerage and Asset Management & Custody Activities industries, where the SASB addresses Employee Inclusion as a disclosure topic, have shown strong support for a greater level of detail to highlight the importance of diversity in such roles as research and portfolio management, trading, IT, and others. Issuers stated that the proposed metric with a more detailed segregation would be cost-effective to report as it references (EEOC) categories that are used internally by companies. The vast majority of banks and asset management companies, as well as issuers across sectors, consistently communicated that while a gender breakdown is relevant globally, a racial/ethnic group breakdown by EEO-1 categories is feasible only in the United States. In addition, some stated that the provisional metric is overly U.S.-centric and would not provide meaningful information for large multinational companies that operate in different countries.

Benefits

Improves decision-usefulness: Additional breakdown by EEOC category, as well as reporting by segment improves fair representation, usefulness, and completeness of the proposed metric, and therefore provides more relevant information about performance and improves comparability across companies that may have different exposures to various segments.

Improves cost-effectiveness: As stated by issuers, the proposed metric is aligned with the framework used by human resources departments at companies, hence improves alignment, comparability, and verifiability criteria of the metric, which makes it cost-effective to collect and report. By limiting the required quantitative disclosure on race/ethnicity to U.S. operations, the proposal further improves cost-effectiveness.

Improves the SASB standard: This change improves cost-effectiveness by limiting the required quantitative disclosure on race/ethnicity to U.S. operations, which are measurable and complete. It also improves decision-usefulness by only requiring the aggregation of gender data, which is more likely to be comparable across issuers in different industries and geographies.

Proposed Update #2-28 – **Industry:** Asset Management & Custody Activities; **Topic Name:** Transparent Information & Fair Advice for Customers

2017 Technical Agenda Item #2-28 Description

SASB is evaluating the addition of a metric to ensure the relevance and decision-usefulness of the metrics associated with the topic.

Summary of Change – Add Metric

The SASB proposes adding a new metric, “(1) Number and (2) percentage of the registrant’s covered employees with a record of investment-related investigations, consumer-initiated complaints, private civil litigations, or other regulatory proceedings.”

Adherence to Criteria for Accounting Metrics

The Asset Management & Custody Activities industry provisional standard includes a topic, Transparent Information & Fair Advice for Customers, with two associated metrics to describe a financial institution’s approach to ensuring compliance with regulatory requirements and alignment of objectives with clients’ expectations.

The provisional set of metrics includes a quantitative metric asking for the amount of fines and settlements associated with failure to provide adequate and transparent information, and a qualitative metric requesting a description of policies and procedures related to ensuring that such information is passed on to clients. While the provisional set of metrics is useful in assessing the extent to which the registrant has been involved in issues related to transparency in the past, and the procedures it has undertaken to avoid any future complications on this topic, disclosures may nevertheless be insufficient under metric criteria of usefulness and completeness.

The addition of the proposed quantitative metric would improve both the usefulness and completeness of the set of metrics. Research suggests such information is useful as a forward-looking indicator of potential transgressions. The metric also broadens the information set by adding disclosure on past disputes or episodes of noncompliance that may not be directly tied to the firm, but are connected to current employees.

Supporting Analysis

Research highlights that information from BrokerCheck, the Financial Industry Regulatory Authority (FINRA) tool to research the background and experience of financial brokers, advisers and firms, “including disciplinary records, financial disclosures, and employment history of brokers has significant power to predict investor harm.”⁵⁷ Therefore, the percentage of employees with a disciplinary record would be a useful forward-looking indicator for client-initiated litigations and fines and settlements. “The FINRA By-Laws require brokers and registered representatives to report any disclosure event within 30 days after they learn about it and in some instances within 10 days. These rules ensure that there is not a significant lag in when the underlying event occurred and when it is reported.”⁵⁸ Such evidence suggests that addition of the metric would improve usefulness of the SASB standard on the disclosures related to the topic of Transparent Information & Fair Advice for Customers. The proposed change also improves the completeness

⁵⁷ Hammad Qureshi and Jonathan S. Sokobin, “Do Investors Have Valuable Information About Brokers?” FINRA Office of the Chief Economist Working Paper, August 20, 2015, accessed August 29, 2017, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2652535.

⁵⁸ Ibid.

criterion by including a forward-looking indicator which, when combined with the other metrics included in the topic, provides sufficient information for evaluating issues related to the topic.

Stakeholder Consultation

Investors: The metric was proposed by a subject matter expert as a useful forward-looking indicator. Feedback received from analysts indicates that referencing FINRA for a metric related to investment banks and asset managers is the best approach as such data can be standardized and collected in a cost-effective manner.

Issuers: Several large-cap, publicly listed companies with asset management operations stated that the proposed metric is relevant to the disclosure topic, applicable to companies in the industry, and may generate decision-useful information to investors, when the scope of disclosure is defined appropriately.

Benefits

Improves decision-usefulness: The proposed metric would significantly improve the decision-usefulness of the information disclosed on this topic as it provides forward-looking insight into a company's performance. As shown by studies and based on feedback received, the metric has been shown to have predictive ability and is also relevant fundamentally as an indicator of corporate culture with respect to human capital management (e.g., hiring practices).

Improves cost-effectiveness: The proposed metric references the industry regulatory framework and, therefore, the information would be mandatory to report to FINRA. Because companies already collect this data, it would be cost-effective for issuers to report this metric.

Proposed Update #2-29 – **Industry:** Asset Management & Custody Activities; **Topic Name:** Transparent Information & Fair Advice for Customers

2017 Technical Agenda Item #2-29 Description

SASB is evaluating the revision of metric FN0103-07⁵⁹ to ensure the relevance and decision-usefulness of the metrics associated with the topic.

Summary of Change – Revise Metric

The SASB proposes revising provisional metric FN0103-07 to require the discussion of procedures and programs intended to provide adequate and transparent information to customers, including how representatives' compensation structures are linked to sales of investment products and services.

Adherence to Criteria for Accounting Metrics

The Asset Management & Custody Activities industry provisional standard includes a topic, Transparent Information & Fair Advice for Customers, with associated metrics to describe a company's management of related risks and opportunities. Specifically, provisional metric FN0103-07 calls for a "Description of procedure or programs to provide adequate, clear, and transparent information about products and services, including risks, suitability, and conflicts of interest." The current technical protocol associated with this metric outlines the topics the issuer should describe in more detail. These include disclosure on relevant risks associated with complex or high-yield products that may be misaligned with clients' risk tolerance, a company's approach to adhering to FINRA's suitability rule, and disclosure on relevant conflicts of interest ranging from services paid for by clients' commissions and policies on employees' personal trading accounts. While the metric touches on important points for understanding a registrant's risks relating to potential lack of transparency or fairness toward customers, it leaves out a discussion of investment advisors' and sales representatives' compensation structure. Evidence suggests that this structure is relevant as a gauge of potential regulatory and legal issues that the registrant may face. A discussion on incentive structures improves completeness and applicability of the metric, in accordance with the attributes identified in the *SASB Conceptual Framework* as essential for technical protocols.

Supporting Analysis

The SASB's analysis supported by feedback from issuers suggest that misaligned compensation structures for employees involved in selling investment products to individual and institutional clients in several instances have resulted in violation of fiduciary duty through the failure to provide transparent information and fair advice about products, and sales of products not suitable to clients. In one of the more recent cases, a large company in the industry was accused of high-pressure contests for its financial advisers to cross-sell risky loans to clients. Incentive compensation structure allegedly resulted in financial advisers pushing clients to open credit lines even if they did not intend to use them. The case is still active and the company may be liable to compensate damages to clients. There have been multiple cases over the recent years where individual investors were impacted by such sales tactics driven by incentive structure of their advisers. Therefore, companies should discuss compensation of sales employees along with their discussion of procedure or programs to provide adequate, clear, and transparent information about products and services, including risks, suitability, and conflicts of interest.

⁵⁹ FN0103-07: Description of procedure or programs to provide adequate, clear, and transparent information about products and services, including risks, suitability, and conflicts of interest

Stakeholder Consultation

Investors: The SASB did not directly obtain feedback on the proposed change from analysts covering the Asset Management & Custody Activities industry.

Issuers: Some of the largest issuers in the industry stated that compensation of sales employees is a relevant element of the disclosure topic, as when mismanaged it can create conflicts of interest and incentivize advisers to sell products that are not in the best interest of their clients.

Benefits

Improves decision-usefulness: Discussion of compensation provides a relevant element to help analysts assess company performance on the topic. The proposed addition improves the completeness of the metric, as understanding incentive compensation is an integral element for assessing potential for conflict of interest.

Proposed Update #2-30 – **Industry:** Asset Management & Custody Activities; **Topic Name:** Management of the Legal & Regulatory Environment

2017 Technical Agenda Item #2-30 Description

SASB is evaluating the revision of metric FN0103-08⁶⁰ to ensure the relevance and decision-usefulness of the metrics associated with the topic.

Summary of Change – Add Metric and Revise Metric

The SASB proposes splitting metric:

- FN0103-08 Amount of legal and regulatory fines and settlements associated with financial industry regulation and percentage that resulted from whistleblowing actions

into its quantitative and qualitative components:

- FN0103-08 Total amount of losses as a result of legal proceedings associated with fraud, insider trading, anti-trust, anti-competitive, market manipulation, malpractice or other industry regulations

with a new metric subsequently created to capture whistleblower policies:

- Description of the whistleblower policies and procedures

Adherence to Criteria for Accounting Metrics

The current Asset Management & Custody Activities SASB industry standard includes a topic for Management of the Legal & Regulatory Environment with associated metrics to describe a company's management of risks related to the legal and regulatory environment. Specifically, the topic and two associated quantitative metrics provide information to help analysts assess a company's internal control policies to prevent tax evasion, fraud, money laundering, and corruption. The provisional metric FN0103-08 currently measures the amount of legal and regulatory fines and settlements that resulted from whistleblowing actions. The current metric is unlikely to provide a fair representation and complete view of the topic and a company's efforts and abilities to institute a successful whistleblower program, limiting its decision-usefulness. The revision of the existing metric will eliminate the need to disclose the percentage of fines and settlements stemming from whistleblowers. To more adequately capture the nature of a company's whistleblower program, the SASB proposes adding a qualitative metric that will facilitate disclosure of the unique characteristics of a company's whistleblower policies and practices in a more holistic manner. In tandem, both metrics would fairly represent the topic and improve the completeness of the standard.

Supporting Analysis

The provisional metric does not provide a complete picture of a company's whistleblower program, which may reduce its decision-usefulness. During the consultation period (see Stakeholder Consultation), SASB received feedback noting that reporting on the issue generally includes the amount of fines and settlements related to violations of financial

⁶⁰ FN0103-08: Amount of legal and regulatory fines and settlements associated with financial industry regulation and percentage that resulted from whistleblowing actions

industry regulations plus a stand-alone discussion of whistleblower policies. This was confirmed by an analysis of current disclosure practices in SEC filings. As a set, the pair of proposed metrics are more useful in measuring a company's performance on the topic because they provide a mix of quantitative and qualitative information, which is a characteristic that the provisional metric currently lacks. Reporting on the share of fines resulting from whistleblower action does not necessarily highlight the quality of a company's whistleblower policies. "For example," notes a report from Harvard Law, "Elements of an Effective Whistleblower Hotline," "a high volume of calls to a company's hotline (as compared to peers and its industry) may indicate that the company is experiencing significant compliance issues and potentially has an ineffective compliance and ethics program. Conversely, a high volume of hotline calls may suggest that the hotline is working as planned, that the company's compliance and ethics employee training program is effective, that there is greater awareness of the hotline and increased trust in the company's compliance department."⁶¹ The split of the metrics would consequently improve completeness of the metric by allowing investors to understand better the extent to which the volume of whistleblowing-related fines may be influenced by the registrant's policies regarding whistleblowing. The split improves the SASB criteria for fair representation and usefulness by making the links between whistleblowing policies and related fines clearer.

Stakeholder Consultation

Investors & others: A limited number of investors provided feedback on the proposed change. Nevertheless, those who did unanimously stated that the breakdown of regulatory fines and settlements resulting from whistleblowing actions is unlikely to yield additional decision-useful information, and is therefore unnecessary. Alternatively, these analysts and one subject matter expert recommended including a discussion of a company's whistleblower policies because, combined with other metrics proposed by SASB for this topic, it would provide a holistic view of the company's performance. Based on feedback from analysts, the share of fines resulting from whistleblower action does not necessarily highlight the quality of a company's whistleblower policies.

Issuers: Five companies, including large-cap integrated banks with wealth management operations and pure-play asset management issuers, also suggested to change the metric and include a qualitative discussion and analysis on whistleblower policies and a company's procedures.

Benefits

Improves decision-usefulness: Splitting the current provisional metric into two different metrics will improve the decision-usefulness of disclosure by providing a mix of quantitative and qualitative information. The quantitative metric on fines and settlements provides an indication of past performance on the topic, while a stand-alone qualitative discussion of whistleblower policies and practices sheds light on a company's unique whistleblower programs. In tandem, and compared to the previous requirement to report on the percentage of fines and settlements resulting from whistleblowing actions, both metrics fairly represent performance on the topic.

⁶¹ Bill Libit, Walt Draney, and Todd Freier, "Elements of an Effective Whistleblower Hotline," Harvard Law School Forum on Corporate Governance and Financial Regulation, October 25, 2014, accessed September 15, 2017, <https://corpgov.law.harvard.edu/2014/10/25/elements-of-an-effective-whistleblower-hotline/>.

Proposed Update #2-31 – **Industry:** Asset Management & Custody Activities; **Topic Name:** Management of the Legal & Regulatory Environment

2017 Technical Agenda Item #2-31 Description

SASB is evaluating the revision of metric FN0103-09⁶² to ensure the relevance, decision-usefulness, and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Remove Metric

The SASB proposes to remove metric FN0103-09, “Number of inquiries, complaints, or issues received by the legal and compliance office through an internal monitoring or reporting system, and percentage that were substantiated.”

Adherence to Criteria for Accounting Metrics

The current Asset Management & Custody Activities industry provisional standard includes a topic, Management of the Legal & Regulatory Environment, that is focused on a company’s management of risks related to the asset management industry’s legal and regulatory environment. Specifically, the topic and associated metrics provide information to help analysts assess a company’s internal control policies to prevent tax evasion, fraud, money laundering, and corruption. The other metric associated with the topic includes disclosure of the amount of legal and regulatory fines incurred that are associated with industry regulation and a description of the registrant’s policies and procedures regarding internal whistleblowing.

The provisional metric FN0103-09 currently measures the number of inquiries, complaints, or issues received by the legal and compliance office through an internal monitoring or reporting system, and the percentage that were substantiated. This metric is meant to be an indicator of the effectiveness of a company’s internal compliance controls and a forward-looking proxy for potential violations and subsequent fines and penalties. Nonetheless, as indicated by feedback from issuers, the provisional metric is lacking in comparability, as companies have different types of policies and procedures and internal controls, and therefore the number of inquiries could range significantly and not be indicative of actual performance on the topic. The removal of the metric will therefore retain the decision-usefulness of the disclosures contained in the remaining metrics (please refer to Proposed Item #2-30) on the topic, while reducing the cost burden of reporting, and avoiding potential issues in terms of comparability.

Supporting Analysis

SASB analysis of company disclosures has not revealed instances where a company would disclose the number of inquiries, complaints, or issues received by the legal and compliance offices. These findings echo the feedback received from issuers highlighting the issue with the provisional metric FN0103-09 of not being comparable, affecting also its decision-usefulness and appropriateness as a measure of performance.

Stakeholder Consultation

Investors: Several investors stated that the metric would be challenging to interpret in a decision-useful manner.

⁶² FN0103-09: Number of inquiries, complaints, or issues received by the legal and compliance office through an internal monitoring or reporting system, and percentage that were substantiated

Issuers: All three large issuers who provided comments on the disclosure topic unanimously expressed concerns with metric FN0103-09. Companies stated that it would not be cost-effective to obtain information comparable across issuers due to the fact that individual companies may have differences in their internal compliance processes. The current metric does not reference a recognized industry framework.

Benefits

Improves the SASB standard: Removal of the metric improves comparability of the remaining set of disclosures. Given that each company has different approaches to internal controls and reporting issues to internal compliance departments, removal of the metric prevents disclosure comparability issues between registrants.

Improves cost-effectiveness: The provisional metric would be very cost-burdensome to standardize to ensure comparability, and therefore its removal improves cost-effectiveness.

