# BUILDING A SUSTAINABLE AND COMPETITIVE ECONOMY: AN EXAMINATION OF PROPOSALS TO IMPROVE ENVIRONMENTAL, SOCIAL, AND GOVERNANCE DISCLOSURES

## HEARING

BEFORE THE

SUBCOMMITTEE ON INVESTOR PROTECTION, ENTREPRENEURSHIP, AND CAPITAL MARKETS

OF THE

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U.S. HOUSE OF REPRESENTATIVES

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# BUILDING A SUSTAINABLE AND COMPETITIVE ECONOMY: AN EXAMINATION OF PROPOSALS TO IMPROVE ENVIRONMENTAL, SOCIAL, AND GOVERNANCE DISCLOSURES

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**Wednesday, July 10, 2019**

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INVESTOR PROTECTION,
ENTREPRENEURSHIP, AND CAPITAL MARKETS,
COMMITTEE ON FINANCIAL SERVICES,
*Washington, D.C.*

The subcommittee met, pursuant to notice, at 2:06 p.m., in room 2128, Rayburn House Office Building, Hon. Carolyn Maloney [chairwoman of the subcommittee] presiding.

Members present: Representatives Maloney, Scott, Foster, Vargas, Gottheimer, Gonzalez of Texas, Porter, Axne, Casten; Huizenga, Duffy, Stivers, Wagner, Hill, Emmer, Mooney, and Davidson.

E officio present: Representatives Waters and McHenry.

Chairwoman MALONEY. The Financial Services Committee will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time. Also, without objection, members of the full Financial Services Committee who are not members of the subcommittee are authorized to participate in today's hearing.

Today's hearing is entitled, "Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social, and Governance Disclosures."

I now recognize myself for 3 minutes for an opening statement..

This hearing will address one of the most important topics in the markets right now: environmental, social, and governance, or ESG, disclosures. This includes environmental issues such as climate change, social issues such as human rights, and governance issues such as political spending by public companies.

Investors overwhelmingly want companies to disclose ESG information, especially because there is now considerable evidence that companies that perform better on ESG metrics also perform better financially. In fact, over 2,300 investment managers around the world who collectively invest over $80 trillion have formally committed to incorporating ESG factors into their investment decisions by signing on to the U.N.-sponsored Principles for Responsible Investing.

As a result of this investor demand, many companies already disclose at least some ESG information. This is a positive development, but I firmly believe that more must be done.

The ESG disclosures that companies currently make often aren't as detailed as they should be and are difficult to compare across companies because they are not often standardized. I believe the best way to improve the quality and consistencies of these disclosures is for the SEC to establish standards for ESG disclosure that would apply to all public companies in the United States.

Other Federal agencies have already organized—recognized the importance of improved ESG disclosures. Just today, Commissioner Ros Behnam at the CFTC announced the creation of a climate-related market risk advisory committee that will examine best practices for disclosing climate-related risks in the derivatives market. And I applaud Commissioner Behnam for taking action on this important issue.

But now it is time for the SEC to act also. Several of the bills we are considering today would require the SEC to establish standards for ESG disclosures. For instance, Mr. Vargas has a bill that would require public companies to disclose certain ESG metrics, which the SEC would be required to establish. To help the SEC in this task, the bill would also create a sustainable finance advisory committee which would advise the SEC on which ESG metrics companies should have to disclose.

In addition, the Shareholder Protection Act would require public companies to disclose their political spending, which has been a longstanding priority for Democrats on this committee.

Before I close, I want to say one thing about the idea that the SEC shouldn't mandate ESG disclosures, because companies should only be required to disclose information that is material.

First of all, that has never been true. The SEC mandates disclosure of lots of specific information that is not tied to the concept of materiality. And second, this relies largely on the SEC staff to know what information is material to each individual company and then to bring enforcement actions against those companies. But the SEC staff is in no position to second-guess companies about what is material to their specific businesses. And the SEC staff has to rely on the information the companies provide them in the first place. So materiality alone is not sufficient. We have to do more.

I look forward to hearing from our witnesses on all of the bills today.

And with that, the Chair now recognizes the ranking member of the subcommittee, Mr. Huizenga, for 5 minutes for an opening statement.

Mr. HUIZENGA. Thank you, Madam Chairwoman.

Today's hearing entitled, "Building a Sustainable and Competitive Economy," will examine these legislative proposals regarding environmental, social, and corporate governance provisions.

What exactly are these ESGs? And many claim that ESG investing is an investment strategy that focuses on incorporating ESG criterion to investment decisions in addition to the more commonly accepted focus on investments expected financial returns. However, ESG data and criteria span a range of issues, including among others, attempts to measure a company's carbon emissions, labor poli-

cies, human right policies, whether the company engages in, "harmful activities" such as gun manufacturing or sales or cigarette manufacturers, the structures of corporate governance, for instance, whether the CEO and the chairman of the board of directors are the same person or whether a company issues dual class shares.

Before a December meeting of the SEC Investor Advisory Committee, SEC Commissioner Hester Peirce opined that the acronym ESG actually stands for enabling shareholder graft. Additionally, in a 2019 speech in June, she likened the ESG disclosures to that of scarlet letters being pinned on corporations without worrying about facts or circumstances. She went on to say that for some, "naming and shaming corporate villains is fun, trendy, and profitable."

It is clear that demands for ESG information have increased, and many companies have responded by voluntarily increasing the amount of ESG information they disclose. But let's be clear, companies should focus on providing meaningful material disclosure that a reasonable investor needs to make informed decisions with.

I can assure you that if they are seeing what has been claimed that companies that do that do "better", then they will do it. Best practices will bubble up to the top and they will be adapted. And, frankly, they should not be forced to be done under the penalty of law.

After all, companies and boards that are best equipped to determine what ESG factors they believe are material to their individual business in order to create an optimized value for their shareholders and potential investors. What should not happen is that the government mandate these disclosures. Mandatory ESG disclosures only name and shame companies, as well as waste precious company resources that could otherwise be used to create jobs, increase wages, grow the company, expand capacity, maximize shareholder value.

And any politically motivated action disguised as a disclosure mandate will just add yet another hurdle to an even greater cost of going public, which will only discourage more companies for doing so. And as we have talked about in this committee a number of times, we have seen a plunge in these initial public offerings, these IPOs. And instead, we should be looking at ways to lower the cost and reduce barriers on those seeking to become the next Amazon, Microsoft, Starbucks, Google, and the list goes on and on.

Over the last decades, activist, shareholders, and corporate gadflies have, frankly, hijacked the SEC and operate well outside its mandate and push nonmaterial social and political policies. The SEC should be focused on its current mandates of protecting investors; maintaining fair, orderly, and efficient markets; and to facilitate capital formation.

I continue to emphasize that mandating these disclosures is only doing more harm than good. As the U.S. IPO market steadily decreases at an alarming rate, the regulatory compliance costs for businesses continues to grow exponentially. It should be shocking to everyone that countries like China are producing over one-third of all of the IPOs that the world is seeing these days. ESGs do not

help produce or launch more IPOs. And what is being proposed here today stands to reduce an already low number even further.

We as lawmakers should be working to create an atmosphere that helps promote more capital formation, strengthen job creation, and increase economic growth, not harm it.

With that, my time has expired, and I yield back.

Chairwoman MALONEY. Thank you so much.

The Chair now recognizes the gentleman from California, Mr. Vargas, for 2 minutes.

Mr. VARGAS. Thank you very much, Madam Chairwoman. And thank you for yielding and for including my draft legislation, the ESG Disclosure Simplification Act, in this hearing.

I believe this hearing is timely. Environmental, social, and governance matters are growing concern and interest to the investment community. Investors increasingly view ESG disclosures as crucial tools and material information for evaluating a company's financial performance. Research has shown that companies that account for ESG factors tend to perform better with more stable returns.

This is not about name and shame; this is about protecting investors and our economy and our environment. The use of ESG information by investors wouldn't have been possible without the pioneering leadership of organizations like the Global Reporting Initiative, GRI, which is represented here today. And I see Mr. Mohin. Thank you very much for being here.

As many of you are aware, last fall, a coalition of asset managers, nonprofit organizations, public pensions funds, and law professors filed a petition with the SEC for a rulemaking on ESG disclosure. That petition was the impetus for my draft legislation, which I hope will serve as a starting point for a larger conversation on ESG disclosures.

I look forward to hearing from the witnesses.

And I have to say also, it is becoming more and more clear to my friends on the other side that climate change is real. It is not a Chinese hoax. It is something that is impacting all of us, all of our communities, here in Washington, D.C., certainly in California and throughout the world. And that is why I think it is important for this information to be readily available and to be standardized.

So, again, I thank those who have pioneered in this field.

And again, Madam Chairwoman, I thank you for the opportunity of presenting, and I yield back the balance of my time.

Chairwoman MALONEY. Thank you very much.

The Chair now recognizes the ranking member of the full Financial Services Committee, Mr. McHenry, for 1 minute.

Mr. MCHENRY. I thank the Chair, and I also thank the ranking member.

Congress needs to be helping everyday investors. That is our clear motivation. And the best way to help them is by making our public markets healthier and more competitive. Stronger U.S. capital markets will encourage growth, which will lead to more investment opportunities and choices for everyday investors to grow their savings. These are good things. Unfortunately, compared to 20 years ago, families have roughly half the number of publicly listed

companies to choose from when considering investment opportunities for their savings. That is a problem.

I am concerned that this hearing yet again misses the mark by ignoring these really important trends. Instead, at this hearing, we are going to be discussing costly proposals that increase barriers to capital formation, discourage companies from joining or remaining in public markets. And these things hurt everyday mainstream investors and their investment opportunities. So it is time we consider and focus on serious policies to reduce barriers for companies and investors and make our markets much more competitive and, again, the envy of the world.

Chairwoman MALONEY. Thank you.

Today, we welcome testimony from a distinguished panel of witnesses. First, we have Tim Mohin, who is the chief executive for the Global Reporting Initiative. Second, we have James Andrus, who is an investment manager focusing on sustainable investments for the California Public Employees' Retirement System, or CalPERS. Next, we have Paul Atkins, who is the CE0 of Patomak Global Partners and who was formally a Commissioner at the SEC. Next, we have Degas Wright, who is the CEO of Decatur Capital Management in Decatur, Georgia. And last but not least, we have Mindy Lubber, who is president and CEO of Ceres, a sustainability nonprofit in Boston, Massachusetts.

Witnesses are reminded that your oral testimony will be limited to 5 minutes. And without objection, your written statements will be made a part of the record.

Mr. Mohin, you are now recognized for 5 minutes to give an oral presentation of your testimony.

**STATEMENT OF TIM MOHIN, CHIEF EXECUTIVE, GLOBAL REPORTING INITIATIVE (GRI)**

Mr. MOHIN. Thank you, Madam Chairwoman. And I thank the subcommittee for inviting me to testify at today's hearing.

My name is Tim Mohin. I am chief executive of the Global Reporting Initiative, GRI. We are the largest standard setter for environmental, social, and governance, the so-called ESG information. Prior to GRI, I have held senior roles at three different major American companies. I also have experience in both the Executive and Legislative Branches of the U.S. Federal Government. So I speak to you today, not just as the head of the world's largest ESG standard setter, but as an individual who understands the complexities and pressures faced by American companies and also the importance of strong Federal policy.

Today, I will focus my remarks on the ESG Disclosure and Simplification Act. GRI welcomes this legislation. It will strengthen ESG reporting by companies and it will protect investors. And specifically, the bill will level the playing field for both companies and investors.

It relies on international standards. And by doing so, it will not increase reporting burden, because the vast majority of companies are already reporting and they are already reporting to the GRI standards. And it will protect investors by creating essential clear and comparable data.

Let me just share some brief background on GRI to explain why we support this legislation. We were established in the United States by Ceres, who is represented on the panel today, and we became an independent organization in 1997, over 20 years ago. Our success over 20 years is really based on the old axiom that you manage what you measure.

All organizations, including the ones I previously worked for, run on data. And by identifying, measuring, and most importantly, reporting ESG topics, you tend to improve performance on these topics. This is not just some theory. I have seen this firsthand in the companies that I have worked for. Two of my former employees, Intel and AMD, have actually been reporting ESG information for over 20 years.

For these leaders, it is not just about accountability with investors outside the company. This information is a very important decision tool inside the company.

We created the GRI standards to provide the tools needed for companies to collect and report ESG information. But over the years, we have continuously improved these tools. Perhaps the most significant change we have made in the last few years was to completely revamp our governance model, to become the world's only independent, international multistakeholder standard setter for ESG information. And we did that by modeling our governance model on the same governance that the financial standard setters have. And largely as a result of this process, we are now the most adopted ESG standard by both companies and policymakers.

Today, more than 90 percent of the largest 250 companies on the planet are reporting ESG information, and 75 percent of those are using the GRI standards. Here in the U.S., the number is about 600 companies using the GRI standards and about 80 percent of the Dow Jones Industrial Average.

Globally, the market for this information is exploding. We had some information last year that the assets being managed with some form of ESG information are now over 30 trillion U.S. dollars, and that is larger than the GDP of the United States. And it has grown by 34 percent in the last 2 years.

It is growing because investors know that so-called nonfinancial information can have significant financial impacts over the longer term. And policymakers around the world have not missed this trend. They are following this trend. We are tracking right now 139 policies in 61 countries that specifically reference or require the GRI standards. Sixty of those policies in 45 countries are capital market regulations.

So just like financial disclosure, it is essential that this committee and policymakers around the world focus on a single global standard, because we need a common global language if we are going to unlock free trade and capital flows that increasingly depend on this information.

So in conclusion, I want to applaud the committee for the ESG Disclosure and Simplification Act. It will protect investors, it will help unlock free trade, and ultimately, it will help align capital to sustainable business practices.

Thank you for this opportunity to testify today.

[The prepared statement of Mr. Mohin can be found on page 77 of the appendix.]

Chairwoman MALONEY. Thank you.

Mr. Andrus, you are recognized now for 5 minutes for your testimony.

**STATEMENT OF JAMES ANDRUS, INVESTMENT MANAGER-FINANCIAL MARKETS, SUSTAINABLE INVESTMENT, CALPERS INVESTMENT OFFICE**

Mr. ANDRUS. Chairwoman Maloney, Ranking Member Huizenga, and members of the subcommittee, on behalf of the California Public Employees' Retirement System, a reasonable investor, I thank you for the opportunity to testify.

My name is James Andrus, and I am an investment manager for sustainable investments for CalPERS. I applaud and support the subcommittee's focus on building a sustainable and competitive economy.

CalPERS benefits from a system that ensures accountable and transparent corporate governance with the objective of achieving the best returns in value over the long term. I will provide an overview of CalPERS and review various legislative proposals under consideration.

CalPERS is the largest public pension fund in the United States, with approximately $370 billion in global assets. The CalPERS Board of Administration developed governance and sustainability principles. These principles guide the internal and external managers of CalPERS when making investment decisions and provide the framework by which we execute our shareowner proxy voting responsibilities and exchange portfolio companies to achieve long-term returns.

Our Board of Administration also adopted a 5-year ESG strategic plan in 2016. My testimony is primarily based on the principles in ESG's strategic plan.

CalPERS strongly believes that all investors, whether large institutions or private individuals, should have access to disclosures that allow them to make informed investment decisions. We believe that enhanced data and transparency requirements will promote more efficient and sustainable financial markets over the long term.

There are many substantive areas about which long-term investors could use more information. For example, as a member of the Human Capital Management Coalition, we joined others to file a petition with the SEC focused on human capital disclosures.

I am now pleased to discuss, in broad terms, CalPERS' views on the bills before us today. I am proud to say that CalPERS supports the direction of each one.

First, our principles call for robust board oversight and disclosure of corporate charitable and political activity to ensure alignment with business strategy and to protect assets on behalf of shareowners. We have consistently been in favor of such enhanced disclosure, and therefore, support the Shareholders Protection Act. Notably, in the majority opinion of the court in Citizens United, former Justice Anthony Kennedy wrote that with the advent of the internet, prompt disclosure of expenditures can provide share-

holders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters. The First Amendment protects political speech. And disclosure permits citizens and shareholders to react to the speech of corporate entities in a proper way.

CalPERS agrees with Justice Kennedy on the material value of disclosure in this area, and urge Congress, the FEC—or the SEC to implement these important measures.

Next, climate risk disclosure. Detailed corporate disclosures regarding the impact of climate change on corporations' long-term performance are essential. Comprehensive disclosure of risk factors related to climate change should clearly reveal how companies identify and manage such risks to generate sustainable economic returns. The Climate Risk Disclosure Act does this.

Next, ESG disclosure simplification. Consistent with CalPERS' strategic plan, the ESG Disclosure Simplification Act would require companies to make new and more robust ESG disclosures. This legislation would establish an inclusive process for advancing important proposals aligned with integrated reporting. Accordingly, CalPERS supports the approach.

Fourth, corporate human rights. Our principles are clear with regard to human rights. Corporations should adopt maximum progressive practices toward the elimination of human rights violations in all countries or environments in which the company operates. In line with our principles, we advocate for policies, procedures, training, and internal reporting structures to ensure commitment to universal human rights. For those reasons, CalPERS supports the human rights proposal.

Finally, country by country tax payment. Our principles focus significantly on emerging systemic risks and on fostering action that mitigates those risks. Current tax disclosures in the U.S. do not provide investors with sufficient tax-related information to adequately assess companies' values and risks. The legislation before the subcommittee would require the disclosure of overly aggressive international tax planning arrangements, thereby reducing systemic risk.

We look forward to working with the subcommittee and committee to advance these and, hopefully, more proposals. Thank you for inviting me to participate in this hearing. I look forward to your questions.

[The prepared statement of Mr. Andrus can be found on page 53 of the appendix.]

Chairwoman MALONEY. Thank you very much.

Mr. Atkins, you are now recognized for 5 minutes for your testimony.

## STATEMENT OF THE HONORABLE PAUL S. ATKINS, CHIEF EXECUTIVE OFFICER, PATOMAK GLOBAL PARTNERS

Mr. ATKINS. Thank you, Chairwoman Maloney, Ranking Member Huizenga, and members of the subcommittee. Thank you for your invitation to discuss ESG disclosures and the SEC's disclosure regime more generally.

My written testimony provides additional background on SEC disclosure requirements and the legislation under consideration

today. I would like to spend my allotted time focusing on the significant costs that disclosure mandates impose on businesses large and small, investors, workers, and the American economy.

Over the years, in administering the disclosure regime under the Securities Act and the Securities Exchange Act, the SEC has generally focused on the disclosure of information it believes to be important to the reasonable investor. The SEC explained in 1975 that the requirement that information be material is, "necessary in order to ensure meaningful and useful disclosure documents of benefit to most investors without unreasonable cost to registrants and their shareholders."

While many seem to believe that disclosure is costless and harmless, the costs are real. Most significant is the direct costs of the disclosure, which were just three provisions of the Dodd-Frank Act which estimated to total more than $2 billion annually.

Disclosure overload is neither an imagined nor new concept. It is being used as a blunt force instrument by special interest groups and policymakers alike to attempt to impose normative outcomes; this being decried by members of SEC and the Supreme Court for decades. Yet mandatory disclosures have only grown, and there is a growing body of evidence that indicates these ever expanding and ever complex disclosure mandates hinder the goal of a sustainable and competitive economy.

Data shows that expanding in complex mandates dissuade companies from going public. During the past 20 years, IPOs have been on the decline in the United States. In 1996, there were more than 600 IPOs in 1 year. Almost a decade later, there were fewer than 300 over a 2-year period. This downturn doesn't just affect investors; it affects the broader American economy.

It is estimated that as much as 92 percent of job growth occurs after an IPO. A study by the Kauffman Foundation looked at companies that went public between 1996 and 2010, and found that they employed more than 2 million people in 2010 than they did before they went public.

The Treasury Department under President Obama recognized this problem, and in 2011, created the private sector IPO Task Force. The task force surveyed CEOs and found that almost 75 percent cited public disclosures as their biggest concern about going public. Of the public companies' CEOs surveyed, 92 percent named the burden of public reporting as one of the most significant IPO challenges.

An interim report by President Obama's Council on Jobs and Competitiveness noted that regulations have resulted in fewer high-growth entrepreneurial companies going public. In 2012, lead by members of this committee, Congress enacted the JOBS Act, which recognized that the public company disclosure regime inhibits companies from going public. The law established the regime to lessen those requirements on new emerging growth companies.

Beyond company decisions, many ordinary investors are losing out on this valuable investment opportunity, especially compared to high net worth individuals who can more readily participate in private offerings. The venture capital firm Andreessen Horowitz compared the return multiples for tech firms of the 1980s with newer tech firms in the 2000s. In 1986, Microsoft returned to just over

200 times in private value creation, while its public value creation was roughly 600 times. Oracle had similar return ratios in the same year. Now contrast this with Facebook in 2012 and Twitter in 2013, nearly all of whose returns were private.

Since the passage of the JOBS Act, the number of IPOs per year has been almost 190, compared to an average 100 per year in the 5 years prior to the enactment. While this is a significant improvement, there still is more that can be done. Unfortunately, while all of the bills under consideration today are undoubtedly well-intentioned, the reality is that many of them set requirements already provided elsewhere in law, at best, or would mostly engender the type of unintended consequences that prior efforts have visited upon public companies, their investors, their employees, and U.S. economic growth.

I will be happy to answer questions that you may have. Thank you very much.

[The prepared statement of Mr. Atkins can be found on page 40 of the appendix.]

Chairwoman MALONEY. Thank you very much.

Mr. Wright, you are now recognized for 5 minutes for your testimony.

**STATEMENT OF DEGAS A. WRIGHT, CFA, CHIEF EXECUTIVE OFFICER, DECATUR CAPITAL MANAGEMENT, INC.**

Mr. WRIGHT. Chairwoman Maloney, Ranking Member Huizenga, and distinguished members of the subcommittee, I appreciate the invitation to appear before you this afternoon to talk about the proposed legislation that will provide greater disclosure of material information for investors.

My name is Degas Wright, and I am the founding principal of Decatur Capital Management, an institutional investment management firm focused on global and sustainable equity strategies, serving public pension plans, corporations, and individuals. My comments provided today should not be considered a recommendation to buy or sell any of the securities mentioned. I am an investment manager who conducts company research to manage equity portfolios on behalf of our clients. Therefore, my interest in environmental social governance issues is based on the discovery that these items may provide material information.

First, allow me to define material information or materiality. It is the information that a reasonable shareholder would consider is a point in deciding how to vote a proxy, purchase or sell a security. The legislation requesting disclosure of political contributions addresses a relative new material factor in the selection of securities. A recent CEO survey reports that more than half of the interviewed CEOs believe that the uncertainty of current political landscape has a larger impact on their business than in the past.

These firms and their executives use political contribution as an effective tool to address political risk to protect shareholder value. Our research indicates that as political risks increase, political contributions increase. Therefore, political contributions may define the level of the corporation's political risk.

We found that the majority of large corporations' returns were impacted as news of political and regulatory risk increases. The

stock prices decline. Based on our research, we have found that political contributions as a proxy for political risk is materially making investment decisions. The legislation requesting disclosure of climate risk addresses a complex material impact on security pricing. This risk is difficult to measure for several reasons, since the risk parameters may be mispriced due to shortcomings in the available information.

I will not address the science or legal issues regarding climate risk. As an investor, I tend to model risk factors and I treat climate risk as a factor. The best measure for materiality is the capital markets. A number of corporations have developed sustainability reports that include current levels of admissions and admission targets. This information should be required of all listed securities. Based on our research, we have found climate risk to be a material item in making investment decisions.

The corporate tax legislation attempts to address potential tax avoidance risk. The amount of corporate income tax a company pays is material to its profitability. Investors, therefore, seek to understand the extent to which future cash flows are impacted by companies' tax liabilities. Therefore, corporate tax avoidance activities, while perfectly legal, may suggest underlying regulatory or reputational risk.

The legislation requesting disclosure of human rights and value chain risk are material factors in the selection of securities. It is easy to understand that news of human rights violations can impact the reputation and the stock price of a corporation. Again, a number of firms have human rights and value chain policies. We recommend that all listed securities be required to provide this information. Based on our research, we have found human rights risks to be material in making investment decisions.

We support the creation of sustainable finance advisory committee to advise the Securities and Exchange Commission on the evolving issues to ESG materiality and capital markets.

Thank you for your time. The oversight work of this subcommittee is a critical responsibility. And I welcome any questions that you may have.

[The prepared statement of Mr. Wright can be found on page 84 of the appendix.]

Chairwoman MALONEY. Thank you very much.

And Ms. Lubber, you are now recognized for 5 minutes for your testimony.

**STATEMENT OF MINDY S. LUBBER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CERES**

Ms. LUBBER. Great. Good afternoon, and thank you. Thank you for your leadership on picking up these important bills.

