December 31, 2020

Dear Mr. Hales,

The Society for Corporate Governance (the “Society” or “we”) appreciates the opportunity to provide comments to the Sustainability Accounting Standards Board on its Proposed Changes to the SASB Conceptual Framework (“the Proposal”).

Founded in 1946, the Society is a professional membership association of more than 3,400 corporate and assistant secretaries, in-house counsel, outside counsel, and other governance professionals who serve approximately 1,600 entities, including 1,000 public companies of almost every size and industry. Society members are responsible for supporting the work of corporate boards of directors and the executive managements of their companies on corporate governance and disclosure matters.

Introduction

Due in part to the integration of environmental and social (E&S) risks into investment decision-making by a significant number of investors in recent years, the Society appreciates the private sector-led efforts to develop clear standards that can help guide issuers in providing investors relevant and timely disclosure regarding their material E&S issues. While the Society is broadly supportive of SASB’s standards development process and organizational governance efforts (but is not endorsing the standards), we are concerned that the proposed redefinition of “financial materiality” likely will confuse U.S. issuers’ sustainability disclosure efforts, as well as their use of SASB standards. We lay out our concerns, as well as a proposed solution, below.

Established Definition of Materiality

U.S. public company issuers are bound by the definition of “materiality” as articulated by the U.S. Supreme Court, which has held that “an omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.”¹ In other words, in the Court’s view, an omitted fact is material if there is “a substantial likelihood that the disclosure of the

omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.”

The U.S. Supreme Court’s definition of “materiality” (the “TSC Northway/Basic definition”) serves as the foundation of the disclosure framework created by the Securities and Exchange Commission (“SEC”) and, accordingly, guides disclosure decisions and determines the securities law compliance of U.S. public companies, including with respect to environmental, social and governance (“ESG”) matters. For example, the SEC relies upon and applies the TSC Northway/Basic definition in its review of “financial statements filed with the Commission and the performance of audits of those financial statements” as noted in Staff Accounting Bulletin No. 99. In addition, the SEC relies upon and applies the TSC Northway/Basic materiality definition in its Filing Review Process, which is a cornerstone of guidance to U.S. public companies and corporate counsel.

In the decades since the pertinent Supreme Court cases were decided, federal district and appellate courts—and the Supreme Court itself—have applied the TSC Northway/Basic definition of materiality to a variety of specific contexts, further clarifying, refining and entrenching a specific understanding of materiality among public companies, the legal bar and investors. Furthermore, as the SEC has recognized, U.S. public companies, corporate counsel and the accounting profession have, on the basis of this precedent, “developed quantitative thresholds as ‘rules of thumb’ to assist in the preparation of their financial statements, and . . . auditors also have used these thresholds in their evaluation of whether items might be considered material to users of a registrant’s financial statements.” In sum, the TSC Northway/Basic materiality definition is the intellectual bedrock of disclosure by U.S. public companies and defines the parameters of what investors expect to find in SEC-filed disclosures.

Concerns with SASB’s Proposed Redefinition of Materiality

SASB’s proposed modification of the definition of materiality – a term that has been defined by the Supreme Court, has decades of legal precedent behind it, and lies at the core of the U.S. securities disclosure regime – and its renaming of the term to “financial materiality” are concerning. While the Proposal states that SASB “is not seeking to change the intended scope of its definition” (of financial materiality), which was previously more closely aligned with the Supreme Court’s definition, we believe that the definition of “financial materiality” now proposed by SASB meaningfully diverges from the TSC Northway/Basic definition and would create confusion and ambiguity for issuers and investors alike.

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4 [https://www.sec.gov/divisions/corpfin/cffilingreview.htm](https://www.sec.gov/divisions/corpfin/cffilingreview.htm)
The Proposal states:

“For the purpose of SASB’s standard-setting process, information is financially material if omitting, misstating, or obscuring it could reasonably be expected to influence investment or lending decisions that users make on the basis of their assessments of short-, medium-, and long-term financial performance and enterprise value.”  

We highlight three significant semantic differences between this new definition and the well-established TSC Northway/Basic definition below.

Would v. Could

The TSC Northway/Basic definition states that to be material, an omitted fact or misstatement “would” be considered important by a reasonable investor. In contrast, the SASB redefinition states that information is “financially material” if it “could” be reasonably expected to influence an investor decision.