Proposed Update #2-32 – **Industry:** Asset Management & Custody Activities; **Topic Name:** Systemic Risk Management

2017 Technical Agenda Item #2-32 Description

SASB is evaluating the revision of metrics FN0103-10,⁶³ FN0103-13,⁶⁴ and FN0103-14⁶⁵ to ensure the alignment, decision-usefulness, and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Revise Metrics

The SASB proposes replacing the following provisional metrics:

- FN0103-10 (1) Registered and (2) unregistered assets under management
- FN0103-13 (1) Tier 1 common capital ratio (2) Tier 1 capital ratio (3) Total risk-based capital ratio (4) Tier 1 leverage ratio
- FN0103-14 Basel III Liquidity Coverage Ratio (LCR)

with these new metrics:

- Percentage of open-end fund assets under management by category of liquidity classification
- Discussion of how liquidity risk management programs are integrated into portfolio strategy and redemption risk management

Adherence to Criteria for Accounting Metrics

The Asset Management & Custody Activities industry provisional standard includes a topic, Systemic Risk Management, with associated metrics to describe a financial institution’s capacity to operate after economic shocks and the degree to which its operations may affect other companies and the broader economy. The objective of these metrics is to measure how a company manages its liquidity risk and whether it is well positioned to absorb shocks arising from financial and economic stress. A firm’s ability to absorb such shocks is important not only to the firm itself, but also the broader financial system, as financial institutions are usually creditors and debtors to myriad other firms.

Based on the SASB’s analysis and stakeholder feedback, the provisional metrics FN0103-10, FN0103-13, and FN0103-14 are not relevant for measuring the financial stability of companies in the industry. Therefore, the provisional metrics failed to satisfy the fair representation and usefulness criteria for accounting metrics outlined in the *SASB Conceptual Framework*. The provisional metrics were also not aligned with the regulatory approach to addressing systemic risk in the Asset Management & Custody Activities industry.

Adding a discussion of liquidity risk management, including the issuer’s approach to in-kind redemptions and swing pricing, would improve understanding of the firm’s stability. This proposed qualitative metric references SEC regulations for asset managers, including SEC Rule 22e-4, Form N-1A, and Form N-CEN, which require, respectively, disclosures on liquidity risk management, redeem-in-kind policies, and swing pricing policies. The broader scope of discussion on the subject, with disclosure focused on existing regulations, adds to the completeness of the metric, along with alignment and fair representation.

⁶³ FN0103-10: (1) Registered and (2) unregistered assets under management

⁶⁴ FN0103-13: (1) Tier 1 common capital ratio (2) Tier 1 capital ratio (3) Total risk-based capital ratio (4) Tier 1 leverage ratio

⁶⁵ FN0103-14: Basel III Liquidity Coverage Ratio (LCR)

Meanwhile, disclosing the distribution of assets classified under broad buckets of expected liquidity allows for a more granular understanding of the underlying risk of sudden outflows. The SEC requires covered firms to classify their assets as “highly liquid” (can be reasonably expected to be converted in three business days or less, without significantly changing the market value of the investment), “moderately liquid” (between three to seven days), “less liquid” (sale agreed on in up to seven days, but settlement taking longer) or “illiquid” (for assets outside the previous categories). Consequently, the addition of this metric improves the SASB standard by improving fair representation, usefulness, applicability, and alignment.

Supporting Analysis

The provisional metrics are not relevant to asset management companies because capital and liquidity coverage ratios apply to banks and are meant to measure balance sheet and off-balance sheet risk (which is not the risk for investment firms). The provisional metrics proposed for removal primarily focus on assets owned by firms rather than assets under management. Analysis by the SASB shows that liquidity, leverage, and interconnectedness are the factors that highlight exposure to systemic risk for asset managers. Interconnectedness and leverage are addressed through the provisional metrics FN0103-11 (please refer to Proposed Item #2-33) and FN0103-12, which highlight asset managers’ security lending and exposure to derivatives.

The SASB proposes to include two additional metrics measuring liquidity of assets under management. In 2016, the SEC adopted changes “to modernize and enhance the reporting and disclosure of information by registered investment companies and to enhance liquidity risk management by open-end funds, including mutual funds and exchange-traded funds (ETFs).”⁶⁶

Analysis of disclosures made by industry firms shows that at least 10 publicly listed asset management companies, including some of the largest companies, discuss Rule 22e-4, which regulates liquidity risk management programs, in their SEC filings. Consequently, this proposal would improve the usefulness and applicability of the metrics associated with the topic.

Stakeholder Consultation

Investors: All investors who commented on the proposal agreed that metrics FN0103-10, FN0103-13, and FN0103-14 are not relevant or decision-useful for assessing systemic risks of asset managers. Investors stated that metrics measuring liquidity, leverage, and interconnectedness through security lending are applicable.

Issuers: Some of the largest issuers stated that the provisional metrics are not relevant and that the proposed revision is reasonable, as liquidity, leverage, and interconnectedness are the main pillars of the systemic risk for asset managers. Analysis of SEC filings shows that asset management firms discuss the recent SEC proposals on liquidity of open-ended funds.

Benefits

Improves the SASB standard: Removal of the provisional metrics and replacing them with the proposed metrics improves relevance of information provided to investors. The proposed metrics significantly improve fair representation of registrants’ performance on the disclosure topic.

⁶⁶ “SEC Adopts Rules to Modernize Information Reported by Funds, Require Liquidity Risk Management Programs, and Permit Swing Pricing,” U.S. Securities and Exchange Commission, October 13, 2016, <https://www.sec.gov/news/pressrelease/2016-215.html>.

Improves cost-effectiveness: Removing several provisional metrics that were not applicable, and therefore not reported by registrant, and replacing them with those covered by industry regulations and relevant to issuers improves cost-effectiveness of disclosure.

Improves decision-usefulness: Improving fair representation, usefulness, and relevance of metrics included in the disclosure topic significantly enhances decision-usefulness of information provided to investors.

Proposed Update #2-33 – **Industry:** Asset Management & Custody Activities; **Topic Name:** Systemic Risk Management

2017 Technical Agenda Item #2-33 Description

SASB is evaluating the revision of metric FN0103-11⁶⁷ to ensure the alignment and decision-usefulness of the metrics associated with the topic.

Summary of Change – Revise Metric

The SASB proposes replacing provisional metric FN0103-11, “Value of collateral received from securities lending and amount received from repurchase agreements involving clients’ assets” with “Total exposure to securities financing transactions.”

Adherence to Criteria for Accounting Metrics

The Asset Management & Custody Activities industry provisional standard includes a topic, Systemic Risk Management, with associated metrics to describe a financial institution’s capacity to operate after economic shocks and the degree to which its operations may affect other companies and the broader economy.

Provisional metric FN0103-11’s objective is to provide a measure of a company’s interconnectedness and the extent to which it can absorb shocks arising from economic stress, whether internal or stemming from other market participants. However, the metric does not directly address the issues that are relevant for financial stability in this industry and is not well aligned with industry reporting practices. As such, the provisional metric does not meet the criteria of usefulness, applicability, and alignment, as set forth in the *SASB Conceptual Framework*.

The proposed metric, which provides a measure of a firm’s securities financing exposure, would improve understanding of the systemic risk to which a firm is exposed and would be aligned with existing industry reporting practices. The proposed metric uses the Bank for International Settlements’ guidelines for measuring exposure to securities financing transactions (SFTs), helping assess the extent to which the registrant is interconnected with the broader financial sector and the risk that a shock to the broader economy or one of the sector’s firms could affect the registrant itself. This change adds to the standard by adding to the metric’s alignment, usefulness, and completeness.

Supporting Analysis

The proposed revision aligns disclosure on SFTs with the Basel III⁶⁸ framework. The report states that, “secured lending and borrowing in the form of SFTs is an important source of leverage, and ensures consistent international implementation by providing a common measure for dealing with the main differences in the operative accounting frameworks.”

The intent of provisional metric FN0103-11 was to measure exposure to such financing activities, but its structure did not align with existing reporting frameworks. The value of collateral received is not how asset managers and banks address their leverage and interconnectedness risks associated with the SFT activities. The provisional metric is not capturing all the elements of risk associated with such activities and therefore does not satisfy the completeness

⁶⁷ FN0103-11: Value of collateral received from securities lending and amount received from repurchase agreements involving clients’ assets

⁶⁸ “Basel III Leverage Ratio Framework and Disclosure Requirements,” Bank for International Settlements, Basel Committee on Banking Supervision, January 2014, accessed August 29, 2017, <http://www.bis.org/publ/bcbs270.pdf>.

criterion. Value of collateral received is also volatile, so it may not necessarily be useful for assessing company's risk exposure as it may change substantially under new market conditions. The SFT exposure in the proposed format, though, is addressed by the Securities Financing Transactions Regulation, and the SASB's analysis of industry disclosures shows that a large number of U.S. and international publicly listed companies report this information in their SEC filings. As such, the new metric adds to the alignment, usefulness, and completeness of the SASB standard.

Stakeholder Consultation

Issuers: Feedback from a limited number of large-cap issuers indicated that the change is warranted and that existing SFT disclosure under Basel III is aligned with the proposed SASB metric.

Others: Feedback from subject matter experts confirmed that the value of collateral is impossible to measure and disclose in a decision-useful manner and the alignment with the existent regulatory framework improves the aforementioned criteria for metric selection.

Benefits

Improves decision-usefulness: The proposed change ensures alignment of the metric with regulatory reporting requirements, making the information provided to investors more decision-useful.

Proposed Update #2-34 – **Industry:** Asset Management & Custody Activities; **Topic Name:** Integration of Environmental, Social, and Governance Risk Factors in Investment Management & Advisory

2017 Technical Agenda Item #2-34 Description

SASB is evaluating the revision of metric FN0103-17⁶⁹ to ensure the decision-usefulness and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Revise Metric

The SASB proposes replacing metric:

- FN0103-17 Percentage of total proxies voted, and number of proxy votes supporting environmental, social, and/or governance (ESG) shareholder proposals, including percentage resulting in company action

with metric:

- Description of proxy voting and investee engagement policies and procedures

Adherence to Criteria for Accounting Metrics

The provisional Asset Management & Custody Activities standard includes a topic for Integration of Environmental, Social, and Governance Risk Factors in Investment Management & Advisory to describe how companies maintain their fiduciary duty to clients by integrating ESG factors with potential impact on value for investees in investment management. The process of ESG integration involves consideration of ESG factors in valuation, modeling, proxy voting, and engagement with investees and, as a result, in investment decision making by asset managers. Metrics included in the disclosure topic are meant to capture the quality of a registrant’s integration processes in each of the applicable activities.

The provisional metric FN0103-17 is a quantitative measurement of the registrant’s proxy voting activities. However, it does not adhere to the criterion of fair representation, as it is not indicative of the quality of the registrant’s ESG integration. In some cases, such measures may create a moral hazard and incentivize issuers to vote in favor of all ESG proposals without a proper consideration of cost-benefit to investors. Furthermore, the provisional metric includes the percentage of proxies voted that result in company action. However, this is outside of the registrant’s control, which further supports the notion that the metric does not adhere to the fair representation criterion.

The SASB proposes to replace the provisional quantitative metric with a qualitative discussion of the registrant’s policies and procedures around proxy voting and issuer engagement. The proposed change is aimed to improve the criterion of fair representation, while also improving the usefulness of the information generated by the metric. Furthermore, the proposed revised metric supplements the discussion on proxy voting with the discussion on engagement with investees to highlight another relevant aspect of ESG integration and further improve the usefulness of the standard.

⁶⁹ FN0103-17: Percentage of total proxies voted, and number of proxy votes supporting environmental, social, and/or governance (ESG) shareholder proposals, including percentage resulting in company action

The SASB also proposes to align the technical protocol of the updated metric with the disclosure recommendations provided by the United Nations-supported Principles for Responsible Investment (U.N. PRI) in its Reporting Framework for Direct – Listed Equity Active Ownership. The reporting framework addresses asset managers’ approach to proxy voting and engagement that falls within the scope of the disclosure topic and the rationale of the proposed metric. The SASB proposes to include the components. The alignment is likely to improve the cost-effectiveness of the standard.

Supporting Analysis

The Securities and Exchange Commission’s Rule on Proxy Voting by Investment Advisers⁷⁰ requires asset managers to vote “proxies in the best interests of clients, to disclose to clients information about those policies and procedures, and to disclose to clients how they may obtain information on how the adviser has voted their proxies.” Therefore, the “percentage of total proxies voted” included in the provisional metric would not generate distributive and useful information to investors.

While the U.N. PRI signatories have more than \$60 trillion in assets under management (AUM) that is supposed to invest client assets while considering ESG criteria, it has been challenging to understand the definition of ESG integration used by these asset managers, and, therefore, to distinguish among them based on the robustness of their processes. As a part of its 2016 Reporting Framework for Direct – Listed Equity Active Ownership, the U.N. PRI captures proxy voting and engagement as two of the relevant elements applicable to the ESG integration process. The Framework includes multiple questions aimed at understanding asset managers’ policies and procedures around voting proxies, along with a few quantitative indicators.

The U.N. PRI is considering updating the proxy voting and engagement framework by emphasizing the qualitative elements of discussion around decision making in vote casting, as well as the link to investment decision making. The changes are mostly driven by feedback the PRI received from its signatories that quantitative measures on the percentage of proxies supported or number of meetings conducted with investees are not indicative of the quality of ESG integration. Regardless of views on regulations surrounding the shareholder proposal process, companies in the asset management industry must, generally speaking, assess the materiality and alignment of proxy proposals with their clients’ long-term interests. For that reason, measuring the robustness of a company’s approach to proxy voting quantitatively may not necessarily be appropriate without consideration of the cost-benefit of individual proposals. Therefore, the provisional metric fails to satisfy the criterion of fair representation, as to adequately and accurately describe performance related to the applicable disclosure topic.

The U.N. PRI Reporting Framework for Direct – Listed Equity Active Ownership, through its questionnaire for asset managers, primarily hones in on qualitative aspects of performance such as robustness of the adopted policies and ensuring compliance. The SASB proposes to model the approach to measuring performance on the topic on the PRI’s Framework. The proposed update to the provisional metric improves its usefulness and alignment as defined by the *SASB Conceptual Framework* by providing information relevant to assess the quality of ESG integration and by aligning it with the PRI, which is a widely recognized framework. Issuers suggested that a discussion of policies around ESG proxy voting is a more decision-useful way of measuring performance.

Companies would still be able to report quantitative metrics when they feel it is appropriate. To improve cost-effectiveness of such disclosure, SASB aligns the technical protocol of the updated metric with the U.N. PRI guidance on proxy voting and engagement.

⁷⁰ “Final Rule: Proxy Voting by Investment Advisers, 17 CFR Part 275,” U.S. Securities and Exchange Commission, <https://www.sec.gov/rules/final/ia-2106.htm>.

Stakeholder Consultation

Investors: The SASB did not directly obtain feedback on the proposed change from analysts covering the Asset Management & Custody Activities industry.

Issuers: All of the pure-play asset managers and integrated banks involved in asset management activities that provided feedback on the SASB standards stated that the proposed metric is more appropriate and cost-effective to measure performance on the quality of ESG integration efforts. The issuers echoed the feedback the PRI received (as discussed above), suggesting that the provisional metric FN0103-17 is unlikely to be decision-useful as the number of submitted proposals varies, the quality and relevance of those proposals to all investors may vary, the actions taken by investees are outside of asset managers' control, and that, generally, the data would provide no information to help investors in understanding the quality of management of the corresponding disclosure topic by registrants. According to feedback, the discussion on the proposed metric is often reported in ESG filings. Wealth managers commented that the Discussion & Analysis approach to the metric is more appropriate, as the proxy-voting policies may not be applicable to the segment due to the lack of voting rights.

Others: As highlighted above, the SASB received substantial feedback from the U.N. PRI and organizations aligning their approaches to managing ESG integration and asset management activities.

Benefits

Improves decision-usefulness: According to the feedback received, the initial metric might have generated a significant amount of information that would not be decision-useful and potentially misleading to investors, in violation of fair representation, a guiding criterion of metrics development for the standards. Decision-useful information that fairly represents corporate performance concerning the degree and nature of asset managers' engagement with investees and satisfaction of their fiduciary duties is likely to be generated through a standardized and structured discussion of policies and practices rather than quantitative data.

Improves cost-effectiveness: A number of issuers stated that the proposed qualitative metric is more cost-effective to disclose than a quantitative measure due to the scope defined in the technical protocol of the provisional metric.

Proposed Update #2-35 – **Industry:** Asset Management & Custody Activities; **Topic Name:** Integration of Environmental, Social, and Governance Risk Factors in Investment Management & Advisory

2017 Technical Agenda Item #2-35 Description

SASB is evaluating the removal of metric FN0103-18⁷¹ to ensure the relevance and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Remove Metric

The SASB proposes to remove metric FN0103-18, “Ratio of embedded carbon dioxide emissions of proved hydrocarbon reserves held by investees to total assets under management.”