My name is Mindy Lubber. I run Ceres, a national organization that works with hundreds of influential investors and companies to tackle a number of the world's sustainability challenges, including water scarcity and pollution, deforestation, inequitable workplaces, and climate change. I appreciate the opportunity to be here to share our views on corporate disclosure of environmental, social, and governance issues, and to voice support for the various proposals being heard.

I am going to speak in further specificity to the Climate Risk Disclosure Act of 2019, which we strongly support. These bills are firmly rooted in the principles of transparency, of materiality, and of investors' needs for adequate information to assure long-term returns.

One of the things we do at Ceres, we run a network, an investor network on climate risk and sustainability, with 106 institutional investors collectively managing over $26 trillion in assets. And since our founding 30 years ago, our members have consistently felt that sustainability challenges pose material financial risks and that these risks need to be embedded into our capital market systems.

There are some who like to believe that sustainability risks are not real financial risks. But let's be clear. Risks are risks, and they need to be disclosed, whether they come from trade agreements from fluctuating commodity prices, from inflation, from currency changes or climate change. If they are real, if the risks are clear and material, they ought to be analyzed and disclosed. And it doesn't matter which box or category they come from.

We have a long history at Ceres in the field of disclosure. As Tim said, we founded and launched the Global Reporting Initiative in 2007, and it is prospering with 13,000 plus companies reporting. And in 2010, Ceres and our investor network members petitioned the SEC to issue the first of its kind climate disclosure guidance.

Despite the issuance of this guidance, which I will say is not being enforced, our research shows that half of the 600 largest United States companies still do not provide decision useful disclosures on climate-related risks. Those that do often provide disclosures that are mere boilerplate or just too brief and effectively meaningless. So investors right now are simply not getting the information they need to understand how their portfolios are exposed, which in turn exposes them to potential losses.

Mandating those disclosures, as you are suggesting to be done, will help companies better understand their own exposures and opportunities. And these rules will help stimulate their ingenuity and their strategic thinking. It will increase their competitiveness and create, not harm, but create shareholder value, or as the long-held business school mantra suggests, what gets measured gets managed, and with adequate and relevant information being measured, companies will manage their climate risks and do so better.

And mandatory reporting as you suggest will create a level playing field where all companies, every company is required to provide the same information in consistent ways.

Climate change is the greatest economic crisis of this decade and well beyond. And its implications are real. We can analyze them and they need to be disclosed. Nearly every sector of the economy is impacted, from food to agriculture, to transportation, to energy, to apparel, to technology and on and on, which is why so many companies, from Apple to Levi Strauss, to the Gap and others, are disclosing those risks. They are real and they are material.

Consider the following: More than 200 of the largest global companies reported almost $1 trillion at risk from climate impacts, with many of those risks likely to hit in the next 5 years. And our research shows that companies that do provide climate disclosures

are more likely to set relevant goals and to have systems in place to make them more resilient.

So while we applaud the companies that are showing leadership, voluntary reporting is simply not enough. It is not consistent. All players should be required. And the mandatory requirements laid out in this act are thoughtful. They are carefully designed. They meet the needs of investors without unnecessarily burdening companies. These risks can't always be avoided, but with the right information, they can be managed. And when the risks are fundamental, investors and companies need that information.

Thank you for your efforts to make those disclosures real and available. I think they will change the course of information in our capital markets. We strongly support them, and look forward to seeing them.

[The prepared statement of Ms. Lubber can be found on page 61 of the appendix.]

Chairwoman MALONEY. Thank you very, very much.

I now recognize myself for 5 minutes for questions.

First, Mr. Andrus, as you know, opponents of ESG disclosures have been claiming for years that these disclosures aren't material to investors, even though we see more and more evidence every day that ESG disclosures are material to investors.

So as an investment manager at one of the largest institutional investors in the world, I would like to ask you, do you consider ESG disclosures to be material?

Mr. ANDRUS. Thank you very much for the question, Chairwoman Maloney. Yes, all of the bills that are presented today would require the presentation of material information in the regulatory reports. There is much discussion with regard to materiality without a full analysis of what materiality happens to be. There is not one definition of materiality.

The TSE court, which focused materiality on voting, is limited to things that happened in the past. The basic court focused materiality on probability times magnitude, which focuses on things in the future. However, the SEC in item 303, which focuses on forward information, has a two-pronged test for what needs to be reported. And in that two-pronged test, all of the information that is presented today would fit within the current definition of materiality.

There is some criticism, not only of materiality, but that of what reasonable investors want. I consider CalPERS to be a reasonable investor. As well as most of the largest investors in the country, all reasonable investors all desire to have more of this information presented. It is not limited to this country.

The demand for ESG is a worldwide issue. Investors from around the world, all of whom I consider to be very reasonable investors because they have the same responsibilities that CalPERS has to pay money to beneficiaries, are focused on these issues. So, yes, these issues are clearly material.

Chairwoman MALONEY. Mr. Wright, do you agree with this?

Mr. WRIGHT. I do.

Chairwoman MALONEY. Thank you.

Mr. Mohin, do you think the SEC could effectively build on the great work that your organization has done in establishing ESG metrics for companies to disclose?

Mr. MOHIN. Yes, I do. And in my testimony, I made a point about why that is important. As investment flows and capital flows increasingly rely on this information, it is important to have international standards. So if we draw a parallel to the financial standards a few decades ago, it was more sort of a patchwork system. And as we had the international financial reporting system and the FASB come together, now we have basically one system, and it has unlocked free trade.

So it is very important to look at a single global language. And to do that, you really have to focus on an independent, international multistakeholder standard setter like GRI.

Chairwoman MALONEY. Could SEC standards essentially complement your organization standards?

Mr. MOHIN. What I would recommend is that SEC, like they have done with FASB, refer to an independent standard setter like GRI. That way you get the state of the art, it stays up to date.

Chairwoman MALONEY. Ms. Lubber, as you know, some companies already disclose a limited amount of information about the risks of climate change. But as you noted in your testimony, these disclosures are often inconsistent across companies and very often incomplete.

Do you think Mr. Casten's bill would require companies to include sufficient detail on climate risk for investors? And how important is it for the SEC to include industry specific guidance on climate risk disclosures?

Ms. LUBBER. I think it is perfectly consistent with the SEC's role and mandate. Their role is to protect investors to assure material risk disclosure. They do it for many other issues. This notion that if it sounds environmental or social it can't be a real risk, but the risks are real. They are very real, they are very costly for a company who doesn't have enough water. The water risk is in hundreds of millions of dollars to PG&E that just found itself in bankruptcy because of the climate-related climactic changes that caused the fires. We are seeing billions and billions of dollars.

Those risks are risks investors need to know. And the SEC is the place, with the kind of guidance offered in your bills, to structure the kind of material risks and disclosure of those risks so they are consistent with all other risks that companies are asked to disclose.

Chairwoman MALONEY. Thank you very much.

The Chair now recognizes the distinguished ranking member of the subcommittee, Mr. Huizenga, for 5 minutes for questions.

Mr. HUIZENGA. Thank you, Madam Chairwoman.

I wasn't going to go here first, but I just was struck by, Mr. Andrus, in your written testimony, you noted that, "CalPERS' primary responsibility is to our beneficiaries." You talked about investing over the long term. And I couldn't agree more with that.

However, one analysis of CalPERS' decision to disvest itself—or divest itself of tobacco-related products cost the fund and us hardworking CalPERS members over $3 billion. It doesn't strike me that losing money like that is in the best interest of your fund's

beneficiaries, either short term or in the long term, particularly at a time when CalPERS is not fully funded.

And I would like to note, Madam Chair, that CalPERS' newly elected president, Jason Perez, who is a police officer from Corona, California, seems to believe that losing money isn't in the best interest of his fund's beneficiaries either in campaign materials that he sent to eligible CalPERS voters last year. He criticized former CalPERS president Priya Mathur of putting CalPERS members retirement security at risk, "due in part to environmental, social, and governance investing priorities regardless of investment risk."

So, Mr. Atkins, as a former Commissioner with the SEC, what impact does the—you talked about this in your written testimony—about the IPOs have on employment and job growth? And what does an uptick in U.S. IPO charters mean for mom-and-pop 401(k) investors and others?

Mr. ATKINS. Thanks for the question. There are a lot of effects from a robust IPO market. One is particularly as a way for private companies to have an exit ramp to be able to then attract more capital and not just be private.

Mr. HUIZENGA. Do these bills encourage IPO, the process, in your opinion, or do they encourage companies to identify and attract new investors? Or is this going to drive more of that into that private capital world?

Mr. ATKINS. Again, I think that imposing these sorts of detailed disclosure requirements, especially on smaller companies, in my own experience and as have been reflected in the surveys of CEOs and others, that is the one biggest impediment for people wanting to venture into the—

Mr. HUIZENGA. There has been a lot talked about the responsibility of the SEC and the responsibility of corporations. And I have been dealing with section 1502 implementation from Dodd-Frank. I wasn't here for the passage of Dodd-Frank, but we have been living with the echo effect of that. And that had to do with what I think everybody universally would agree is a positive attempt at curving a very real issue dealing with conflict minerals. But in its economic analysis, the final rule of the SEC said it is going to cost compliance. It is going to be between $3 billion to $4 billion initially and then $207 million to $609 million a year. Mary Jo White, President Obama's SEC Commissioner and Chair, had talked about what the proper role of the SEC should be in all of these things.

And I am curious, as a former SEC Commissioner yourself, how would you feel about another group, as has been suggested by Mr. Mohin, setting standards that the SEC then needs to follow and rather than them coming up with those standards themselves or letting industry come up with that? So I am curious what you think of that idea.

Mr. ATKINS. I think it is best to leave it to the private markets to come up with the standards rather than designate yet another something like FASB or GASB, these various other groups to do that.

Mr. HUIZENGA. So let's talk, and kind of finally here, about our competitiveness internationally. We are seeing IPOs go up a little bit. They are not nearly where they had been. And I am just curious if you believe that the Federal Government needs to force,

under penalty of law, companies big and small to disclose this kind of information. Mr. Mohin, in his testimony, noted that some of his clients have been doing this for 20 years voluntarily.

Is it necessary for the Federal Government and through the SEC to come in with a hammer and force them and maybe put them into a forum as had been suggested that not even the SEC would determine but that an outside group would determine?

Mr. ATKINS. Yes, it undoubtedly raises costs. And it is not just the cost of putting the disclosure together to hiring lawyers and all that, but it is the knock on the cost of threat of litigation and that sort of thing.

Mr. HUIZENGA. And I will just note, Madam Chair, as my time is up, but I do believe that the most effective way of doing this is to make sure that this is voluntary by these companies, demanded by clients, customers, investors, beneficiaries, rather than having the Federal Government mandate this.

So with that, I yield back.

Chairwoman MALONEY. The gentleman's time has expired.

And the gentleman from California, Mr. Vargas, is now recognized for 5 minutes.

Mr. VARGAS. Thank very much, Madam Chairwoman. And, again, thank you for holding this hearing.

Mr. Atkins, let me ask you a follow-up question, if I may. Do you think that climate change is real?

Mr. ATKINS. I don't know. It certainly is a topic of discussion, but I don't think that really matters.

Mr. VARGAS. You don't think climate change matters?

Mr. WRIGHT. No. It doesn't matter what I think.

Mr. VARGAS. Well, it does today, that is why we have you here, and it certainly matters to me. So, do you think climate change is real? And if it is, do you think humans have impacted it at all?

Mr. ATKINS. There are studies that show that is the case. I haven't really studied the studies. But obviously, it is a topic of discussion in the public sphere and elsewhere.

Mr. VARGAS. Have you followed it at all?

Mr. ATKINS. Well, of course, in newspapers and things like that.

Mr. VARGAS. And have you come to any conclusion yourself?

Mr. ATKINS. I think there is a lot of data out there that shows various ways. So, I haven't really come to any—

Mr. VARGAS. You haven't come to a conclusion one way or another?

Mr. ATKINS. Not that I focused on, no.

Mr. VARGAS. Okay. I think that is the problem.

I think it is interesting, when I was in law school, one of the big issues was the issue of the ozone depletion. And we took it seriously as a country and we took it seriously as a world. We knew that the CFCs were, in fact, destroying the ozone layer, so we came up with alternatives and the world invested in these alternatives. And we found out that, in fact, you can see Mother Nature cure herself.

And it is interesting that here, presume here there has been testifying, saying it doesn't know if it is real. When most of the scientists, in fact virtually all of them, point at climate change and

say it is real. We see in California the fires are bigger. We see they burn hotter. We see all the flooding.

It is interesting, one of the groups of people that I have met in my life, they are real cold blooded, are insurance actuaries. I used to be a vice president of Liberty Mutual. I could tell you, these people, they have cold water that runs through their veins. They simply look at the numbers.

And it is interesting, these events that are happening every 100 years or 200 years, and they are happening in a much shorter time period. Something is changing. It is obviously climate change. All the scientists tell us that. There are a couple of kook scientists who say otherwise, but all the scientists point in the same direction and say, of course there is climate change. And that is why I think it is so important to have these disclosures. And again, I am sorry that the United States isn't leading on this as we should be and taking this seriously and not thinking it is some kind of a hoax.

But I do want to get back to the issue of the destruction of shareholder value. Mr. Mohin, I heard here that, in fact, these disclosures will destroy shareholder values. It sounds to me it is just the opposite. Studies point the other way, do they not?

Mr. MOHIN. They absolutely do. And I wanted to thank Congressman Vargas for this legislation. It is fantastic legislation, because these issues, climate change, human rights, ethics, diversity, environment health and safety, these are critical issues. And if they were disclosed in an orderly fashion, then I think investors and companies would have far more information to make these all important decisions. If, in fact, they were included in the financial definition of materiality, we might not have these massive issues that we are facing today. So, it is very, very important to level the playing field.

And if you look at what is happening in the world today, with the majority of companies, all the big companies reporting using the GRI standards, it is obvious the trend line here, companies are seeing it is important, investors are asking for the information, so it is already happening. I think where it is important for this subcommittee is to level the playing field so that we don't have those companies that are kind of lying in the weeds and not stepping up and reporting.

Mr. VARGAS. Mr. Andrus, do you agree with that? Do you agree that, in fact, this is valuable information for an investor like yourself for CalPERS?

Mr. ANDRUS. Thank you for the question. Yes, it is valuable information. It is information we track. And in this particular case, we are asking you to basically instruct the SEC to make it a regulatory item such that we get comparable information from all of the companies and then we can shut down some of the noise on some of the issues that some other people, in fact, complain about. I think that items that are before you are critical issues that we track, and we look forward to additional disclosure.

Mr. VARGAS. I have to thank all of you for being here. My time is almost up. The only thing I would like to say is this: Climate change is not the only thing, but it is super important, and we have to take it seriously and start making decisions that impact it in a way that is positive, not negative.

And I have 4 seconds left, so I will yield back. Thank you.

Chairwoman MALONEY. Thank you.

The ranking member of the Full Committee, Mr. McHenry, is now recognized for 5 minutes.

Mr. MCHENRY. I yield to my colleague from Arkansas, Mr. Hill.

Mr. HILL. I thank my friend from North Carolina. And I appreciate all the witnesses, a very informed group, and very helpful to the committee's work.

And I do come at this from the point of view that our officers and directors of our companies have a legal obligation in making—taking their obligations very seriously as a fiduciary under the business judgment rule, and therefore, something that is material should be disclosed. If it is a risk factor and it is material, it should be disclosed. If something is material financially, it should be disclosed, not only for the 5 years covered by the 10K, but in the outyears so that—and shareholders can be informed. And that is a fundamental part of our system is that issue of materiality. And as a general statement, I think they do that.

I have been a public company director. I have been an investment manager, so I understand that. And we balance that with the cost associated with these issues. And so, it is a very careful balance, just like Mr. Huizenga, my friend from Michigan, talked about the views of beneficiaries at CalPERS are doing that. And it seems that that over $130 billion shortfall or whatever the number is now in CalPERS has caused some beneficiaries to question that these decisions to not invest in certain categories were maybe a bad decision, in retrospect, after doing the study he cited.

But there is a bigger issue, which is there are fewer public companies. And so, this issue is there are fewer things for CalPERS to invest in. So, I think that is why we are so diligent here about balance.

Conflict minerals, Mr. Atkins testified about the cost. And I got a letter from a chief accounting officer of a $2 billion in market cap company the other day that is active in my—has representation in my State. And she told me that they have $1 billion revenue in this company and that conflict minerals cost them $250,000 a year to comply with that rule, and they had no certainty really whatsoever if they were doing a good job or not. And she went on to tell me that in Form SD, she never had one question from an investor about the filing from their investor relations department about conflict minerals. And this is a company that sources different things in their inventory from around the world.

I also come at this from the point of view that if we are reporting things that are material, then we can't just go from one subject to another and compel something as material because somebody thinks it is material, if it is not material in the judgment of these fiduciaries that we have appointed as board members. I quote here from a Fortune 500 board member: "We are asked as a corporation to take a public stance on very complicated issues. We have crime in the cities. We have 1,000 complicated issues that are very material to our civilization. But if we spend our time in a meeting taking public stands on all of them, I think it would be quite counterproductive."

I don't like the fact that people will constantly present this issue and never discuss a solution. And so, I think our companies are sensitive to their philanthropic objectives, et cetera. But that director was Charlie Munger at Berkshire Hathaway. His colleague, Warren Buffett, on the issue of climate change and insurance companies, and since they are a big property and casualty insurer, they said there are more material things on any 1 year that are more material to their pricing. And that in property and casualty pricing that changes every year. You are not making a 100-year decision and you are able to reflect those different risks.

My final comment on this was I read an article just the other day, and here is the quote: "A climate disaster triggered by the continued burning of oil and coal could result in the submergence of Florida, Holland, and other low-lying areas over the next 50 years, according to the Ohio State University."

Do you all agree with that? Does somebody agree with that? Because this article was written on February 2, 1978.

So I don't know that, while we are concerned about these issues, if they are material to a company, I think they ought to be disclosed.

Mr. Atkins, are there penalties if you don't disclose material information?

Mr. ATKINS. Well, severe penalties from the SEC, but then also private litigation.

Mr. HILL. I think if it is material, officers and directors ought to have the right to determine that and customize it for their report and not be compelled to a uniformed standard set by somebody else.

I thank my friend from North Carolina.

Chairwoman MALONEY. Thank you.

The gentleman from Illinois, Mr. Casten, is now recognized for 5 minutes.

Mr. CASTEN. Thank you so much, Chairwoman Maloney. And thank you so much to the panelists.

I am excited to be here today, and I am very proud to have introduced the Climate Risk Disclosure Act with Representative Cartwright in the House.

There are more than 200 of the world's largest listed companies who have forecasted climate change could cost them a combined total of almost $1 trillion, according to a report from the Carbon Disclosure Institute. But investors largely lack access to the basic information about the potential impact of the climate crisis on American companies. And not just companies. When Chairman Powell from the Federal Reserve was first here, not this morning, but when he first came earlier in the year, I asked him whether Fannie and Freddie mortgage lenders were factoring in the risk to a 30-year mortgage in low-lying areas, and his comment was that would be an interesting thing to think about, but he wasn't sure we did.

That is a big deal if you are taking the other end of that risk. And there ain't nothing wrong with having transparency of information, despite what some folks here have said today. And I just would like to remind people that the SEC was not created in order to allow businesses to hide information and protect their profits. It

was created to compel businesses to disclose information and protect investors.

Capitalism is an awesome thing. It depends on competitive markets. And we best not forget that competitive markets depend on transparency of information, no matter how much we as business owners don't want to provide all that information.

To that end, the Climate Risk and Disclosure Act would require public companies to disclose more information about their exposure to climate-related risks, which will help investors assess and, let's be clear, hedge those risks and effectively remove the subsidies that currently accrue to companies that aren't mitigating those risks. Risk and reward are related, right? And if people don't know what your risk is, they get to hedge it.

That is the point of it. That is why 33 groups have endorsed the bill and are committed to addressing the necessity of climate risk disclosure.

I would like to ask the Chair for unanimous consent to enter into the record this letter of support.

Chairwoman MALONEY. Without objection, it is so ordered.

Mr. CASTEN. Thank you.

How is my time? Close.

The Task Force on Climate-Related Financial Disclosures, set up by the G20's Financial Stability Board, found in its report that climate-related disclosure had improved since 2016, but only about a quarter of companies disclosed information aligned with more than 5 of their 11 recommendations, and there was only a 3-percent increase from to 2016 to 2018in the number of firms disclosing.

I want to start with Ms. Lubber.

It is clear that some companies generally disclose climate risks, but those disclosures are typically very vague and don't always provide investors with a good sense of the scale of the risks that the company faces from climate change.

Do you believe that the qualitative and quantitative disclosures of climate risks required by the Climate Risk Disclosure Act would be a meaningful improvement on the status quo for investors?

Ms. LUBBER. I think there is no question. The risks are real; they can be calculated. But they need to be consistent. They need to be comparable, company to company. Investors need that information, and the SEC ought to mandate the disclosure of it.

We are talking about, or some of your colleagues, somehow this is an extraordinary extra burden. It ought not to be seen just as climate risk. It is a material financial risk, as you talk about. The SEC knows how to regulate that. They regulate it for inflation, for currency, for trade. They can regulate it for the material risks of climate.

And I don't believe the burden is that high. I believe it is doable, manageable, could fit in under the regimes that they have. But it ought to be, as you designed in your bill, consistent, comparable, and, frankly, mandatory so the laggards don't get away with not doing it while the leaders do.

Mr. CASTEN. So, Mr. Mohin, I was delighted to hear about what GRI has done. This is going to date me a little bit. Twenty years ago, one of my first jobs out of grad school was doing lifecycles, car-

bon modeling for companies like British Petroleum, using a lot of WRI data.

Can you help us understand, if we were to adopt these rules tomorrow, do companies need to reinvent the wheel for how to actually go through and calculate these risks? Or, through the good work that GRI and WRI and others have done, are the templates largely in place at this point?

Mr. MOHIN. The templates are largely in place, Congressman. And they continue to evolve and grow as the mega-trends of having this information go from sort of more the reputational space into the global capital markets. The disclosures have become much more professionalized and the taxonomy standardized.

Mr. CASTEN. Okay.

Last question, with the time I have left, to Mr. Wright: Can you help me understand what the long-term risks are to investors in companies that fail to disclose these risks?

Mr. WRIGHT. Yes, it is very important. And one of the things that we are seeing is that many companies have already taken that upon themselves, to start reporting voluntarily this information. However, the information is not consistent. And that is the information we need to really understand the transitional aspect and the impact it has on employees and also investors.

Mr. CASTEN. Thank you.

I yield back.

Mr. VARGAS [presiding]. Thank you very much.

The gentlewoman from Missouri, Mrs. Wagner, is now recognized for 5 minutes.

Mrs. WAGNER. I thank the Chair.

And I certainly thank our witnesses for being here to testify today.

The United States continues to experience a slump in the number of new businesses, which in 2017 hit a 40-year low. The U.S. is only seeing half the number of domestic initial public offerings, or IPOs, that it had seen just some 20 years ago, while, at the same time, the U.S. doubled the regulatory compliance costs a business must incur.

While the U.S. IPO market is steadily decreasing, foreign markets, particularly in China, are growing. Instead of placing additional burdens on public companies, we should be encouraging more growth and more IPOs here in the United States, which will lead to more investment opportunities and choices for Main Street investors—Main Street investors, real people—to grow their savings and their retirement accounts.

Commissioner Atkins, I too am concerned about the decline in American IPOs over the last few decades and the growing trend of American companies opting for private capital as opposed to public markets. Meanwhile, China's IPO market—are you ready for this?—they produced over one-third of the world's IPOs in 2017. China. Which makes the decline in American IPOs even more troubling.

Why should we find these trends concerning, sir?

Mr. ATKINS. First of all, a robust public market is a good democratic type of situation to have, where people are going out to the public to raise capital rather than just private investors. And it is

a lot cheaper to do it with private investors, the way things are now, and you are subjecting yourself to a lot more regulation if you go to public markets.

Mrs. WAGNER. Doubled—doubled—in the last 20 years.

Would the bills discussed in today's hearing create additional requirements on American public companies, adding to their regulatory compliance costs?

Mr. ATKINS. Oh, I definitely think so, yes.

Mrs. WAGNER. How would the bipartisan capital formation provisions from the JOBS and Investor Confidence Act of 2018 help encourage more U.S. IPOs and make us more competitive globally?

Mr. ATKINS. A number of those provisions—for example, taking aim again at Sarbanes-Oxley Section 404 is one example of unintended consequences of a lot more burdens on smaller companies. And so, the provision in that Act to extend the situation there for smaller companies to not have to be subject to that is just one. But there are others there that would increase access to capital and, that I think would be very helpful for growing companies.

Mrs. WAGNER. What else? What else should Congress be doing or not doing to make U.S. capital markets more attractive?