SASB’s substitution of “could” for “would” clearly makes more probable the likelihood that a reasonable person would find an omitted fact or misstatement to be “important” to their investment decision. Common usage of each word (“could” vs. “would”) suggests that a reasonable investor is more likely to find a particular disclosure to be sufficiently probative or influential with respect to an investment decision when applying SASB’s proposed definition of “financial materiality” as compared to the U.S. Supreme Court definition. In effect, one can more easily conclude that an omitted fact or misstatement is important to the reasonable investor if such fact or misstatement is simply capable of being (i.e., “could”) be) important to the reasonable investor, as opposed to the lower probability of an omitted fact or misstatement being likely to be (i.e., “would”) be) important to the reasonable investor. We believe, in effect, that use of “could” reduces the degree of relevance and impact that a fact or misstatement must have on the reasonable investor in order for that fact/misstatement to “reasonably be expected to influence investment or lending decisions” and, therefore, to be considered “financially material.” This lower threshold of relevance would result in increased disclosure making it more difficult for investors to discern important from irrelevant information and would exacerbate concerns of legal liability, thus inhibiting the willingness of issuers to use SASB standards.

Investing v. Lending

The SASB definition for the first time adds “lending decisions” to investment decisions and we believe this changes the standard to include information that a company might give a lender. This is an expansion that we don’t believe the Court or the SEC intends to cover. TSC v. Northway defines materiality in terms of what a reasonable investor, rather than a lender, would find important in an investment or voting decision. This makes sense since lenders are in a unique position and have superior access to information from companies with whom they intend to enter into a debtor-creditor relationship. This is not at all similar to the mix of information needed by an investor upon which to make an investment decision. In fact, lenders seek to be repaid while investors seek return. The two are different and the materiality definition would be inappropriately broadened by including information that “could influence”

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7 Id. at p. 11
lenders. Moreover, the SEC’s mandate is to protect investors rather than lenders. For this additional reason, we think the proposed definition meaningfully changes the Supreme Court standard.

“Medium and Long-term”

SASB’s proposed redefinition of “financial materiality” extends the relevant time horizon of an investment decision to include the “medium and long-term.” U.S. issuers generally eschew making medium- and long-term projections or statements because of the risk of litigation and U.S. capital market participants’ typical three-year investment horizon. SASB’s inclusion of “medium- and long-term financial performance and enterprise value” in its redefinition of “financial materiality” puts U.S. issuers in an analytically fraught position (i.e., does disclosing information pursuant to SASB standards effectively imply that a U.S. issuer believes that such information is, in fact, material to an investor’s view of the company’s “medium and long-term financial performance”?) This quandary is particularly relevant in light of the fact that some environmental and social information sought by certain investors and other stakeholders may be relevant to a particular company over a period of time frequently longer than the ordinary investment time horizon. Given the expanded time horizons incorporated within SASB’s proposed redefinition of “financial materiality,” U.S. issuers would effectively be deploying two definitions of “materiality”: the SASB “financial materiality” definition for SASB-related disclosures, and the TSC Northway/Basic definition for non-SASB-related disclosures. Such an outcome would unnecessarily complicate issuer and/or investor determinations regarding “materiality” and would not be helpful to U.S. issuers, their communication to investors, or efforts to increase the use of SASB standards in the American market.

If U.S. issuers were to apply two different definitions of “materiality,” investors and the companies themselves would likely find the disclosures more confusing and difficult to interpret. Having to toggle back and forth between the SASB “financial materiality” definition and the TSC Northway/Basic definition replaces clarity with confusion, and complicates the issuer’s task of disclosing its material risks and the investor’s task of clearly understanding those material risks. SASB’s proposed redefinition of “financial materiality” could also constrain adoption of the SASB standards among U.S. issuers, which operate in a challenging litigation environment. As a practical matter, companies may simply apply the TSC Northway/Basic definition to all disclosures, including those pursuant to standards or metrics articulated by SASB; U.S. companies would be in a stronger analytical and legal position by continuing to rely on U.S. Supreme Court precedent and being able to crisply articulate why a certain disclosure is material and how it arrived at that decision. At the same time, if public companies continued to rely exclusively on the TSC Northway/Basic definition, investors’ interest in clear disclosures would be vindicated.

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In sum, the Society does not support altering the deeply ingrained definition of materiality that underlies the U.S. disclosure framework. While the Society understands SASB’s goal of becoming more

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8 “Issuers remain[ed] reluctant to make such disclosures beyond those necessary to comply with SEC reporting requirements. The primary basis for this reluctance had been attributed to the significant litigation risks imposed on the company, and possibly its directors and officers, as a result of predictive disclosures that later turned out to be incorrect.” “What Exactly is Forward-Looking Information,” CFA Institute, July 2014; https://www.cfainstitute.org/-/media/documents/article/position-paper/forward-looking-information-a-necessary-consideration-in-sec-review.ashx
global by, among other things, “remov[ing] and/or modify[ing] references to U.S.-based regulations,” the Society believes that this objective can be accomplished by SASB crafting a globally-relevant definition of a term other than “materiality” or “financial materiality” (for example, “sustainability materiality”). To the extent SASB sees value in moving away from the U.S. definition of materiality, the Society encourages SASB to coin a new term to guide its standards, rather than abandoning a term that has the weight of significant Supreme Court precedent and decades of application behind it.

Thank you for the opportunity to comment.

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