Adherence to Criteria for Accounting Metrics

The provisional Asset Management & Custody Activities standard includes a topic for Integration of Environmental, Social, and Governance Factors in Investment Management & Advisory to describe how companies maintain their fiduciary duty to clients by integrating ESG factors with potential impact on value of investees in investment management. The process of ESG integration involves consideration of ESG factors in valuation, modeling, proxy voting, and engagement with investees and, as a result, in investment decision making by asset managers. Metrics included in the disclosure topic are meant to capture the quality of registrants’ integration processes in each of the applicable activities.

The provisional metric FN0103-18 measures the ratio of embedded carbon dioxide emissions of proved hydrocarbon reserves held by investees to total assets under management, which is focused on the climate risk, specifically carbon-related climate risk, exposure of companies held in portfolios of asset managers.

The provisional metric does not satisfy the SASB criterion of fair representation as it is not indicative of the registrant’s quality of integration of ESG factors in investment management and is, for the most part, derivative of investment strategies employed by registrants (which are most often driven by investor mandates). To fulfill their fiduciary duty, investment managers consider a wide range of financial and non-financial factors, including balance sheet, income statement, and cash flow items, as well as various ESG-related metrics, in constructing portfolios. Exposure to carbon reserves is one of many factors that needs to be taken into account and, therefore, when taken in isolation and not relative to a benchmark, may not be indicative of poor risk-return profile of individual mandates. Higher carbon exposure may often be the result of a specific strategy employed by the managers, and therefore such managers should not be evaluated based on that indicator alone.

The metric fails to satisfy the criterion of verifiability due to its complexity of calculation, heavy reliance on estimates, and significant reporting cost burden. Further, the provisional metric fails to satisfy the criterion of usefulness as it fails to provide information investors in asset management companies as issuers would be able to use for comparability purposes and act upon. Therefore, the SASB proposes to remove the provisional metric FN0103-18.

⁷¹ FN0103-18: Ratio of embedded carbon dioxide emissions of proved hydrocarbon reserves held by investees to total assets under management

Supporting Analysis

Analysis of corporate disclosure showed that no asset managers report embedded carbon dioxide emissions of proved hydrocarbon reserves held by their investees. The recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) for asset managers include a metric focused on exposure to carbon emissions, not on carbon reserves. Feedback the TCFD received from issuers indicated extreme complexity of calculation of their metric and the need to avoid overlap and use of estimates. This highlights the fact that the provisional metric is unlikely to be cost-effective to report due to the lack of verifiability. The TCFD itself also acknowledges these limitations of the metric by stating the following: “The Task Force acknowledges the challenges and limitations of current carbon footprinting metrics, including that such metrics should not necessarily be interpreted as risk metrics. Nevertheless, the Task Force views the reporting of weighted average carbon intensity as a first step and expects disclosure of this information to prompt important advancements in the development of decision-useful, climate-related risk metrics. [. . .] The Task Force recognizes that some asset owners and asset managers may be able to report the weighted average carbon intensity and other metrics on only a portion of their investments given data availability and methodological issues.”⁷²

Stakeholder Consultation

Issuers & others: Feedback from issuers and subject matter experts suggest that metric FN0103-18 is not a decision-useful measure of ESG integration, which is the focus of the disclosure topic. This supports the conclusion that the provisional metric does not satisfy the criterion for fair representation. Inherently, the provisional metric is highlighting only one of the many ESG risks investees of asset managers are exposed to, which was thought of as inappropriate by multiple issuers in the industry. Instead, issuers and subject matter experts stated that metrics included in this topic should describe the processes a company employs to integrate ESG in its investment management and the strategies it employs to increase the assets under management (AUM) employing ESG integration (e.g., waiting for investor demand, or active creation and marketing of products and education of clients on the benefits of ESG investing). According to feedback from issuers and other stakeholders (including the U.N. PRI), metric FN0103-18 was not providing decision-useful information to assess quality of ESG integration, was not cost-effective, was difficult to standardize, and was not useful to compare asset managers that use different investment strategies.

Investors: Investors unanimously stated that metrics included in this topic should describe the processes a company employs to integrate ESG in its investment management and the strategies it employs to increase the assets under management (AUM) employing ESG integration (e.g., waiting for investor demand, or active creation and marketing of products and education of clients on the benefits of ESG investing). According to investor feedback, metric FN0103-18 was not providing decision-useful information to assess quality of ESG integration, was not cost-effective, was difficult to standardize, and was not useful to compare asset managers that use different investment strategies.

Benefits

Improves the SASB standard: By removing the metric, SASB reduces the amount of information that is unlikely to be decision-useful to a reasonable investor, thereby improving materiality of the standard. It further improves cost-effectiveness for reporting for issuers.

⁷² “Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures,” Task Force on Climate-related Financial Disclosures, June 2017, accessed September 19, 2017, https://www.eenews.net/assets/2017/06/29/document_cw_02.pdf.

Proposed Update #2-36 – **Industry:** Asset Management & Custody Activities; **Topic Name:** Activity Metrics

2017 Technical Agenda Item #2-36 Description

SASB proposes to include activity metrics for the Asset Management & Custody Activities industry.

Summary of Change – Add Activity Metrics

The SASB proposes adding the following activity metrics: “Total (1) registered and (2) unregistered assets under management (AUM)” and “Total assets under custody and supervision.”

Rationale

The SASB proposes adding activity metrics as a new element of the Asset Management & Custody Activities standard. At the time of release of the provisional standards for the Financials sector, the SASB had not incorporated the concept of activity metrics into the industry standards. Activity metrics are useful for measuring the scope and scale of a company’s operations, providing normalization factors for the performance metrics included in the disclosure topics.

Supporting Analysis

The proposed metrics are aligned with industry norms for reporting the size of operational activities. Moreover, the metrics are commonly reported by publicly listed companies in annual SEC filings, underlining their relevance and suggesting that their addition would not have a significant negative impact on the cost-effectiveness of the standard. Finally, the metrics are regularly used by analysts and third-party data providers to measure the size of asset management companies and custodian banks, suggesting that adding them as a component of the SASB standard would improve overall decision-usefulness of the information disclosed by registrants.

Registered AUM include those subject to the regulations of the Investment Company Act of 1940 (1940 Act) (such as mutual funds), managed under the Employee Retirement Income Security Act of 1974 (ERISA), subject to the Undertakings for Collective Investment in Transferable Securities (UCITS) directive, or managed under the Commodity Futures Trading Commission’s (CFTC’s) Commodity Pool Operator (CPO) regulations. Unregistered AUM are those that do not fall under the definition of “registered AUM.”

Stakeholder Consultation

Investors: The SASB received feedback from three large-cap integrated banks with asset and wealth management operations that the proposed metric related to AUM is relevant, decision-useful, and partially disclosed already (registered AUM). The SASB did not receive feedback regarding the assets under custody metric.

Issuers: The SASB received limited feedback from investors on the proposed activity metrics in the Asset Management & Custody Activities industry. The feedback indicates that the proposed metric related to AUM is cost-effective to report as it is aligned with internally collected information and, for the most part, is already disclosed publicly. The SASB did not receive feedback regarding the assets under custody metric as it was proposed after the consultation period to ensure applicability to the custody banks, the segment included in the scope of the industry.

Benefits

Improves the SASB standard: The activity metrics provide investors with normalization factors to ensure comparability of SASB metrics across issuers.

Improves decision-usefulness: The proposed metrics improve decision-usefulness of all quantitative SASB metrics included in the standard by allowing investors to convert them from absolute to relative measures of performance.



FINANCIALS SECTOR

CONSUMER FINANCE INDUSTRY

Sustainability Accounting Standard

Sustainable Industry Classification System™ (SICS™) #FN0201

Prepared by the
Sustainability Accounting Standards Board®

October 2017

Proposed Changes to Provisional Standard - Basis for Conclusion

Proposed Update #2-37 – **Industry:** Consumer Finance; **Topic Name:** Financial Inclusion

2017 Technical Agenda Item #2-37 Description

SASB is evaluating the removal of the topic, including corresponding metrics, due to its potential to affect corporate value, relevance across the industry, and interest among investors.

Summary of Change – Remove Topic and Metrics

The SASB proposes removing the provisional topic Financial Inclusion, along with its associated metrics:

- FN0201-01 Revenue from credit and debit products targeting unbanked and underbanked segments
- FN0201-02 Percentage of new accounts held by first-time credit card holders

Adherence to Principles for Topic Selection

This topic, included in the provisional standard for the Consumer Finance industry, relates to the financial inclusion of unbanked or underbanked individuals and its impact on financial outcomes of companies in the industry. The proposal to remove the topic, and its corresponding metrics, is based on a lack of evidence of the topic’s potential to materially affect the value of companies in the industry and its lack of systematic relevance across the industry. Further, the proposal is reflective of investor and issuer consensus. While companies in the Consumer Finance industry primarily provide services through credit products and have unbanked and underbanked individuals as primary customers, the FDIC [defines](#) an unbanked individual as those lacking access to checking and savings accounts, which are not a core product for the industry. In other words, financial inclusion is a much more relevant topic to companies providing checking and savings accounts to consumers. Furthermore, related aspects of this topic are captured in separate topics within the provisional standard, including Responsible Lending & Debt Prevention as well as Transparent Information & Fair Advice for Customers.

Supporting Analysis

Findings from the SASB’s own internal research along with feedback from investors led to the conclusion that the topic of Financial Inclusion is not relevant to the Consumer Finance industry. The SASB’s analysis of corporate disclosure and research of the existent evidence failed to identify instances of pure-play Consumer Finance companies or integrated banks with consumer finance operations addressing the social issue of individuals being excluded from the financial system while increasing their corporate value in the long term. By definition, unbanked customers are those with no access to checking or savings accounts. Given that Consumer Finance companies normally do not have checking and savings accounts as a core product, the topic is not directly relevant to these companies. On the other hand, the SASB’s evidence-based research uncovered multiple instances in recent years of industry companies involved in predatory sales practices. Unbanked and underbanked segments are often primary targets for sales of pre-paid debit and high-interest credit cards, which present significant industry-specific risks to companies within the industry. While such practices often provide a positive short-term financial impact, they result in negative social externalities such as imposing substantial cost on unbanked and underbanked consumers through high-fee products, thereby contributing to their indebtedness. In the long run, predatory selling practices were shown to have a negative financial impact on the value of Consumer Finance companies. The provisional standard includes two separate topics—Responsible Lending & Debt Prevention, and Transparent Information & Fair Advice for Customers (please refer to Proposed Item #2-40)—which address industry-specific risks closely related to Financial Inclusion, including the aggressive or predatory selling practices described here. Therefore, the Financial Inclusion topic may be removed

without limiting the standard's coverage of those related risks that are reasonably likely to have material impacts on companies in the industry.

Stakeholder Consultation

Investors: Multiple investors unanimously stated that, for many Consumer Finance companies, unbanked and underbanked customers are a primary segment of revenue generation. Investors do not think of such practices as a sustainability issue linked to Financial Inclusion. In fact, on the contrary, investors stated that providing services to unbanked and underbanked customers exposes industry companies to sustainability risks related to fair advertising and marketing and aggressive selling practices. In sum, investors believed that the topic of Financial Inclusion was not relevant given the other topics proposed and the characteristics of the industry.

Issuers: Several integrated banks commented that the topic is unlikely to be material to their operations. These companies indicated that the risks associated with servicing underbanked customers—as they are already “included”—is the real sustainability issue for companies. That related issue would be addressed in the proposed Selling Practices topic (please refer to Proposed Item #2-40).

Benefits

Improves the SASB standard: The proposal would improve the focus of the SASB standard by removing a topic that failed to provide relevant and decision-useful information to investors due to it not being relevant across the industry and its lack of potential to affect corporate value. Therefore, the removal improves decision-usefulness and cost-effectiveness of the standard.

Proposed Update #2-38 – **Industry:** Consumer Finance; **Topic Name:** Customer Privacy & Data Security

2017 Technical Agenda Item #2-38 Description

SASB is evaluating revisions to the topic, including the corresponding metrics FN0201-03,⁷³ FN0201-04,⁷⁴ and FN0201-05,⁷⁵ due to its potential to affect corporate value, relevance across the industry, and interest among investors.

Summary of Change – Revise Topic

The SASB proposes to split the provisional disclosure topic “Customer Privacy & Data Security” into two separate topics -- “Customer Privacy” and “Data Security” -- with the following metrics:

Customer Privacy

- Number of account holders whose information is used for secondary purposes, percentage who have opted in
- Total amount of losses as a result of legal proceedings associated with customer privacy

Data Security

- Number of data security breaches, percentage involving customers’ personally identifiable information (PII), number of customers affected
- Card-related fraud losses from: (1) card-not-present fraud and (2) card-present and other fraud
- Description of data security and fraud prevention efforts related to new and emerging technologies and/or new and emerging threats

Adherence to Principles for Topic Selection

The Consumer Finance industry provisional standard includes a topic for Customer Privacy & Data Security with associated metrics to describe how a company identifies and addresses vulnerabilities and threats to customer data security and how it manages the balance between leveraging customer personal data for revenue opportunities and protecting customer privacy. In order to align the standard with the *SASB Conceptual Framework*, and maintain distinct sustainability topics, the SASB is proposing to split the “Customer Privacy & Data Security” into its two different angles.

The Customer Privacy topic addresses risks and opportunities associated with a company’s internal use of data supplied by customers for activities that were not the primary purpose for which they were collected (for example, for use in targeted advertising and/or transfer to third parties). The metrics for this disclosure topic would focus on providing more detail on the policies and procedures around the use of private customer data for ancillary purposes, along with information on legal or regulatory actions taken against the registrant that are related to customer protection and privacy.

⁷³ FN0201-03: Number of data security breaches and percentage involving customers’ personally identifiable information

⁷⁴ FN0201-04: Amount of fraudulent transaction activity, percentage from: (1) card-not-present fraud and (2) card-present and other fraud

⁷⁵ FN0201-05: Description of data security and fraud prevention efforts related to new and emerging technologies and/or new and emerging threats

The Data Security topic addresses risks and opportunities associated with how registrants deal with the safety of the data supplied to them by customers from external threats. The metrics for this disclosure topic would focus on providing more detail on efforts related to safeguarding data against emerging and continuously evolving cybersecurity threats and technologies, actual security breaches compromising customers' personally identifiable information, and credit/debit card fraud.

Supporting Analysis

The nature of both elements of the current provisional disclosure topic are fundamentally different, as one relates to how companies manage customer private data for internal purposes (i.e., intended use), and the other focuses on how this information is protected from external threats (i.e., unintended use). As such, corporate policies, programs, and strategies to manage these distinct issues are inherently different.

The Customer Privacy topic addresses risks and opportunities associated with secondary uses of customer information. In managing this topic, companies need to determine how these data are going to be used, how to obtain customer consent to use such information for secondary purposes, and how to reduce the risks to reputation of increasing public focus on customer privacy, among other considerations.

Data Security addresses how companies ensure that the data given to them by customers is not stolen or compromised by external parties. In managing this topic, companies need to invest heavily on information technology to have robust cybersecurity systems in place to prevent misappropriation of customer private data and reduce the negative impact of security breaches if they do occur.

Additionally, the regulatory environment governing and affecting both topics is different. For example, privacy-related regulations include: Regulation P: Privacy of Consumer Financial Information in the U.S., the Data Protection Directive in the E.U., Japan's Act on the Protection of Personal Information, Hong Kong's Personal Data (Privacy) Ordinance, and Australia's Privacy Act, among others. Cybersecurity regulatory requirements include the SEC Division of Corporation Finance's CF Disclosure Guidance: Topic No. 2: Cybersecurity; and the New York State Department of Financial Services' 23 NYCRR 500 Cybersecurity Requirements for Financial Services Companies.

Adherence to Criteria for Accounting Metrics

The SASB proposes to retain provisional metrics FN0201-03, FN0201-04, and FN0201-05 included in the "Customer Privacy & Data Security" provisional topic within the new stand-alone "Data Security" topic. These metrics assess external risks and opportunities associated with the safety of data provided by customers. Specifically, FN0201-03 requires registrants to disclose relevant information on the number of data security breaches suffered during a given period and the percentage of these that involved customers' personally identifiable information. The SASB proposes an additional change to metric FN0201-03 (please refer to item #2-39).

FN0201-04 provides information on the value of card-related fraud losses as an indicator of the robustness of a registrant's security and fraud prevention systems. The metric is in line with the SASB criteria for metrics due to applicability, comparability, verifiability, and completeness. The SASB additionally proposes to change the provisional metric FN0201-04 from "Amount of fraudulent transaction activity, percentage from: (1) card-not-present fraud and (2) card-present and other fraud" to "Card related fraud losses from: (1) card-not-present fraud and (2) card-present and other fraud" to align the terminology with that used by companies in the Consumer Finance industry.

Finally, FN0201-05 encourages registrants to describe data security and fraud prevention efforts related to new and emerging technologies and threats. The discussion is intended to give more detail into the registrant's initiatives and

approaches toward safeguarding customer data, and it complements the other quantitative metrics with important narrative. The metric improves the SASB standard in terms of completeness.