Mr. ATKINS. Well, reduce the regulatory burden. We talked about the conflict-minerals provision of Dodd-Frank. That was a huge gift to consultants, all sorts of consulting firms. Even if you look at your credit card, Citibank and others have to analyze that strip of metal on the back to make sure that there are no conflict minerals in it. So, that adds a huge burden even to the largest companies like that and, as well, to small ones.

Mrs. WAGNER. Any other things that you can cite that would make U.S. capital markets more attractive certainly from a regulatory reform—

Mr. ATKINS. So, as Chairman Clayton and his colleagues are doing at the SEC, I think, taking a real examination of the regulatory rule book that is there with respect to going public in the United States and remaining public. For example, they are looking at corporate governance and other things, because when you—

Mrs. WAGNER. Right.

Mr. ATKINS. Oh.

Mrs. WAGNER. Please, go ahead.

Mr. ATKINS. When you look at ESG, as Barbara Novick of BlackRock says, "G" is the most important part of the ESG.

Mrs. WAGNER. Thank you. I appreciate—

Mr. HUIZENGA. Would the gentlelady yield?

Mrs. WAGNER. And I would yield, yes.

Mr. HUIZENGA. I appreciate it. In the remaining seconds here, again, it strikes me, as we are hearing testimony about companies using and doing things without a government mandate, it begs the question of whether we have to have the Federal Government come in and force them to do these things that they see as good practices.

So, with that, I yield back.

Mrs. WAGNER. Thank you. I yield back.

Mr. VARGAS. Thank you very much.

The gentleman from Illinois, Mr. Foster, is now recognized for 5 minutes.

Mr. FOSTER. Thank you, Mr. Chairman.

And thank you to our witnesses.

A newly released report from the London School of Economics examined instances of legal action on climate change for a 30-year period, ending this year. The report found that climate change cases are on the rise worldwide, and, to date, climate change litigation has been brought in at least 28 different countries, with about three-quarters coming from the U.S.

Increasingly, plaintiffs are making claims against investment funds and companies for failing to incorporate climate risk into their decision-making and for failing to disclose climate risk to their beneficiaries.

Mr. Andrus, Mr. Wright, and Ms. Lubber, what can the rise in climate change lawsuits tell us about the need for more high-quality climate risk disclosures by companies?

Ms. Lubber?

Ms. LUBBER. Certainly, we are seeing more lawsuits not only as it relates to investors but as it relates to fiduciaries—board members at companies. And being somebody who trains corporate board members on the financial issues of climate or water, what they are telling us is they want more information, they don't want to be sued. They see their duty—one of the first duties of a fiduciary of a company is to analyze risk and act on it for the company.

I think one way to make sure that we are not seeing lawsuits prevail is for people to have the information so they could act asresponsible fiduciaries and respond to the very real issues.

But there is no doubt we are seeing more litigation in many parts of the world around climate change, and that will just grow. I think there are ways to head it off through better management.

Mr. FOSTER. More clarity on the responsibilities to report and to factor these in would probably reduce the amount of litigation. Is that—

Ms. LUBBER. I am sorry. Could you—

Mr. FOSTER. If there was more clarity on the exact responsibilities to factor in climate change into policies and decisions, then that would likely reduce the amount of litigation that you see.

Ms. LUBBER. Precisely.

And the information that is being asked for is consistent with how the SEC does their business. It is not a massive new corporate burden. There will be definitions but as defined by the bills.

We are just looking for material information that allows companies to manage themselves better and investors to know where their real risks are and where they aren't. And it allows fiduciaries, corporate board members, to know where their real risks are and where they aren't. And we all know better information leads to better decisions.

Mr. FOSTER. Okay. Any other comments?

Mr. Andrus?

Mr. ANDRUS. Yes, thank you, Congressman.

Basically, based upon what you are saying, it is additional evidence that what we are talking about is actually material and there is an actual need to have this information disclosed on a regulatory basis.

Mr. FOSTER. Uh-huh.

Now, Mr. Wright, as you noted in your testimony, that, as an investment manager, you measure climate risk for clients and, as part of that analysis, you routinely measure a company's baseline carbon emissions; however, of the 186 firms you evaluated, only 18 percent report their current level of emissions.

Could you say a little bit about how having comprehensive information on emission levels for all companies in this sector might be helpful in making investment decisions?

Mr. WRIGHT. Yes. Thank you for the question.

Basically, what we found is that environmental news can impact future stock prices. And so, as we have more information that is positive, that would actually benefit our holdings. So, as we get more information, we can make better decisions relative to the stocks that we own, to include the fact that these companies are making transitional plans, so we want to see what their future plans are, where we can price that into the stock valuation.

Mr. FOSTER. Thank you.

I guess that pretty much completes my question, so I yield back the balance of my time.

Mr. VARGAS. Thank you very much.

The gentleman from Ohio, Mr. Davidson, is now recognized for 5 minutes.

Mr. DAVIDSON. Thank you, Mr. Chairman.

And thank you to our witnesses. I appreciate your expertise and coming here and sharing it with us and, frankly, your passion for environmental and social goals and, I think, more on the underlying basis, for the high-functioning capital markets that are the envy of the world here in the United States.

I think when you think about fiduciary duties, from what I gather, many of you simply want to look at a broader definition of a fiduciary duty, so that the fiduciary duty involves not just quantitative things like discounted cash flow but an essay question on, "How do you feel about these environmental/social goals that are out there?" Some of you might say, if you properly take those into account, you would get the same discounted cash flows across the board.

I am just curious. All of you are involved at some level in the investment sector. And just go down the line. Does your firm currently employ ESG in their investing practices?

Mr. MOHIN. Thank you, Congressman. We are a standards setter, so that wouldn't apply to GRI.

Mr. DAVIDSON. Next?

Mr. ANDRUS. Yes.

Mr. DAVIDSON. Yes?

Mr. ATKINS. We are a consulting firm, so no.

Mr. WRIGHT. Yes, we do.

Ms. LUBBER. And of our 160 investor members, whose assets total $26 trillion, they all in one way or another are analyzing ESG risks and incorporating them.

Mr. DAVIDSON. Thank you.

And while we heard previous testimony that the companies that use ESG outperform those that don't, the studies on that are varied.

And, frankly, even with CalPERS—Mr. Andrus, you highlighted that the CalPERS does use ESG as part of its metrics. And I am just curious, is CalPERS currently considered to be fully funded on its pension obligations or underfunded?

Mr. ANDRUS. Congressman, we are underfunded. But it is important to point out that what is being discussed here is focused on disclosures—

Mr. DAVIDSON. Yep.

Mr. ANDRUS. —which is additional transparency—

Mr. DAVIDSON. Got it. And I appreciate that.

When I look at—for the record, Jason Perez, a CalPERS board member, estimates that it costs CalPERS $8 billion for divesting from tobacco, for example.

And so, while tobacco is performing well, you can appreciate people on an individual level deciding, "I am not going to invest in tobacco." And, at some level, a firm, you might feel that way, but an institution—when you are reserving and you are fully funded, that is one thing. When you are underfunded—I just talked with some of my teachers from Ohio today, and what they wanted to know is their retirement is secure. They don't want to take wild risks.

And maybe you felt that you are protecting people not just from the harmful effects of tobacco but from a potential crash in the value of tobacco, and some of the bets turn out wrong in every investment. In fact, for every long there is a short, right?

And so, when you look at the information that you are seeking to standardize, people would draw different conclusions on that. I just don't understand how that is different than the market functions today.

For example, Mr. Atkins, my concern—in the current practice, using ESG goals, American Century Sustainable Equity Fund divested itself from ExxonMobil, but it increased holdings in ConocoPhillips because their corporate governance practice they found better. Same sector, different return. Do you see examples such as the one I described often, as it pertains to ESG funds?

Mr. ATKINS. Part of the problem with the whole ESG concept is it is very squishy. And so even a lot of the types of frameworks that are out there, it is very difficult to pin down exactly what it means.

Mr. DAVIDSON. And here is the closing thing I would say. Heavily institutional investors are relying on proxy firms. So proxy firms are required, or permitted, by the institutional investors when they take corporate proxies—not required. But the proxy advisors are dominated by two firms, 97 percent of the market. And they are already employing ESG. They are already influencing the market. They are influencing the practices of institutional investors.

And I think it would be really nice to have a hearing at some point in the future on how proxy advisory is already influencing ESG.

And, with that, I yield.

Mr. VARGAS. Thank you very much.

The gentleman from Georgia, Mr. Scott, is now recognized for 5 minutes.

Mr. SCOTT. Thank you, Mr. Chairman.

Ms. Lubber, you spoke of the relationship between performance on environmental, social, and governance measures and company

performance. As a matter of fact, in your written testimony, you state this. You say, "Disclosure is valuable for its ability to stimulate ingenuity and strategic thinking by businesses, which can improve sustainability, performance, increase a company's competitiveness in a resource-constrained economy, and create shareholder value." That is a very good statement and a worthy one.

Could you share with us a little bit, go into a little detail, what you meant by this and how influential you feel a company's performance is on these environmental, social, and governance measures to their overall performance?

Maybe you could give us an example. Take an environmental issue like climate change. How does that relate to a company's performance?

Ms. LUBBER. Great.

Mr. SCOTT. And then give me an idea—we talked about the example of the environment. What would be a social change? Give us an example of that and the climate change and tell us how that works.

Ms. LUBBER. Sure.

Very quickly, on the social side, when Nike many years ago was found to be employing in their supply chain in Southeast Asia young children, sewing and stitching their soccer balls, that was a reputational catastrophe that hit their bottom line.

And so they said, we have to be doing better, not only on the "E" side but on the "S" side. We want to know who is making our products, what standards they are being held to. If there are contractors, should those contractors be held to the same standards.

And it is not only Nike. PepsiCo. PepsiCo has a program, Performance with Purpose, and they have goals on social, environmental, and governance issues. And what that has done is it allows them to better manage their supply chain and know who is doing what. It allows them to better manage the risks from water problems and climate problems.

And, by doing that, they are providing their—studying the performance of those issues, they are disclosing them, and the disclosure forces them to manage it better. When they know that they have human-rights risks in their supply chain, they are acting and they are acting quickly.

Mr. SCOTT. Well, let me ask you this, because you brought up the Nike thing. The most recent one is this business of the Betsy Ross flag on the sneaker brought up by Kaepernick. How do you evaluate that with truth and honesty? I was very torn with that. I am a sort of patriotic fellow.

Ms. LUBBER. Yes. So—

Mr. SCOTT. I love this country.

Ms. LUBBER. Right. You are asking a great question. And I will say, reputational harm to companies can run to the shareholder value. Again, when Apple found out in their supply chain that there were toxic chemicals being used in some of the resources that went into the phones and what that meant on the health of their workers, that was a huge reputational risk. So, it does matter.

What we saw at Nike—and not everything can be valued immediately. I will come back to places where you can more precisely value it. When you come back to Nike, when they first put out the

Colin Kaepernick ad, my understanding is, first of all, it was a very thought-out decision by their board of directors. They knew it was a risk. When they first put it out, they saw a slight drop in sales. And then, in the week following it and the weeks since then, they have seen a straight uprise in sales.

The public does vote in what they purchase, and they are looking for, all the polls show, companies that are consistent with the values of those consumers.

Mr. SCOTT. So you are saying, in essence, that on this particular situation with Nike and the Betsy Ross flag that Nike made the right decision?

Ms. LUBBER. What I am saying is the consumers—I am saying that they made a decision, and it almost doesn't matter—just as Mr. Atkins doesn't know everything about climate change, I don't know everything about—but what we saw is, as it relates to share value, the strength and profitability of that company, they did well. And they did well, and they are hearing it from their consumers.

The fact of the matter is, not every issue can be evaluated completely, but that is an example where we are seeing positive feedback from the most important people to Nike, their consumers.

Mr. SCOTT. Thank you very much for your very well-thought-out insight.

Mr. VARGAS. Thank you very much.

The gentleman from West Virginia, Mr. Mooney, is now recognized for 5 minutes.

Mr. MOONEY. Thank you, Mr. Chairman.

So, looking at these proposed bills, Mr. Atkins, let me just ask you this. The proposed bills require companies to disclose country-by-country reporting of tax payments.

In your opinion, are the employees of the SEC international tax—are the employees of the SEC's—are they international tax experts with intimate knowledge of the tax laws of dozens of countries? And if not, do you think it is appropriate for Congress to pass an SEC disclosure bill knowing that the SEC cannot review the disclosures for accuracy?

Mr. ATKINS. Yes, I think that is very problematic. And I think largely, those things depend on the company, but are probably immaterial. And FASB already requires material issues to be reported like that in the financial statements.

Mr. MOONEY. All right.

So, following up to that with other requirements that these bills would impose upon you or ask you to require you to come up with, Commissioner Atkins, to your knowledge, how many environmental law experts are on staff at the SEC?

Mr. ATKINS. I am not sure. There might be some people in corporation finance, but as far as scientists and all that, I don't know.

Mr. MOONEY. A couple more. How about, how many human rights experts are on staff at the SEC?

Mr. ATKINS. I am not sure.

Mr. MOONEY. And how many election law experts are on staff at the SEC?

Mr. ATKINS. I have no clue.

Mr. MOONEY. I think the goal—and the point I am trying to make, obviously, is the goal should be for the SEC and this com-

mittee to work on solving capital formation issues that are hindering American companies, entrepreneurs, and mom and pop investors. I think these bills are pushing you outside of your area of what SEC's mandate is.

Mr. ATKINS. I think that is fair to say.

Mr. MOONEY. Yes.

Well, I think I have made my point. I know there are a lot of other people in the queue, Mr. Chairman, so I am happy to yield my time back to the ranking member or to—

Mr. HUIZENGA. If the gentleman will yield?

Mr. MOONEY. Sure.

Mr. HUIZENGA. If the gentleman will yield for a moment, I will take care of this little piece of business, because I do want to submit for the record five different articles, the first article being an article from The Wall Street Journal entitled, "CalPERS' Dilemma: Save the World or Make Money?"

The second is a report from the Institute for Pension Fund Integrity.

The third is a report from the Pacific Research Institute.

The fourth is an article from MarketWatch entitled, "Opinion: ESG—or Socially Responsible—Funds May Soothe Your Conscience But Could Weaken Your Portfolio."

And the fifth and final one is an article from Chief Investment Officer, "CalPERS President Loses Her Board Seat."

Mr. VARGAS. Without objection, it is so ordered.

Mr. HUIZENGA. Thank you. I wanted to get that little piece of business done.

And I think as my friend was making the point and as I was trying to make the point in a much shorter period of time with my colleague from Missouri, we have heard time and time and time again so far from the panel about how private businesses have made decisions.

I happen to think it is stupid that Nike pulled the Betsy Ross flag shoes, but that is their decision. It is my decision whether I go and outfit myself with Nike or not. There are things like that that businesses make those decisions all the time. The question is, who is going to decide what the next Betsy Ross flag is or not and whether that should be part of somebody's social justice portfolio or not?

I happen to think that it was a fairly innocuous flag from 1774, I believe, or 1773, as I recall, before we were even declaring independence that didn't seem like a current social statement to me. In fact, it seemed like it might have been a workaround for the commentary on the current 50-star flag that had been of some consequence at the time.

But, who is going to be making those decisions? I sure in the heck don't want it to be the SEC. And I certainly don't think that it ought to be some sort of other sidecar institution that the SEC has handed off that responsibility to. I am okay with a privately held company making those decisions and all of us voting with our wallets. But that is a very different equation than having the Federal Government come in, under penalty of law, deciding what those standards are that these companies should adhere to.

I appreciate my friend from West Virginia yielding me his time, and I yield back to him.

Mr. MOONEY. I yield back, Mr. Chairman.

Mr. VARGAS. Thank you very much.

The gentlewoman from California, Ms. Porter, is now recognized for 5 minutes.

Ms. PORTER. Hello.

Mr. Atkins, you were an SEC Commissioner from 2002 to 2008, and some pivotal things happened during that time, like the setup for the global economy blowing up. And a key part of your job at the SEC during that time was to regulate the biggest broker-dealers. And while you were at the SEC, they began what is called the Consolidated Supervised Entity Program. And the SEC created this to oversee those banks. And there were five banks in that program, including some who are no longer with us, like Bear Stearns, Lehman Brothers, a couple survivors, like Merrill Lynch. And the whole point of that program was for the SEC, through supervision, to make sure those banks didn't collapse.

Do you recall, how did those banks feel about this new CSE Program and this new alternative capital standard they had to meet?

Mr. ATKINS. I don't recall offhand.

Ms. PORTER. Okay. So they were actually quite happy. Lehman Brothers wrote that it applauds and supports the SEC for adopting this new rule.

And so the 5 biggest banks were in this program in 2004, 2005, 2006, 2007, and 2008, while you were at the Commission. Did the SEC assess the stability of those banks before you enacted the CSE Program?

Mr. ATKINS. Well, that was the staff in Trading and Markets. And I was assured by them that they had the capability and the wherewithal to administer the program.

Ms. PORTER. You were assured by the staff that those banks were stable and would be well-supervised by the CSE Program.

Mr. ATKINS. That they had the wherewithal to administer the program as we were adopting it.

Ms. PORTER. There were definitely issues with those banks right at the start that the SEC was fully aware of. One of the other Commissioners, Harvey Goldschmid, said during a 2004 meeting, "If anything goes wrong, it's going to be an awfully big mess. Do we feel secure, if these drops in capital occur, we really will have investor protection?"

Did you have any similar concerns, and did you express them?

Mr. ATKINS. Oh, I did. As I said, my question of the staff was, do you have the resources to properly administer that program? And I was—

Ms. PORTER. So, despite the fact that while you were at the SEC as a Commissioner these banks became highly leveraged, were given weaker capital requirements and supervision, and a disastrous crash did in fact occur all under your watch, you have then publicly railed against labor unions, environmental, gay rights groups challenging the practices of big banks through shareholder activism. And, in fact, you called companies who "cave to social activism" "weenies." And that is a direct quote.

So you personally presided over the most disastrous financial downturn since the Great Depression. You did not stand up to the big banks. Why are you in a position to call other corporations who respond to their shareholders "weenies?"

Mr. ATKINS. I think that was a very unfair characterization. First of all, I didn't preside over it. I was a member of the Commission. And that is a body that, like this one, adopts rules and is the—

Ms. PORTER. You would like this committee to do more strict oversight over the SEC? Because I would probably be there for that. If that is what you are suggesting, I will inform your current Commissioners.

Mr. ATKINS. I was comparing the role of a Commissioner to a member of this committee.

But be that as it may, there were many other financial institutions that were much more heavily levered than the banks in the CSE Program. But the staff, like I said, had assured me—

Ms. PORTER. Okay. Let's stop there. Reclaiming my time, what is your job now, Mr. Atkins?

Mr. ATKINS. I am a CEO of a consulting firm here in Washington, Potomac Global Partners.

Ms. PORTER. And what do you charge as a consultant?

Mr. ATKINS. I am sorry?

Ms. PORTER. What do you charge as a consultant?

Mr. ATKINS. It varies. It depends on the project and things like that.

Ms. PORTER. So I guess I am struggling, in a capitalist economy, as a capitalist, to understand why anybody would pay you big bucks when you, in fact, didn't stand up and were a weenie in the wake of the financial crisis and then are labeling other people that.

The duty of a corporation—

Mr. HUIZENGA. Mr. Chairman, that is inappropriate.

Ms. PORTER. Those are his quotes.

Mr. STIVERS. You just called him a weenie.

We should take down her words, Mr. Chairman.

Mr. VARGAS. Was the—just to understand—and the time has expired. Just to understand the quote, were you quoting material that Mr. Atkins—so it is a direct quote from Mr. Atkins that you are quoting?

Ms. PORTER. Yes. He has called companies, "weenies who often cave to social activists."

Mr. ATKINS. I don't recall that, but whatever.

Mr. STIVERS. Mr. Chairman, I believe she called him a weenie and—a point of order.

Ms. PORTER. Let me ask you, Mr. Atkins—

Mr. STIVERS. That is different than a quote, Mr. Chairman.

Ms. PORTER. I would like to have my time reclaimed from this discussion.

Mr. STIVERS. Rule 17, rules of decorum, Mr. Chairman.

Mr. VARGAS. My understanding is that the witness is not a protected class. It only applies to Members of Congress.

Ms. PORTER. So let me just ask you, Mr. Atkins—

Mr. VARGAS. Your time has expired, though, so I apologize.

Ms. PORTER. Because of his objections?

Mr. VARGAS. Excuse me?

Ms. PORTER. Because of the objections?

Mr. VARGAS. There was about 3 seconds left, and I believe that your time was expired by the time that the objection was made. That is what I think I saw. I could be wrong.

Ms. PORTER. I feel very confident that I have made my point. Thank you.

Mr. STIVERS. Mr. Chairman, I would insist on my point of order, that we keep decorum in the hearing room. That is the obligation of the chairman.

Mr. VARGAS. Yes. And, again, we will keep decorum. Direct quotes, of course, are—I have heard things even from our President that I wouldn't repeat. But, again, those are direct quotes, and I believe that the quote was a direct one. But thank you for the objection.

Okay.

Mr. STIVERS. I insist on my point of order.

[Discussion off the record.]

Mr. VARGAS. A quorum is established, and the point of order is not sustained.

The gentleman from Wisconsin, Mr. Duffy, is now recognized for 5 minutes.

Mr. DUFFY. Thank you.

Mr. Mohin, how much do you make?

Mr. MOHIN. Pardon me?

Mr. DUFFY. How much do you make?

Mr. MOHIN. I am not sure that is material to the hearing.

Mr. DUFFY. This is all about disclosure. The gentlelady from California wanted to ask Mr. Atkins that, so how much?

Mr. MOHIN. I believe my remuneration is publicly available in our annual report.

Mr. DUFFY. So what it is?

Mr. MOHIN. It ranges each year depending on—

Mr. DUFFY. What was it last year?

Mr. MOHIN. $250,000.

Mr. DUFFY. Mr. Andrus?

Mr. ANDRUS. $300,000.

Mr. DUFFY. Mr. Wright?

Mr. WRIGHT. I have elected not to answer that because I am a business owner and I have a—

Mr. DUFFY. We are all about disclosure here. This is transparency.

Mr. WRIGHT. But, however, I have—

Mr. DUFFY. You are declining to be transparent.

Ms. Lubber, how about you?

Ms. LUBBER. $230,000. And it is fully disclosed in our 990 and available to the public.

Mr. DUFFY. Thank you.

So, Mr. Mohin, when we talk about things that should be disclosed, are there some harmful activities that you think should be disclosed to the public? So, in the banking sector, if banks bank certain industries, should that be disclosed?

Mr. MOHIN. Thank you for the question. Sir, we are a standards setter, so our role is to create the world's best standards using multistakeholder—

Mr. DUFFY. Standards for banks. Should banks disclose who they bank?

Mr. MOHIN. The disclosure based on our standards is really a matter for companies and the regulators of those companies. So we set the standards; others choose to use them or not.

Mr. DUFFY. We want to know, if you invest in a gun manufacturer or a gun retailer, is that something you think the public should know?

Mr. MOHIN. Again, sir, our disclosure—

Mr. DUFFY. I am talking about, do you think we should know that?

Mr. MOHIN. As a standards setter, it is not something that we have a position on.

Mr. DUFFY. Or about whether you invest in abortion clinics or THC or whether you support the American flag or whether you will bank detention centers. Are those things that you think are important for the public to know?

Mr. MOHIN. Actually, it is quite an interesting question, because our independent standards setting board actually chooses which standards go through that process, and none of the issues that you just mentioned have actually made it through that process. And so, by employing the world's experts in terms of what is a sustainability issue, none of those has actually gotten through.

To the point that Mr. Huizenga made, some of these issues do bubble to the top—

Mr. DUFFY. So, on the social side, what do you want disclosed on the social side?

Mr. MOHIN. We actually have our disclosure standards. We have 33 topic-specific standards—

Mr. DUFFY. Give me a couple. What are your favorites?

Mr. MOHIN. Human rights, ethics, environment, health and safety. Some of the basics—

Mr. DUFFY. So, on the environment side, who sets the environmental standard? You guys do? You set the priorities?

Mr. MOHIN. No, no, we don't set the standards. The experts. We have subject-matter experts from—

Mr. DUFFY. You set the standards on what you should do on your environmental standards. So you have your experts internally—

Mr. MOHIN. Not internally, no, sir.

Mr. DUFFY. Externally.

Mr. MOHIN. They come from industry, they come from civil society—

Mr. DUFFY. How are you funded?

Mr. MOHIN. Pardon?

Mr. DUFFY. How are you funded?

Mr. MOHIN. We have sources of funding that are 70 percent self-funded and 30 percent from grants.

Mr. DUFFY. So, if you look at the political spectrum on who funds you, is it down the middle of the road? No political persuasion? Left? Right? Who funds you?

Mr. MOHIN. Of the 30 percent that is grant funding, it is majority government. So we have fundings from government that actually cite our standards in their legislation.

