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Via Email: rule-comments@sec.gov

Office of the Secretary
Securities and Exchange Commission (SEC)
100 F Street, NE
Washington, DC 20549-1090

RE: File Number S7-06-16 Concept Release: Business and Financial Disclosure Required by Regulation S-K

Dear Office of the Secretary:

On behalf of the B Lab community of more than 1,700 certified B Corps around the globe, and our five global partner organizations, B Lab UK, B Lab Europe, Sistema B, B Lab Portugal and B Lab Australia and New Zealand, B Lab, Inc. ("B Lab") is pleased to present its response to the Commission's concept release (the "*Release*") seeking comment on modernizing disclosure in periodic reports, and, in particular, Subsection IV.F of the Release, "Disclosure of Information Relating to Public Policy and Sustainability Matters." Business and Financial Disclosure Required by Regulation S-K, Concept Release No. 33-10064 (Apr. 13, 2016) [hereinafter Release].

B Lab is a non-profit organization seeking to create a business infrastructure that allows and encourages for-profit businesses to act as stewards for the human, social and environmental capital they control to the same degree they act as stewards of financial capital. As discussed in more detail below, we believe that many reasonable investors both want and need information relating to the impact of issuers' operations on the markets broadly and on systemic risks in order to make fully informed investment and voting decisions.

ESG and Financial Performance

The Release poses an important series of questions involving the relationship between an issuer's ESG performance and its financial performance. There is a growing body of data demonstrating the linkage between the two, and we are confident that the Commission will receive a significant number of comments addressing this link, and suggesting specific ESG information about issuers that relates directly to their financial performance, and that is therefore material to investors with respect to both investment and voting decisions. In this regard, we note that there are a number of organizations, including the Sustainability Accounting Standards Board ("SASB"), that have developed measurement regimes that allow for consistent reporting on ESG metrics. B Lab has developed an assessment of a firm's performance that focuses on the firm's impact on its stakeholders (the "BIA"). The BIA has been used by the 1700 companies that have been certified by B Lab, but also by an additional 40,000 firms that have used the tool to measure their impact.

In light of the substantial work that has already been done by NGOs and academics demonstrating the positive correlation between an issuer's ESG performance and the financial return on its securities, and the volume of comments likely to be received on those matters, we encourage the Commission to give serious consideration to ensuring that ESG matters that are material to the financial performance of issuers are fairly incorporated into SEC reporting standards. Failing to do so will have the effect of forcing the market to act based on what is reported, which will lead to decision-making based on financial metrics and similar data that fail to incorporate important elements of value, resulting in the misallocation of financial capital. However, we believe that other commenters are far more qualified to provide guidance on the financial materiality of ESG matters to individual issuers.

Investors Recognize That ESG Performance Affects the Broad Market

Rather than focusing our response on disclosure that is material because of the relationship between an issuer's ESG performance and the financial returns on its securities, we will address the relationship between an issuer's ESG performance and the value of other securities owned by investors. Most critically, an issuer's poor ESG performance can create externalities that have a negative effect on the performance of other securities, particularly over the long-term. For example, issuers that contribute to the amount of carbon in the atmosphere contribute to climate risk, which is likely to create negative effects on the long term value of securities across the market. *See* Intergovernmental Panel on Climate Change, IPCC, 2014: Climate Change 2014: Synthesis Report. Contribution of Working Groups I, II and III to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change 64 (The Core Writing Team et al. eds., 2015) ("Continued high emissions would lead to mostly negative impacts for biodiversity, ecosystem services and economic development and amplify risks for livelihoods and for food and human security."). A historical example would be the poor governance at financial firms prior to the 2008 market break, which led to the destruction of trillions of dollars in stock market value. *See* Int'l Monetary Fund, Global Financial Stability Report—Risk Taking, Liquidity and Shadow Banking: Curbing Excess While Promoting Growth 105 (2014) ("There is a broad consensus that excessive risk taking by banks contributed to the global financial crisis.").

The risk that particular issuers pose to the market as a whole is material to most investors, because most investors are diversified. Hermes Investment Management, a well-known UK pension advisor, explains why most investors need to understand the effects of their investments on the markets as a whole, and to shun investments that rely on negative sum strategies:

> Most investors are widely diversified; therefore it makes little sense for them to support activity by one company which is damaging to overall economic activity. . . . [I]t makes little sense for pension funds to support commercial activity which creates an equal or greater cost to society by robbing Peter to pay Paul.

Hermes Investment Management, Hermes Responsible Ownership Principles 18, https://www.hermes-investment.com/wp-content/uploads/2015/09/the-hermes-corporate-ownership-principles.pdf.

Because of this diversification, the performance of the markets included in their portfolio is more important to investors than the performance of any one security. Investors who are invested across the market earn most of their return from beta—the market return, rather than alpha—the individual securities they pick. *See* Raj Thamotheram & Aidan Ward, *Whose Risk Counts?*, *in* Cambridge Handbook of Institutional Investment and Fiduciary Duty 207, 212 (James P. Hawley et al. eds., 2014) ("about 80 percent of the ability of a fund to meet its liabilities comes from the beta, the market return, but . . . 80 percent of the resources are funneled into chasing alpha, which is often illusory or not cost-effective when real costs (including trading activity and knock-on impact) are considered.").

