Comments on Concept Release on Business and Financial Disclosures Required by Regulation S-K

Brent J. Fields
Secretary
United States Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Via email to rule-comments@sec.gov

Re: Concept Release on Business and Financial Disclosures Required by Regulation S-K
File Number S7-06-16
Release Number 33-10064; 34-775599

Dear Mr. Fields:

We appreciate the SEC's invitation to comment on its new concept release on Business and Financial Disclosure Required by Regulation S-K. We commend the agency for asking for investor input on public policy and sustainability matters specifically. We would very much like to see the SEC reinforce its existing regulations on disclosure of sustainability information, and to enforce that regulation. Despite its having been on the books for many years, many companies still do not report environmental and social information, and there is rarely a way to judge how factual and complete is the reporting that does exist. There are some high-profile legal actions currently aimed at examining whether corporate non-disclosure of material information violates securities laws[1], but this is more a signal of investor concern than it is a remedy. Investors should not have to rely on litigation to compel enforcement of current regulations.

Sustainability issues have proven to be material to investors, yet despite the fact that sustainability issues have been required in Regulation S-K for many years, company disclosures remain patchy, inconsistent, and insufficient for investors. We do recognize, as the staff did in the concept release, that many companies are doing some kind of sustainability reporting, but while many large cap companies do so, very few smaller companies do much in the way of sustainability reporting. Moreover, because such reporting is almost entirely voluntary, there is no standard governing it, so even when companies do disclose information on related topics, that information may not be comparable. Investors need information that conforms to some known, transparent standard in order to be able to compare companies with their peers when constructing investment portfolios.

The Commission notes that the current statutory framework for adopting disclosure requirements is generally consistent with a framework considered for environmental and social disclosure developed in 1975, and we commend the Commission for recognizing that materiality is an eternally evolving concept. This has been demonstrated countless times. For example, in 1975, while our knowledge of the health effects of asbestos was developing, there had only been three "modern" lawsuits—tried in

[1] Lauren Kurtz, "Increasing Number of Investigations into Fossil Fuel Industry's "Disinformation campaign", Columbia Law School Climate Law Blog, May 6th, 2016.

federal courts, with juries—at that point. Since then, there have been many more, and by 2013, approximately 100 companies had filed for bankruptcy protection due to asbestos liabilities.[2]

Similarly, while climate change was known in 1975, most of the financial community's awareness of and concern over the issue has come since the turn of the millennium. A recent analysis[3] showed that the financial value at risk from climate change is in the trillions of dollars: a business-as-usual emissions path provides a mean estimate of value at risk of $2.5 trillion, but the study also notes that much of the risk is tail risk. At the 99th percentile, the value at risk is $24.2 trillion, which can "have particular relevance in some financial management regimes, such as insurance." Either way, there is clearly a great deal of financial value at risk from climate change. It was not possible to make such an estimate four decades ago.

The concept release also quotes earlier comments to the effect that environmental and social factors have not, by some investors at least, been considered material. That understanding is changing. Recent reports from major investment institutions, including UBS,[4] Morgan Stanley,[5] MSCI,[6] and TIAA[7] all point to the many studies that show statistically significant, positive correlations between ESG performance and financial performance. At Pax, we have been collecting studies from financial institutions and academic institutions that link ESG performance with financial performance since 2000, and to date we have collected 356 studies, all of which show that more sustainable companies or funds have financial performance that is comparable with, or better than, those of less sustainable peers. We would be happy to share this list of studies with SEC staff if that would be helpful. In sum, there is ample evidence that environmental, social and governance factors are relevant to financial performance; if these factors were all immaterial, it would be difficult to explain how there could be so many studies showing correlations of financial and ESG performance over the past decade and a half.

Specific responses to numbered questions are below.

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[2] Lawrence G. Cetrulo, "History of Asbestos, Asbestos Litigation, and Regulation," Cetrulo LLP, n.d. http://www.dri.org/dri/course-materials/2013-asbestos/pdfs/05_Cetrulo.pdf

[3] Simon Dietz, Alex Bowen, Charlie Dixon & Philip Gradwell, "'Climate value at risk' of global financial assets," *Nature Climate Change*, 13 April 2016. http://www.nature.com/nclimate/journal/vaop/ncurrent/full/nclimate2972.html

[4] UBS, "To integrate or to exclude: Approaches to sustainable investing," Third Quarter 2015, http://www.ubs.com/us/en/wealth/research/sustainable-investing--upholding-your-values--furthering-your-go.html.

[5] Morgan Stanley Institute for Sustainable Investing, "Sustainable Reality: Understanding the Performance of Sustainable Investment Strategies," March 2015, https://www.morganstanley.com/sustainableinvesting/pdf/sustainable-reality.pdf.

[6] Zoltán Nagy, Altaf Kassam and Linda-Eling Lee, "Can ESG Add Alpha? An Analysis of ESG Tilt and Momentum Strategies," MSCI, June 2015, https://www.msci.com/documents/10199/4a05d4d3-b424-40e5-ab01-adf68e99a169.