Mr. DUFFY. I would note that I think we should be focused less on your ESG requirements and we should focus on returns. And that is what CalPERS should probably do as well. Because if they continue to perform the way that they have, I am sure they are going to come to this institution and their members will come to this institution and say, we want more money, we want you to bail us out.

And I guess, Mr. Atkins, to get your opinion, I think what this is is to try to set up disclosures to put political pressure on companies to do things that the Congress could never pass itself. So if you want companies to comply with different standards, whether it is global cooling from the 1970s or global warming from the 1990s or now there is climate change today, pass it through the Congress. Right? Or if you don't like guns, debate it in the Congress.

But I think what you want to do is get disclosures so you can put political pressure on companies to get them to change what they are doing because of political pressure. Am I wrong on that, Mr. Atkins? And if I am, you can tell me I am.

Mr. ATKINS. Sometimes, that is what, as I said in my testimony, either government or others try to use for normative reasons.

Mr. DUFFY. And to your point, I think you expressed some concern when you were asked about global warming. I think if you look at the predictions that have been made over the last 30, 40, 50 years, most of them have not come to pass. Many of them have not. And so you might just go, how accurate have the predictions been, even from—go back to Al Gore's movie. Many of the predictions that were made didn't come to pass. And so I don't—I think that we—anyway, my time is up.

I yield back.

Mr. VARGAS. Thank you.

The gentleman from Texas, Mr. Gonzalez, is now recognized for 5 minutes.

Mr. GONZALEZ OF TEXAS. I yield back.

Mr. VARGAS. The gentleman yields back.

The gentleman from Ohio, Mr. Stivers, is now recognized for 5 minutes.

Mr. STIVERS. Thank you, Mr. Chairman.

Mr. Andrus, have you ever read the article that was submitted into the record, "Save the World or Make Money?", about CalPERS?

Mr. ANDRUS. No, sir, I have not.

Mr. STIVERS. So what is your goal as an investment manager at CalPERS? Who do you work for? Who do you consider your fiduciary? And what do you consider your goal?

Mr. ANDRUS. So I work for the Board of Administration. They are the fiduciaries of the—

Mr. STIVERS. I am sorry. Who do you work for the benefit of?

Mr. ANDRUS. I work for the benefit of our pensioners and the workers of the State of California.

Mr. STIVERS. And can you explain to the folks in the hearing what happened in the chairman's race recently for the board of your pension?

Mr. ANDRUS. Mr. Perez won a board election. And in the chairman's race, the board then selected another chairman.

Mr. STIVERS. I'm sorry, the Chair of your board lost her board seat, correct?

Mr. ANDRUS. Correct.

Mr. STIVERS. What was that issue over?

Mr. ANDRUS. I do not know what the issue was over. I do know what Mr. Perez ran on.

Mr. STIVERS. Okay. All I know is that it says here that it was angry pensioners and beneficiaries that felt like the fund was not focused enough on returns.

What is the annual return of CalPERS? I saw something that said it is about 7 percent. Does that sound about right?

Mr. ANDRUS. That is our discount rate. Over the last 10 years, we have been above that.

Mr. STIVERS. Okay. And you recently had to change your amortization policy from 30 years to 20 years on investment losses, which forced all the pensioners and the public folks who fund those pensions to increase their contributions. Is that correct? That happened last year, February 2018. Is that correct?

Mr. ANDRUS. That is correct. That is not the reason why that change was—

Mr. STIVERS. But the result was that pensioners are paying more money and local governments are paying more money. Is that correct?

Mr. ANDRUS. That is correct.

Mr. STIVERS. So it seems to me that if I was an investment manager at CalPERS, I would be a lot more focused on increasing my rate of return for my pensioners, because they are the ones who are suffering right now. And I hope you will focus on that.

I have nothing against environmental stewardship, sustainable social governance, and all that, but I think the key thing here is about the policemen and the firemen and the public workers that need the best return they can get.

And I appreciate your answering my questions.

Mr. Atkins, who decides materiality for a company?

Mr. ATKINS. The company itself, in their disclosure.

Mr. STIVERS. Who is in a best position to decide materiality for a company?

Mr. ATKINS. Again, the company itself.

Mr. STIVERS. I think so too.

And are there a lot of societal issues we could decide that, gee, this is a great social justice cause?

Mr. ATKINS. I am sure among us all.

Mr. STIVERS. I believe the answer is yes. But is the most important social justice cause for a pension to provide pensions for their pensioners?

Mr. ATKINS. That is what it is instituted to do, yes.

Mr. STIVERS. Isn't that their purpose?

Mr. ATKINS. Yes, sir.

Mr. STIVERS. And if it doesn't benefit that purpose, is it helpful to the pensioners? Maybe. But if it hurts the return—and it could hurt the return—it could actually damage the pensioners.

And we have already had this asked and answered, but what happens to the number of public companies as you increase disclosure requirements on public companies? What choice will companies make on becoming public?

Mr. ATKINS. We have seen that overall regulatory burden, including disclosure burden, causes companies not to choose to go public.

Mr. STIVERS. And what does that do to mom and pop investors?

Mr. ATKINS. It provides them fewer choices for investment.

Mr. STIVERS. So, if you are a big pension like CalPERS, you can get access to private equity. Is that correct? You can still invest in those companies.

Mr. ATKINS. Depending on the rules of—

Mr. STIVERS. But if you are a mom and pop investor and you are a small-business owner, do you have those same opportunities?

Mr. ATKINS. Unless you are an accredited investor, probably not.

Mr. STIVERS. Probably not. And especially on Main Street in Logan, Ohio, and in Lancaster, Ohio, and Pickerington, Ohio, that I represent.

And I am all for folks who want to use environmental and social justice as their investment strategy, but for those folks, aren't their companies that voluntarily disclose and give people options?

Mr. ATKINS. Oh, sure.

Mr. STIVERS. Thank you.

I yield back.

Mr. VARGAS. Thank you very much.

The gentleman from Arkansas, Mr. Hill, is now recognized for 5 minutes.

Mr. HILL. Thank you, Chairman Vargas.

Again, this has been a great panel and very informative. And thanks for your forbearance in being here this afternoon.

There were a couple of bills that I haven't heard much discussion about. One was on disclosure on corporate taxes being paid that was proposed. And, again, it struck me as—I was confused, because, in my experience, corporate taxes are disclosed pretty well, I think.

And I have pulled about 10 different public companies to look at their tax disclosure and their 10-K. Did it cover Federal taxes? The answer was yes. Did it cover State taxes? Yes. Did it disclose taxes they paid internationally? The answer was yes.

And it also tends to, in the footnote, reconcile those, and it gives some additional commentary, depending on how complicated the company is, again, unique to the company, unique to this issue of financial statement preparation.

Mr. Atkins, do we need this additional direction on taxes, tax disclosure?

Mr. ATKINS. I think it is problematic. Again, it is very focused, very detailed, as you were saying. I used to be a—

Mr. HILL. What would investors gain from that compared to what people were reporting and have reported for decades now?

Mr. ATKINS. Well, already, companies need to report material information regarding their taxes, their tax liabilities and litigation and that sort of thing.

Mr. HILL. It also seemed to imply that there was some interest in knowing business around the world. And, of course, of our Fortune 500 companies, 50 percent of revenues of the Fortune 500 are international.

So I went and pulled for many of these same companies, does it disclose their business by country or region? And the answer is yes. I just pulled Procter & Gamble for fun. Forty-four percent in the U.S. and Canada, 24 percent of sales in Europe, 9 percent in China.

So I am missing something again in this bill, if this is necessary. Do we need more segment analysis? Are we missing something there?

Mr. ATKINS. Yes, again, it is very narrowly focused on tax issues by countries.

Mr. HILL. Okay. Thank you for that.

And then another bill that I noted was on political or—I guess, political expensing or lobbying expenses maybe. And this bill doesn't have a bill number. It is the Shareholder Protection Act about corporate expenditures over $10,000.

Again, I have seen companies have proxy proposals on that year after year, and they just don't tend to pass. I think there are about 60 companies that had something related to disclosing lobbying expenses or political contribution expenses, and they got about a third of the vote in favor.

So, in your experience as a Commissioner, what is the issue here? What am I missing on this? They have the ability to have a proxy solicited, go through a process in the annual meeting, and people don't seem to be interested in that information.

Mr. ATKINS. By and large, these sorts of proposals fail. And at a couple of companies here and there, they have passed, depending on the particular circumstances of the company. But, overall, shareholders reject these.

Mr. HILL. Yes.

I guess my main point here is, I agree with so many of the comments made today that companies have an obligation to disclose materiality things that will impact their business and their shareholder investing, whether it is related to climate change because they have risk associated with that. They have an obligation to disclose material risks now.

The key thing I think that is important is they have that obligation, they have civil and in some cases criminal penalties associated with not reporting material standards. And the beauty of our system is, in fact, that it is unique to each company. Each company determines that board and that management team with full input. We have shareholder activists, we have institutional investors that some of you represent, all engaging in that conversation.

And so I view these bills, while interesting ideas and well-meaning, I just don't think that they are needed and that these issues are being addressed now by boards of directors, shareholders, corporate officers, and our process that we have now.

And, with that, Mr. Chairman, I yield back the balance of my time unless the ranking member wants time.

I yield back.

Mr. VARGAS. Thank you very much.

Before we wrap up, I would like to take care of one administrative matter. Without objection, I would like to submit letters and statements for the record from the Carbon Disclosure Project; Public Citizen; the Council for Institutional Investors; the FACT Coalition; Principles for Responsible Investment; Morningstar; Professors Cynthia Williams and Jill Fish; TIAA; and the International Corporate Accountability Roundtable.

I would also like to thank our witnesses today. I think the information was very valuable. I know it got a little rough there at points, but I appreciate very much you being here and your testimony. It is invaluable. So, thank you.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing is now adjourned.

[Whereupon, at 3:57 p.m., the hearing was adjourned.]

# APPENDIX

July 10, 2019

HEARING BEFORE THE SUBCOMMITTEE ON INVESTOR PROTECTION, ENTREPRENEURSHIP, AND CAPITAL MARKETS OF THE COMMITTEE ON FINANCIAL SERVICES OF THE UNITED STATES HOUSE OF REPRESENTATIVES

Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social and Governance Disclosures

Testimony of Paul S. Atkins
July 10, 2019

Chairwoman Maloney, Ranking Member Huizenga, and Members of the Subcommittee:

Thank you for inviting me to appear here today to discuss Environmental, Social, and Governance, or "ESG" disclosures, and the Securities and Exchange Commission ("SEC") disclosure regime more generally. From 2002 to 2008, I served as a Commissioner of the SEC, and before that I served on the staff of two former SEC Chairmen, in addition to roles in private practice. In 2009, I founded Patomak Global Partners, a Washington, DC based consultancy, and have served as the Chief Executive Officer since that time.

## Background on SEC Disclosure

### *History and Purpose*

For more than 85 years, the securities laws of the United States, and in particular the Securities Act of 1933, have been based primarily on the principle of disclosure. This was a conscious decision of the drafters of the statutes.[1] The SEC's statutory mission is to maintain fair, orderly, and efficient markets, facilitate capital formation, and to protect investors. It carries out the last part by ensuring market participants have accurate material information about the securities in which they invest. As described on the Commission's website, "The laws and rules that govern the securities industry in the United States derive from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it."[2] Various competing and special interests have from time to time attempted to control the type of disclosures required by the SEC. However, over the years, the Commission has generally focused on disclosure of "material" information.

### *Materiality*

The requirement of materiality is derived from SEC Rule 10b-5, which was promulgated pursuant to the SEC's authority under section 10(b) of the Securities Exchange Act of 1934. Section 10(b) makes it unlawful, in connection with the purchase or sale of any security, to use or employ "any manipulative or deceptive device or contrivance in contravention of such rules

[1] *See* Commissioner Troy Paredes, *Remarks at The SEC Speaks in 2013*, U.S. Sec. & Exch. Comm'n (Feb. 22, 2013), http://www.sec.gov/news/speech/2013/spch022213tap.htm#P222267.
[2] *See* U.S. Sec. & Exch. Comm'n, *What We Do*, https://www.sec.gov/Article/whatwedo.html (last modified June 10, 2013).

and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."[3] Rule 10b-5 provides that, in connection with the purchase or sale of any security, it shall be unlawful "[t]o make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made . . . not misleading."[4] In 1975, the SEC stated "[i]n administering the disclosure process under the Securities Act and the Securities Exchange Act, the Commission has generally... requir[ed] disclosure only of such information as the Commission believes is important to the reasonable investor—material information." It furthered that this requirement is "necessary in order to insure meaningful and useful disclosure documents of benefit to most investors without unreasonable costs to registrants and their shareholders."[5]

The courts have since expounded on what information is "material" and warrants disclosure. The objective standard for materiality was set by the Supreme Court in *TSC Industries v. Northway* (1976).[6] As Justice Thurgood Marshall wrote for the majority in the context of a controversy regarding a proposed merger, an omitted fact is material only if there is "a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."[7] Fundamentally, it is not enough that some investors may view a fact as important; rather, it must be important to the *reasonable* investor. As former SEC Chair Mary Jo White eloquently stated, "what some investors might want may not be what reasonable investors need."[8] In the forty-plus years since the Supreme Court decision in *TSC Industries*, the Supreme Court has repeatedly upheld the doctrine of materiality, including most recently in 2011 in *Matrixx Initiatives, Inc. v. Siracusano*.[9] Importantly, the Commission continues to abide by its own precedents and those of the Supreme Court, rather than adhere to other approaches that would dilute the focus on materiality.

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[3] *See* 15 U.S.C. § 78j(b) (2006).
[4] *See* 17 C.F.R. § 240.10b-5 (2011).
[5] *See* 40 Fed. Reg. 51, 656 (Oct. 16, 1975).
[6] *See TSC Industries v. Northway*, 426 U.S. 438, 439 (1976).
[7] *See Id.* at 449.
[8] *See* Chair Mary Jo White, ***The Path Forward on Disclosure***, U.S. Sec. & Exch. Comm'n (Oct. 15, 2013), https://www.sec.gov/news/speech/spch101513mjw#_ftn7.
[9] *See Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1311 (2011).

*Cost of Disclosure*

While many seem to believe that disclosure is costless and harmless, the costs of disclosure are real. Not only is there the direct cost of the disclosure, which for just three provisions of the Dodd-Frank Act was estimated to be $4.5 billion to $6 billion, with annual ongoing costs between $670 million and $2.1 billion,[10] but there is a cost to investors of "disclosure overload." In 2013, then SEC Chair Mary Jo White decried the issue, noting: "When disclosure gets to be 'too much' or strays from its core purpose, it could lead to what some have called 'information overload' – a phenomenon in which ever-increasing amounts of disclosure make it difficult for an investor to wade through the volume of information she receives to ferret out the information that is most relevant."[11] The concept of "disclosure overload" is not a new concept, as the Supreme Court recognized this very threat in *TSC Industries*, stating that "[s]ome information is of such dubious significance that insistence on its disclosure may accomplish more harm than good." Moreover, SEC Chairmen and Commissioners, regardless of party affiliation, have recognized the real risks of disclosure overload.[12]

Even though the problem of disclosure overload was noted by the Supreme Court more than 40 years ago, mandatory disclosures have continued to increase since then. In particular, the Sarbanes-Oxley and Dodd-Frank Acts greatly increased the number of mandated public company disclosures. The issue has been studied across various disciplines and in international fora as well. One study notes that since 2010, several organizations including the Financial Accounting Standard Board ("FASB") and the International Accounting Standard Board ("IASB") have kicked-off projects on the development of disclosure framework reform, as a result of information overload.[13] An IASB study found over 80 percent of respondents agreed that improvements could be made to the way financial information is disclosed, half of which felt such improvements were needed across all parts of the annual report, not just the financial

[10] *See* Pay Ratio Disclosure, 80 Fed. Reg. 50,103 (Aug. 18, 2015); *See also* Conflict Minerals, 77 Fed. Reg. 56,273 (Sept. 12, 2012); *See also* Disclosure of Payments by Resource Extraction Issuers, 81 Fed. Reg. 49,359 (Jul. 27, 2016).
[11] *See* Chair Mary Jo White, *The Path Forward on Disclosure*, U.S. Sec. & Exch. Comm'n (Oct. 15, 2013), https://www.sec.gov/news/speech/spch101513mjw#_ftn7.
[12] *See, e.g.,* Commissioner Troy Paredes, *Remarks at The SEC Speaks in 2013*, U.S. Sec. & Exch. Comm'n (Feb. 22, 2013), https://www.sec.gov/news/speech/2013-spch022213taphtm#P33_8287; *See also* Chair Mary Jo White, *The Path Forward on Disclosure*, , U.S. Sec. & Exch. Comm'n (Oct. 15, 2013), https://www.sec.gov/news/speech/spch101513mjw#_ftn7.
[13] *See* Dirk Beerbaum, *Disclosure Overload – A Literature Review*, SSRN (Oct. 5, 2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2669135.

statements.[14] Hans Hoogervorst, head of the IASB, noted that "many companies present non-financial information on, for example, sustainability issues [and] for the investor, it is often difficult to see the woods through the multitude of information trees."[15]

In addition to costs to investors, studies have also found that disclosure costs contribute to companies' decision to go public or remain private.[16] The Treasury Department under President Obama recognized this problem and in March 2011 convened a conference on access to capital. This conference led to the creation of the private-sector IPO Task Force "to examine the conditions leading to the IPO crisis and to provide recommendations for restoring effective access to the public markets for emerging, high-growth companies."[17] In its report to the Treasury Department, the IPO Task Force found that 72 percent of the CEOs surveyed cited public disclosure impact on business among their biggest concern about going public.[18] Of public company CEOs surveyed, 92 percent named administrative burden of public reporting as one of the most significant IPO challenges. As part of a 2017 study, the Treasury Department conducted outreach to numerous stakeholders who cited nonfinancial disclosure requirements as a factor affecting public companies since the Sarbanes-Oxley Act.[19] Similarly, an interim report by President Obama's Council on Jobs and Competitiveness noted "well-intentioned regulations aimed at protecting the public from the misrepresentations of a small number of large companies have unintentionally placed significant burdens on the large number of smaller companies. As a result, fewer high-growth entrepreneurial companies are going public, and more are opting to provide liquidity and an exit for investors by selling out to larger companies. This hurts job creation, as the data clearly shows that job growth accelerates when companies go public, but often decelerates when companies are acquired."[20]

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[14] *See* Kirstina Reitan, *Joint Effort Needed to Tackle Disclosure Problem*, IFRS (Jan. 24, 2013), https://www.ifrs.org/news-and-events/2013/01/joint-effort-needed-to-tackle-disclosure-problem/.
[15] *See* Hans Hoogervorst, *Better Communication*, IFRS (June 30, 2016), https://www.ifrs.org/-/media/feature/news/speeches/2016/hans-hoogervorst-zurich-conference-2016.pdf?la=en.
[16] *See* Michael Dambra et al., *The JOBS Act and IPO Volume: Evidence That Disclosure Costs Affect the IPO Decision*, J. Fin. Econ., (Aug. 25, 2014), http://leeds-faculty.colorado.edu/bhagat/JOBSAct-IPO-Volume.pdf.
[17] *See* IPO Task Force, *Rebuilding the IPO On-Ramp*, U.S. Sec. & Exch. Comm'n (Oct. 20, 2011), https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf.
[18] *See Id.* at 38.
[19] *See* Steven Mnuchin, Craig Phillips, *A Financial System That Creates Economic Opportunities*, U.S. Dep't of the Treasury (Oct. 2017), https://www.treasury.gov/press-center/press-releases/documents/a-financial-system-capital-markets-final-final.pdf.
[20] *See* Jobs Council, *Taking Action, Building Confidence*, Jobs Council (Oct. 2011), http://files.jobs-council.com/jobscouncil/files/2011/10/JobsCouncil_InterimReport_Oct11.pdf.

*The Need for More Public Companies*

The benefits to the economy and jobs market of more companies going public has been well documented. It is estimated that 90% to 92% of job growth occurs after IPO, with most of that growth occurring in the first five years following IPO.[21] A study by the Kauffman Foundation estimated that the 2,766 companies that went public from 1996 to 2010 collectively employed 2.2 million more people in 2010 than they did before they went public, while total sales among these companies increased by over $1 trillion during the same period.[22] Another study found that emerging growth companies' post-IPO employment increased 156%.[23] Likewise, a 2017 study concluded that successful IPOs are a critical component of both post-IPO job creation and new firm creation by giving employees in companies that successfully go public the wealth necessary to absorb the risk of creating a firm or joining a startup.[24] Robust public markets also come with enhanced transparency and incorporate the maximum amount of information, which aids in price discovery and investor protection.

Unfortunately, another well-known fact is that public company offerings have been on the decline in the United States, with only half as many public companies available for investors to invest in compared to twenty years ago. This trend in the United States is unusual compared to other countries with similar institutions and economic development, as one study found that while U.S. listings dropped by about half since 1996, listings in a sample of developed countries increased by 48%.[25]

In 1996, when IPOs were at their peak, there were more than 600 IPOs in one year, yet there were approximately 260 IPOs total between 2008 and 2010.[26]

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[21] *See* IPO Task Force, *Rebuilding the IPO On-Ramp*, U.S. Sec. & Exch. Comm'n (Oct. 20, 2011), https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf; *See also* The The Economist, *A Helping Hand for Startups*, The Economist (Oct. 8, 2011), http://www.economist.com/node/21531482; *See also* IHS Global Insight, Venture Impact Study 2010.

[22] *See* Kauffman Foundation, *Post-IPO Employment and Revenue Growth for U.S. IPOs June 1996-2010*, Kauffman Foundation (May 21, 2012), https://www.kauffman.org/what-we-do/research/2012/05/postipo-employment-and-revenue-growth-for-us-ipos-june-19962010.

[23] *See* Martin Kenney, Donald Patton & Jay R. Ritter, Post-IPO Employment and Revenue Growth for U.S. IPOs, June 1996-2010, at 1 (May 2012).

[24] *See* Tania Babina et al., *Going Entrepreneurial? IPOs and New Firm Creation*, Semantic Scholar (Feb. 2017), https://pdfs.semanticscholar.org/baaa/6ceb811c36e7c3de3cef63f47ec7347f170b.pdf?_ga=2.77677204.1889961591.1562339932-774756550.1562339932.

[25] *See* Craig Doidge et al., *The U.S. Listing Gap*, 123 J. of Fin. Econ. 464, 467 (Mar. 2017).

[26] *See* Les Brorsen, *Looking Behind the Declining Number of Public Companies,* Harvard Law School Forum (May 18, 2017), https://corpgov.law.harvard.edu/2017/05/18/looking-behind-the-declining-number-of-public-companies/.

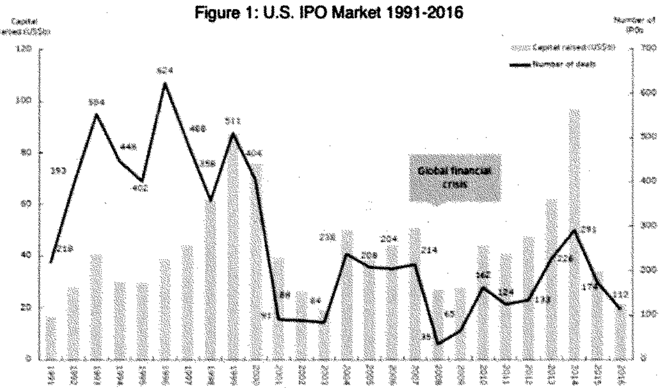


**Figure 1: U.S. IPO Market 1991-2016**

Source: Looking Behind the Declining Number of Public Companies, EY May 18, 2017

In light of this and other data, Congress in April 2012 swiftly acted. Led by Members of this Committee the "Jumpstart Our Business Startups" or "JOBS" Act was enacted. The JOBS Act recognized that the public-company disclosure regime inhibits companies from going public and thus established a regime to lessen those requirements on new emerging-growth companies.

When firms conduct an IPO and offer securities in public markets, everyday investors gain an investment opportunity and can participate in these markets with minimal hurdles or restrictions. In contrast, if firms choose not to go public and raise capital through a private offering or an exempt offering, these sales can be subject to limitations and restrictions on who can participate. To the extent that regulatory requirements are impacting companies' decisions to go public, many ordinary investors are losing out on this valuable investment opportunity, especially compared to high net-worth individuals who are more able to participate in private offerings. One venture capital firm, Andreessen Horowitz, compared the return multiples for technology-related firms of the 1980s with such newer technology firms as Twitter and Facebook in the 2000s. In 1986, Microsoft returned just over 200x in private value creation, while its public value creation was roughly 600x. Oracle had similar return ratios in the same year. Contrast this with Facebook in 2012 and Twitter in 2013, nearly all of whose returns were private.[27]

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[27] *See* Morgan Bender et al., *US Tech Funding*, LinkedIn Slide Share (June 2015), https://www.slideshare.net/a16z/state-of-49390473

Since the passage of the JOBS Act, the number of IPOs per year has been almost 190, compared to an average 100 per year in the five years prior to enactment. While this is a significant improvement, there is still more that can be done. Unfortunately, as discussed in further detail below, the draft bills under consideration today would inhibit rather than facilitate more IPOs. While the bills are likely well-intentioned, the reality is that many of them set requirements already provided elsewhere in law, at best, or would mostly engender the type of unintended consequences prior efforts have visited upon public companies, their investors and U.S. economic growth.