Additionally, the SASB proposes to add three new metrics. These are related to the new stand-alone “Customer Privacy” topic. The first metric is the number of account holders whose information is used for marketing purposes and the percentage of customers who opted in. The quantity of clients whose information is shared, how it is shared, and their say in the process, allow for a deeper understanding of the registrant’s approach to managing this topic. The metric adds to the objectives of the standard due to its comparability across all issuers in the industry. The second proposed metric measures the amount of legal and regulatory fines and settlements associated with customer privacy. This metric helps to gauge past performance in terms of regulatory compliance. As this metric includes references to regulatory rules, it adds to the objectives of the standard due to its applicability, comparability, verifiability, and alignment. Finally, the third metric is a discussion of transparency policies and practices and how customers are informed about how their data are being used for secondary purposes. This information is helpful in assessing risks and opportunities from potential legal and regulatory actions resulting from customer complaints, along with societal expectations and changing customer perceptions around data privacy. The three metrics are in line with the *SASB Conceptual Framework* criteria of completeness.

Stakeholder Consultation

Investors: Several large investors who provided feedback on the topic unanimously stated that they look at data security and customer privacy as distinct topics, and were supportive of the SASB approach to split the provisional disclosure into two. Analysts stated that the proposed metrics would be helpful in assessing performance on both topics.

Issuers: The SASB received feedback from a limited number of integrated banks and pure-play consumer finance companies on the proposed split. The companies that provided feedback unanimously stated that they draw a distinction between issues related to data security and those related to customer privacy. Integrated banks with both commercial banking and consumer finance operations stated that they may use customer information for secondary purposes only in their credit card segment.

Benefits

Improves the SASB standard: The proposed topic split would highlight two distinct sustainability challenges faced by the industry, thereby improving the relevance and completeness of the standard.

Improves decision-usefulness: As highlighted by feedback, the proposed split of the topic and associated metrics would be decision-useful for analysts to assess performance on these two distinct sustainability issues.

Proposed Update #2-39 – **Industry:** Consumer Finance; **Topic Name:** Customer Privacy & Data Security

2017 Technical Agenda Item #2-39 Description

SASB is evaluating the revision of metric FN0201-03⁷⁶ to ensure the decision-usefulness of the metrics associated with the topic.

Summary of Change – Revise Metric

The SASB proposes revising provisional metric FN0201-03 from “Number of data security breaches and percentage involving customers’ personally identifiable information” to “Number of data security breaches, percentage involving customers’ personally identifiable information (PII), number of customers affected.”

Adherence to Criteria for Accounting Metrics

The Consumer Finance industry provisional standard includes a topic, Customer Privacy & Data Security, with associated metrics that describe a company’s management of risks related to the storage and protection of its users’ sensitive data. The provisional metric is ambiguous in terms of what data are being asked for. Specifically, the technical protocol of the provisional metric does not satisfy two technical protocol attributes, measurability and completeness. The proposed revision will eliminate ambiguity regarding what data are being asked for by clarifying that the number of unique data security breaches shall be disclosed, thereby improving the measurability and completeness of the metric. Furthermore, the proposed revised metric will provide more useful information by including the number of customers affected by such data security breaches—a critical element to understanding the magnitude of the breaches. The proposed metric benefits from being more aligned with current corporate disclosures on the topic than the current metric. Overall, the proposed metric will better accomplish the core objectives of the standard by clarifying that the number of unique incidents is to be disclosed, improving the measurability and completeness of the associated technical protocol; as well as the inclusion of the number of customers affected by such incidents, which will improve the usefulness of the metric.

Supporting Analysis

The technical protocol associated with the provisional metric does not satisfy the measurability and completeness attributes of a technical protocol, as it does not specify what is intended to be measured by “number of data security breaches.” This may include number of unique instances of breaches, or it may include the number of exposed customer records. For example, if a company faced two cyberattacks during the reporting period with one exposing 200,000 customer records and another exposing 50,000 customer records, the provisional metric is unclear whether the company would report this as “2” or “250,000.” Evidence shows that both the number of incidents and the number of customers affected are useful data points for understanding the frequency and magnitude of data security breaches.

Furthermore, an analysis of corporate disclosures demonstrates that, broadly speaking, this structure of disclosure that includes the number of incidents and the number of customers affected is a best practice for corporate disclosures. For example, after their own major breaches, some of the largest publicly listed companies⁷⁷ in the Financials and

⁷⁶ FN0201-03: Number of data security breaches and percentage involving customers’ personally identifiable information

⁷⁷ Brad Arkin, “Important Customer Security Announcement,” Adobe, October 3, 2013, accessed August 8, 2017, <https://blogs.adobe.com/conversations/2013/10/important-customer-security-announcement.html>.

Technology sectors revealed, for the respective incidents, the number of accounts affected. In greater detail, one company's public disclosure after a data breach that came to light in 2016 provides an illustrative example of the alignment of the proposed change with current corporate disclosures on the topic. In 2016, the company disclosed an unauthorized data breach associated with more than one billion user accounts, the largest known data breach to date. The firm's disclosure distinguished between unique incidents and number of records compromised, consistent with the proposed metric.⁷⁸

Stakeholder Consultation

Investors: Many investors across multiple industries and sectors consistently communicated during the SASB's consultation period that clarification of this metric was necessary—and there was strong agreement for the proposed metric.

Issuers: Multiple issuers voiced confusion over the wording of the metric in its current version and communicated that it needed to be clarified in a manner similar to the proposed revision.

Benefits

Improves the SASB standard: The proposed revision will enhance the standardization of the metric by improving the measurability and the completeness of the technical protocol.

Improves decision-usefulness: The proposed revision will generate more useful information, given that both the number of unique cybersecurity data breaches and the number of customers affected are important elements needed to better understand corporate performance on the topic.

⁷⁷ Tanya Agrawal, David Henry, and Jim Finkle, "JPMorgan Hack Exposed Data of 83 Million, Among Biggest Breaches in History," *Reuters*, October 2, 2014, <https://www.reuters.com/article/us-jpmorgan-cybersecurity-idUSKCN0HR23T20141003>; Cory Scott, "Protecting Our Members," LinkedIn, May 18, 2016, accessed August 8, 2017, <https://blog.linkedin.com/2016/05/18/protecting-our-members>; Keir Thomas, "Citigroup Hack Nabs Data from 210K Customers," *PCWorld*, June 9, 2011, accessed August 8, 2017, http://www.pcworld.com/article/229891/Citigroup_Hack_Nets_Over_200k_in_Stolen_Customer_Details.html; "Yahoo Security Notice December 14, 2016," Yahoo, December 14, 2016, accessed July 24, 2017, <https://help.yahoo.com/kb/SLN27925.html>.

⁷⁸ Ibid.

Proposed Update #2-40 – **Industry:** Consumer Finance; **Topic Name:** Transparent Information & Fair Advice for Customers / Responsible Lending & Debt Prevention

2017 Technical Agenda Item #2-40 Description

SASB is evaluating revisions to the topics, including the corresponding metrics, due to their potential to affect corporate value, relevance across the industry, and interest among investors.

Summary of Change – Revise Topic and Associated Metrics

The SASB proposes merging the topics “Transparent Information & Fair Advice for Customers” and “Responsible Lending & Debt Prevention” into a single disclosure topic called “Selling Practices.” The underlying metrics are listed below.

Transparent Information & Fair Advice for Customers:

- FN0201-06 Amount of legal and regulatory fines and settlements associated with disclosure, transparency, or marketing
- FN0201-07 Payout ratio for add-on products

Responsible Lending & Debt Prevention:

- FN0201-08 For customers with FICO scores above and below 640 (subprime): (1) average customer debt (2) average APR (3) mean and median age of accounts (4) average monthly full payment rate
- FN0201-09 Percentage of applications accepted for applicants with FICO scores above and below 640 (subprime)
- FN0201-10 Average annual fees per account for pre-paid transaction products

Within the new topic “Selling Practices,” the SASB proposes several revisions to the provisional metrics included in the topics being merged:

The SASB proposes changing metric:

- FN0201-06 Amount of legal and regulatory fines and settlements associated with disclosure, transparency, or marketing

to this metric:

- Total amount of losses as a result of legal proceedings associated with customer privacy

The SASB proposes changing metric:

- FN0201-08 For customers with FICO scores above and below 640 (subprime): (1) average customer debt (2) average APR (3) mean and median age of accounts (4) average monthly full payment rate

to the following metric:

- (1) Average fees from add-on products; (2) average APR; (3) average age of accounts; (4) average number of trade lines; (5) average annual fees for pre-paid products for customers with FICO scores above and below 660

Additionally, the SASB proposes changing the following metric:

- FN0201-09 Percentage of applications accepted for applicants with FICO scores above and below 640 (subprime)

to this metric:

- Approval rate for (1) credit and (2) pre-paid products for applicants with FICO scores above and below 660

To capture performance on all the applicable aspects of the new “Selling Practices” topic, the SASB proposes adding two new metrics:

- Percentage of remuneration for covered employees that is variable and linked to the amount of products and services sold
- (1) Number of complaints filed with the Consumer Financial Protection Bureau (CFPB); (2) percentage with monetary or non-monetary relief; (3) percentage disputed by consumer; (4) percentage resulted in investigation by the CFPB

Adherence to Principles for Topic Selection

In order to align with the *SASB Conceptual Framework*, the topics “Transparent Information & Fair Advice for Customers” and “Responsible Lending & Debt Prevention” will be merged into “Selling Practices.”

The elements of these two provisional topics are related and represent the same sustainability topic of “Selling Practices and Product Labeling” as defined by the SASB’s universe of 30 sustainability topics. Therefore, “Selling Practices” should be presented as a stand-alone disclosure topic in the Consumer Finance standard to fairly represent company performance in a way that is actionable by companies. Specifically, the “Selling Practices” topic relates to the social capital dimension and addresses transparency, accuracy, and comprehensiveness of marketing statements, advertising of financial products and services, and fair advice to customers. As such, companies take a holistic approach to managing this sustainability topic, and therefore relevant metrics should be provided as a set within a single disclosure topic.

There are three key elements within the Selling Practices topic, performance on which can materially impact a company’s operations and financial condition. Firstly, incentive compensation structure, where a company’s policies may unintentionally create a risk of selling products and services that are not in the best interest of clients. Secondly, transparency of information provided to customers with respect to primary and add-on products. And lastly, the characteristics of the portfolio of products sold, where poor performance on the first two elements could result in high concentration of risky products held by customers. Performance on all three elements needs to be analyzed holistically in order to assess how well consumer finance companies manage selling practices of their key products.

Adherence to Criteria for Accounting Metrics

As stated above, the SASB proposes a stand-alone disclosure topic in the Consumer Finance industry to be called Selling Practices. Overall, the SASB proposes to include five quantitative accounting metrics to measure performance on the disclosure topic. As a set, these metrics would satisfy completeness of the information reported to investors by addressing the three key elements of the issue mentioned above. The proposed metrics satisfy the SASB's criteria for fair representation as they address incentive structure for sales workers, customer complaints related to selling practices, the amount of fines and settlements for mismanagement of the issue, and key characteristics of customer portfolios of credit products which are all the applicable and decision-useful indicators of performance, as supported by SASB research and feedback received from issuers and investors.

SASB proposes two new metrics:

- Percentage of remuneration for covered employees that is variable and linked to the amount of products and services sold
- (1) Number of complaints filed with the CFPB, (2) percentage with monetary or non-monetary relief; (3) percentage disputed by consumer; (4) percentage resulted in investigation by the CFPB

Compensation of retail bankers as well as number of complaints related to credit and pre-paid debit products are relevant measures of company performance and yield information useful to investors. The technical protocol of each metric ensures comparability and verifiability of reported data by providing definitions of variable compensation and referencing data from the Consumer Financial Protection Bureau (CFPB).

The SASB proposes updating the provisional metric FN0201-06, which specifies that issuers disclose the amount of legal and regulatory fines and settlements associated with disclosure, transparency, or marketing. The current technical protocol describes the relevant regulations that should be considered when determining which fines and settlements are appropriate to include in the calculation. SASB proposes to expand the scope of violations to those related to predatory, aggressive, and discriminatory selling practices by referencing such regulations as the Credit Card Accountability Responsibility and Disclosure Act of 2009 (CARD Act), the Fair Credit Reporting Act (FCRA), and the Equal Credit Opportunity Act (ECOA), among others. Furthermore, while the current technical protocol provides measurable and relevant guidance, it fails to incorporate a number of key U.S. regulations and is U.S.-centric. To address this, the technical protocol will be updated to require registrants to report on compliance with both international and U.S. based regulations, which improves the completeness and usefulness of the metric.

The provisional metric FN0201-08 specifies that the registrant discloses: (1) average customer debt, (2) average APR, (3) mean and median age of accounts, (4) average monthly full payment rate—for customers with FICO scores both above and below 640. Upon further research, these quantitative indicators are not fully aligned with existing issuer norms and do not provide a complete view. The revision of this metric will remove average customer debt and average monthly full payment rate to improve alignment with the data points disclosed by issuers. Further, it will add average fees from add-on products, average number of trade lines, and average annual fees for pre-paid products and change the FICO split from 640 to 660. The included data points and the FICO breakdown further improve alignment with company disclosure. The revision of the metric will improve its completeness and usefulness to align with criteria for accounting metrics per the *SASB Conceptual Framework*.

The SASB also proposes a revision to the provisional metric FN0201-09, which specifies that the registrant discloses the percentage of applications accepted for applicants with FICO scores above and below 640. While the current metric is useful and comparable, it does not align with the common industry norm for splitting prime and subprime

borrowers by a FICO score of 660, as supported by feedback received from multiple investment analysts. The proposed change to align the metric with the prime/subprime split will increase the comparability of the metric, ensuring its alignment with those already in use by issuers. Further, the commonly used industry term is “approval rate” rather than “acceptance rate.” Therefore, the SASB proposes to update the wording of the metric for alignment purposes.

Supporting Analysis

The current technical protocol associated with metric FN0201-06 provides guidance to registrants on which violations are relevant to include in the calculation in determining the amount of legal fines and settlements related to disclosure, transparency, and marketing. The protocol references a number of regulations that may be relevant such as the Credit CARD Act of 2009, the Truth in Lending Act, the Telephone Consumer Protection Act (TCPA), and the Dodd-Frank Wall Street Reform Act. However, the guidance fails to include international regulations and, as a result, the proposed revision includes a more exhaustive list of regulations: the Payment Services Directive; the Consumer Rights Directive; the Fair Credit Reporting Act; Unfair, Deceptive, and Abusive Acts and Practices; and the Telephone Consumer Protection Act. The revised technical protocol will improve the completeness of the metric.

The proposed revisions to metric FN0201-08 will make the information more useful to investors when evaluating companies. The previously described changes include eliminating two components while adding three other components. The elimination of average customer debt is a result of further research suggesting this component is outside of the control of the company in regards to revolving credit and does not seem to be relevant to the angle of aggressive and predatory sales. Further, the full payment rate is proposed to be removed as evidence fails to support the measure being relevant and decision-useful. The addition of the average number of trade lines, average fees from add-on products, and average annual fees per account for pre-paid products are proposed to be included as indicators of revenue generation practices.

The proposed revision to split the information for customers with FICO scores above and below 660 rather than 640 aligns with the industry definition of prime and subprime. This will increase the comparability of the metric with other references of prime and subprime composition.

The scandal involving one of the largest credit card issuers that happened in fall of 2017 showed that incentive structures may have a significant impact on the behavior of retail bankers. Aggressive sales targets were one of the main reasons bankers opened approximately 2 million fake accounts. The company was fined by the CFPB, but the main financial impact was reputational damage. In the quarter following the scandal, new account openings at the company fell significantly, while the number of clients who closed their accounts with the bank increased.

Customer complaints filed with the CFPB may be indicative of company selling practices. The CFPB collects this data and reports it publicly. Complaints are classified, associated with a company, and include the outcomes of each case. The fact that the data is already publicly available should allow companies to openly disclose it in their filings. Moreover, collecting and reporting the data should be cost-effective. At the same time, reference to the CFPB ensures verifiability and comparability of the complaint data.

Stakeholder Consultation

Investors: Multiple investors unanimously stated that selling practices is a very important sustainability topic that may have a significant financial impact on companies if not managed properly. Analysts agreed with the proposed change to address the scope of performance holistically rather than through stand-alone topics and found the proposed metrics to be relevant and decision-useful for measuring performance on the topic.

Issuers: The SASB received issuer feedback supporting that, as proposed, the topic is relevant, the metrics are decision-useful, and they can be reported in a cost-effective manner. Issuers stated that merging the two provisional topics is the right approach and improves the standard.