Investors do, in fact, recognize this link. As the Release notes, firms with approximately $59 trillion in assets under management have signed onto the U.N.'s Principles for Responsible Investment ("PRI"). The preamble to those six principles makes it clear that the commitment to integrating ESG factors into investing is not simply a matter of increasing the performance of specific companies, but rather the markets in which those companies sit:

> In this fiduciary role, we believe that [ESG] issues can affect the performance of investment portfolios (to varying degrees across companies, sectors, regions, asset classes and through time).

Principles for Responsible Investment, Principles for Responsible Investment 4, https://www.unpri.org/download_report/3847. Accordingly, investment fiduciaries must take a broad market view into account in order to meet their fiduciary obligations. This point was highlighted in a recent report, Fiduciary Duty in the 21st Century, co-authored by the UN Global Compact, the UNEP Financial Initiative and PRI. That report explicitly recognized that investors can only do well if the market does well as a whole:

> Responsible investment is an approach to investment that explicitly acknowledges the relevance to the investor of ESG factors, *and of the long-term health and stability of the market as a whole.*

United Nations Global Compact et al., Fiduciary Duty in the 21st Century 3 (2015) (emphasis added). Indeed, the report goes even further, and notes the link that fiduciaries should draw between ESG performance and their effect on their ultimate beneficiaries:

> Wider social, economic and environmental issues: These are issues that have the potential to seriously affect the investors' ability to deliver on its organisational or investment objectives but that may have limited financial impact within the relevant time period. For example, *these could be issues that affect the stability and health of economic and environmental systems*, or they could be issues that are, or have the potential to be, important to beneficiaries or other stakeholders.

Id. at 19 (emphasis added). Often these structural issues manifest over long time periods, so that beneficiaries concerned only with short term performance may have different interests than longer term beneficiaries. A report prepared by BlackRock and Ceres described the obligation of fiduciaries must balance these interests carefully:

> Investment practices that foster intergenerational transfers of risk and wealth raise duty of impartiality concerns for long-term investors. Changes in understanding of systemic risk, and related investment management practices among global peers, demonstrate an ongoing evolution in the prudence standards against which the conduct of fiduciaries is judged.

Keith L. Johnson, *Fiduciary Duty and ESG Engagement*, *in* 21st Century Engagement: Investor Strategies for Incorporating ESG Considerations into Corporate Interactions 35, 35 (BlackRock & Ceres eds. 2015), https://www.blackrock.com/corporate/en-us/literature/publication/blk-ceres-engagementguide2015.pdf.

Forward looking asset owners, like CalPERS, which manages $300 billion of pension assets for California's public employees, understand the issue as well, as illustrated by a statement from their investment beliefs, which include consideration of risk factors that affect both individual issuers and portfolios:

> As a long-term investor, CalPERS must consider risk factors, for example climate change and natural resource availability, that emerge slowly over long time periods, but could have a material impact on company *or portfolio* returns.

CalPERS, Towards Sustainable Investment & Operations: Making Progress 37 (2014), http://www.calpers.ca.gov/eip-docs/about/pubs/esg-report-2014.pdf (emphasis added).

These statements from BlackRock, CalPERS, and Hermes show that both managers and owners need disclosure to include data that allows them to make decisions that will contribute to beta, and not just alpha—so that the greatest investment risks can be managed by the investment community. As Thamotheram and Ward state:

> Real risk management – from the perspective of long-horizon, well-diversified investors – drives beta, the underlying real return on productive investment, by limiting the negative impact of real economy events.

Thamotheram & Ward, *supra*, at 213.

In his Foreword to the CAMBRIDGE HANDBOOK, former Vice President of the United States and Co-founder and Chairman of Generation Investment Management made this connection forcefully:

> Investing is a means to secure our future well-being. This requires a broader consideration by fiduciaries of systemic effects – for example, consideration of how investments can create better markets tomorrow, rather than simply focusing on "beating" the market today. Incentives that encourage fiduciaries to take advantage of asymmetries have frequently seduced fiduciaries to succumb to a self-destructive cycle of short-termism and have clearly generated unhealthy outcomes for the system as a whole.

Al Gore, *Foreword*, *in* Cambridge Handbook of Institutional Investment and Fiduciary Duty xvi, xvi (James P. Hawley et al. eds., 2014). Thus, in order to fully exercise their duties, asset owners and managers must consider the effect of their investment and voting decisions on the market as a whole, not merely on the alpha of any one particular issuer.

Disclosure of ESG Data Relevant to Market Performance is within the Commission's Mandate.