Discussion of Draft Bills

*ESG Disclosure Simplification Act*

The *ESG Disclosure Simplification Act* requires companies to disclose their views about the link between ESG metrics and long-term business strategy and requires the Commission to define ESG metrics and companies to disclose those metrics. An advisory committee would be established to aid the Commission's determination of the metrics. The issue with ESG standards is that they are subjective, making them difficult to both define and measure. Commissioner Hester Peirce recently described the challenge of this kind of an approach: "ESG scoring is often arbitrary because these reports are read and analyzed by machines. Illustrating this arbitrariness, Sarah Teslik, a consultant on ESG issues, recommends that companies 'go look at the list of things they grade on and then disclose the way they talk. You may be doing something just right, but you called it a practice; you didn't call it a policy. And you only get credit if you call it a policy.'"[28]

Additionally, the boards and management of public companies have a legal obligation to uphold fiduciary duty and maximize shareholder return with a focus on long term value creation. To the extent that these metrics prevent businesses from carrying out this obligation by focusing on obscure and subjective targets that might not be appropriate for their business model, this would conflict with their fiduciary duty.

The bill would also ordain the developed ESG metrics as "material" for the purposes of securities laws, upending almost a century of case law precedent, and opening the door for any

[28] *See* Commissioner Hester Peirce, *Scarlet Letters: Remarks Before the American Enterprise Institute,* U.S. Sec. & Exch. Comm'n (Jun. 18, 2019), https://www.sec.gov/news/speech/speech-peirce-061819.

type of information to be deemed "material," based on the whim of a particular group of people at a particular time.

*The Shareholder Protection Act*

The *Shareholder Protection Act* would require public companies to disclose their political spending activity. The bill does not purport to have an investor protection or other related policy goal, but rather states it will "establish necessary accountability." Given the current disclosures and data available, it is not clear where the accountability is lacking. The results of a 2016 report by the Committee for Economic Development ("CED") found that even in light of the *Citizens United* decision, "most of the money raised and spent to support candidates in federal elections comes from individual donations subject to contribution limits and disclosed to the public ... [L]arge corporations or publicly held companies have not engaged in independent spending or contributed large sums to Super PACs."[29] A follow up CED report supported this claim, and noted that labor unions "have played a larger role than the business community."[30] Besides the fact that companies are already required to disclose political contributions, it is well-documented that many calling for these types of proposals are not looking to enhance shareholder value, but rather to prevent companies from exercising their freedom of speech.[31] The bill states that, "historically, shareholders have not had a way to know, or to influence, the political activities of corporations they own." In fact, a process does already exist for shareholders to bring matters to the attention of companies they own and that is the shareholder proposal process granted by SEC Rule 14a-8 that has been in place since 1942.[32] Over the years, shareholder proposals requiring political and lobbying disclosures have

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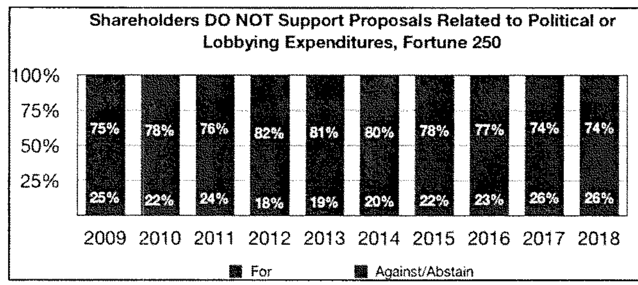
[29] *See* the Comm. For Econ. Dev. Of The Conference Bd., *The Landscape of Campaign Contributions*, Comm. For Econ. Dev. (Nov. 2016), https://www.ced.org/reports/single/the-landscape-of-campaign-contributions
[30] *See* the Comm. For Econ. Dev. Of The Conference Bd., *The Landscape of Campaign Contributions*, Comm. For Econ. Dev. (July 10, 2017), https://www.ced.org/reports/the-landscape-of-campaign-contributions1
[31] *See* Joe Trotter, *New Report Unveils Effort to Censor Corporate Speech*, Inst. For Free Speech (June 5, 2014), https://www.ifs.org/news/new-report-unveils-effort-to-censor-corporate-speech/; *See also* Kimberly Strassel, *The Corporate Disclosure Ruse*, Wall Street Journal (May 31, 2012), https://www.wsj.com/articles/SB10001424052702303552104577438553017191964; *See also* Deneen Moore, *Union Activists' Strong-Arm Tactics*, Nat'l Ctr. For Pub. Pol'y Research (Sept. 25, 2006), https://nationalcenter.org/project21/2006/09/25/union-activists-strong-arm-tactics-deneen-moore/ (Charles Schwab Corporation became a target of labor unions for the personal support of Social Security reform by the company's founder, Charles Schwab. "Although the company wanted to enhance shareholder value through this advocacy, its participation in the public policy debate and exercise of political freedoms seemed too much of a threat to union activists.")
[32] *See* 17 CFR § 240.14a-8 (2013).

consistently been rejected by shareholders. Last year, roughly 74% of Fortune 250 shareholders rejected these proposals.




*Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act of 2019*

This bill would require issuers that are required to file an annual report to conduct an annual analysis to identify any human-rights risks or impacts in the operations and value chain of the issuer and rank them based on severity. In addition to the impracticability for global companies with complicated supply chains to comply with this rule and the sheer compliance costs, which for a similar Dodd-Frank provision relating to conflict minerals was estimated to be $3 to $4 billion,[33] the SEC is not equipped to address public policy goals of this nature through its disclosure regime. This was demonstrated by preliminary observations of the conflict minerals disclosure rule. The U.S. Government Accountability Office found that "[c]ompany filings indicate companies exercised due diligence but most were unable to determine whether or not conflict minerals used came from covered countries, or whether they financed or benefited armed groups."[34] What is worse is that a rule of this nature may have the opposite of the intended policy goal. Following implementation of the conflict minerals rule, an empirical analysis found that "[i]nstead of reducing violence, the evidence indicates the policies increased the incidents in which armed groups looted civilians and committed violence against them."[35]

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[33] *See* Conflict Minerals, 77 Fed. Reg. 56,273 (Sept. 12, 2012)
[34] *See* Kimberly Gianopoulos, *SEC Conflict Minerals Rule: 2017 Review of Company Disclosures in Response to the U.S. Securities and Exchange Commission Rule*, U.S. Gov't Accountability Office (Apr. 26, 2017), https://www.gao.gov/assets/690/684300.pdf; *See also* Kimberly Gianopoulos, *Company Reports on Mineral Sources in 2017 Are Similar to Prior Years and New Data on Sexual Violence Are Available*, U.S. Gov't Accountability Office (June 2018), https://www.gao.gov/assets/700/692851.pdf.
[35] *See* Dominic Parker and Bryan Vadheim, *Resource Cursed or Policy Cursed?*, Univ. of Wis. (June 3, 2016), https://aae.wisc.edu/dparker5/papers/ParkerVadheimJAERE.pdf

For this reason, the SEC should focus on its mission of regulating capital markets and protecting investors, rather than being tasked with lofty goals it is not equipped to handle, such as "supporting the public interest in ensuring publicly traded companies do not cause or contribute to adverse human rights impacts…".[36] Not to mention, shareholders have already rejected human-rights risk assessment proposals when they have come to a vote. This proxy season, of the eleven proposals that received a final vote, all of them were rejected, with an average support rate of 26%.[37] Finally, if the goal of this legislation is to reduce human rights violations, why does it only target public companies through the SEC disclosure regime, rather than all companies? Disproportionately requiring this costly, onerous disclosure from SEC-registered public companies only furthers the disincentive to go public, contributing to the public company issue discussed earlier.

*Corporate tax disclosure bill*

This bill would, among other things, require issuers to disclose in both annual and quarterly reports (1) the total pre-tax profit of the issuer during the period; (2) the total amount of state taxes paid by the issuer during the period; (3) the total amount of federal taxes paid by the issuer during the period; and, (4) the total amount of foreign taxes paid by the issuer during the period. The bill would also require issuers to disclose several metrics on a country-by-country basis.

Although much of this information is already collected by the IRS, including a country-by-country breakdown for multinational enterprise groups that report $850 million or more of revenues in the preceding annual reporting period,[38] some groups have argued that the SEC should require disclosure of this information for investors. However, this information is not material.

Companies are already required to provide footnote disclosure of material tax items in financial statements. Moreover, when Congress previously explored requiring companies to file additional tax information with the Commission, then-SEC Chairman Harvey Pitt stated that "[w]e believe the disclosure on corporate tax matters a company supplies in its filings provides

[36] *See* H.R.___, Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act of 2019 [DRAFT]
[37] Author's calculations using ISS Corporate Solutions data
[38] *See* Internal Revenue Serv., *Frequently Asked Questions*, https://www.irs.gov/businesses/international-businesses/frequently-asked-questions-faqs-country-by-country-reporting (last updated May 16, 2019).

sufficient information and that the provision of tax returns to the Commission or public disclosure to public investors is not necessary."[39] Furthermore, the SEC, the Department of Justice and other agencies can already request tax returns when needed for enforcement purposes in both tax and non-tax cases.

*Climate Risk Disclosure Act of 2019*

This bill would require public companies to disclose in their annual reports information relating to the financial and business risks associated with climate change and would require the SEC to establish climate-related risk disclosure metrics and guidance. The problem with this bill is that it seems to assume that there are not any climate-related disclosures today and that the SEC is equipped to develop specific requirements for climate-related disclosures. Both those assumptions are incorrect.

First, it is important to note that in 2010, the SEC published an interpretive release discussing how existing disclosure requirements may apply to climate-related issues.[40] For example, if a company's physical facilities are exposed to extreme weather risks and the company is making significant business decisions related to relocation or insurance, to the extent that those matters are material, companies should already be disclosing them.

Second, while some sustainability advocates have called for these disclosures, there is disagreement about whether and what information would be considered material and useful by the reasonable investor. SEC Division of Corporation Finance Director Bill Hinman made this very point in a speech earlier this year stating, "market participants who do support additional sustainability disclosure requirements do not themselves uniformly recommend additional disclosure on the same sustainability issues."[41] If the proponents disagree on what should be disclosed, it seems doubtful that the SEC, which does not have expertise in climate-related matters, should develop such standards. As Director Hinman stated, "[s]ubstituting regulatory

[39] *See* Letter from Harvey Pitt, Chairman, U.S. Sec. Exch. Comm'n, to Charles Grassley, Senator, U.S. Senate (Aug. 15, 2002) (on file with Tax Notes)
[40] *See* U.S. Sec. & Exch. Comm'n; Commission Guidance Regarding Disclosure Related to Climate Change, 75 Fed. Reg. 6,290 (Feb. 8, 2010) (codified at 17 C.F.R. Pt. 211, 231, 241).
[41] *See* William Hinman, *Applying a Principles-Based Approach to Disclosing Complex, Uncertain and Evolving Risks*, U.S. Sec. & Exch. Comm'n (Mar. 15, 2019), https://www.sec.gov/news/speech/hinman-applying-principles-based-approach-disclosure-031519

prescriptions for market-driven solutions, especially while those solutions are evolving, in [his] view, is something [the SEC] need[s] to manage with utmost care."[42]

[42] *Id.*

**Testimony of**

**James Andrus**
**Investment Manager, Sustainable Investments**
**California Public Employees' Retirement System**

**Before the**
**United States House of Representatives**
**Committee on Financial Services**
**Subcommittee on Investor Protection, Entrepreneurship and Capital Markets**

**Hearing on**
**"Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social and Governance Disclosures"**

**July 10, 2019**

Chairwoman Maloney, Ranking Member Huizenga, and other Members of the Subcommittee:

Thank you for the opportunity to testify at today's hearing. My name is James Andrus, and I am an Investment Manager for the Sustainable Investments program for the California Public Employees' Retirement System ("CalPERS"). I am pleased to appear before you today on behalf of CalPERS. I applaud and support the Subcommittee's focus on building a sustainable and competitive economy. CalPERS appreciates that Environmental, Social, and Governance ("ESG") disclosures play an important role in that work.

My testimony discusses how CalPERS benefits from a system that ensures effective, accountable and transparent corporate governance, while at the same time promoting capital formation with the objective of achieving the best returns and value for shareowners over the long-term. Ultimately, CalPERS's primary responsibility is to our beneficiaries, and so our long-term investment returns are central to all our thinking about these issues. I will provide an overview of CalPERS, discuss our governing principles, and review various legislative proposals under consideration.

**CalPERS**

CalPERS is the largest public pension fund in the United States ("U.S."), with approximately $370 billion in global assets as of market close on June 30, 2019. CalPERS has equity holdings in over 10,000 public companies globally. CalPERS is a fiduciary that provides over $22 billion annually in retirement benefits to more than 1.9 million public employees, retirees, their families, and beneficiaries. Delivering investment returns is our investment office's number one job. Achieving good investment returns helps us avoid increasing the contributions required from California's communities. Increasing contributions takes away budget resources otherwise available for those communities to provide public services. For this reason, we are focused on ESG topics that can affect our returns.

To promote long-term returns, CalPERS has developed and implemented a set of Governance and Sustainability Principles ("Principles"), which are included in the appendix to this testimony. Updated annually, these Principles are a statement of our views on best practices to guide the internal and external managers of CalPERS when making investment decisions and provide the framework by which we advocate with policy-makers, execute our shareowner proxy voting responsibilities and engage portfolio companies to achieve long-term returns.

**CalPERS ESG Strategic Plan and Principles**

In August of 2016, the CalPERS Board of Administration adopted an ESG 5-Year Strategic Plan ("Strategic Plan") for the purpose of minimizing risk, maximizing returns, and ensuring accountability from all those involved. Within this broad framework, my testimony will highlight CalPERS' views on data and corporate reporting, among other topics central to the ESG disclosure dialogue. Together, our Principles and our Strategic Plan support a robust reporting regime for publicly traded companies that would address issues that impact shareowner value over the long-term. Together, they have guided us to work with partners and advocate for policies that address climate change, board diversity, improvements in human capital management, and governance issues such as majority voting. I applaud this Subcommittee for focusing on certain matters that we consider critical to a sustainable economy.

Before we discuss the specific proposals, I think it is important to note that the proposals we are discussing today are limited to publicly traded companies. For the past few years, the majority of capital raised in the U.S. has not been generated through public offerings. To the contrary, the majority of capital raised in the U.S. is now through so-called "private" offerings, which do not have the disclosure obligations or investor rights and other protections that are the hallmarks of the public capital markets. In part because of the dramatic shift in where capital is being raised, we at CalPERS are changing where we invest as well. As fiduciaries focused on maximizing our returns for our beneficiaries, we are increasingly focused on private market opportunities. Despite the generally greater risks and costs of these private investments, we must focus on maximizing our long-term returns, and we cannot simply ignore the market where more than half of new investments are made.

This raises an important point for today's discussion: most of the ESG-related policy dialogue focuses only on the public markets. Moving forward, we encourage you to also consider how important ESG issues like those we are discussing today can be carried into the non-public market space as well.

**Legislative Proposals: Strong Disclosure for Stronger Capital Markets**

The U.S. is home to the world's most dynamic and robust capital markets. As a significant institutional investor with a long-term investment horizon, CalPERS fundamentally depends on the integrity and efficiency of our financial markets to provide the sustainable, risk-adjusted returns that allow us to meet our commitments over the course of multiple decades. We believe that enhanced data and transparency requirements will promote more efficient and sustainable financial markets over the long-term.

Corporate reporting plays a key role in sustaining capital markets. As a long-term shareowner, CalPERS understands first-hand that effective disclosures are essential to enhancing the efficiency of global capital markets, to focusing companies' management on risks and opportunities, supporting informed decision-making about shareowner proposals, and, ultimately, to delivering our pensioners their promised retirement and health benefits.

Our Principles outline opportunities to strengthen effective disclosures and guide our advocacy efforts. We strongly believe that all investors, whether large institutions or private individuals, should have access to financial reporting disclosures that allow providers of capital to make informed decisions whether to buy, sell, or hold certain securities. Likewise, such disclosures provide investors with the information they need to decide how to vote their shares. Without high-quality, consistent, and comparable disclosures, CalPERS and other investors are disadvantaged as we make capital allocation decisions and assess the performance of corporate boards and management teams.

Critically, CalPERS and other pension funds will be inhibited from adequately exercising their fiduciary duty without such disclosures. Such disclosures are necessary to close the information gap that occurs when management of a company is aware or should be aware of certain risks, yet such information is not available to shareowners. In line with this view, we strongly support the Securities and Exchange Commission's ("SEC") work to comprehensively review the disclosure requirements of Regulation S-X and Regulation S-K and have actively responded to the relevant requests for comment in support of greater transparency.[1] Indeed, there are many substantive areas about which long term investors could use more information. For example, as a member of the Human Capital Management Coalition, we joined others to file a petition with the SEC focused on human capital disclosures.[2]

We are excited and pleased by the opportunity to weigh in on the proposals before the Subcommittee today. It is our belief that this package of bills will require issuers to view ESG metrics through the lens of long-term business strategy, will encourage corporations to be mindful of ESG and other risks that could impact their operations, and will provide for greater transparency regarding cash flow, corporate expenditures, and public policy engagement. I will now discuss, in broad terms, CalPERS' views on the bills before us today.

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[1] *See* Letter from CalPERS to Brian J. Fields, Secretary, U.S. Securities and Exchange Commission (Nov. 30, 2015) (available at https://www.sec.gov/comments/s7-20-15/s72015-38.pdf); Letter from CalPERS to Brian J. Fields, Secretary, U.S. Securities and Exchange Commission (July 21, 2016) (available at https://www.sec.gov/comments/s7-06-16/s70616-267.pdf).

[2] *See* Letter from Human Capital Management Coalition to William Hinman, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission (July 6, 2017) (available at https://www.sec.gov/rules/petitions/2017/petn4-711.pdf)

*Shareholder Protection Act of 2019*

Our Principles call for robust board oversight and disclosure of corporate charitable and political activity to ensure alignment with business strategy and to protect assets on behalf of shareowners. As fiduciaries, we need to know how our capital is being used, including if and when political expenditures are made. We have consistently been in favor of enhanced disclosure of such spending and therefore support the "Shareholder Protection Act of 2019." In fact, during the most recent proxy season, we supported various shareowner proposals that would require companies to report their political spending and to adopt board oversight procedures.

Notably, in the majority opinion of the Court in *Citizens United*, former Justice Anthony Kennedy wrote that:

> With the advent of the Internet, prompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters. Shareholders can determine whether their corporation's political speech advances the corporation's interest in making profits, and citizens can see whether elected officials are "'in the pocket' of so-called moneyed interests." [] The First Amendment protects political speech; and disclosure permits citizens and shareholders to react to the speech of corporate entities in a proper way. This transparency enables the electorate to make informed decisions and give proper weight to different speakers and messages.[3]

Setting aside other aspects of the Court's decision and with the important caveat that I am not commenting on CalPERS' overall position on the decision, former Justice Kennedy's words make clear that the Supreme Court envisioned future action by Congress to enhance corporate political transparency. We agree and urge Congress or the SEC to implement these important disclosures.

*Climate Risk Disclosure Act of 2019*

Embedded in our Principles is the expectation that corporate boards disclose fair, accurate, and material information relevant to investment decisions, thereby enabling shareowners to evaluate risks, past and present performance, and to draw inferences regarding future performance. For investors navigating the complexity of climate change, it is essential to have detailed scenario-based corporate disclosures regarding the potential impact of both the transition and physical

[3] *Citizens United v. FEC*, 558 U.S. 310 (2010).

risks to corporations' performance across time horizons (short, medium and long-term). Comprehensive disclosure of risk factors related to climate change should clearly reveal how companies identify and manage such risks to generate sustainable economic returns. Investors need companies to provide a detailed explanation of how each significant climate-related risk affects the company, as well as disclosure of exactly how the company plans to address and manage the risk. For investors, as the providers of the capital, knowing what measures the board of directors is taking to manage and mitigate risks creates trust and confidence regarding their investments. We therefore support the "Climate Risk Disclosure Act of 2019" because it will support investors in understanding the sustainability of their investments and in the development of the type of sustainable economy through which pension funds such as CalPERS can generate the returns we need over the long-term.

*ESG Disclosure Simplification Act of 2019*

Our Principles call on us to encourage corporate boards to present balanced and understandable assessments of companies' positions and prospects in their annual corporate reports. Accurate and accessible reports are critical for shareowners to assess a company's performance, business model, strategy and long-term prospects.

Consistent with CalPERS' Strategic Plan, the "ESG Disclosure Simplification Act of 2019" ("ESG Disclosure Act") would require companies to make new and more robust ESG disclosures. This legislation would establish an inclusive process for advancing important proposals aligned with our Strategic Plan objectives related to integrated reporting. Moreover, the legislation's suggested process is thoughtful: its proposal to establish a committee to advise the SEC in the development of appropriate disclosures would provide the SEC additional access to knowledgeable and innovative thinkers.

These additional disclosures are important to better understand companies' potential long-term performance and risks. The process identified in the ESG Disclosure Act should produce high quality ESG disclosures. As we stated in our comments on Regulation S-K, we believe that enhanced corporate reporting related to governance, risk, and compliance helps to put historical performance, as well as risks, opportunities, and prospects for the company into context.

CalPERS has advocated for many of these reforms outside of Congress as well. In 2018, CalPERS signed the Petition for Rulemaking on ESG Disclosure[4] ("the Petition"), which was authored by securities law professors Cynthia A. Williams and Jill E. Fisch. The Petition called on the SEC to develop a comprehensive framework requiring issuers to disclose identified ESG aspects of company operations.

[4] Petition from Fox, Saul A. and Williams, Cynthia A. to Brian J. Fields, Secretary, U.S. Securities and Exchange Commission (Oct. 1, 2018) (available at https://www.sec.gov/rules/petitions/2018/petn4-730.pdf).

Detailed disclosures around not only the probability of certain occurrences but also the result and implications on performance will help investors understand a company's strategic objectives and its progress in meeting them. Accordingly, we support the ESG Disclosure Act.

*Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act of 2019*

Our Principles are clear with regard to human rights:

> Corporations should adopt maximum progressive practices toward the elimination of human rights violations in all countries or environments in which the company operates.

In line with our Principles, we advocate for policies, procedures, training and internal reporting structures to ensure commitment to universal human rights. We support the "Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act of 2019" because of its focus on the protection of human rights.

*Country by Country Tax Payment Disclosure*

Our Principles focus significantly on emerging systemic risks, stating that CalPERS will advocate for a disclosure regime that better enables earlier identification of risks that threaten global markets. Likewise, our Principles state that CalPERS will work to foster action that mitigates those risks.

The Organization for Economic Cooperation and Development ("OECD") has stated that changes are needed to effectively prevent double taxation and tax avoidance. The first step in addressing these significant issues is tax transparency.

As an investor in many of the largest public companies in the world, we are acutely aware of the complexities of international taxes, and the increasingly important role that taxes play in corporate profitability. Unfortunately, current tax disclosures in the United States do not provide investors with sufficient tax-related information to adequately assess companies' valuations and risks. This lack of transparency creates an information gap whereby management may be well aware of risks being taken while shareowners are left in the dark. The legislation before the Subcommittee would require the disclosure of overly aggressive international tax planning arrangements, thereby reducing systemic risk and ensuring stronger long-term outcomes.

**Conclusion**

CalPERS is a fiduciary whose primary goal is making good investments in order to fulfill our responsibility to our members. We have a long history of focusing on ESG topics because of the risks they pose to our returns. CalPERS' believes companies' long-term value creation requires effective identification and management of the ESG risks and opportunities relevant to their business.

Policy-makers have an important role to play in creating a policy context that incentivizes the companies we invest in to employ sustainable business practices while generating returns that meet public pension funds' needs. Policies that encourage sustainable business practices and require disclosures that help investors identify companies that are able to both deliver the returns we need and have measurable positive social and environmental impacts are useful in encouraging capital to flow toward a more sustainable economy.

The legislative proposals before the Subcommittee today could both minimize risk and promote greater capital formation, and CalPERS voices its support for them. We look forward to working with the Subcommittee and Committee to advance these, and hopefully more, proposals in the future. Thank you, Chairwoman Maloney and Ranking Member Huizenga for inviting me to participate in this hearing, and I look forward to your questions.