Benefits

Improves the SASB standard: The proposed changes ensure the standard is aligned with the *SASB Conceptual Framework* for topic and metric development. The proposed metrics for the merged topic address all relevant elements of performance (incentive compensation of employees, transparency of information provided to clients, and characteristics of product portfolio) and provide decision-useful information to investors.

Improves completeness and usefulness: The proposed metrics as a set ensure that disclosure on all the relevant risk factors of performance on the topic is provided to investors. Reporting the proposed metrics as a set would yield decision-useful information and help investors assess selling practices of consumer finance companies.

Improves alignment: The proposed changes ensure that the standard is aligned with industry norms and is thus more comparable.

Improves cost-effectiveness: Referencing data collected by regulatory bodies ensures that the metrics are cost-effective to disclose. At the same time, it improves the comparability and verifiability of the data.

Proposed Update #2-41 – **Industry:** Consumer Finance; **Topic Name:** Activity Metrics

2017 Technical Agenda Item #2-41 Description

SASB proposes to include activity metrics for the Consumer Finance industry.

Summary of Change – Add Activity Metrics

The SASB proposes adding the following activity metrics:

- Number of unique consumers with an active (1) credit card account, (2) pre-paid debit card account
- Number of (1) credit card accounts, (2) pre-paid debit card accounts

Rationale

The SASB proposes adding activity metrics as a new element of the Consumer Finance standard. At the time of release of the provisional standards for the Financials sector, the SASB had not incorporated the concept of activity metrics into the industry standards. Activity metrics are useful for measuring the scope and scale of a company's operations, providing normalization factors for the performance metrics included in the disclosure topics.

Supporting Analysis

The proposed metrics measure the size of credit and pre-paid debit card portfolios in terms of number of individuals and number of products. While the data are not disclosed consistently, some of the largest credit card issuers report the number of credit and pre-paid debit cards in their portfolios. These metrics are used by analysts as operational factors impacting revenue growth as highlighted in some sell-side reports. Further, metrics focused on the number of individual customers rather than on the total value of accounts may be particularly valuable to normalize accounting data related to the topics of Data Security and Customer Privacy where the magnitude of impact may be correlated with the number of accounts impacted rather than with their value or generated income.

Stakeholder Consultation

Issuers: The SASB received feedback from two large-cap companies in the industry that the proposed metrics are relevant, decision-useful, and partially disclosed by some companies in their SEC filings.

Investors: The SASB did not receive feedback from investors specifically related to the usefulness of the proposed activity metrics.

Benefits

Improves the SASB standard: Activity metrics provide investors with normalization factors to ensure comparability of SASB metrics across issuers.

Improves decision-usefulness: The proposed metrics improve decision-usefulness of all quantitative SASB metrics included in the standard by allowing investors to convert them from absolute to relative measures of performance.



FINANCIALS SECTOR

MORTGAGE FINANCE INDUSTRY

Sustainability Accounting Standard

Sustainable Industry Classification System™ (SICS™) #FN0202

Prepared by the
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Proposed Changes to Provisional Standard - Basis for Conclusion

Proposed Update #2-42 – **Industry:** Mortgage Finance; **Topic Name:** Environmental Risk to Mortgaged Properties

2017 Technical Agenda Item #2-42 Description

SASB is evaluating the revision of metric FN0202-01⁷⁹ to ensure the relevance, applicability, and decision-usefulness of the metrics associated with the topic.

Summary of Change – Revise Metric

The SASB proposes revising provisional metric FN0202-01 from “Number and value of mortgage loans in Federal Emergency Management Agency (FEMA) special flood hazard areas” to “(1) Number and (2) value of mortgage loans in Federal Emergency Management Agency (FEMA) Special Flood Hazard Areas or foreign equivalent.”

Adherence to Criteria for Accounting Metrics

The Mortgage Finance industry provisional standard includes a topic, Environmental Risk to Mortgaged Properties, with associated metrics to describe a financial institution’s exposure to climate risks through its mortgage lending. Specifically, metric FN0202-01 calls for disclosure of the number and value of mortgages in areas deemed at risk of flooding by FEMA, allowing shareholders to evaluate the extent to which the registrant is exposed to adverse weather events arising from changes in flooding frequency. While this indicator is appropriate in the context of U.S.-only mortgage books, the provision for disclosure on equivalent areas in other regions would improve the applicability of the metric to companies with operations in other markets, and the completeness and comparability of reported information. In this way, the proposal would better accomplish the core objectives of the standard, offering investors a more decision-useful set of disclosures.

Supporting Analysis

The SASB proposes updating the language of provisional metric FN0202-01 to include “or foreign equivalent” so that companies in the industry can better report on their loan-origination activities outside the United States. This change would capture information that is relevant to shareholders and seen as significant in assessing risks for industry companies. Examples of “foreign equivalents” include Canada’s Provincial/Territorial Flood Damage Reduction Programs, the goal of which is to discourage development in flood-vulnerable areas, and the European Union’s Floods Directive, which requires development of flood hazard maps and flood risk maps for areas where real risks of flood damage exist.

Stakeholder Consultation

Investors: Investors raised concerns during the 2016–2017 consultation period that metric FN0202-01 was very U.S.-centric and would be challenging to report at the enterprise level by globally diversified companies. Generally, feedback indicated that allowing reporting per non-U.S. laws and regulations would be beneficial. The SASB has not received feedback on this specific proposal.

Issuers: Issuers raised similar concerns about technical guidance associated with the SASB metrics. This specific proposal has not received issuer feedback, but as shown by the supportive analysis, the change would be relevant to issuers exposed to the non-U.S. market.

⁷⁹ FN0202-01: Number and value of mortgage loans in Federal Emergency Management Agency (FEMA) special flood hazard areas

Benefits

Improves the SASB standard: The update would provide alignment with the SASB standards that were released later and incorporate more research on the metric. The alignment improves applicability of the standard for issuers with non-U.S. exposure while improving the comparability of data disclosed to investors.

Proposed Update #2-43 – **Industry:** Mortgage Finance; **Topic Name:** Transparent Information & Fair Advice for Customers / Responsible Lending & Debt Prevention

2017 Technical Agenda Item #2-43 Description

SASB is evaluating revisions to the topics, including the corresponding metrics, due to their potential to affect corporate value, relevance across the industry, and interest among investors.

Summary of Change – Revise Topics and Associated Metrics

The SASB proposes merging two topics, “Transparent Information & Fair Advice for Customers” and “Responsible Lending & Debt Prevention,” into a single disclosure topic called “Lending Practices.” The underlying metrics for each provisional disclosure topic are listed below.

Transparent Information & Fair Advice for Customers:

- FN0202-04 Description of variable compensation structure of loan originators
- FN0202-05 Number and value of mortgages issued to minorities
- FN0202-06 Number and value of mortgages provided to low or moderate-income individuals/families
- FN0202-07 Amount of fines and settlements associated with violation of the mortgage industry provisions of Regulation Z (Truth in Lending Act) relating to communications to customers

Responsible Lending & Debt Prevention:

- FN0202-08 Number and value of Qualified Mortgages (QMs), by minority status and income classification
- FN0202-09 Number and value of mortgages of the following types: (1) Hybrid or Option ARM, (2) Prepayment Penalty, (3) Higher Rate; overall, by minority status, and by income classification
- FN0202-10 Ratio of amount of first mortgage principal reduction to amount of foreclosed mortgages
- FN0202-11 Number of (1) modifications, (2) foreclosures, (3) short sales or deeds in lieu of foreclosure, and (4) total mortgages
- FN0202-12 Foreclosure rate by segment: subprime, non-subprime jumbo, non-subprime conventional, and nonconventional

Additionally, SASB proposes the following changes to the metrics of the newly formed Lending Practices topic:

- Revising metric FN0202-04 from “Description of variable compensation structure of loan originators” to “Description of remuneration structure of loan originators”
- Revising metric FN0202-07 from “Amount of fines and settlements associated with violation of the mortgage industry provisions of Regulation Z (Truth in Lending Act) relating to communications to customers” to “Total amount of losses as a result of legal proceedings associated with communications to customers and remuneration of loan originators”

- Revising metric FN0202-09 from “Number and value of mortgages of the following types: (1) Hybrid or Option ARM, (2) Prepayment Penalty, (3) Higher Rate; overall, by minority status, and by income classification” to “(1) Number and (2) value of residential mortgages of the following types: (a) Hybrid or Option ARM, (b) Prepayment Penalty, (c) Higher Rate, (d) Total; by FICO scores above and below 660”
- Revising metric FN0202-11 from “Number of (1) modifications, (2) foreclosures, (3) short sales or deeds in lieu of foreclosure, and (4) total mortgages” to “(1) Number and (2) value of residential mortgage (a) modifications, (b) foreclosures, (c) short sales or deeds in lieu of foreclosure, by FICO scores above and below 660”
- Removing metric FN0202-05, “Number and value of mortgages issued to minorities”
- Removing metric FN0202-06, “Number and value of mortgages provided to low or moderate-income individuals/families”
- Removing metric FN0202-08, “Number and value of Qualified Mortgages (QMs), by minority status and income classification”
- Removing metric FN0202-10, “Ratio of amount of first mortgage principal reduction to amount of foreclosed mortgages”
- Removing metric FN0202-12, “Foreclosure rate by segment: subprime, non-subprime jumbo, non-subprime conventional, and nonconventional”

Adherence to Principles for Topic Selection

In order to improve alignment with the *SASB Conceptual Framework*, this proposal would merge the “Transparent Information & Fair Advice for Customers” topic and the “Responsible Lending & Debt Prevention” topic into a single disclosure topic and rename the new topic “Lending Practices.”

The elements of these two provisional topics are related and represent the same sustainability topic of “Selling Practices and Product Labeling” as [defined](#) by the SASB’s universe of 30 sustainability topics. Therefore, “Lending Practices” should be presented as a stand-alone disclosure topic in the Mortgage Finance standard to fairly represent company performance in a way that is actionable by companies. Specifically, the “Lending Practices” topic relates to the social capital dimension and addresses transparency, accuracy, and comprehensiveness of marketing statements, advertising of financial products, and services and fair advice to customers. As such, companies take a holistic approach to managing this sustainability topic, and therefore relevant metrics should be provided as a set within a single disclosure topic.

Performance on three key elements within the Lending Practices topic can materially impact a company’s operations and financial condition. First, the incentive structures and compensation policies of loan originators may unintentionally encourage them to promote lending products and services that are not in the best interest of clients. Secondly, lack of transparent information provided to customers with respect to primary and add-on products may impact reputation and invite regulatory scrutiny and costly litigation. Finally, poor performance on the first two elements could affect the characteristics of the portfolio of products, resulting in a high concentration of risky products being sold. Performance on all three elements should be analyzed holistically in order to assess how mortgage finance companies are managing the lending practices of their key products.

Adherence to Criteria for Accounting Metrics

The proposal reduces the combined accounting metrics from nine metrics covering two topics to four metrics intended to measure performance on the Lending Practices topic, which would improve the completeness of the

information reported by addressing the three key elements of the issue mentioned above. The proposed metrics satisfy the SASB's criteria for fair representation as they address (a) the remuneration structure for loan originators, (b) the amount of fines and settlements related to violations related to misleading and opaque communications with customers and to compensation of loan originators, and (c) the loan portfolio characteristics. All these elements are relevant and decision-useful indicators of performance, as supported by SASB research and feedback received from issuers and investors.

SASB's proposed updates to the metrics are detailed below:

- The SASB proposes broadening the scope of metric FN0202-04 by changing the term "variable compensation" to "remuneration structure of loan originators." The expanded scope will allow issuers to discuss all aspects of remuneration practices, which is a broader concept than just variable compensation. Further, the terminology is aligned with that used by certain E.U. regulations focused on employee remuneration.
- The SASB proposes revising metric FN0202-07 to improve its completeness and to broaden its scope to ensure applicability to non-U.S. operations. While the current metric provides measurable and relevant guidance, it fails to incorporate fines and settlements related to violations of loan originator compensation. The technical protocol will reference Regulation Z, including relevant subparts for consideration such as [Loan Originator Compensation and Steering 12 CFR 226](#). The revisions will improve the completeness of the metric.
- The SASB proposes revising metrics FN0202-09 and FN0202-11, which relate to (a) the number and value of mortgage types and (b) the number of mortgages by modifications, foreclosures, short sales or deeds in lieu of foreclosure, and total mortgages, respectively. For both metrics, the SASB proposes to split data by prime and subprime loans based on a FICO score threshold of 660. FICO scores are widely used and disclosed within the industry, whereas more detailed demographic information such as minority status, which was initially proposed in FN0202-09, is not. Additionally, for metric FN0202-11 the proposed revision will add a requirement to disclose information on the "value" of modifications, foreclosures, and short sales, not just the "number" of such operations. These revisions will improve the completeness and alignment of the metrics.
- The SASB proposes removing metric FN0202-10, which compares the amount of the first mortgage principal reduction to the amount of foreclosed mortgages. The SASB's research indicates this provisional metric overlaps with provisional metric FN0202-11. Principal reductions are a type of loan modification and will thus be included in metric FN0202-11, making FN0202-10 redundant. The removal of the metric will improve the cost-effectiveness of the standard.
- As described above, the scope of the newly merged disclosure topic will focus on the risks stemming from predatory and aggressive lending practices and from failure to provide transparent information and fair advice to customers. Separately, the SASB has proposed adding a new disclosure topic in the industry called "Discriminatory Lending," addressed separately under Proposed Change 2-44, to cover industry practices related to discrimination based on race and gender in mortgage origination. Metrics FN0202-05, FN0202-06, and FN0202-08 are better suited for that topic, as they fall outside the scope of the newly defined "Lending Practices" topic covered by this proposed change. In contrast to the "Lending Practices" topic, which addresses aggressive and predatory lending to consumers, the "Discriminatory Lending" topic would focus

on cases of racial and gender discrimination in lending, when customers with similar credit profiles would be offered different terms on mortgage loans purely based on their race or gender. Therefore, the SASB proposes removing them from the “Lending Practices” topic and transferring some, as appropriate, to the “Discriminatory Lending” topic.

- In sum, the new “Lending Practices” topic, resulting from merging the original “Transparent Information & Fair Advice for Customers” topic with the “Responsible Lending & Debt Prevention” topic, will include four metrics. These four new and revised metrics will enhance the completeness and usefulness of information disclosed on the lending practices of Mortgage Finance companies.

Supporting Analysis

Evidence of financial impact and disclosure from companies suggest that practices around origination of risky mortgages and the aggressive and predatory targeting of mortgage borrowers are closely tied to the issue of providing transparent information and fair advice to borrowers. The SASB’s research, as well as feedback received from issuers and investors, highlights that the metrics to assess performance on the topic should capture the incentive compensation structure of loan originators, the transparency of information provided to customers, and the performance of the registrant’s mortgage portfolio.

The proposed revisions to metric FN202-04 will make the information more useful to investors when evaluating companies. Expanding the scope of the metric by allowing issuers to discuss all elements of compensation, including non-monetary and non-variable elements of compensation, will improve completeness of the metric alignment with industry norms.

The proposed revisions to metric FN0202-07 provide guidance to registrants on which violations are relevant to include in calculating the amount of legal fines and settlements related to communication with customers and remuneration of loan originators.

The proposed revisions to metrics FN0202-09 and FN202-11 will split the information for customers with FICO scores above and below 660. This change will align the standard with industry definitions of prime and subprime mortgages. The majority of listed mortgage finance companies break down their loan portfolio by FICO scores rather than by income classifications or by minority status, as originally framed in the provisional standard. To increase alignment with current industry disclosures, the SASB proposes to change the breakdown from minority status and income classification to FICO tiers. This change will also improve the comparability of the metrics to references of prime and subprime compositions in other SASB metrics included in the Mortgage Finance standard.

The SASB proposes removing provisional metric FN0202-10 based on research that indicates overlap with other metrics. There has been a significant decrease in the number of mortgage principal reductions in recent years. Data from the Federal Housing Finance Agency demonstrate that the number of underwater homeowners with loans owned or guaranteed by Fannie Mae or Freddie Mac has declined by 80 percent from 2011 to 2015. Eliminating this metric on a stand-alone basis will improve the cost-effectiveness of the standard.

Stakeholder Consultation

Investors: Multiple investors unanimously stated that lending practices are a very important sustainability topic that may have a significant financial impact on companies if not managed properly. Analysts agreed with the proposed changes on addressing the scope of performance holistically rather than through stand-alone topics, and found the

proposed metrics to be relevant and decision-useful. Specifically, investors suggested including a FICO breakdown of mortgage loans and recommended the Loan-to-Value (LTV) ratio as a useful indicator of performance.

Issuers: The SASB received feedback on the Mortgage Finance industry standard from a limited number of issuers, primarily large-cap integrated banks. The feedback indicated that the proposed topic is relevant and that the metrics are decision-useful and can be reported in a cost-effective manner. Issuers stated that merging the two provisional topics is a suitable approach that improves the standard.