The *Release* looks to Environmental and Social Disclosure, Release No. 33-5627 (Oct. 14, 1975) ("*1975 Release*") and notes that the statutory framework for adopting disclosure requirements remains consistent with the framework from that time period. Release at 210. Under that framework, ESG data relevant to an issuer's effect upon broad market performance should be included in an issuer's periodic filings. The *1975 Release* notes the relevance of what investors themselves seek in analyzing what is material. *See id.* at 209–210. As the *Release* itself notes, more than $59 trillion is under management by institutions that operate under PRI regime, which looks to the effects of investments on "portfolio" performance. BlackRock, the world's largest asset manager ($4.6 trillion assets under management), as quoted above, understands the importance of such issues in its analysis. Moreover, the law governing the fiduciaries who control much of the market is evolving to require them to consider such information.

The *1975 Release* makes clear, and the *Release* reiterates, that the analysis is one of material information to a reasonable investor with respect to both investment and voting decisions. Vice President Gore makes this connection: investing and voting "require[] a broader consideration by fiduciaries of systemic effects." Gore, *supra*, at xvi. Although the decision in the *1975 Release* suggested that the environmental and social policies in question were not economically significant, and that the statutory framework looked to such significance as an important consideration, the effect of ESG performance on the market is clear—and this is an economic question of paramount importance to investors. As one commentator put it more bluntly:

> Investment decisions that intentionally manage systems as well as portfolios can create a rising tide of investment opportunities - and help avoid burning down the house.

Steve Lydenberg, It's Time for Investors to Start Reporting on Both Portfolio and Systems-Level Performance, Responsible Investor (Jan. 8, 2016), https://www.responsible-investor.com/home/article/iip_lyd/.

Actions

Accordingly, in determining what ESG reporting will be efficient, the Commission should consider not just the effect of ESG performance on the financial performance of individual issuers, but what disclosure will efficiently provide information relevant to market effects and systemic risk. This could involve line items regarding ESG matters that the Commission concludes have a significant effect on the markets and systemic risk, but line items are not the only way to encourage broader, market-relevant ESG disclosure. Clarification that such information may be provided within a safe harbor would encourage issuers to integrate the information they may already be providing outside of periodic filings.

The prescription of standardized metric sets and assessments when information is provided would allow for meaningful comparisons among issuers. Thus, the Commission could follow the lead of the Small Business Administration, which does exactly that under its proposed rules for "Impact SBICs," a new class of SBICs that that seek to generate positive and measureable social impact, along with financial return (the "SBA Proposal"). Under the Proposal, impact funds would be required to use pre-approved *measurement* standards including the following:

> — The Impact Reporting and Investment Standards ("IRIS"), an impact evaluation framework created by [the Global Impact Investor Network]
>
> — The G4 Sustainability Reporting Standards, produced by the Global Reporting Initiative ("GRI"); and
>
> — The standards produced and maintained by the Sustainability Accounting Standards Board ("SASB").

Small Business Investment Company Program—Impact SBICs, 81 Fed. Reg. 5666, 5669 (proposed February 3, 2016) (to be codified at 13 C.F.R. pt. 107). The SBA explained the reason for proposing such standards:

> The purpose of these standards is to establish a common language companies and investors can use to report the positive and negative impacts that result from their activities . . . [and to] promote[] the use of best practices across the [impact fund] industry.

Id. After proposing uniform measurement standards, the SBA goes on to propose uniform *assessment* standards for impact, as well. Such a standard is necessary, the SBA explains, to reduce the risk of selective reporting:

> . . . impact measurement standards only provide guidance on how to report impact data. . . .
>
> As with financial performance, each individual investor is empowered to reach his or her own conclusions about what constitutes "success" with regard to impact. . . . The use of independent and transparent assessment systems not only helps reduce the risk of selective reporting, but it also promotes the use of best practices across the industry.

Id. The SBA Proposal goes on to cite the Global Impact Investment Ratings System ("GIIRS") as an assessment system approved for Impact Funds; GIIRS is based on the BIA maintained by B Lab. The role is to provide a set of metrics that is comparable across companies:

> . . . B Lab staff collects a standard set of IRIS impact metrics from each company in the portfolio. That data is then run through the GIIRS assessment criteria, each of which is assigned a specific weight. The end result is a ratings report with an overall impact score and scores for each individual sub-component of the overall assessment. Since each rating uses the same set of core metrics, assessment criteria and weightings, one investment fund's score can be compared to that of another.

Id. at 5670.

In order to encourage consistent reporting, the Commission should not require B Lab or any other metric or assessment provider to consent to being named as an expert, because the role of such assessments is to standardize the application of impact metrics and measurements across issuers, allowing apple-apples comparisons on a fully transparent basis. Requiring the standard setters themselves to undertake expert liability is likely to discourage the use of such assessments in filed documents, and curb a nascent business practice poised to provide independent, valuable and comparable information rubrics regarding ESG information.

Conclusion

The Commission has taken an important step in considering the need to ensure that investors are receiving disclosure with respect to ESG matters that are material with respect to their investment and voting decisions. We believe that investors want and need ESG information not simply to address the performance of particular securities in their portfolios, but rather to manage systemic risks and costs that their individual investments may pose to their entire investment portfolios. We respectfully urge the Commission to take such action.

Sincerely,

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Head of Legal Policy

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