**Written Testimony of Mindy S. Lubber**
**Chief Executive Officer and President, Ceres**

**Prepared for the U.S. House of Representatives, Committee on Financial Services, Subcommittee on Investor Protection, Entrepreneurship and Capital Markets**

**"Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social and Governance Disclosures"**

**Comments on the Climate Risk Disclosure Act of 2019**

**July 10, 2019**

Chair Maloney, Ranking Member Huizenga, and members of the Subcommittee:

Thank you for the invitation and opportunity to appear before you today. I am the CEO and President of Ceres, a nonprofit organization working with many of the most influential investors and companies to build sustainability leadership within their own enterprises and to drive sector and policy solutions throughout the economy. Through our membership networks of more than 100 plus companies and 160 investors, we work with these private sector leaders to tackle the world's biggest sustainability challenges, including climate change, water scarcity and pollution, and deforestation. We believe today's hearing is timely and necessary and we appreciate your attention to these challenges. Congressional action is crucial to ensure capital markets are transparent and fair and protect investors from material risks, such as those from climate change, whether those risks arise in short, medium or long term timeframes. We thank this subcommittee for focusing on the importance of corporate environmental, social and governance (ESG) disclosures. My remarks will primarily be confined to a discussion of the **Climate Risk Disclosure Act of 2019**, although I will touch generally on the critical importance of other types of ESG disclosure requirements.

Ceres' investor network includes more than 160 North American investors representing $26 trillion in assets under management.[1] This network advances leading sustainable investment practices, corporate engagement strategies, and key policy and regulatory solutions. These financial leaders are working under the assumption that climate change creates a material financial risk to their portfolios and these risks are worthy of further examination as it relates to their investments.

Many of these investors are also engaging the world's largest corporate greenhouse gas emitters on climate change through the global initiative Climate Action 100+, of which we are a founding partner organization. This collaboration includes investors from around the world with more than $33 trillion in assets under management who are engaging companies on improving their governance practices, curbing emissions, and strengthening climate-related financial disclosures.

[1] https://www.ceres.org/networks/ceres-investor-network

We appreciate the opportunity to share our views on the critical need for mandatory corporate disclosure of the financial risks posed by climate change to better protect the investing public and position companies to thrive in a just and sustainable zero-carbon global economy.

**Ceres' work on corporate sustainability and climate risk disclosure**

Ceres was founded 30 years ago by a group of investors and environmentalists who had a vision of a better way to do business. They began to evaluate the role and responsibilities of companies and investors to comprehensively integrate sustainability — the real cost of pollution, the financial implications of resource depletion, the impacts of climate change, and water scarcity and pollution — into their financial analysis as key financial and corporate issues. It was clear — even 30 years ago — that the costs of environmental degradation to our economy was a monumental and global cost with implications for every sector of our economy, every company and their employees operating within it, and to our communities

This coalition of investors, public pension fund trustees, labor unions, religious investors and environmentalists crafted a groundbreaking code of conduct for companies called the Ceres Principles — a set of guidelines calling for integrating sustainability into practices, into reporting and into setting goals for continuous improvement.

Ceres went on to co-found the Global Reporting Initiative (GRI), setting the standard for corporate sustainability reporting, now a mainstream practice used by nearly 13,400 companies worldwide. I am very happy to testify today alongside my friend and colleague Tim Mohin, who leads the GRI, the leading global sustainability standard.

Within a decade, environmental and social issues were beginning to be considered and reported on as corporate financial imperatives, not merely externalities. New frameworks for reporting highlighted the risks and opportunities — providing the tools to not only measure corporate performance on environmental, social and governance (ESG) issues, but also to act on them.

Today, Ceres works with hundreds of the largest companies worldwide to improve reporting, including with Ceres Company Network members, a group of 50+ US based companies, nearly 75 percent of them Fortune 500 firms, which we influence through direct stakeholder engagement, standard-setting and regular benchmarking. Through our global collaboration — We Mean Business — we work with hundreds of global companies to address climate issues through better reporting (both sustainability reporting as well as full integration into financial filings), setting science-based emissions reduction targets and addressing public policy initiatives.

Since the founding of our investor network in 2003, the interest of some of the worlds' largest investors has continued to grow given the clear and substantial financial risks to their portfolios

and their need to receive adequate information to make investment decisions. Ceres has worked with investors to make the case to the U.S. Securities and Exchange Commission (SEC or Commission) to prioritize improving the disclosure of material climate-related and other sustainability risk in financial filings. Ceres and our members have met frequently with SEC leadership and staff, drafted petitions to the SEC asking for interpretive guidance on climate risk disclosure, and evaluated the SEC's and corporations' approaches to climate disclosure.[2] Our work led the SEC to issue *Commission Guidance Regarding Disclosure Related to Climate Change* on January 27, 2010, the first guidance issued by a securities regulator explaining how existing disclosure rules apply to the physical, business, and legal developments related to climate change.[3]

In July 2016, Ceres organized a letter,[4] signed by 45 investors representing $1.1 trillion in assets under management, noting that in regard to climate change, "existing SEC rules have not, as applied by the Commission to date, produced sufficient information for investors to evaluate material risks, which we believe are becoming increasingly significant to companies in multiple sectors." The letter also noted that staff at the SEC have issued very few comment letters about the inadequacy of current climate risk disclosures, and have not "pursued enforcement actions for failure to meet disclosure requirements, despite a very active financial risk and disclosure enforcement agenda in other areas."

Regarding the need for SEC rules to improve climate risk disclosure, the letter continues:

> In a number of cases, additional guidance or line-item disclosure requirements are needed to elicit consistent, comparable, decision-useful narrative and metrics-based sustainability information that is useful to investors. For example, the business plans of many oil and gas, electric power, and coal companies appear to pose material financial risks to investors, because they are based on forecasts for increasing demand that fail to take into account the accelerating transition to a low carbon global economy. Even as enforcement actions may be warranted to address materially inadequate disclosures by these companies under the existing rules, new disclosure rules regarding the alignment of business plans with the greenhouse gas reduction targets of the Paris agreement may be necessary.

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[2] https://www.ceres.org/resources/tools/sec-sustainability-disclosure-search-tool; https://www.ceres.org/resources/reports/cool-response-sec-corporate-climate-change-reporting; https://archive.ceres.org/resources/reports/sustainable-extraction-an-analysis-of-sec-disclosure-by-major-oil-gas-companies-on-climate-risk-and-deepwater-drilling-risk/view.

[3] https://www.federalregister.gov/documents/2010/02/08/2010-2602/commission-guidance-regarding-disclosure-related-to-climate-change. See also https://www.sec.gov/news/press/2010/2010-15.htm and https://www.nytimes.com/2010/01/31/opinion/31sun3.html.

[4] https://www.ceres.org/news-center/press-releases/unprecedented-response-investors-call-sec-improve-reporting-climate

**Widespread support for improving climate and sustainability risk disclosure**

Data from recent reports from the Intergovernmental Panel on Climate Change (IPCC) and the U.S. government (National Climate Assessment) have demonstrated the urgent need for improved corporate disclosure and performance in response to climate change. The U.S. Fourth National Climate Assessment found, in the worst case scenario, that the economy could lose as much as 10-14 percent of its GDP by the end of the century.[5] In terms of sectoral impacts, the report found, "With continued growth in emissions at historic rates, annual losses in some economic sectors are projected to reach hundreds of billions of dollars by the end of the century—more than the current gross domestic product (GDP) of many U.S. states."[6]

The IPCC's Special Report from September 2018 found that global warming of 1.5 °C is projected to inflict up to $54 trillion in damage to the global economy by 2100, while warming of 2 °C is projected to inflict up to $69 trillion in damages in the same time period. Just last week, Moody's Analytics reconfirmed those finds in a new report, stating that such warming will "universally hurt worker health and productivity" and that more frequent extreme weather events "will increasingly disrupt and damage critical infrastructure and property."[7]

Initiatives led by companies and institutional investors worldwide have recognized these reports and in response have elevated the urgency of climate action and disclosure.

Some of the largest financial firms, corporations and investors worldwide have worked together for the last four years, as members of the Financial Stability Board's (FSB) Task Force on Climate-related Financial Disclosures (TCFD), to create globally applicable guidelines for climate-related financial disclosures.[8] The TCFD was created because G20 nations asked the Financial Stability Board to study how to improve climate risk disclosure in financial filings worldwide. The TCFD has been an important factor in elevating this issue on the agendas of companies and governments in the last four years.

For several years, investors have released global statements to world government leaders urging them to accelerate climate action and improve corporate climate risk disclosure. In June 2019, 477 investors with $34 trillion (USD) in assets, a record number of signatories, urged world government leaders to step up ambition on climate change and enact strong policies by

[5] U.S. Global Change Research Program, *Fourth National Climate Assessment Volume II: Impacts, Risks and Adaptation in the United States* at 1360 (Figure 29.3), showing projections of direct damage to the current U.S. economy for six impact sectors as a function of global average temperature change.
[6] *Fourth National Climate Assessment Volume II: Impacts, Risks and Adaptation in the United States — Report in Brief at 13.*
[7] https://www.washingtonpost.com/climate-environment/moodys-analytics-says-climate-change-could-cost-69-trillion-by-2100/2019/07/02/f9fb94ac-99cb-11e9-916d-9c61607d8190_story.html?utm_term=.c58fab6519e0
[8] https://www.fsb-tcfd.org/publications/

2020 to achieve the goals of the Paris Agreement, including phasing out thermal coal power and pricing carbon.[9]

This statement is notable for its emphasis on improving corporate climate risk disclosure in financial filings, including asking governments to commit to implementing the TCFD recommendations in their jurisdictions and other items. Regarding climate risk disclosure, investors called on governments to do the following:

- Commit to improve climate-related financial reporting.
- Publicly support the TCFD recommendations and the extension of its term.
- Commit to implement the TCFD recommendations in their jurisdictions, no later than 2020.
- Request the FSB incorporate the TCFD recommendations into its guidelines.
- Request international standard-setting bodies incorporate the TCFD recommendations into their standards.[10]

And some of the largest asset management firms in the world have thrown their weight behind improving corporate climate risk disclosure and performance. In 2017, State Street Global Advisors (SSGA) stated, "Over the course of four years, SSGA has held over 240 climate-related engagements with 168 companies. Through these engagements we found that few companies can effectively demonstrate to investors how they integrate climate risk into long-term strategy. This is particularly important for companies in the oil and gas, utilities and mining sectors where long investment horizons could render assets stranded."[11] SSGA also called on high-impact sector companies to provide disclosures on board oversight of climate risks, long-term greenhouse gas (GHG) emissions goals, carbon price assumptions, and the impacts of scenario planning on long-term capital allocation decisions.[12]

BlackRock has named climate risk disclosure as one of its top corporate engagement priorities for several years. The company's approach to engagement on climate risk notes:

> For companies most directly impacted by climate change, we expect the whole board to have demonstrable fluency in how climate risk affects the business. The company should explain the board's oversight of its executives' approach to managing and mitigating the risk. Over the next few years, we expect that companies will enhance their disclosures related to climate risk, as awareness and understanding of the potential impacts of climate change and the TCFD's recommendations spreads.[13]

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[9] Global Investor Statement to Governments on Climate Change, *available at* https://www.ceres.org/news-center/press-releases/477-investors-usd-34-trillion-assets-urge-g20-leaders-keep-global
[10] Id.
[11] https://www.ssga.com/investment-topics/environmental-social-governance/2017/perspectives-on-effective-climate-change-disclosure.pdf
[12] Id.
[13] https://www.blackrock.com/corporate/literature/publication/blk-commentary-engaging-on-climate-risk.pdf

In addition, Larry Fink of BlackRock has written about the close ties between sustainability and financial performance:

> Profits are in no way inconsistent with purpose – in fact, profits and purpose are inextricably linked. Profits are essential if a company is to effectively serve all of its stakeholders over time – not only shareholders, but also employees, customers, and communities. Similarly, when a company truly understands and expresses its purpose, it functions with the focus and strategic discipline that drive long-term profitability. Purpose unifies management, employees, and communities. It drives ethical behavior and creates an essential check on actions that go against the best interests of stakeholders. Purpose guides culture, provides a framework for consistent decision-making, and, ultimately, helps sustain long-term financial returns for the shareholders of your company.[14]

**Companies' climate risk disclosure and performance**

Public disclosure of sustainability and climate risk information is not just about the act of reporting. The value of this disclosure is two-fold. First, if the data provided is robust and comparable, it can meet the needs of investors and other stakeholders for information about sustainability risks and opportunities facing companies, and the sustainability risks those companies impose on society.

Second, disclosure is valuable for its ability to stimulate ingenuity and strategic thinking by businesses, which can improve sustainability performance, increase a company's competitiveness in a resource-constrained economy and create shareholder value. Ceres' research has found examples of companies that provide good discussions of climate risks in financial filings and also undergo in-depth analysis of the strategic risks and opportunities from climate.

For example, American International Group (AIG) presents climate as a business risk and an opportunity. AIG's 2017 annual financial filing notes that climate change-related catastrophic events pose a threat to property and could create lost assets, increase claim costs, and interrupt operations.[15] AIG recognizes that legal, regulatory and social responses
to climate change may affect the company's business, such as the potential for new regulations that contradict the company's current assumptions. AIG also frames climate change as an opportunity; the company says its underwriting, product development, modeling and

[14] https://www.blackrock.com/americas-offshore/2019-larry-fink-ceo-letter
[15] American International Group, Inc., Annual Report on Form 10-K for The Year Ended December 31, 2016 (Feb. 23, 2017). http://www.aig.com/investor-relations/sec-filings

sustainability practices can adapt to climate-related risks and provide customers with innovative products and services that anticipate these risks.[16]

PepsiCo links environmental performance to risks for its business operations, finances and brand reputation. In its 2017 annual financial filing, the company identifies the potential adverse effects of water scarcity on its supply chain and business operations.[17] Higher production costs and investments in water-efficient technologies could encumber the company's business and financial performance. At the same time, PepsiCo says failing to maintain high ethical, social, and environmental practices, such as a failure (or a perception of a failure) to act responsibly with respect to water use, human rights in the supply chain or public health concerns, could affect PepsiCo's reputation and brand image. Water scarcity therefore poses a double risk: not only can lack of water negatively affect the company's business operations and finances, a failure to be water efficient may adversely affect consumer perceptions of its brands.[18]

Ceres' research has found that companies that disclose climate-related financial risks in annual financial disclosures—such as Baxter International Inc., Molson Coors Brewing Company, and Procter & Gamble—are nearly twice as likely to have time-bound commitments to reduce GHG emissions than companies that do not.[19]

On the other hand, we have seen too many examples of companies that were insufficiently prepared for climate risks face challenges within recent years. This includes electric power companies that had to temporarily shut down generating facilities because the water used for cooling was too warm to work properly, automakers and chipmakers that suffered losses due to floods in Thailand affecting their manufacturing plants, and oil and gas companies which suffered damage to oil refineries due to storm surge or hurricanes. For example, one study found that Toyota suffered $1.25 billion and Honda $1.4 billion in lost operating profits due to the Thailand floods.[20]

The most recent example is the power company PG&E, which some have called the first climate change related bankruptcy. Extensive damage from 2017 and 2018 wildfires "was due in large part to extremely hot, dry conditions that spawned more frequent and intense fires."[21] The

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[16] AIG case study excerpted from Ceres, Turning Point: Corporate Progress on The Ceres Roadmap for Sustainability at 59, available at http://www.ceres.org/turningpoint.
[17] PepsiCo Inc., Form10-K for the Year Ended December 31, 2016 (Feb. 15, 2017). http://www.pepsico.com/Investors/SEC-Filings
[18] PepsiCo case study excerpted from Ceres, Turning Point: Corporate Progress on The Ceres Roadmap for Sustainability at 59.
[19] Ceres, *Turning Point: Corporate Progress on The Ceres Roadmap for Sustainability* at 50.
[20] Masahiko Haraguchi, Upmanu Lall, *Flood risks and impacts: A case study of Thailand's floods in 2011 and research questions for supply chain decision making*, International Journal of Disaster Risk Reduction (2014) at 7 (Table 6), citing Toyota and Honda press releases.
[21] https://www.forbes.com/sites/chunkamui/2019/01/24/pge-is-just-the-first-of-many-climate-change-bankruptcies/#657981497e5f

bankruptcy has not only caused billions in losses for shareholders, but also losses to insurers, customers and creditors, and losses to taxpayers due to disaster relief costs.[22]

**The energy sector and climate risk disclosure**

For decades, investors have been engaging with fossil fuel companies around the risks and opportunities associated with climate change. These investor-led initiatives have ranged from efforts to increase company investment in renewable energy to improving operational efficiency to addressing methane emissions and beyond.

However, for much of that time, companies largely dismissed investor concerns about the potential for dramatic shifts in business as usual market dynamics resulting from global action to address climate change. Fossil fuel companies expressed skepticism about the need to factor in the possibility of a broad, global set of initiatives that would lead to meaningful policy intervention on climate change.

Nearly without exception, the world's leading oil and gas companies have based long-term business planning on a business as usual, rising fossil fuel demand, outlook. Given that the industry regularly invests in projects with multi-decadal time horizons, the decisions companies make today will help determine their financial viability far into the future. Widespread assumptions that the future will resemble the past created a false sense of certainty and optimism regarding technology and climate risk, leading, in many cases, to inefficient deployment of capital.

Key among the steps that investors have called for is an assessment of the impacts on a company's portfolio and business strategy of policies and restrictions consistent with achieving the globally agreed upon target to limit global average temperature rise to well below two degrees Celsius above pre-industrial levels. This request achieved new urgency when the 21st Conference of the Parties to the United Nations Framework Convention on Climate Change achieved unanimous agreement and outlined a clear path to achieve this target in Paris in December 2015.

The Paris Agreement goal of keeping global temperature rise well below two degrees Celsius, and aspiring to a 1.5 degree goal, is already shaping the national policy decisions of major economies—and the world is actively working to shift away from fossil fuels to less carbon-intensive fuel sources.

Many corporations around the world, including some of the largest international oil and gas companies, have not fully incorporated the adoption of a binding two degrees or less Celsius climate accord into their business planning. In some cases, executives from those companies

[22] Id.

have expressed a view that a two degrees Celsius cap on climate warming will not prove achievable. Yet for the past two decades or more, energy companies have operated under a set of assumptions about the future business environment that are looking increasingly unrealistic.

Irrespective of whether governments actually achieve a two degrees Celsius cap (or 1.5 degrees, which is now the scientific goal) on global temperature increases, it cannot be ignored that many governments are making major commitments to the low-carbon transition by tightening regulations and performance standards designed to reduce the use of oil and coal. But perhaps just as significant from the point of view of a global transition in energy usage, societal patterns for fuel use are also changing through the advent of digital technologies that provide energy savings or alter choices among different fuels. Given the long capital horizons in the oil industry, where investments made today may not pay off for decades, it is imperative that the industry be particularly attuned to the potential for disruptive change. In considering how the business landscape for the energy sector may change given these trends in the coming decades, companies need to consider multiple variables at once.

That is why investors have urged companies to conduct low-carbon scenario analysis, which allows a company to design a strategy that is resilient to multiple possible outcomes.[23] Shell and Equinor have used scenario analysis to redesign their long-term strategies—including dramatic increases in their clean energy investments. Such an approach has been endorsed by the TCFD, and by large asset managers like State Street and Blackrock, as discussed above. Even the Pope, at a recent Vatican convening of oil sector executives, endorsed TCFD-focused scenario analysis as a key tool to help companies prepare for a low-carbon future.[24]
In the transportation sector, investor demand for low-carbon scenario analysis is also rising. Transportation is the largest and fastest growing source of U.S. GHG emissions, yet U.S. companies in the sector, including truck and auto manufacturers, have been slow to conduct and disclose information about low carbon scenario analyses. Given tightening global regulations and disruption in the transportation sector from new technologies (including electrification and automation), as well as from new business models for mobility, disclosure of climate scenario analyses, along with other risks, are critical in order to enable companies and investors to assess a variety of outcomes and future climate risk.

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[23] See Ceres reports providing guidance to companies on undertaking and disclosing scenario analyses, covering electric power (https://www.ceres.org/news-center/press-releases/new-ceres-framework-enables-us-electric-power-industry-assess-climate) and oil and gas (https://www.ceres.org/resources/reports/framework-2-degrees-scenario-analysis-guide-oil-and-gas-companies-and-investors).
[24] See *The Energy Transition & Care For Our Common Home: Participant Statement on Climate Risk Disclosures*, available at https://news.nd.edu/assets/323601/2019_vatican_disclosures_statement_final.pdf; Notre Dame president co-signs climate change accords with energy and investor executives at Vatican summit, June 14, 2019, available at https://news.nd.edu/news/vatican-and-notre-dame-co-sign-climate-change-accords-with-energy-and-finance-executives/.

Over the past year, many of the largest electric power companies and biggest greenhouse gas (GHG) emitters in the power sector have undertaken climate scenario analysis, released more robust climate risk reports and made deeper commitments to medium- and long-range greenhouse gas emission reductions. These actions have come at a crucial time, with the release last fall of the Special Report on Global Warming of 1.5 °C[25] by the Intergovernmental Panel on Climate Change (IPCC) highlighting the critical needs for the power sector to achieve net zero emissions before 2050 and to supply clean energy to support a broader range of uses in order to avoid the worst impacts of climate change.

U.S. power companies that have issued reports based on climate scenario analyses include AES Corporation, PPL Corporation, Duke Energy, Southern Company, Dominion Energy, and CMS Energy. Out of these disclosures, one of the strongest is from the Virginia-headquartered AES Corporation. The company's climate scenario report[26] is well aligned with the recommendations of the TCFD and utilizes three climate scenarios, including a "well-below 2-Degree Celsius" scenario. AES details its new focus on four primary "Clean Energy Growth Platforms" – illuminating pathways of opportunity aligned with clean energy transition in the areas of energy efficiency, renewables and energy storage.

By way of another example, late last year Minneapolis-headquartered Xcel Energy disclosed its long-range GHG reduction plans, announcing a bold new commitment to provide 100 percent carbon-free electricity to its customers by 2050 and achieve an 80 percent reduction by 2030. In March 2019, Xcel also released its report "Building a Carbon-free Future"[27] based on analysis tied to the Paris Agreement targets of well-below 2°C and 1.5°C, and the company subsequently has announced more detailed clean energy transition plans tied to specific generating assets.

It is encouraging to see these leading examples, yet there is a broad range of companies in the electric power sector and beyond that have yet to undertake and/or disclose an assessment of their exposure to climate risk – a troubling gap that legislation like this could help bridge.

**The SEC's approach to climate risk disclosure**

In 2007, Ceres worked with a group of investors, including one of the largest U.S. pension funds, the California Public Employees' Retirement System (CalPERS), to file a petition[28] with the SEC for interpretive guidance on disclosing the material financial risks posed by climate change. I testified before the Senate Banking Committee in 2007 about the importance of the

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[25] https://www.ipcc.ch/sr15/

[26] https://s2.q4cdn.com/825052743/files/doc_downloads/2018/11/AES_Climate_Scenario_Report111318.pdf

[27] https://www.xcelenergy.com/company/corporate_responsibility_report/library_of_report_briefs/a_carbon_free_future

[28] https://www.sec.gov/rules/petitions/2007/petn4-547.pdf

SEC acting on that petition, speaking on behalf of 22 petitioners, include leading institutional investors in the U.S. and Europe managing more than $1.5 trillion in assets, that we mobilized in support of that guidance.[29] And in 2010, the SEC issued first-of-its-kind disclosure guidance on climate risks under Chair Mary Schapiro's leadership.[30]

Since then, as discussed above, climate risk has become a mainstream concept among the global investment community. The guidance has been an important factor in changing how our capital markets approach climate risk. It does a great job of showing how climate change poses significant risks in a range of industries, and it explains when companies are required to disclose physical risks, regulatory risks and opportunities, and other material issues in financial filings.

But the guidance has only had a meaningful impact when SEC leadership and staff made an effort to ensure issuers used it. The guidance initially led to a jump in the percentage of S&P 500 companies that reported climate risks in SEC filings, from 45 percent in 2009 to 56 percent in 2010. And in 2010 and 2011, SEC staff issued 49 comment letters to companies in cases where their disclosure was inadequate.[31]

Yet today, the SEC is doing very little to ensure companies disclose material climate risks and opportunities. A search for SEC comment letters asking issuers to improve their climate-related disclosure in Commission filings reveals only one such letter from January 2017 to the present, to the company FLEX LNG Ltd.[32]

Unfortunately, today the SEC climate disclosure guidance is not being implemented or enforced. In many ways it appears that the SEC is abdicating its responsibilities and, at the present time, its efforts are simply not resulting in meaningful improvement in the quality of climate risk disclosure in financial filings.

**Climate Risk Disclosure Act of 2019**

Ceres supports climate disclosure rules at the SEC because of the need for comparable, robust reporting that meets investors' needs and helps companies manage risks. Also, because of the urgency of the climate crisis, we cannot afford to continue hoping that SEC leadership will prioritize climate risk disclosure and fully implement the 2010 climate disclosure guidance.