[7] Amy O'Brien, Lei Liao and Jim Campagna, "Responsible Investing: Delivering competitive performance," TIAA Global Asset Management, April 2016, https://www.tiaa.org/public/pdf/ri_delivering_competitive_performance.pdf.

Question 216: Are there specific sustainability or public policy issues that are important to informed voting and investment decisions? If so, what are they? If we were to adopt specific disclosure requirements involving sustainability or public policy issues, how could our rules elicit meaningful disclosure on such issues? How could we create a disclosure framework that would be flexible enough to address such issues as they evolve over time? Alternatively, what additional Commission or staff guidance, if any, would be necessary to elicit meaningful disclosure on such issues?

- There are specific sustainability issues, and sometimes public policy issues, important to informed voting and investment decisions. The specific issues that apply in one sector, industry, subindustry or even company might have different weight in others. Just as accounting standards are an eternal work in progress, responding to financial innovation and changing economics, the list of material ESG issues is not going to be one single, fixed list of specific issues that applies to everyone. We recommend that the SEC examine existing reporting standards, such as the Global Reporting Initiative and the integrated reporting framework, to establish a current baseline of potentially material issues, and require that companies consult such standards in reporting. It would be both time-consuming and burdensome to require every company to report extensively on every issue in these broad standards, but it is reasonable to require that companies report on how they assess the materiality of various issues, and why they selected specific issues to report on.

Question 217: Would line-item requirements for disclosure about sustainability or public policy issues cause registrants to disclose information that is not material to investors? Would these disclosures obscure information that is important to an understanding of a registrant's business and financial condition? Why or why not?

- Materiality, as the SEC has stated many times, is a judgment call; as the agency states in SAB99, "the omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that is it probably that the judgment of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item." What is material to one investor may not be to another. What is clear, given the literature cited above that links ESG factors to financial performance, that increasing numbers of investors do think ESG information is material. We do not believe that it is useful to apply the standard of materiality to each individual ESG issue, especially when those issues are viewed at the most disaggregated level; that is not a standard that is applied to financial reporting, though there are no doubt many items in many 10-Ks and 10-Qs that, taken in isolation, would be difficult to see as material. It is the whole picture that investors need to see, and the picture is made up of many pixels. We believe that companies are capable of conducting reasonable materiality assessments, as some do now, and investors are usually willing to ask for information that is not reported. Finding the right balance will require the kind of constant interaction of companies and their investors that all kinds of required reporting do now. The larger burden is the inability of investors to have robust knowledge of companies' prospects if they have no sustainability information or performance to add to their analyses of investments.

Question 218: Some registrants already provide information about ESG matters in sustainability or corporate social responsibility reports or on their webites. Corporate sustainability reports may also be available in databases aggregating such reports. Why do some registrants choose to provide sustainability information outside of their Commission filings? Is the information provided on company websites sufficient to address investor needs? What are the advantages and disadvantages of registrants providing such disclosure on their websites? How important to investors is integrated reporting, as opposed to separate financial and sustainability reporting? If we permitted registrants to use information on their websites to satisfy any ESG disclosure requirement, how would this affect the comparability and consistency of the disclosure?

- We do not believe that the information provided on company website is sufficient to address investor needs. While some companies provide thorough and useful information on sustainability, such reporting is rarely connected to financial performance, and in any case, there are far more companies that report nothing, or next to nothing. In order to be most useful to investors, such disclosures must be guided by some standard of accuracy, as accounting standards are, and must apply to all companies, or at least most, so that investors can make reasonable comparisons among peers.

Question 221: What, if any, challenges would registrants face in preparing and providing this information? What would be the additional costs of complying with sustainability or public policy line-item disclosure requirements, including the administrative and compliance costs of preparing and disseminating disclosures, beyond the costs associated with current levels of disclosure? Please quantify costs and expected changes in costs where possible.

- Registrants that have never reported on sustainability information do face a learning curve. This has proven to be manageable at many large cap companies, judging by how many do provide such reporting; some even have such reporting assured, at additional cost. For small companies that have no history of such reporting, the learning curve may initially be steeper, but smaller companies also tend to have smaller impacts, and not as many impactful lines of businesses as large cap companies do, making such reporting and materiality assessments simpler. Pax World Management has done sustainability reporting for several years, and we have been able to do this, after a modest initial consulting expense, with existing resources.

Question 223: In 2010, the Commission published an interpretive release to assist registrants in applying existing disclosure requirements to climate change matters. As part of the Disclosure Effectiveness Initiative, we received a number of comment letters suggesting that current climate change-related disclosures are insufficient. Are existing disclosure requirements adequate to elicit the information that would permit investors to evaluate material climate change risk? Why or why not? If not, what additional disclosure requirements or guidance would be appropriate to elicit that information?

- We do not believe that existing disclosures are adequate. The guidance the Commission provided in 2010 was both thorough and thoughtful; the inadequate state of current disclosure is more a matter of a lack of enforcement than a need for additional requirements.

Thank you again for the opportunity to comment on this concept release, and we appreciate the Commission's thoughtfulness in preparing the release itself.

Sincerely,

Joseph F. Keefe

President and CEO

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Julie Fox Gorte

SVP for Sustainable Investing

Pax World Management LLC