Benefits

Improves the SASB standard: The proposed changes address all relevant elements of performance and provide decision-useful information to investors. Broadening the scope of some of the metrics as well as revising the technical protocols to be consistent with industry norms will improve the completeness and measurability of the metrics, as well as their alignment with practices already used in the industry.

Improves cost-effectiveness: Referencing data collected by regulatory bodies and already disclosed in SEC filings ensures the metrics are cost-effective to disclose. At the same time, it improves comparability and verifiability of data.

Proposed Update #2-44 – **Industry:** Mortgage Finance; **Topic Name:** Discriminatory Lending

2017 Technical Agenda Item #2-44 Description

SASB is evaluating the addition of the topic, including corresponding metrics, based on investor interest and its potential to affect corporate value.

Summary of Change – Add Topic and Metrics

The SASB proposes adding a disclosure topic, “Discriminatory Lending,” including the following corresponding metrics:

- (1) Number, (2) value, and (3) weighted average Loan-to-Value (LTV) ratio of mortgages issued to (a) minority and (b) all other borrowers, by FICO scores above and below 660
- Total amount of losses as a result of legal proceedings associated with discriminatory mortgage lending
- Description of policies and procedures for ensuring nondiscriminatory mortgage origination

The last metric is a modification of provisional metric FN0202-05, “Number and value of mortgages issued to minorities” included in the “Transparent Information & Fair Advice for Customers” disclosure topic (see Proposed Item #2-43).

Description of Topic

The Mortgage Finance industry aggregates individual data points to determine the terms and conditions of loans, including key provisions such as the size of the loan, interest rate, up-front points, or other fees. However, the process can be opaque and involve subjectivity, which can result in intentional or unintentional discriminatory lending practices by the mortgage originator. Discriminatory lending presents significant risks in the form of (1) fines or settlements for violations of regulations such as the Equal Credit Opportunity Act (ECOA) or Fair Housing Act, (2) reputational risk, or (3) negative financial performance due to loan mispricing. Companies can reduce the risk of intentional or unintentional discriminatory lending by employees through the implementation of strong processes, internal controls, and monitoring of the loan portfolio, among other techniques. Proactive companies that develop strong techniques for preventing discrimination can effectively mitigate the risks associated with discriminatory lending.

Adherence to Criteria for Accounting Metrics

Within the proposed Discriminatory Lending topic, SASB proposes including three metrics to help investors assess performance. The metrics describe the processes the registrant has in place to ensure nondiscriminatory lending, the amount of mortgage lending broken down by minority status along with relevant financial characteristics, and the amount of fines and settlements associated with violations of applicable laws and regulations. The three metrics satisfy the criteria for accounting metric selection outlined in the *SASB Conceptual Framework*. The metrics ensure fair representation by adequately and accurately focusing on relevant elements of the proposed topic. The usefulness of the proposed metrics is supported by feedback received during the consultation period from issuers and investors. As a set, the metrics ensure completeness as they provide enough data for investors to assess the quality of a company’s performance on the disclosure topic.

The proposal includes the additional breakdown by FICO scores of loans issued to minorities and their weighted average LTV ratios because this provides information useful for assessing the characteristics of loans issued to minorities rather than simply the amount of those loans, as called for in provisional metric FN0202-05. This information would allow investors to compare the characteristics of loans registrants originate to minorities versus those to all others. The data could be indicative of discriminatory practices when combined with other indicators included in the disclosure topic.

Supporting Analysis

The Mortgage Finance industry has a long history of engaging in discriminatory lending practices. Recent lawsuits have shown that, leading up to the 2008 financial crisis, (1) minorities were pushed into purposefully unsuitable loans and (2) minorities were given worse terms on the same loans as non-minorities. In 2012, one of the largest mortgage lenders agreed to pay \$175 million to settle the accusations of discriminatory mortgage origination practices. The bank's lending data showed, in 2007, an African American borrower who had qualified for a regular loan was 2.9 times more likely to be steered into a subprime loan, and a Hispanic borrower was 1.8 times more likely, when compared to similar creditworthy white borrowers.⁸⁰ Subprime loans, which are determined by the credit quality of individual borrowers, carry higher interest rates and fees. The company further faced significant, albeit difficult to measure, reputational damage as a result. This wasn't an isolated incident, as other originators have faced similar lawsuits. For example, a former employee of one of the largest integrated banks admitted that the company pushed minority borrowers into subprime loans and that senior executives tried to cover up the racial disparity. The company denied any wrongdoing but agreed to pay a \$55 million settlement.⁸¹

Discussion of provisions of the ECOA and Fair Housing Act related to nondiscriminatory mortgage origination can be found in the SEC filings of publicly listed companies. Under the current regulatory requirement, companies filing with the SEC must disclose material instances of violation of the ECOA and Fair Housing Act.

The vast majority of mortgage finance companies use LTV ratios and FICO scores as key characteristics of their mortgage loan portfolios when reporting data in their SEC filings. The breakdown was recommended to be included by a number of analysts during the consultation period.

Stakeholder Consultation

Investors: All investors who provided consultative feedback to the SASB unanimously commented that the topic is very relevant to Mortgage Finance companies. Analysts stated that the proposed metrics would be decision-useful and would improve the quality of available information on the topic.

Issuers: The SASB received feedback from some of the largest mortgage originators that the topic is relevant and that the metrics are both decision-useful and cost-effective to report. It was highlighted that some of the metrics are already provided in the SEC filings.

⁸⁰ Charlie Savage, "Wells Fargo Will Settle Mortgage Bias Charges," *The New York Times*, July 12, 2012, accessed August 14, 2017, <http://www.nytimes.com/2012/07/13/business/wells-fargo-to-settle-mortgage-discrimination-charges.html>.

⁸¹ Michael Corkery, "JPMorgan to Pay \$55 Million to Settle Mortgage Discrimination Complaint," *The New York Times*, January 18, 2017, accessed August 14, 2017, <https://www.nytimes.com/2017/01/18/business/dealbook/jpmorgan-55-million-mortgage-discrimination-settlement.html>.

Benefits

Improves the SASB standard: Ensures the standard is aligned with the *SASB Conceptual Framework* for topic and metric development. The proposed metrics for the merged topic address all relevant elements of performance and provide decision-useful information to investors.

Proposed Update #2-45 – **Industry:** Mortgage Finance; **Topic Name:** Management of the Legal & Regulatory Environment

2017 Technical Agenda Item #2-45 Description

The SASB is evaluating the removal of the topic, including corresponding metrics, due to its potential to affect corporate value, relevance across the industry, and interest among investors.

Summary of Change – Remove Topic and Metrics

The SASB proposes removing the topic Management of the Legal & Regulatory Environment and its associated metric FN0202-13, “Amount of fines and settlements associated with mortgage industry regulations.”

Adherence to Criteria for Accounting Metrics

This topic, included in the provisional standard for the Mortgage Finance industry, relates to the sustainability impacts of changes in the regulatory environment and their impact on companies’ financial performance. The proposal to remove the topic, and its corresponding metric, is based on the fact that material information related to legal and regulatory issues is sufficiently addressed by several other topics in the standard, including “Lending Practices” (see Proposed Item #2-43) and “Discriminatory Lending” (see Proposed Item #2-44).

Supporting Analysis

Research released after the provisional standard was issued suggests that the aspect of regulatory violations addressed by the topic is not applicable to the Mortgage Finance industry. Legal and regulatory issues related to mortgage derivatives are addressed in the Investment Banking & Brokerage industry. Meanwhile, as mentioned above, other sustainability-related legal and regulatory considerations that are relevant to the Mortgage Finance industry are addressed in the “Lending Practices” and “Discriminatory Lending” disclosure topics.

Stakeholder Consultation

Investors: The SASB did not receive specific feedback from investors with respect to removal of the disclosure topic. Nevertheless, general feedback indicated that the set of topics included in the proposed industry standard (which excluded this disclosure topic) adequately addresses sustainability issues, including those related to the legal and regulatory environment, faced by companies in the Mortgage Finance industry. Further, the SASB’s research indicated that key aspects of the provisional topic are addressed in other disclosure topics in the Mortgage Finance industry or other industries in the Financials sector, which prompted the SASB not to prioritize consultation on this topic.

Issuers: The SASB received limited feedback on the Mortgage Finance industry standard from both integrated banks and pure-play mortgage finance companies. The SASB prioritized feedback on updates to other disclosure topics and metrics because the SASB evidence research and disclosure analysis supported the removal case. The feedback received from the issuers commenting on the proposed set of disclosure topics found that the set of topics proposed adequately addresses sustainability issues faced by companies in the industry.

Benefits

Improves the SASB standard: By removing the topic, the proposal would improve the focus of the standard by including only those sustainability topics reasonably likely to have material impacts on companies in the industry.

Proposed Update #2-46 – **Industry:** Mortgage Finance; **Topic Name:** Activity Metrics

2017 Technical Agenda Item #2-46 Description

SASB proposes to include activity metrics for the Mortgage Finance industry.

Summary of Change – Add Activity Metrics

The SASB proposes adding the following activity metrics:

- (1) Number and (2) value of mortgages originated by category: (a) residential and (b) commercial
- (1) Number and (2) value of mortgages purchased by category: (a) residential and (b) commercial

Adherence to Criteria for Accounting Metrics

The SASB proposes adding activity metrics as a new element of the Mortgage Finance standard. At the time of release of the provisional standards for the Financials sector, the SASB had not incorporated the concept of activity metrics into the industry standards. Activity metrics are useful for measuring the scope and scale of a company's operations, providing normalization factors for the performance metrics included in the disclosure topics.

Supporting Analysis

The proposed metrics measure the size of a company's mortgage portfolio in terms of the number of individual loans and their total value. An analysis of current disclosure practices by top companies in the industry shows that metrics measuring the amount of mortgage origination are disclosed in their SEC filings by several companies. Additionally, data on mortgage origination are available in the Bloomberg Professional Service; specifically, data is available for 18 companies listed on U.S. stock exchanges, including five of the largest mortgage originators by market capitalization.

Stakeholder Consultation

Investors: Investor feedback was limited on the Mortgage Finance industry standard. The SASB heard from investors that it would be extremely beneficial to have the data disclosed across all companies in the industry in a standardized manner.

Issuers: The SASB received limited feedback on the Mortgage Finance industry standard from both integrated banks and pure-play mortgage finance companies. Nevertheless, the SASB received issuer feedback that the proposed metrics are relevant, decision-useful, and cost-effective, because they are partially disclosed by some companies in their SEC filings.

Benefits

Improves the SASB standard: The activity metrics provide investors with normalization factors to ensure comparability of the SASB metrics across issuers.

Improves decision-usefulness: The proposed metrics improve decision-usefulness of all the quantitative SASB metrics included in the standard by allowing investors to convert them from absolute to relative measures of performance.



FINANCIALS SECTOR

SECURITY & COMMODITY EXCHANGES INDUSTRY

Sustainability Accounting Standard

Sustainable Industry Classification System™ (SICS™) #FN0203

Prepared by the
Sustainability Accounting Standards Board®

October 2017

Proposed Changes to Provisional Standard - Basis for Conclusion

Proposed Update #2-47 – **Industry:** Security & Commodity Exchanges; **Topic Name:** Managing Business Continuity & Technology Risks

2017 Technical Agenda Item #2-47 Description

SASB is evaluating the revision of metric FN0203-09⁸² to ensure the decision-usefulness of the metrics associated with the topic.

Summary of Change – Revise Metric

The SASB proposes revising provisional metric FN0203-09 from “Number of data security breaches and percentage involving customers’ personally identifiable information” to “Number of data security breaches, percentage involving customers’ personally identifiable information (PII), number of customers affected.”

Adherence to Criteria for Accounting Metrics

The Security & Commodity Exchanges industry provisional standard includes a topic, Managing Business Continuity & Technology Risks, with associated metrics that describe a company’s management of risks related to the storage and protection of its users’ sensitive data. The provisional metric is ambiguous in terms of what data are being asked for. Specifically, the technical protocol of the provisional metric does not satisfy two technical protocol attributes: measurability and completeness. The proposed revision will eliminate ambiguity regarding what data are being asked for by clarifying that the number of unique data security breaches shall be disclosed, thereby improving the measurability and completeness of the metric. Furthermore, the proposed revised metric will provide more useful information by including the number of customers affected by such data security breaches—a critical element to understanding the magnitude of breaches. The proposed metric benefits from being more aligned with current corporate disclosures on the topic than the current metric. Overall, the proposed metric will better accomplish the core objectives of the standard by clarifying that the number of unique incidents is to be disclosed, which improves the measurability and completeness of the associated technical protocol, as well as the inclusion of the number of customers affected by such incidents, which will improve the usefulness of the metric.

Supporting Analysis

The technical protocol associated with the provisional metric does not satisfy the measurability and completeness attributes of a technical protocol, as it does not specify what is intended to be measured by “number of data security breaches.” This may include the number of unique instances of breaches, or it may include the number of exposed customer records. For example, if a company faced two cyberattacks during the reporting period with one exposing 200,000 customer records, and another exposing 50,000 customer records, the provisional metric is unclear whether the company would report this as “2” or “250,000.” Evidence shows that both the number of incidents and the number of customers affected are useful data points for understanding the frequency and magnitude of data security breaches.

Furthermore, an analysis of corporate disclosures demonstrates that, broadly speaking, this structure of disclosure that includes the number of incidents and the number of customers affected is a best practice for corporate disclosures. For example, after their own major breaches, some of the largest publicly listed companies⁸³ in the Financials and

⁸² FN0203-09: Number of data security breaches and percentage involving customers’ personally identifiable information

⁸³ Brad Arkin, “Important Customer Security Announcement,” Adobe, October 3, 2013, accessed August 8, 2017, <https://blogs.adobe.com/conversations/2013/10/important-customer-security-announcement.html>.

Technology sectors revealed, for the respective incidents, the number of accounts affected. In greater detail, one company's public disclosure after a data breach that came to light in 2016 provides an illustrative example of the alignment of the proposed change with current corporate disclosures on the topic. In 2016, the company disclosed an unauthorized data breach associated with more than one billion user accounts, the largest known data breach to date. The firm's disclosure distinguished between unique incidents and number of records compromised, consistent with the proposed metric.⁸⁴

Stakeholder Consultation

Investors: Many investors across multiple industries and sectors consistently communicated during the SASB's consultation period that clarification of this metric was necessary—and there was strong agreement for the proposed metric.

Issuers: Multiple issuers voiced confusion over the wording of the metric in its current version and communicated that it needed to be clarified in a manner similar to the proposed revision.

Benefits

Improves the SASB standard: The proposed revision will enhance the standardization of the metric by improving the measurability and the completeness of the technical protocol.

Improves decision-usefulness: The proposed revision will generate more useful information, given that both the number of unique cybersecurity data breaches and the number of customers affected are important elements needed to better understand corporate performance on the topic.

⁸³ Tanya Agrawal, David Henry, and Jim Finkle, "JPMorgan Hack Exposed Data of 83 Million, Among Biggest Breaches in History," *Reuters*, October 2, 2014, <https://www.reuters.com/article/us-jpmorgan-cybersecurity-idUSKCN0HR23T20141003>; Cory Scott, "Protecting Our Members," LinkedIn, May 18, 2016, accessed August 8, 2017, <https://blog.linkedin.com/2016/05/18/protecting-our-members>; Keir Thomas, "Citigroup Hack Nabs Data from 210K Customers," *PCWorld*, June 9, 2011, accessed August 8, 2017, http://www.pcworld.com/article/229891/Citigroup_Hack_Nets_Over_200k_in_Stolen_Customer_Details.html; "Yahoo Security Notice December 14, 2016," Yahoo, December 14, 2016, accessed July 24, 2017, <https://help.yahoo.com/kb/SLN27925.html>.

⁸⁴ Ibid.

Proposed Update #2-48 – **Industry:** Security & Commodity Exchanges; **Topic Name:** Activity Metrics

2017 Technical Agenda Item #2-48 Description

SASB proposes to include activity metrics for the Security & Commodity Exchanges industry.

Summary of Change – Add Activity Metrics

The SASB proposes adding the following activity metrics:

- Average daily number of trades executed by product or asset class
- Average daily volume traded by product or asset class

Rationale

The SASB proposes adding a section with activity metrics as a new element of the Security & Commodity Exchanges standard. At the time of release of the provisional standards for the Financials sector, the SASB had not incorporated the concept of activity metrics into the industry standards. Activity metrics are useful for measuring the scope and scale of a company's operations, providing normalization factors for the performance metrics included in the disclosure topics.

Supporting Analysis

The proposed metrics measure the size of the operational activities of companies in the industry. Average daily volume and average daily number of trades are widely used industry metrics measuring the operational performance of exchanges. The proposed metrics are aligned with those reported by three of the four publicly listed companies in the industry in their SEC filings, and are often mentioned on earnings calls. The SASB's research suggests that the metrics also appear in valuation models of sell-side analysts.