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[29] https://www.banking.senate.gov/hearings/climate-disclosure-measuring-financial-risks-and-opportunities; https://archive.ceres.org/press/press-releases/major-investors-state-officials-environmental-groups-petition-sec-to-require-full-corporate-climate-risk-disclosure
[30] https://www.federalregister.gov/documents/2010/02/08/2010-2602/commission-guidance-regarding-disclosure-related-to-climate-change
[31] https://www.ceres.org/resources/reports/cool-response-sec-corporate-climate-change-reporting
[32] https://searchwww.sec.gov/EDGARFSClient/jsp/EDGAR_MainAccess.jsp?search_text=%22climate%20change%22&sort=Date&formType=FormUPLOAD&isAdv=true&stemming=true&numResults=10&numResults=10

Voluntary disclosure, such as sustainability reporting, is and will remain important for companies to communicate their impacts on people and the environment, and the risks and opportunities they face. But only rules can provide investors with the robust disclosure they need *from all companies* to make better investment decisions.

As discussed above, climate change—from rising sea levels and extreme storms to the rapid transition to new, low-carbon technologies—poses material financial risks to companies across all sectors of the economy. We have already seen companies in industries like electric power, oil and gas, coal and insurance suffer losses because of their slow reactions to the climate crisis, and we will see more losses unless companies rapidly improve their strategies, actions and disclosures related to climate.

The **"Climate Risk Disclosure Act of 2019"** will allow the market — through investors and others — to better assess risks posed by climate change and take advantage of opportunities, spurring both public and private sector action on the issue, while promoting financial stability across the U.S. economy.

The Act would require issuers to identify and disclose physical risks and transition risks related to climate change, with the latter defined expansively to include not only changing markets and new technologies, but regulatory risks related to Federal, State and local laws and international agreements. It would also require issuers to disclose an evaluation of potential financial impacts, risk management strategies, and any corporate governance processes and structures related to climate change. These requirements are carefully designed to meet the needs of investors without imposing undue burdens upon corporations. The requirements also build upon voluntary climate disclosure standards that have arisen in the last twenty-five years and that many companies already implement.[33]

The Act would require the SEC to issue final climate disclosure rules within one year, in conjunction with the EPA Administrator, the Secretary of Energy, the Administrator of NOAA, the Director of the Office of Management and Budget, and the head of any other Federal agency determined appropriate by the Commission ("climate principals"). Including consultation with agencies with extensive expertise in the risks and opportunities posed by climate change is very helpful and should result in reporting requirements that take account of rapidly evolving scientific findings about climate change.

The Act includes several other provisions that are closely aligned with the needs of investors and climate disclosure developments in recent years:

- It would require the SEC to establish climate disclosure metrics specialized for specific sectors, including finance, insurance, transportation, electric power and non-renewable

[33] See, for example, the CDSB Climate Change Reporting Framework, https://www.cdsb.net/what-we-do/reporting-frameworks/climate-change and the TCFD disclosure recommendations, https://www.fsb-tcfd.org/publications/final-recommendations-report/.

energy. Investors have been increasingly focused on helping to develop and encourage the use of industry-specific metrics, such as those developed by the Sustainability Accounting Standards Board,[34] which help them better evaluate how climate risk presents different types of risks to different industries.[35] In addition, the focus on these industries make sense, as they face the most significant risks and opportunities related to climate change.

- It would require disclosure of input parameters, assumptions and analytical choices regarding climate scenario analyses, and would require companies to consider a business as usual warming scenario ("baseline scenario"), a well below two degrees Celsius scenario, and any additional climate analysis scenario considered appropriate by the Commission, in consultation with the climate principals. These requirements are essential to a transparent scenario analysis, are well aligned with the expectations Ceres and investors we work with have laid out,[36] and are responsive to shortcomings in various scenario analyses that companies have disclosed in recent years.[37]

SEC inaction to improve climate disclosure is especially concerning given the progress that other regulators around the world are making. For example, the UK government just announced plans to establish a joint task force with its financial regulators to analyze the most effective way to approach climate disclosure, including exploring the possibility of mandatory reporting.[38] Even other U.S. financial regulators are considering these risks. Just a few weeks ago, members of the Commodity Future Trading Commission (CFTC) held a meeting focused on climate related financial risks.[39] Expert witnesses discussed the impact of climate change on the future stability of the global financial system, financial industry approaches to the mitigation of such risks, and challenges that lie ahead for regulators and participants in the derivatives industry. CFTC Commissioner Rostin Behnam plans to form a subcommittee focused exclusively on examining climate related financial market risk.[40] The SEC should be taking similar steps to consider the risks climate change poses to the financial system and to the various industries it oversees.

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[34] https://www.sasb.org/standards-overview/download-current-standards/

[35] The SASB Technical Bulletin on Climate Risk found "that climate change affects 72 out of 79 industries (93 percent of the capital markets, or $27.5 trillion) but manifests differently from one industry to the next" (https://library.sasb.org/climate-risk-technical-bulletin/).

[36] See the Global Investor Coalition on Climate Change's series of "Investor Expectations on Climate Change" Sector reports, available at https://globalinvestorcoalition.org/reports/. Individual reports cover steel companies, oil and gas, automotive, electric power and mining.

[37] See, for example, https://www.ceres.org/news-center/press-releases/new-exxon-report-step-forward-investor-disclosure-climate-change-falls

[38] See UK Government, *Green Finance Strategy: Transforming Finance for a Greener Future* (July 2019) at 15, available at https://www.gov.uk/government/publications/green-finance-strategy. The report also welcomed the actions being taken by UK regulators with respect to disclosure, such as the Financial Conduct Authority's October 2018 discussion paper which sought views on the value of introducing a requirement for financial services firms to report publicly on how they manage climate risks to their customers and operations (Id.).

[39] https://www.cftc.gov/PressRoom/Events/opaeventmrac051219

[40] https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement061219

Current corporate disclosure on climate risk in SEC filings is still minimal and does not enable investors to compare how companies are managing this risk. The market is currently lacking this vital information, and as a result, we could be dramatically undervaluing the financial impacts on the economy. I therefore urge Members of the Subcommittee to support the "Climate Risk Disclosure Act of 2019."

**Related issues**

I also appreciate that this hearing is considering regulations in regards to mandatory human rights due diligence and disclosure. Similar to what I've discussed in my comments on climate risk disclosure, voluntary corporate reporting on human rights is an inadequate tool for fully assessing the scope and severity of business's impacts on human rights. Current voluntary frameworks on human rights risk disclosure are piecemeal, poorly enforced, and do not meet the needs of investors. Disclosure in financial filings is generally inadequate:

> "Ceres and CookESG Research found that S&P 500 companies disclosed more information about workers' rights and workplace practices than about human rights, equal employment, and anti-discrimination policies. Foreign companies generally disclosed more information than their U.S. competitors. Overall, however, companies failed to detail the financial implications of human and workers' rights-related risks and opportunities."[41]

Mandatory human rights due diligence – coupled with effective enforcement – can be a critical tool to spur private sector action on systemic human rights issues, to which large multinational companies are direct contributors. With the legislation under consideration, the US would join a number of other countries already implementing some form of mandatory human rights due diligence regulations, including the UK, France, and Australia.

Climate and sustainability risk disclosure should not be considered in a vacuum — policy makers should also take into account whether the SEC continues to permit investors to raise these issues in shareholder proposals. For decades, shareholder proposals have been a critical tool investors rely upon to encourage companies to disclose and mitigate sustainability risks. Despite the rapid growth in ESG-themed investing[42] and the significant improvements in corporate governance that have resulted from proposals,[43] some in the corporate community have been pushing for SEC rule changes that would curtail investors' rights to include proposals

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[41] Ceres press release, *New SEC Search Tool Finds Inadequate Human and Workers' Rights Disclosure in Financial Filings* (May 31, 2018), available at https://www.ceres.org/news-center/press-releases/new-sec-search-tool-finds-inadequate-human-and-workers-rights-disclosure. See also https://www.ceres.org/news-center/blog/financial-filings-require-decision-useful-disclosure-human-rights.

[42] https://www.ussif.org/trends

[43] https://www.ussif.org/files/Public_Policy/Comment_Letters/Business%20Case%20for%2014a-8.pdf, p. 6

on companies' proxy ballots. I ask that you continue to exercise your oversight authority to protect the shareholder proposal process.

As you are likely aware, the SEC recently announced plans for rulemaking[44] focused on changes to Rule 14a-8, possibly including raising the thresholds for filing and/or re-filing shareholder proposals. We thank Chairwoman Waters for her attention to this issue, as evidenced by her amendments that were filed and adopted as part of the Financial Services and General Government House Appropriations bill. Ceres continues to believe that the current process offers both access for investors and protection for companies against resolutions that are not relevant, appropriate, or demonstrate sufficient interest from shareowners. We encourage additional steps be taken to preserve the existing SEC rules.

Nearly all shareholder proposals are advisory, meaning that corporations are under no legal obligation to act even if a majority vote in favor of a resolution. Numerous benefits associated with the form of 'shareholder democracy' enabled by the current process are detailed in two white papers by Ceres, ICCR, and USSIF.[45] The existing rules allow shareholders of all sizes to project their interests by aggregating their voices through voting. Through shareholder engagement and voting, investors act as a sort of immune system for capital markets, seeking out emerging risks and sending signals to companies to fix problems before they cause crises.

In addition, some corporate trade associations argue that shareholder proposals are costly, but when companies allow the proposals onto their proxy ballots without legal challenge, the costs are quite small. Costs include adding 1-2 pages to the proxy statement including the 500 word resolution and (typically) an opposition statement by the company. Time spent by corporate boards on things like the opposition statement can be viewed as a benefit to companies since proposals are required to address significant, unaddressed policy issues for the company. Overall, the benefits to companies and society of shareholder proposals are significant and outweigh the costs, which are negligible.[46]

As for climate risk disclosure, there is strong mainstream recognition of the value of shareholder proposals. A Goldman Sachs equity research report, "Shareholder engagement in the age of transparency," states, "We believe shareholder resolutions can offer additional insight into emerging material risks and externalities for issues, as well as management responsiveness." The report also notes that support for environmental and social shareholder proposals has been rising for several years, with nearly 30% of the votes, on average, placed in favor of shareholder proposals.

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[44] https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201904&RIN=3235-AM49
[45] https://www.ussif.org/files/Public_Policy/Comment_Letters/Business%20Case%20for%2014a-8.pdf; https://www.iccr.org/sites/default/files/resources_attachments/investor_response_to_chamber_14a-8_nov_9_final_2.pdf
[46] https://corpgov.law.harvard.edu/2017/06/15/the-dangerous-promise-of-market-reform-no-shareholder-proposals/

**Conclusion**

This subcommittee's work to advance corporate ESG disclosure could not be happening at a better time. Ceres' research shows that nearly 400 of the 600 largest publicly traded companies in the U.S. have commitments to reduce GHG emissions, 300 actively manage water resources, and nearly 300 actively protect employees' human rights.[47] Companies have begun to incorporate sustainability risks and opportunities into their decision-making in ways we could not have dreamed of thirty years ago. The Climate Risk Disclosure Act of 2019 is an essential part of the next 30 years of progress.

Thank you.

[47] https://corpgov.law.harvard.edu/2019/06/15/get-us-there-the-ceres-strategic-plan/

**U.S. House Committee on Financial Services**
**Subcommittee on Investor Protection, Entrepreneurship and Capital Markets**

***Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social and Governance Disclosures***

July 10, 2019

Tim Mohin, Chief Executive, Global Reporting Initiative (GRI)

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I thank the Subcommittee for inviting me to appear at today's hearing. This Subcommittee has an integral role in ensuring that financial markets, international trade, and banking remain stable and strong for all Americans, and the policy being considered today is a crucial part of that mission.

I have had the pleasure of serving as Chief Executive for the Global Reporting Initiative (GRI) since 2017. Prior to this role, I served in senior roles for major U.S. companies, including Intel, Apple and AMD. I also have experience working in the Executive and Legislative branches of the Federal government. So, I speak on this issue not only as head of the world's most widely used standards for non-financial reporting, but also as an individual who understands the complexities and pressures faced by reporting companies as well as the importance of Federal policy.

GRI applauds the legislative initiatives and the Subcommittees' focus to improve Environmental, Social and Governance (ESG) disclosures. Our experience of over twenty years demonstrates that these disclosures can provide substantial benefits for business and investors.

Today, I will limit my comments to the "ESG Disclosure Simplification Act of 2019." GRI strongly supports this proposal as a way to strengthen the existing reporting requirements for publicly traded companies. Specifically, we welcome:

- the acknowledgement that ESG disclosures are important for investors;

- the reliance on internationally recognized, independent, multi-stakeholder ESG disclosure standards;
- the establishment of a Sustainable Finance Advisory Committee. This will support the ongoing efforts by many international organizations such as GRI and Ceres to facilitate the transition to sustainable global markets, and we would stand ready to collaborate with this Committee as appropriate.

**Background on GRI**

GRI was founded in the United States. Soon after the Exxon Valdez disaster in 1989, Ceres, who is represented on the panel today, was formed to help define corporate transparency. In 1997, Ceres spun off the Global Reporting Initiative (GRI). Our mission has always been to provide world-class disclosure standards for ESG information.

Our theory of change boils down to the axiom that "you manage what you measure." All organizations run on data. By identifying, measuring – and most importantly reporting – about the most material ESG topics, these issues will be managed, and performance will improve. Public disclosure is a crucial aspect of this paradigm because it enhances the credibility and accountability of the information and provides investors and other stakeholders with essential decision-making information.

**The GRI Standards**

We created the GRI Standards to ensure that organizations have an effective tool to collect and report ESG information. Over the last twenty-two years since GRI was formed, the landscape for ESG information has changed substantially, and GRI has changed to meet the evolving needs.

Companies collect this information to both inform their internal decisions and demonstrate their corporate responsibility. While this remains a powerful driver for reporting, new demands have entered this market. Investors, asset owners, capital markets, analysts, policy-makers and civil society are increasingly interested in ESG disclosure. The market for ESG information has grown because it has value for investors.

As the interest from financial stakeholders increased, GRI adapted its governance model to mirror the widely adopted financial standards organizations such as the Financial Accounting Standards Board (FASB) or the International Financial Reporting Standards (IFRS). Similar to these organizations, the GRI governance model is independent and structured to serve the public interest. This means that the Standards are developed by the fully independent Global Sustainability Standards Board (GSSB)[1] according to a Due Process Protocol[2]. The process incorporates oversight, public consultation and reflects widely-accepted international normative frameworks, such as UN conventions, the OECD Guidelines for Multinational Enterprises, ILO conventions, and many others.

In addition to this independent and public process, the GRI governance model is also multi-stakeholder. This means that our governance bodies are comprised of representatives from multiple constituencies across multiple regions of the world. When the GSSB creates or revises a disclosure standard, they select a working group of global experts in the topic. The meetings and proceedings of these working groups are public and result in a consultation draft. Only when the public comments have been resolved and the due process protocol has been satisfied, will the final Standard be issued.

GRI's independent, multi-stakeholder governance process results in Standards that represent the global best practice for a wide range of topics. Currently, GRI offers thirty-three topic-specific Standards on economic, environmental and social topics. We also offer universal disclosure Standards which apply to all reporting organizations, as well as a framework of reporting principles which assist report preparers and assurers. All of these assets are offered free of charge.

**Adoption of the GRI Standards**

Today, 93% of the 250 largest companies (by revenue) worldwide publish ESG information and three out of four of them use the GRI Standards[3]. Of the S&P500 companies, 86% issue sustainability reports annually[4] with more than two thirds using the GRI Standards. The GRI Standards are used by more than 600 companies with US headquarters – which is one of our largest rates of adoption in the world.

[1] https://www.globalreporting.org/standards/gssb-and-standard-setting/
[2] https://www.globalreporting.org/standards/media/2099/gssb-due-process-protocol-2018.pdf
[3] https://assets.kpmg/content/dam/kpmg/xx/pdf/2017/10/executive-summary-the-kpmg-survey-of-corporate-responsibility-reporting-2017.pdf
[4] https://www.ga-institute.com/press-releases/article/flash-report-86-of-sp-500-indexR-companies-publish-sustainability-responsibility-reports-in-20.html

The information created using the GRI Standards is the dominant source of ESG data used by analysts, investors, asset owners and capital markets in the US and around the world. In the United States, 78% of the 30 companies in the Dow Jones Industrial Average use the GRI Standards for ESG disclosure. The most recent study of the Global Sustainable Investment Alliance estimated that, globally, sustainable, responsible and impact investment assets under management in the five major markets (Europe, United States, Japan, Canada, and Australia/New Zealand) stood at $30.7 trillion at the start of 2018, a 34% increase in two years[5]. Another study reports that 82% of mainstream investors consider ESG information when making investment decisions[6].

**Materiality**

Both financial and ESG disclosure rely on the concept of materiality to determine what must be disclosed. However, the application of this concept is different in each case. In financial reporting, issuers must disclose information on the topics that could materially impact the finances[7] of the organization. Because ESG information includes environmental and social impacts on the world outside of the reporting organization, the magnitude of these impacts must also be considered to determine materiality. The materiality methodology in the GRI Standards instructs issuers to identify and address the most relevant environmental, social and governance issues to their organization and affected communities throughout their value chains. This analysis must be conducted in consultation with a broad range of stakeholders, including investors. Comparing this method to the concept of financial materiality, the major points of differentiation are inclusion of the "externalities" associated with an issuer's value chain and consultation with stakeholders.

GRI urges the subcommittee to incorporate this approach into its ESG disclosure legislation. Focusing strictly on short-term financial impacts will result in the exclusion of key issues such as human rights and greenhouse gas emissions from corporate disclosures. These exclusions would leave companies and investors exposed to risks which, over the long-term, can have significant financial implications.

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[5] http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf
[6] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2925310
[7] Information 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." (TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976))

**Reliance on Independent Standards Bodies**

GRI strongly supports the provision in the draft Bill that requires reliance on internationally recognized, independent, multi-stakeholder standards. The GRI Standards enjoy wide adoption aming issuers and policy makers because they conform to these requirements.

Just as the Securities and Exchange Commission recognized FASB as the designated standard-setter for financial disclosures, the same principle holds for ESG disclosure. Independent standards bodies are designed to stay current with the best practices and represent all points of view to create the "state of the art" disclosure standards. Specifying the type or form of disclosures in legislation will lock in the practice and quickly devolve into a "box-ticking" exercise. We applaud the sponsors of this legislation for requiring ESG disclosures to be based on international, independent, multi-stakeholder ESG standards.

**Burden Reduction**

By relying on independent, multi-stakeholder standards, the legislation will not add to the reporting burden of companies since 600 companies with US headquarters – the vast majority of the companies currently reporting ESG information in the US - are already reporting against the GRI Standards which fit this description.

**Unlocking Free Trade**

GRI tracks the number and type of regulations focused on ESG reporting. Currently, we are aware of 139 policies in 61 countries that specifically reference or require the GRI Standards for ESG disclosure. This figure includes references or requirements to the use of the GRI Standards in 61 capital market regulations in 45 countries.

As global trade increasingly relies upon ESG information, it is essential that issuers use a common language to disclose this information. As evidenced by the uptake in policies around the world, the GRI standards are the global common language for ESG disclosure. In order to facilitate global free

trade, we strongly urge the Subcommittee to adopt the GRI Standards as the ESG disclosure framework for new legislation.

**Alignment with other ESG Standards and Frameworks**

GRI works to drive harmonization on disclosure of all ESG topics, including the crucial issue of climate change. For example, the GRI Standards and CDP's climate change questions (2017) are fully aligned[8]. Given that more than 7,000 companies subscribe to CDP (a similar adoption rate to the GRI Standards), this alignment improves the consistency and comparability of climate data, making corporate reporting more efficient and effective. Further, the recent Task Force on Climate-related Financial Disclosures (TCFD) drew heavily from the GRI Standards to launch their recommendations, increasing the alignment of disclosures [9].

Through our work in the Corporate Reporting Dialogue[10], the Impact Management Project[11] and ongoing bi-lateral discussions, GRI is focused on further harmonizing ESG disclosures world-wide. This alignment will reduce the burden on issuers and increase the utility of this information for investors and other stakeholders.

**Human Rights and Tax Payment Disclosure Policy**

GRI supports the intent of the discussion draft bills on disclosure of Tax Payments and Human Rights practices. The comments above also apply to these bills. In addition, we would draw the Subcommittee's attention to GRI's new standard-setting activities on these issues and, again, advocate that the policy defers to the resultant independent disclosure standards.

GRI expects to issue a new disclosure Standard on tax and payments to governments this year[12], which includes a public country-by-country reporting (CbCR) requirement. Our expert-led standard-setting

[8] https://www.globalreporting.org/standards/resource-download-center/linking-gri-and-cdp-how-are-gri-standards-and-cdp-climate-change-questions-aligned/
[9] https://www.fsb-tcfd.org/wp-content/uploads/2017/12/FINAL-TCFD-Annex-Amended-121517.pdf
[10] https://corporatereportingdialogue.com/
[11] https://impactmanagementproject.com/
[12] https://www.globalreporting.org/standards/work-program-and-standards-review/disclosures-on-tax-and-payments-to-government/

process has clearly established that CbCR is needed to enable stakeholders to derive a more informed understanding of possible intra-group profit shifting activities aimed at tax savings. The Standard was brought forth with primary interest from the investor community, who want to see better clarity on tax transparency and country-level disclosure. Transparency on corporate taxes will allow for more informed public debate, creating an environment for better policy and investment decisions. At the same time, greater transparency will promote trust and credibility in the taxation system while discouraging organizations from engaging in aggressive tax avoidance practices.

GRI is currently reviewing its disclosure standards pertaining to human rights practices[13]. A central premise of this work is aligning with internationally accepted norms such as the United Nations Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises. We are planning to release the draft standards for public comment towards the end of this year/beginning of next year.

**Funding**

GRI has always offered its disclosure standards as a free public good. This policy enhances both the accessibility and credibility of the Standards. A small fraction of issuers, analysts or investors who rely on the GRI Standards support the development of the Standards. As the Subcommittee considers ESG disclosure legislation, it should include sustaining support for the establishment of independent, multi-stakeholder disclosure standards.

**Conclusion**

GRI applauds the Subcommittee's work to develop legislation to require ESG disclosure based on international, independent, multi-stakeholder Standards. This legislation can help protect investors, unlock free trade, reduce issuer burden and ultimately align capital with sustainable business practices.

Thank you for the opportunity to testify today.

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[13] https://www.globalreporting.org/standards/work-program-and-standards-review/review-of-human-rights-related-gri-standards/

**United States House of Representatives Committee on Financial Services**
**Subcommittee on Investor Protection, Entrepreneurship, & Capital Markets**
**Written Statement of**
**Degas A. Wright, CFA**
**Chief Executive Officer**
**Decatur Capital Management, Inc.**
**July 10, 2019**

Chairwoman Maloney, Ranking Member Huizenga and distinguished members of the subcommittee. I appreciate the invitation to appear before you this afternoon to talk about the proposed legislation that will provide greater disclosure of material information for investors.

I am an investment manager who conducts company research to manage equity portfolios on behalf of our clients. One of the key factors in estimating the value of an equity security has traditionally been the analysts' ability to understand and forecast a company's earnings. During my career in the industry, though, I have observed that the accuracy of forecasted earnings has diminished, and, subsequently, the role of forecasting earnings has become less important in estimating a stock's valuation. I believe that the increasing role played by intangible assets in modern corporations is at the heart of this problem. Corporate investment in traditional tangible assets such as factories, machinery, and inventory has dropped from 15% of gross added value in 1977 to 9% by 2014, while corporate investment in intangible assets such as research & development, brands, media content, and business processes increased from 9% to 14% of added value over the same time frame.[1] The critical issue is that the role of intangible assets in driving earnings has increased, but accounting statements, rules, and required disclosures have not kept pace.

My interest in environmental, social, and governance (ESG) issues is based on the discovery that these items may provide material information, tangible and intangible assets, to make the best investment decisions on behalf of our clients. First, allow me to define material information or materiality, it is information that a reasonable shareholder would consider is important in deciding how to vote a proxy, purchase or sell a security. Therefore, my perspective is the information that we will discuss today is material to a reasonable shareholder. If you agree that this information is material to shareholders, then, it follows that this information should be shared with all shareholders and investors resulting in the Securities Exchange Commission to amend the reporting rules.