Stakeholder Consultation

Issuers: The SASB did not receive feedback from issuers specifically related to the usefulness of the proposed activity metrics. The fact that all issuers in the industry (which has only four U.S.-listed companies) already provide this data highlights the relevance of the proposed metrics as decision-useful indicators of operational performance.

Investors: The SASB did not receive feedback from investors specifically related to the usefulness of the proposed activity metrics.

Benefits

Improves the SASB standard: The activity metrics provide investors with normalization factors to ensure the comparability of SASB metrics across issuers.

Improves decision-usefulness: The proposed metrics improve decision-usefulness of all quantitative SASB metrics included in the standard by allowing investors to convert them from absolute to relative measures of performance.



FINANCIALS SECTOR

INSURANCE INDUSTRY

Sustainability Accounting Standard

Sustainable Industry Classification System™ (SICS™) #FN0301

Prepared by the
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October 2017

Proposed Changes to Provisional Standard - Basis for Conclusion

Proposed Update #2-49 – **Industry:** Insurance; **Topic Name:** Environmental Risk Exposure

2017 Technical Agenda Item #2-49 Description

SASB is evaluating the revision of metric FN0301-01⁸⁵ to ensure the relevance, decision-usefulness, and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Revise Metric

The SASB proposes revising provisional metric FN0301-01 from “Probable Maximum Loss (PML) of insured products from weather-related natural catastrophes, by insurance segment, type of event, and type of risk insured” to “Probable Maximum Loss (PML) of insured products from weather-related natural catastrophes.” In addition, the technical protocol would be updated to include a breakdown by the probability of occurrence for 1-in-100 and 1-in-250-year return periods, a breakdown by geographic region, a breakdown by net and gross of reinsurance, and a note requiring registrants to discuss how climate change-related impacts are integrated in catastrophe modeling, scenario analysis, and calculation of PML.

Adherence to Criteria for Accounting Metrics

The Insurance industry provisional standard includes a topic, Environmental Risk Exposure, with associated metrics to describe a company’s exposure to climate change-related risks and opportunities in its underwriting activities. Provisional metrics FN0301-01 through FN0301-05 are intended to measure the exposure of an insurer’s portfolio of policies sold and its approach to integrating ESG factors in underwriting processes. Specifically, provisional metric FN0301-01 measures the amount of losses a company would suffer in the worst-case scenario of extreme weather events (i.e., “probable maximum loss”).

The SASB proposes updating the metric to ensure alignment with disclosure provided by property and casualty insurance companies. In addition, the SASB proposes revising the metric’s technical protocol, including adding a breakdown of the metric by 1-in-100 and 1-in-250-year return periods to improve alignment with the current format of disclosure by issuers, adding a breakdown by region to provide information on the geographic exposure of the underwriting portfolio, and reporting such information net and gross of reinsurance to highlight the amount of exposure mitigated through purchase of reinsurance. Please note that included in this set of changes is a proposal to remove provisional metric FN0301-05, which is discussed in the proposal #2-50.

The proposal to add the breakdown by region is aligned with Proposed Item #2-50 (which covers FN0301-02). The alignment of FN0301-01 and FN0301-02 would improve the completeness and usefulness of the metrics associated with the topic by allowing analysts to compare a company’s disclosure of probable versus actual losses to assess its management of the environmental risk exposure in underwriting activities, including the robustness of its forecast models and pricing strategies.

Finally, the SASB proposes asking registrants to discuss how climate change scenarios are accounted for in catastrophe modeling, and therefore PML calculation, to align disclosure with the recently released recommendations by the Task Force on Climate-related Financial Disclosures (TCFD).

⁸⁵ FN0301-01: Probable Maximum Loss (PML) of insured products from weather-related natural catastrophes, by insurance segment, type of event, and type of risk insured

Together, these changes would improve the completeness and alignment of the metric, thereby better accomplishing the core objectives of the standard by offering investors a more decision-useful set of disclosures.

Supporting Analysis

The SASB's analysis indicates that companies in the industry currently report PML data using 1-in-100 and 1-in-250-year return periods. Further, such information is traditionally reported net and gross of reinsurance.

Recent TCFD recommendations include supplemental guidance for insurance companies, recommending that they describe the scenarios used in underwriting activities. The metric recommended by the TCFD states that, "Insurance companies should provide aggregated risk exposure to weather-related catastrophes of their property business (i.e., annual aggregated expected losses from weather-related catastrophes) by relevant jurisdiction." As described above, the revised SASB metric would require registrants to discuss climate scenario analysis, including a qualitative narrative on the critical input parameters, assumptions, considerations, and analytical choices used alongside the PML metric, which is a quantitative indicator of climate risk. The revised metric would address the TCFD recommendation, as it is the industry-specific indicator used by companies in their financial reports.

Stakeholder Consultation

Investors: Multiple investors unanimously stated that the provisional metric should be aligned with current industry reporting and should include disclosure on the probability of occurrence using the widely accepted scenarios (1-in-100 and 1-in-250-year). Feedback also indicated that adding geographic exposure and requiring disclosure both net and gross of reinsurance would improve the decision-usefulness of the metric.

Issuers: The SASB has received feedback from a limited number of Property & Casualty (P&C) insurance companies. Nevertheless, the feedback received was extensive and constructive, confirming that the probability of occurrence under different scenarios should be included in the metric to allow comparability across companies. Feedback indicated that this change would improve the completeness of the metric as well as its alignment with the format currently used by insurers in their SEC filings.

Benefits

Improves decision-usefulness: Additional disclosure on the probability of occurrence of climate events will improve completeness and provide decision-useful information to complement the PML data.

Improves cost-effectiveness: The proposed change is aligned with existing reporting and would therefore be cost-effective for issuers to implement.

Improves alignment: The proposed changes align the metric with the disclosure guidance recommended by the TCFD for insurance companies.

Proposed Update #2-50 – **Industry:** Insurance; **Topic Name:** Environmental Risk Exposure

2017 Technical Agenda Item #2-50 Description

SASB is evaluating the revision of metrics FN0301-02⁸⁶ and FN0301-05⁸⁷ to ensure the alignment and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Revise Metric and Remove Metric

The SASB proposes revising provisional metric FN0301-02 from “Total annual losses attributable to insurance payouts from (1) modeled natural catastrophes and (2) non-modeled natural catastrophes” to “Total annual losses attributable to insurance payouts from (1) modeled natural catastrophes and (2) non-modeled natural catastrophes, by type of event and geographic segment (net and gross of reinsurance).”

Additionally, the SASB proposes removing metric FN0301-05, “Percentage of policies in which weather-related natural catastrophe risks have been mitigated through reinsurance and/or alternative risk transfer.”

Adherence to Criteria for Accounting Metrics

The Insurance industry provisional standard includes a topic, Environmental Risk Exposure, with associated metrics to measure how insurance companies manage exposure to environmental risks such as extreme weather events driven by climate change–related impacts in their underwriting portfolios. Specifically, provisional metric FN0301-02 attempts to capture the possible losses through policy payouts that the registrant may incur in cases of extreme weather events, and the amount of losses that were modeled versus the amount that were not. Meanwhile, provisional metric FN0301-05 addresses risk mitigation practices through the purchase of reinsurance and risk-transfer products.

The focus of this proposed change is to address the industry’s reliance on reinsurance practices to mitigate environmental risk. Specifically, the SASB proposes removing metric FN0301-05 while transferring the elements covered by this metric into the newly revised FN0301-02, which would include a breakdown of modeled and non-modeled catastrophic losses, gross and net of reinsurance. Additionally, the SASB proposes including a breakdown of these losses by geographic segment and by type of weather event. The proposal to add this breakdown is aligned with Proposed Item #2-49 (which covers FN0301-01). The alignment of FN0301-01 and FN0301-02 would improve the completeness and usefulness of the metrics associated with the topic by allowing analysts to compare a company’s disclosure of probable versus actual losses to assess its management of the environmental risk exposure in underwriting activities, including the robustness of its forecast models and pricing strategies.

Together, these changes would improve the usefulness and completeness of the reported data, as well as improve alignment with current disclosures in SEC filings. If metric FN0301-02 is revised, the removal of a redundant metric (FN0301-05) would also improve the cost-effectiveness of the metrics, thereby better accomplishing the core objectives of the standard by offering investors a more decision-useful set of disclosures.

⁸⁶ FN0301-02: Total annual losses attributable to insurance payouts from (1) modeled natural catastrophes and (2) non-modeled natural catastrophes

⁸⁷ FN0301-05: Percentage of policies in which weather-related natural catastrophe risks have been mitigated through reinsurance and/or alternative risk transfer

Supporting Analysis

Analysis of the SEC filings of the industry's largest companies shows that the disclosure of catastrophe losses as well as probable maximum losses is often presented as net and gross of reinsurance, as well as net and gross of taxes. Such breakdown provides analysts with decision-useful information showing the extent to which losses were reduced by payouts of reinsurance policies.

Further, companies also provide information on geographic segments for which losses were recorded and disclose the specific catastrophic events that resulted in such losses. The proposed change would align the metric with those currently reported in corporate filings. This would improve the cost-effectiveness of disclosure.

Stakeholder Consultation

Investors: All investors who provided feedback on the proposed change unanimously suggested aligning the format of the SASB metrics for the Insurance industry with those currently used in corporate filings to ensure comparability and decision-usefulness.

Issuers: The SASB has received feedback from a limited number of P&C insurance companies. Nevertheless, the feedback received was extensive and constructive, confirming that the proposed change is appropriate as it aligns with current reporting practices used in SEC filings and is cost-effective.

Benefits

Improves cost-effectiveness: The change eliminates redundancy in the SASB standard and improves cost-effectiveness by aligning disclosure with current reporting practices.

Proposed Update #2-51 – **Industry:** Insurance; **Topic Name:** Environmental Risk Exposure

2017 Technical Agenda Item #2-51 Description

SASB is evaluating the revision of metric FN0301-03⁸⁸ to ensure the relevance and decision-usefulness of the metrics associated with the topic.

Summary of Change – Revise Metric

The SASB proposes adding a bullet point to the technical protocol of metric FN0301-03, “Description of how environmental risks are integrated into: (1) The underwriting process for individual contracts; (2) The management of firm-level risks and capital adequacy,” to ask registrants to provide disclosure of how incentives to improve the climate resiliency of properties or vehicles are considered in the pricing of policies.

Adherence to Criteria for Accounting Metrics

The Insurance industry provisional standard includes a topic, Environmental Risk Exposure, with associated metrics to measure how insurance companies manage exposure to environmental risks such as extreme weather events driven by climate change–related impacts in their underwriting portfolios. The metrics included in the disclosure topic capture the possible losses through policy payouts the registrant may incur in cases of extreme weather events, the amount of losses that were modeled versus not, and the amount of those losses that were mitigated through the purchase of reinsurance products. Specifically, provisional metric FN0301-03 captures the registrant’s approach to managing environmental risks in its underwriting activities and capital adequacy.

With respect to a company’s integration of climate-related risks in the underwriting process, the technical protocol asks registrants to discuss their approach to catastrophe modeling to improve the robustness of forecasts and to enhance policy pricing strategy, which could allow them to minimize losses in cases of extreme weather events. However, the provisional metric does not mention the need for a more in-depth discussion of a registrant’s strategy for using policy pricing to incentivize policyholders to reduce the environmental risk exposure of their portfolios. The proposed change would improve the completeness and relevance of the technical protocol by providing information on the climate resiliency of the underwriting portfolios.

The SASB further proposes aligning the technical protocol of metric FN0301-03 with the recent recommendations from the Task Force on Climate-related Financial Disclosures (TCFD). The recommendations for insurance companies include a section on discussion of climate-related risk exposure of underwriting portfolios, which falls under the scope of the disclosure topic and is covered in the provisional metric. This alignment will improve the comparability of the standard.

Supporting Analysis

Analysis of SEC filings and sustainability reports of the largest companies in the industry shows that pricing incentives are often mentioned as a strategy for reducing the risk exposure of underwriting portfolios. For example, a large Property & Casualty (P&C) insurer states in its sustainability report: “[W]e have implemented the following underwriting, coverage, and pricing strategies which may contribute to a reduction in climate-related losses to policyholders.

⁸⁸ FN0301-03: Description of how environmental risks are integrated into: (1) The underwriting process for individual contracts (2) The management of firm-level risks and capital adequacy

- “Encouraging efforts to improve building resiliency by providing pricing incentives for properties identified as having favorable risk characteristics relative to mitigation of climate-related losses (e.g., Insurance Institute for Business and Home Safety (IBHS) Fortified standards).”

Companies discuss pricing incentives to improve the climate resiliency of properties along with their enhancement of catastrophe modeling methodologies, which ensures completeness in their approach to mitigating environmental risk exposure.

The TCFD’s guidance for Insurance industry companies recommends discussion of climate-related risks in underwriting portfolios. These recommendations are aligned with the SASB’s approach to the Environmental Risk Exposure topic and associated metric FN0301-03, but include several specific elements of discussion that are worth highlighting in the technical protocol to ensure a more complete discussion of companies’ approach to managing the issue. Aligning the provisional metric’s underlying protocol with the TCFD recommendations would improve the comparability of the standard.

Stakeholder Consultation

Investors: All investors who provided feedback on the proposed change unanimously agreed with the proposed approach.

Issuers: The SASB received feedback from a limited number of P&C insurance companies. Nevertheless, the feedback received was extensive and constructive, confirming that the proposed element would fit well within the discussion covered by metric FN0301-03.

Benefits

Improves the SASB standard: Aligning the elements of discussion in the technical protocol with current disclosure formats and practices used in SEC filings and with TCFD recommendations would improve the comparability and alignment of the standard.

Proposed Update #2-52 – **Industry:** Insurance; **Topic Name:** Policies Designed to Incentivize Responsible Behavior

2017 Technical Agenda Item #2-52 Description

SASB is evaluating the revision of metric FN0301-06⁸⁹ to ensure the relevance and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Revise Metric

The SASB proposes revising the technical protocol associated with metric FN0301-06, “Discussion of products or product features that incentivize healthy, safe, and/or environmentally responsible actions or behavior,” by removing the note that asks registrants to disclose how incentives to improve the climate resiliency and resource efficiency of properties or vehicles are considered in policy pricing.

Adherence to Criteria for Accounting Metrics

The Insurance industry provisional standard includes a topic, Policies Designed to Incentivize Responsible Behavior, with associated metrics to measure how insurance companies grow their business by creating new products and adapting existing products while incentivizing policyholders to act responsibly, reducing environmental and social externalities. Specifically, provisional metric FN0301-06 asks registrants to discuss how they incentivize healthy, safe, and environmentally responsible behavior of policyholders through policy pricing. Included in the associated technical protocol is a discussion of features that incentivize climate resilience of insured properties. This element of the discussion relates to the Environmental Risk Exposure disclosure topic, which is included as a stand-alone topic in the provisional standard. Therefore, the SASB proposes removing this element of the discussion from metric FN0301-06.

As supported by feedback and SASB research, the proposed change improves the relevance of information provided to investors in both impacted disclosure topics. The proposal improves the applicability of metric FN0301-06 by aligning discussion of policy pricing with the appropriate disclosure topic, Environmental Risk Exposure. It also improves the completeness of both impacted metrics.

Supporting Analysis

Analysis of current disclosure practices in SEC and sustainability filings of the largest companies in the industry shows that pricing incentives are often mentioned as a strategy for reducing the risk exposure of underwriting portfolios. For example, a large insurance company states in its sustainability report: “[W]e have implemented the following underwriting, coverage, and pricing strategies which may contribute to a reduction in climate-related losses to policyholders.

- “Encouraging efforts to improve building resiliency by providing pricing incentives for properties identified as having favorable risk characteristics relative to mitigation of climate-related losses (e.g., Insurance Institute for Business and Home Safety (IBHS) Fortified standards).”

Companies discuss pricing incentives to improve resiliency of properties along with enhancement of catastrophe modeling methodologies, which ensures completeness of the approach to mitigation of environmental risk exposure. Therefore, the proposal to transfer the technical protocol note from the provisional metric FN0301-06

⁸⁹ FN0301-06: Discussion of products or product features that incentivize healthy, safe, and/or environmentally responsible actions or behavior

to a metric under the more relevant Environmental Risk Exposure topic would improve the representativeness and applicability of the SASB metrics.

Stakeholder Consultation

Investors: All investors who provided feedback on the proposed change unanimously stated that the proposal would better distinguish between the Environmental Risk Exposure topic and the Policies Designed to Incentivize Responsible Behavior topic.

Issuers: The SASB has received feedback from a limited number of P&C insurance companies. Nevertheless, the feedback received was extensive and constructive, indicating agreement with the proposal.

Benefits

Improves the SASB standard: The proposed change would improve companies' disclosure on the climate resilience of their underwriting portfolios by improving the relevance, completeness, and alignment of the corresponding metrics of the impacted disclosure topics.

Proposed Update #2-53 – **Industry:** Insurance; **Topic Name:** Plan Performance

2017 Technical Agenda Item #2-53 Description

SASB is evaluating revisions to the topic, including the corresponding metrics, due to its potential to affect corporate value, relevance across the industry, and level of investor interest.

Summary of Change – Revise Topic and Remove Metric

The SASB proposes changing the topic name from “Plan Performance” to “Transparent Information & Fair Advice for Customers.”

Further, the SASB proposes removing provisional metric FN0301-10, “Average number of days from reported claim to settlement of claim,” and adding a new metric, “Total amount of losses as a result of legal proceedings associated with failure to provide adequate, clear, and transparent information about products and services.”

In addition, the SASB proposes minor technical protocol changes of provisional metric FN0301-11, “Description of efforts to provide information to new and returning customers in a clear and conspicuous manner” to improve its structure.

Adherence to Principles for Topic Selection

The Insurance industry provisional standard includes a topic, Plan Performance, with associated metrics to describe how companies must protect consumers by providing transparent information and fair advice. Insurance products play an important societal role in smoothing out the impact of unexpected economic shocks, allowing policyholders to minimize the financial impact of events such as illnesses, accidents, and deaths. However, unclear insurance policies, ambiguous product terms, and potentially misleading sales tactics can erode brand reputation, lead to legal disputes, and reduce the number of services and products offered if regulators deem certain policies overly complex and unsuitable for customers. In addition, customer dissatisfaction may reduce insurance usage, potentially leading to extremely negative financial outcomes such as personal bankruptcies, for individuals and families. Companies that maintain transparent policy terms and direct customers toward the products best suited to them will be better positioned to maintain their brand reputation, avoid regulatory scrutiny, and protect shareholder value.

The SASB proposes changing the topic name to “Transparent Information & Fair Advice for Customers” to better capture the sustainability angle of the topic. The social challenges posed by the topic arise not from the timeliness of settlements, which are also covered under the topic, but from the failure to provide transparent information and fair advice to clients when selling policies. Changing the topic name will more faithfully reflect the issue that the SASB intends to capture, which is the transparency of products sold and the customer-centeredness of firms.

In addition, the SASB proposes removing provisional metric FN0301-10, as it will no longer be relevant under the scope of the updated topic, and adding a new metric, “Total amount of losses as a result of legal proceedings associated with failure to provide adequate, clear, and transparent information about products and services.” These revisions would improve the decision-usefulness of the standard and the completeness of the metrics associated with the topic by allowing issuers to better understand their position relative to competitors and allowing investors to better gauge company performance on the issue.

Supporting Analysis

According to feedback received from a few large insurance companies, some in the industry have been actively trying to improve the transparency of their policies in recent years. The SASB's analysis of company disclosures, websites, marketing materials, and CSR reports shows increasing focus on transparency and customer satisfaction.

The SASB's evidence-based research uncovered a number of cases in which large insurers have been fined for misrepresentations of policy details. Apart from the increased costs associated with and resulting from litigation, insurers also face the potential for reputational damage, leading to negative demand-side impacts. The proposed change of the scope of the disclosure topic reflects the stakeholder consensus and is supported by evidence. The issues covered in the proposed disclosure topic are actionable by companies and relevant to the majority of issuers in the Insurance industry. The proposed changes to the metrics will also improve the completeness and usefulness of the set of metrics included in the disclosure topic, resulting in disclosure of decision-useful information to investors.

Stakeholder Consultation

Investors: Investors raised concerns during the 2016–2017 consultation period about whether the topic of “Plan Performance” adequately captured the sustainability challenges faced in the Insurance industry. They indicated that the aspects the standard should address under the topic relate to companies' ability to provide clients with transparent information and fair advice about the insurance products sold to them, and that three of the four existing metrics are appropriate. They suggested that the name and the narrative of the topic should focus on transparency rather than firm accountability, and that metric FN0301-10 was not relevant to the topic as it is impacted by various factors unrelated to sustainability and varies significantly by line of product, making it challenging to report at a company level and not comparable across companies.

Issuers: The SASB received only limited feedback from issuers on the Insurance industry standard. Nevertheless, P&C and Life insurance companies unanimously stated that the focus of the disclosure topic should be around transparency of information provided to clients at policy origination.

Benefits

Improves the SASB standard: The proposed name change would clarify the scope of the topic by better capturing the nature of the sustainability impacts that the SASB intends to address. The proposed change to the metrics would increase the decision-usefulness of the associated disclosures by making them more relevant to issuers.

Proposed Update #2-54 – **Industry:** Insurance; **Topic Name:** Systemic Risk Management

2017 Technical Agenda Item #2-54 Description

SASB is evaluating the revision of metrics FN0301-12,⁹⁰ FN0301-13,⁹¹ FN0301-14,⁹² and FN0301-15⁹³ to ensure the alignment, decision-usefulness, and cost-effectiveness of the metrics associated with the topic.

Summary of Change – Revise Metrics

The SASB proposes removing the following provisional metrics:

- FN0301-12 Non-policyholder liabilities
- FN0301-13 (1) Notional amount of CDS protection sold, (2) notional amount of debt securities insured for financial guarantee, and (3) risk-in-force covered by mortgage guarantee insurance
- FN0301-14 Value of collateral received from securities lending and amount received from repurchase agreements
- FN0301-15 Amount of life and annuity liabilities that can be surrendered upon request: (1) Within three months without penalty (2) With penalties lower than 20 percent

and replacing them with the following new metrics:

- Global Systemically Important Insurer (G-SII) assessment score by category
- Discussion on how results of mandatory and voluntary stress tests and risk-based capital requirements are integrated into capital adequacy planning, long-term corporate strategy, and other business activities

Adherence to Criteria for Accounting Metrics

The Insurance industry provisional standard includes a topic, Systemic Risk Management, with associated metrics to describe a financial institution’s capacity to operate after economic shocks and the degree to which its operations may affect other companies and the broader economy.

Provisional metrics FN0301-12, FN0301-13, FN0301-14, and FN0301-15 include several measures normally used for measuring systemic risks, but are incomplete or not sufficiently industry-specific. The proposed addition of G-SII scores incorporates information from FN0301-12 and FN0301-13, along with other relevant data, making it a more complete and industry-specific indicator. The indicator measures an insurer’s systemic risk by calculating scores in five different categories (i.e., size, global activity, interconnectedness, asset liquidation, and substitutability). These data are generally provided to local regulators in the U.S., with similar standards existing in other countries. The change would therefore improve the completeness of the metric as it encompasses a broader view of systemic risk that can be condensed into a single indicator. It also would add to the comparability, applicability, alignment, and verifiability of the metric, as data for G-SII scores are already collected by most industry participants.

⁹⁰ FN0301-12: Non-policyholder liabilities

⁹¹ FN0301-13: (1) Notional amount of CDS protection sold, (2) notional amount of debt securities insured for financial guarantee, and (3) risk-in-force covered by mortgage guarantee insurance

⁹² FN0301-14: Value of collateral received from securities lending and amount received from repurchase agreements

⁹³ FN0301-15: Amount of life and annuity liabilities that can be surrendered upon request: (1) Within three months without penalty (2) With penalties lower than 20 percent

Regarding the proposed addition of a qualitative discussion of compliance with risk-based capital standards, practically all companies in the industry discuss the issue in their SEC filings. By focusing on a more in-depth discussion of how such risks and solvency assessments integrate environmental, social, and governance (ESG) factors and how these inform the company's ESG strategy, the metric provides information currently not disclosed by insurers, thereby better accomplishing the core objectives of the standard by offering investors a more decision-useful set of disclosures.

Supporting Analysis

The first proposed metric addresses regulatory frameworks relevant to the Insurance industry and the "Systemic Risk Management" topic. While insurers discuss capital adequacy planning in their filings, they do not link such discussion to the sustainability of their long-term business strategy. The proposal would call for companies to discuss how ESG factors inform the quantitative and qualitative aspects of their capital adequacy planning, long-term corporate strategy, and other business activities, as well as how their enterprise risk management efforts inform their approach to integrating ESG factors into their business strategy. At the same time, such discussion would tie the regulatory and financial aspects of the topic back to its sustainability impacts, better addressing the completeness and usefulness criteria established in the *SASB Conceptual Framework*.

The second proposed metric references the International Association of Insurance Supervisors' (IAIS) Updated G-SII Assessment Methodology of insurance companies.⁹⁴ The IAIS methodology and proposed G-SII scores were endorsed by the Financial Stability Board (FSB) created by the G-20. This methodology is the most relevant and comprehensive assessment of systemic risk as it relates to the Insurance industry. The methodology for calculating the G-SII scores for each of the five categories considers performance on some of the provisional metrics along with other applicable indicators. For example, the scores incorporate non-policyholder liabilities and derivatives trading; these elements are currently covered by provisional metrics FN0301-12 and FN0301-13. Therefore, the proposed change condenses these elements into a single metric, while adding a more robust set of measures. An SASB analysis shows that practically all large publicly listed insurers already broadly discuss these regulations along with the IAIS methodology in their SEC filings, which ensures the applicability, alignment, and cost-effectiveness of the proposed metrics.

In addition, a couple of the provisional metrics proposed for removal lack relevance in the context of the industry. As substantiated by feedback, metrics FN0301-14 and FN0301-15 are not applicable to insurance companies.

As a result, all these proposed changes combine to add to the usefulness, applicability, comparability, completeness, and alignment of the metrics associated with this topic.

Stakeholder Consultation

Investors: The SASB received feedback from multiple investors that the provisional metrics included in the Systemic Risk Management topic are not relevant and decision-useful indicators of performance. For example, the amount of life and annuity liabilities that can be surrendered upon request was not found to be a relevant risk indicator for companies in the industry. Moreover, several investors stated that derivatives and non-policy liability exposures are reported in company filings, but may not necessarily provide a complete picture of systemic risk exposure, suggesting that the provisional metrics are not complete.

Issuers: The SASB has received feedback from a few large-cap issuers that some of the provisional metrics are not relevant for the Insurance industry. Input from the companies generally pointed to the need for a more complete set

⁹⁴ "Global Systemically Important Insurers: Updated Assessment Methodology" International Association of Insurance Supervisors, June 16, 2016, accessed August 29, 2017, <https://www.iaisweb.org/file/61179/updated-g-sii-assessment-methodology-16-june-2016>.

of metrics, as opposed to a seemingly arbitrary focus on aspects of the topic. Additionally, feedback indicated the importance of regulatory views and ratings of performance on systematic risk. The SASB did not obtain direct input on the specific proposed metrics, though research indicates that the proposed metrics are more consistent with the industry's approach on assessing systemic risk.

Benefits

Improves decision-usefulness: The G-SII metric satisfies the SASB criteria of providing a minimal set of decision-useful metrics while incorporating all the relevant elements of the topic from a sustainability point of view.

Improves cost-effectiveness: Systemically important insurers are currently required to collect and compute their G-SII scores. Therefore, by improving alignment with the existent IAIS methodology, the proposal would improve the cost-effectiveness of the standard.

Proposed Update #2-55 – **Industry:** Insurance; **Topic Name:** Integration of Environmental, Social, and Governance Risk Factors in Investment Management

2017 Technical Agenda Item #2-55 Description

SASB is evaluating the addition of a metric to ensure the relevance, alignment, and decision-usefulness of the metrics associated with the topic.

Summary of Change – Add Metric

The SASB proposes adding the following metric, “Total invested assets by industry and asset class.”

Adherence to Criteria for Accounting Metrics

The Insurance industry provisional standard includes a topic, Integration of Environmental, Social, and Governance Risk Factors in Investment Management, which is focused on a company’s management of exposure to ESG risks and opportunities in portfolios of invested assets. The associated provisional metrics included in the topic (i.e., FN0301-16 and FN0301-17) ask companies to discuss how they integrate ESG factors in investment of policy premiums and the ESG risks to which their portfolios are exposed.

While the provisional metrics may provide investors with sufficient information around companies’ policies and procedures related to ESG integration, they fail to provide a quantitative measure of the risk exposure of their portfolios. Therefore, the SASB proposes adding a metric to measure exposure of investment portfolios by industry. As each and every industry has its unique sustainability risks and opportunities, understanding the breakdown of investment portfolios to various economic sectors would allow analysts to better assess industry-specific ESG risks and opportunities insurers are exposed to. Adding a quantitative measure to the existing metrics would also allow analysts to compare risk exposure among industry peers; based on their respective views, each analyst could quantify a relative risk exposure of individual companies.

The proposed addition would improve the completeness of the information provided to investors when combined with the existing set of provisional metrics, thereby better accomplishing the core objectives of the standard by offering a more decision-useful set of disclosures.

Supporting Analysis

Insurance companies are required to report their investment portfolios to state regulators and the National Association of Insurance Commissioners (NAIC) in regulatory filings. An analysis of current disclosure practices in SEC filings also shows that a large number of insurance companies report their investment portfolios in Forms 10-K and 20-F. In some cases, disclosure is provided at a sector level. Insurance companies report their stock and bond investments on the NAIC Schedule D, derivatives on Schedule DB, cash and cash equivalents on Schedule E, real estate on Schedule A, and mortgage loans on real estate on Schedule B. The format in which the data is reported on regulatory schedules is much more detailed than what the proposed metric calls for. For that reason, the proposal would not duplicate original disclosure in regulatory filings but rather provide a high-level view of investment portfolios through a sustainability—rather than traditional financial risk—lens. Therefore, the proposed metric would ensure a more complete set of relevant data with which to assess an industry firm’s approach to ESG integration in investment management. Investment portfolios of insurance companies may range significantly in terms of their exposure to individual industries. For that reason, the data generated by the proposed metric would be decision-useful to compare companies against each other to determine the relative risk exposure to industry-specific ESG factors.

Stakeholder Consultation

Investors: Multiple investors unanimously stated that disclosure of investment portfolios by industry would be extremely decision-useful. These investors stated that companies report the data in regulatory filings, but at a very granular level that makes it challenging to compare. All analysts agreed that reporting the data in SEC filings would improve comparability substantially and add value to the total mix of information on the topic.

Issuers: During consultation, only one issuer provided feedback on this topic. This issuer indicated they saw the benefit of disclosing the proposed data in SEC filings as a complement to the regulatory schedules. According to the issuer's feedback, as such information is already reported in great detail, it would not create additional cost burden for insurance companies to report the proposed metric.

Benefits

Improves decision-usefulness: As highlighted by issuer and investor feedback, the quantitative measure would significantly improve the decision-usefulness of the standard and help to quantify disclosure on qualitative metrics while having no impact on the cost-effectiveness of the standard. It would allow for greater comparability of performance, which leads to more informed decision making. The proposed metric would further improve the completeness of disclosures, providing a fuller picture of the level of integration of ESG factors and exposure to them in investment portfolios.

Proposed Update #2-56 – **Industry:** Insurance; **Topic Name:** Activity Metrics

2017 Technical Agenda Item #2-56 Description

SASB proposes to include activity metrics for the Insurance industry.

Summary of Change – Add Activity Metric

The SASB proposes adding the following activity metric, “Number of policies held by segment: (1) property & casualty, (2) life, (3) assumed reinsurance.”

Rationale

The SASB proposes adding activity metrics as a new element of the Insurance standard. At the time of release of the provisional standards for the Financials sector, the SASB had not incorporated the concept of activity metrics into the industry standards. Activity metrics are useful for measuring the scope and scale of a company’s operations, providing normalization factors for the performance metrics included in the disclosure topics.

Supporting Analysis

The proposed metric measures the size of an insurance company’s underwriting portfolio by high-level segment. The SASB’s research shows that this information is disclosed in regulatory filings but at a much more detailed level. Therefore, the proposed activity metric would be relevant and cost-effective to report; additionally, it would complement regulatory disclosure and add a higher level of comparability when used as a normalization factor.

Stakeholder Consultation

Investors: The SASB received feedback from a few investors that the proposed activity metrics would not be costly to report on, as the data is already disclosed in regulatory filings at a much more detailed level. These investors also indicated that such disclosure would be relevant and decision-useful.

Issuers: The SASB received feedback from a few issuers that the proposed activity metrics are relevant to the disclosure topic and are currently disclosed by companies in their regulatory filings. Some issuers also wanted to see a more detailed breakdown than what the SASB is proposing.

Benefits

Improves the SASB standard: The proposed activity metric would provide investors with normalization factors to ensure the comparability of the SASB’s performance metrics across issuers.

Improves decision-usefulness: The proposed activity metric would improve the decision-usefulness of all quantitative performance metrics included in the industry standard by allowing investors to convert them from absolute to relative measures of performance.