**Disclosure of Political Risk**
The legislation requesting disclosure of political contribution addresses a relative new material factor in the selection of securities. We have found in our research that political risk can be measured, and this political risk impacts the pricing of securities. The 2017 KPMG global CEO outlook survey reports that more than half of the interviewed CEOs believe that the uncertainty of the current political landscape has a larger impact on their business than in the past. Approximately 70% of the CEOs have been taking steps to address the political risk to protect shareholder value. These firms and their executives view political donations as an effective tool for corporate political activism and therefore donate sizable amounts to political candidates. Since the Citizens United v. FEC Supreme Court decision, corporate political action committees (PACs) campaign contributions have increased. The total campaign contributions raised by corporate PACs exceeded $2.2 billion for the 2016 election cycle compared to $630 million in the 2000 election cycle, an increase of 250%.[2]

As investors, how can we measure a firm's political risk? One study uses the firm's quarterly earnings conference calls and measures the share of the call devoted to the discussion of political risk. The information shared on the conference calls provide different information than what is included in the quarterly financial statement reports. The study indicates that as the share of political comments of the conference call increases that this serves as a measure for political risk. Typically investment models predict that an increase in any kind of risk, and therefore an increase in the firm's political risk may trigger an increase in the firm's stock return volatility. The study measured risk across several different categories to include; health, economic policy & budget, environment, security & defense, tax policy, trade, technology & infrastructure, and political process. The study finds that as firms face higher political risk in these categories; subsequently, they will donate more to political campaigns that address these risks.[3]

The ability to evaluate conference calls may not be available to the typical investor. The Federal Election Commission provides public access to federal campaign contributions; however, there are limited sources for contributions to state and local level. Therefore, most investors cannot fully measure political risk.

However, if the correlation between a firm's political risk and political contributions is positive, then, the political contribution may serve as a proxy for political risk. Based on our research, we have found that political contributions serve as an active strategy to reduce a corporation's political risks. In fact, a number of listed firms include a discussion of political contributions in their sustainability reports.

We have evaluated the news related to political influence to determine if this information is material to stock performance. We found that the majority of large corporations' returns were

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impacted as news of political and/ or regulatory risk increases, the stock prices decline. Based on our research, we have found that political contributions, as a proxy for political risk, is material in making investment decisions.

**Disclosure of Climate Risk**

The legislation requesting disclosure of climate risks addresses a complex material impact on security pricing. This risk is difficult to measure for several reasons since the risk parameters may be mispriced due to shortcomings in the available information.

I will not address the science or legal issues regarding climate risk. As an investor, I attempt to model risk factors and I treat climate risk as a factor. First, a definition of climate risk is important. I view climate risk as the impact on a corporation's financial performance based on the current and future effects of climate change – which can be referred to as physical risk and transitional risk. The physical risk addresses damage based on the impact of carbon emissions on the environment. An example is the impact on insurance companies that have to underwrite coverage for properties in coastal areas that are experiencing an increased number of catastrophic flooding and storm events.

The transitional risk is the risk from moving the current emission levels to a future of lower emission levels. An example is the impact on energy firms that are focused on fossil fuels, which may see reduced revenues as the preference for alternative energy sources increase.

Predicting the timing of the impact of climate change is difficult; however, we have observed the change in firm behavior related to climate change has already started to occur. Therefore, I will explain as an investor how we measure the climate risk for our clients and how the proposed legislation will assist us in this process.

The initial step is to measure the baseline carbon emissions. This measures the total amount of greenhouse gases that are emitted into the atmosphere directly by the corporation, indirectly by purchasing energy, and other indirectly outsourced activities. In order to compare across firms, we measure the carbon emissions as metric tons per $1 million of firm's revenues. This is referred to as carbon intensity.

We analyzed 3000 listed U.S. firms that are members of the Russell 3000 Index which represent about 98% of all U.S incorporated equity securities. A number of corporations are voluntarily providing material emission information to investors. The number of firms that are reporting their baseline or current carbon emissions is approximately 417 or 14% of firms. Among the 186 energy firms we evaluated, which may be most impacted by climate risk, 33 or 18% report their current level of emissions.

A further step is to identify stranded assets; this is similar to the treatment of impairment of assets and takes into account regulatory, economic, and physical effects. Currently, stranded assets are fossil fuel supplies that will have a lower economic return as a result of the transition to a low carbon economy sometime in the future. The number of firms that are reporting their emission targets is approximately 363 or 12% firms. Among the 186 energy firms that we evaluated, 7 or 4% have included emission reduction target policies. Several of these firms use climate change scenario analysis to forecast the impact on their financial performance which is a material issue to shareholders and investors.

Many firms have turned to organizations such as the Global Reporting Initiative to provide guidelines. The Global Reporting Initiative (GRI) is an international independent standards organization that works with corporations and governments to understand and communicate the impacts of climate change. Also, a number of firms have used peer reviews, media content, and thought leaders in sustainability to develop issues that are material to their business model. In addition, firms have requested that the Stakeholder Committee selected by CERES review their sustainability reports. CERES is a sustainability nonprofit organization working with investors and corporations to address climate change, water scarcity, pollution, and inequitable workplaces.

If listed firms are required to report their current level of carbon emissions, stranded assets, and transition plans this will provide shareholders with material information to evaluate the physical and transition risks.

We continue to evaluate methods to price the environmental impact on stock prices.
One method is based on the news around environmental issues to include carbon emissions and air quality. We have found that those firms with positive environmental news compared to firms with negative environmental news outperform one year later. Based on our research, we have found climate risk to be material item in making investment decisions.

**Disclosure of Tax Avoidance Risk**

The amount of corporate income tax a company pays is material to its profitability. Investors therefore seek to understand the extent to which future cash flows are based on artificial tax structures. These artificial tax structures may be challenged in the future which will impact the firm's stock valuation. Furthermore, corporate tax avoidance activities, while perfectly legal, may suggest underlying regulatory or reputation risks

A study by the Principles of Responsible Investment (PRI), a United Nations supported organization, assessed the levels of corporate income tax disclosure at 50 large multinational companies in the healthcare and technology sectors. The study found insufficient explanation and data to test corporate commitments around avoiding profit shifting. Profit shifting is one

of the primary methods to avoid the payment of taxes. Typically, corporations did not provide explanations regarding their operations in low tax jurisdictions where business operations were not apparent. The corporations' disclosures lacked any country level data on common economic activity indicators such as revenue, profits, employee numbers and taxes paid. The U.S. listed firms are required to report only foreign and domestic taxes.[4]

As an investor, it is important to know that the firm's tax practices of our portfolio companies can withstand stakeholder scrutiny and potential regulatory changes. As corporate tax regimes are reconsidered across countries to avoid revenue loss to tax avoidance, multinational companies will face increased pressure to defend their tax-related transactions and/or may see new forms of taxation applied. Also, if corporations disclose country by country tax rates, this will allow investors to determine the appropriate effective tax rate. Most corporations report their domestic effective tax rates in their quarterly reports which may not capture their global effective tax rate.

As investors, we have been unable to evaluate the full impact of tax avoidance risk given the lack of country by country tax reporting. By providing this detailed information, it will increase transparency and accountability.

Companies pursuing aggressive tax avoidance activities may be indicative of management's preference for high risk strategies. One case study involves a foreign based international bank that trades on the U.S. Exchange. This bank operated a tax avoidance division. The tax avoidance division generated more than $1 billion annually from 2007 to 2011. This operation was disclosed in 2012 and the tax authority levied a $300 M tax penalty for the most recent year of the operation. Since the tax penalty in 2012, the firm has experienced other issues and has lost over 45% of its stock value. Therefore, based on our research, tax avoidance risk is a material issue.

**Disclosure of Human Rights Risk**

The legislation requesting disclosure of human rights and value chain risks are material factors in the selection of securities. It is easy to understand that news of human rights violations can impact the reputation and the stock price of a corporation.

A number of corporations are voluntarily providing material human rights information to investors. The number of firms in the Russell 3000 that have a human rights policy that seeks to avoid child, forced or compulsory labor is approximately 906 or 30% of firms. Also, a number of firms have policies that use human rights criteria in the selection and monitoring of its suppliers or sourcing partners is approximately 720 or 24%.

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We have found in our research that news on human rights can be measured and this risk impacts the pricing of securities. It should be no surprise that the firms in the consumer related sectors such as financials, consumer goods and services are significantly impacted by both positive and negative news related to human rights. We have found that those firms with positive human rights media news compared to firms with negative human rights news outperform one year later. Based on our research, we have found human rights risk to be material item in making investment decisions.

**Sustainable Finance Advisory Committee**

We support the creation of a Sustainable Finance Advisory Committee to advise the Securities Exchange Commission (SEC) on environmental, social, and governance issues (ESG). The committee will assist the Commission in evaluating the evolving issues related to ESG materiality and capital markets.

Thank you for your time. The oversight work of this Subcommittee is a critical responsibility and I welcome any questions that you may have.

**References**

[1] Gu, F, Lev, B. Time to Change Your Investment Model (September 2017). Financial Analyst Journal.

[2] Shen,S.. Political Ties and Predictable Returns (November 2018). Available at SSRN: http://ssr.com

[3] Hassan, T., Hollander, S., van Lent, L., Tahoun, A.. Firm Level Political Risk: Measurement & Effects (April 2019). Available at SSRN: http ://ssrn.com

[4] Ravishankar, V.. Evaluating and Engaging on Corporate Tax Transparency: An Investor Guide (2018) www.unpri.org.

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Via Hand Delivery

July 9, 2019

The Honorable Carolyn B. Maloney
Chair
Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Bill Huizenga
Ranking Member
Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

*Re: July 10, 2019, Hearing entitled "Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social and Governance Disclosures"*[1]

Dear Madam Chair and Ranking Member Huizenga:

I am writing on behalf of the Council of Institutional Investors (CII) to express our appreciation for holding the above referenced hearing and to provide you with our views. We would respectfully request that this letter be made a part of the hearing record.

CII is a nonprofit, nonpartisan association of public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include a range of asset managers with more than $35 trillion in assets under management.[2]

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[1] Hearings, Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social and Governance Disclosures (July 10, 2019), https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=404000.

[2] For more information about the Council of Institutional Investors ("CII"), including its board and members, please visit CII's website at http://www.cii.org.

**Environmental, Social, and Governance (ESG) Disclosures**

CII's members look to public company disclosure documents for information about the full range of material risks facing registrants, including risks that may be labeled ESG.[3] A number of these risks have assumed greater importance in recent years from the perspective of investors[4] and companies.[5]

For example, a recent survey of Securities and Exchange Commission (SEC) filings found a "significant increase" in environmental and social disclosures from 2018 to 2019 in seven categories.[6] The increase in those disclosures may reflect a growing body of research associating various ESG factors with improved corporate performance.[7]

To our great disappointment, CII has found disclosures on various ESG risks too often consist of boilerplate risk identification without adequate discussion of how those risks apply to the individual registrant.[8] And many registrant' disclosures relating to ESG risks provides no basis for investors to understand the scope of the risks or the likelihood of their coming to fruition.[9]

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[3] *See* Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission 6 (July 8, 2016), https://www.sec.gov/comments/s7-06-16/s70616-49.pdf ("CII's members look to registrants' disclosure documents for information about the full range of material risks facing registrants, including environmental, social and governance ("ESG") risks.").

[4] *See* Dennis Fritsch, PhD, ESG: Do You or Don't You, RI & UBS 34 (June 11, 2019) (registration required), https://www.ubs.com/global/en/asset-management/insights/sustainable-and-impact-investing/2019/esg-do-you-or-don-t-you.html (survey of investors finding that "the top advantage[] of taking ESG into account . . . were an improved risk profile"); The Application of Environmental, Social, and Governance Principles in Investing and the Role of Asset Managers, Proxy Advisors, and Other Intermediaries, Hearing Before the S. Comm. on Banking, Hous. & Urban Affairs, 116th Cong. (Apr. 2, 2019) (Testimony of John Streur, President and CEO, Calvert Research and Management), https://www.banking.senate.gov/imo/media/doc/Streur%20Testimony%204-2-19.pdf ("in 2018, more than $12 trillion in the United States (U.S.) was invested in strategies that consider ESG criteria—a 38% increase since 2016").

[5] *See* Era Aganosti, White & Case LLP et al., E&S Disclosure Trends in SEC Filings 2018-2019, White & Case (June 26, 2019), https://www.whitecase.com/publications/alert/es-disclosure-trends-sec-filings-2018-2019 ("Forty-seven of the companies surveyed (or 94 per cent) increased their E&S disclosures in Form 10-Ks and proxy statements between 2018 and 2019."); Testimony of John Streur ("Eight years ago, just 20% of the S&P 500 provided any type of reporting on relevant ESG risks [and] [t]oday, 85% of companies in the S&P 500 actively report on ESG risks factors."); Governance & Accountability Institute, Inc., "FLASH REPORT: 85% of S&P 500 Index Companies Publish Sustainability Reports in 2017 (Mar. 20, 2018), https://www.ga-institute.com/press-releases/article/flash-report-85-of-sp-500-indexR-companies-publish-sustainability-reports-in-2017.html ("From 2013 to 2017, the frequency of [ESG] reporting has increased each year, **now up to 85% of companies reporting in 2017**").

[6] Era Aganosti.

[7] *See* Rebecca Moore, Investing, ESG Investments a Good Option for Retirement Plans, PLANSPONOR, Mar. 27, 2019, https://www.plansponsor.com/esg-investments-good-option-retirement-plans/ ("'a growing body of research' that suggests companies with a holistic consideration of ESG measures have better long-term financial outcomes and may provide more opportunities for profitable investing endeavors"); Gunnar Freide et al., ESG and Financial Performance: Aggregated Evidence From More Than 2000 Empirical Studies, 5(4) J. Sustainable Fin. & Investment 210 (2015), https://www.tandfonline.com/doi/full/10.1080/20430795.2015.1118917 (aggregating the results of about 2200 individual studies and concluding that most found positive correlations between corporate financial performance and ESG investing).

[8] Letter from Kenneth A. Bertsch at 7.

[9] *Id.*

CII believes that clearer and more comparable information about key ESG risks would benefit investors and the U.S. capital markets. In that regard, we are encouraged by private sector efforts to harmonize ESG disclosures such as those of the Corporate Reporting Dialogue (CRD).[10] It is our understanding that the CRD is designed to more closely align ESG disclosure standards among a number of competing corporate reporting frameworks.[11]

We think that adoption by investors and issuers of common ESG disclosure standards would be a highly significant market improvement, but we are not yet confident this can come about through private, non-mandatory work. However, even should a voluntary approach fall short on providing comparable and reliable disclosures of key metrics, we think the work of the participants in the CRD and related efforts will be important in clarifying best practice and informing proposed legislation or eventual rule-making.[12]

Aside from this, CII believes that as part of its routine disclosure reviews, the SEC staff should actively challenge issuers to disclose material ESG risks. That disclosure should, at a minimum, be sufficiently detailed to provide insights as to how management plans to mitigate risks relating to ESG issues, and how associated decisions could be material to a company's business or their investors.[13]

Climate-Related Disclosures

We agree with the conclusion of the recently released report of the CDP, formerly known as the Carbon Disclosure Project, that:

> The demand for climate-related information is growing. Understanding that inadequate information can lead to the mispricing of assets and a misallocation of

[10] Press Release, CDSB, Leading Corporate Reporting Bodies Launch Two-Year Project for Better Alignment (Nov. 7, 2018), https://www.cdsb.net/harmonization/860/leading-corporate-reporting-bodies-launch-two-year-project-better-alignment ("Through this new project, participants will map their respective sustainability standards and frameworks to identify the commonalities and differences between them, jointly refining and continuously improving overlapping disclosures and data points to achieve better alignment, taking into account the different focuses, audiences and governance procedures.").

[11] *Id.* ("The Corporate Reporting Dialogue was launched four years ago as the principal working mechanism globally to achieve dialogue and alignment between the key standard setters and framework developers which have significant international influence on the corporate reporting landscape.").

[12] *See* Letter from Cynthia A. Williams et al. to Mr. Brent J. Fields, Secretary, Securities and Exchange Commission (October 1, 2018), https://www.sec.gov/rules/petitions/2018/petn4-730.pdf (calling for the development of "a comprehensive framework requiring issuers to disclose identified environmental, social, and governance (ESG) aspects of each public-reporting company's operations"); Council of Institutional Investors, Podcast: The Voice of Corporate Governance, A New SEC Rulemaking Petition on ESG Disclosure with Rachel Curley (Oct. 3, 2018), https://www.cii.org/podcasts (discussing the October 2018 petition with the Securities and Exchange Commission for a rulemaking on ESG disclosures).

[13] *See* William Hinman, Director, Division of Corporation Finance, Remarks at the 18th Annual Institute on Securities Regulation In Europe (Mar. 15, 2019), https://www.sec.gov/news/speech/hinman-applying-principles-based-approach-disclosure-031519 ("And as they do so I would suggest they ask themselves whether their disclosure is sufficiently detailed to provide insight as to how management plans to mitigate material risks and how their decisions in the area of risk could be material to the business and their investors.").

> capital, more and more financial decision makers are demanding information on the business risks and opportunities associated with climate change.[14]

CII would expect that with more rigorous SEC staff oversight, issuer disclosures about climate related risks would be more robust. We believe the 2010 SEC guidance on disclosure relating to climate change[15] was helpful, and note recent industry comments that those requirements are clear.[16] And we commend William Hinman, the Director of the SEC's Division of Corporation Finance, for reminding issuers earlier this year that the 2010 SEC guidance "remains a relevant and useful tool for companies when evaluating their disclosure obligations concerning climate change matters."[17] However, we are unsure of the extent to which this guidance is reflected in SEC staff comment letters to companies on relevant disclosures.[18]

We acknowledge that the SEC's ability to improve climate related risk disclosures is, as indicated by the U.S. Government Accountability Office, significantly constrained by the absence of an agreed upon "framework for companies to use to report these disclosures."[19] Despite that constraint, however, we agree with many investors that the SEC could currently do more to promote improvements in the quality of disclosures of risks related to climate change.[20]

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[14] CDP, Global Climate Change Analysis 2018 (2019), https://www.cdp.net/en/research/global-reports/global-climate-change-report-2018.

[15] Commission Guidance Regarding Disclosure Related to Climate Change, Securities Act Release No. 9,106, Exchange Act Release No. 61,469, 75 Fed. Reg. 6,290 (Feb. 8, 2010), https://www.govinfo.gov/content/pkg/FR-2010-02-08/pdf/2010-2602.pdf.

[16] United States Government Accountability Office, Climate-Related Risks, SEC Has Taken Steps to Clarify Disclosure Requirement 25 (Feb. 2018), https://www.gao.gov/assets/700/690197.pdf ("representatives from five industry associations with whom we spoke all noted that they consider the current requirements for climate-related disclosures adequate"); *but see, e.g.*, Christian Weller, Workers Face Undisclosed Risks As Companies Often Don't Disclose Environmental, Other Challenges, Forbes, Apr. 2, 2019, https://www.forbes.com/sites/christianweller/2019/04/02/workers-face-savings-risks-as-companies-often-dont-disclose-environmental-other-challenges/#1bba802e7d9f (commenting that climate change guidance "left a lot of room for managers to either not disclose anything or to disclose little new or relevant information").

[17] William Hinman.

[18] *See* Alexandra Semenova, News, SEC Stops Prodding Companies to Detail Climate Change Impacts, BNA, July 16, 2018, https://news.bloomberglaw.com/corporate-law/sec-stops-prodding-companies-to-detail-climate-change-impacts ("The Securities and Exchange Commission last issued a climate change-related public comment letter in September 2016, when it asked Chevron Corp. to expand its risk factor disclosure related to California's greenhouse gas emission regulations.").

[19] United States Government Accountability Office at 27; *see, e.g.*, Michael Kapoor, News Article, U.K. Business, Politicians Back Environmental-Risk Reporting Push, Bloomberg L. (July 5, 2018) (registration required & on file with CII) ("the accounting profession . . . said that standard measurement practices for climate risks still need to be developed").

[20] *See, e.g.*, Ben Lefebvre & Anthony Adragna, Energy & Environment, Democrats Want Companies to Disclose their Climate Risks – and Fossil Fuel Industry is Worried, Politico, June 17, 2019, https://www.politico.com/story/2019/06/17/democrats-energy-industry-climate-risk-1483586 (discussing Securities and Exchange Commission lack action and noting that "[i]nvestor groups support the idea of companies disclosing more information [about climate risk], which they said would help them determine where best to direct their dollars").

As one example, last month we submitted a letter to Director Hinman urging the SEC staff to revisit their approach to interpreting Rule 14a-8(i)(7),[21] the "ordinary business" exclusion of the shareholder proposal rule.[22] Our letter was in response to several controversial staff decisions, including three decisions permitting corporations to avoid a shareowner vote on voluntary resolutions intended to improve disclosure relating to climate change.[23]

CII plans to continue to support the efforts of our members and other institutional investors who have been urging companies to be more transparent about climate risks.[24] As has been recently reported, those efforts to-date have "helped drive the recent uptick in disclosures."[25] Those reports were confirmed by the recently issued 2019 Status Report of the Task Force on Climate-Related Financial Disclosures (TCFD Report).[26]

The TCFD Report found that progress was "being made to improve the availability and quality of climate-related financial information."[27] The TCFD Report, however, also identified the need "for companies to provide more clarity on the potential financial impact of climate-related issues on their businesses . . . [because] [w]ithout such information, users may not have the information they need to make informed financial decisions."[28] As indicated, we believe that more clarity about climate related risk disclosures would likely require an agreed upon framework for companies to report those disclosures.

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[21] Shareholder Proposals, 17 C.F.R. § 240.14-8(i)(7) (1995) (amended Sept. 16, 2010), *available at* https://www.law.cornell.edu/cfr/text/17/240.14a-8 (describing exclusion for "***Management functions:*** If the proposal deals with a matter relating to the company's ordinary business operations").

[22] Letter from Kenneth A. Bertsch, Executive Director, Council of Institutional Investors et al. to William H. Hinman, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission 5 (June 20, 2019), https://www.cii.org/files/issues_and_advocacy/correspondence/2019/2019%20June%20letter%20to%20SEC%20CorpFin%20on%2014a-8%20i7%20FINAL(1).pdf ("CII urges the Staff to revisit its approach to Rule 14a-8(i)(7) so that it is more consistent with the language and intent of the underlying rule.").

[23] *See, e.g.*, Ben Lefebvre & Anthony Adragna ("The . . . SEC has blocked shareholder resolutions aimed at requiring climate risk disclosures, arguing . . . that a climate measure directed at Exxon was an attempt by a subset of shareholders to "micromanage" the fossil fuel giant [and] [i]t made a similar ruling for oil and gas producer Devon Energy against a climate resolution in March.").

[24] *See* Chris Butera, Large Investor Coalition Pressures ESG Disclosure on 700 Companies, CIO, June 17, 2019, https://www.ai-cio.com/news/large-investor-coalition-pressures-esg-disclosure-700-companies/ ("A massive institutional investor consortium [including Washington State Investment Board and the New York Common Retirement Fund] is pushing more than 700 companies to reveal more on their environmental impact, including ExxonMobil, Amazon, and Volvo."); Brad Plumer, Companies See Climate Change Hitting Their Bottom Lines in the Next 5 Years, N.Y. Times, June 4, 2019, https://www.nytimes.com/2019/06/04/climate/companies-climate-change-financial-impact.html ("Some institutional Investors, such as the mutual fund company Vanguard Group and New York State's pension fund, have started to urge companies to be more transparent about their climate exposure").

[25] *Id.*

[26] Task Force on Climate-Related Financial Disclosures, 2019 Status Report (June 2019), https://www.fsb.org/wp-content/uploads/P050619.pdf.

[27] *Id.* at iv.

[28] *Id.*

Political Contribution Disclosures

CII policy favors full disclosure of corporate political spending. CII's member-approved policy states:

> The board should develop and disclose publicly its guidelines for approving charitable and political contributions. The board should disclose on an annual basis the amounts and recipients of all monetary and non-monetary contributions made by the company during the prior fiscal year. Any expenditures earmarked for political or charitable activities that were provided to or through a third-party should be included in the report.[29]

CII commented in support of a 2011 "Petition to require public companies to disclose to shareholders the use of corporate resources for political activities" (File No. 4-637).[30] In that comment letter, we emphasized the importance of disclosure in allowing shareholders to evaluate whether corporate political spending serves their interests, as contemplated by the majority opinion in *Citizens United v. Fed. Election Comm'n*[31] invalidating certain limitations on corporate political spending.[32] Our comment also expressed the view that uniform disclosure requirements are preferable to reliance on voluntary disclosure, which may lack consistency.[33]

****

CII shares your goal of building a sustainable and competitive economy. We agree that achieving that goal necessarily includes improving ESG disclosures.

As indicated, CII also agrees that legislation may be necessary to improve ESG disclosures. In that regard, we thank you again for holding this important and timely hearing. We would advocate that any legislative or rulemaking proposals to improve ESG disclosures be developed in a deliberative manner that balances the needs of investors for reliable and complete information with limiting any unnecessary regulatory burden.

We look forward to continuing to provide input to you, members of the Subcommittee, and staff on legislative, regulatory, and private sector efforts to improve ESG disclosures. If we can

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[29] Council of Institutional Investors, CII Corporate Governance Policies, § 2.14b Disclosure (updated Oct. 24, 2018), https://www.cii.org/files/10_24_18_corp_gov_policies.pdf.

[30] Letter from Glenn Davis, Senior Research Associate, Council of Institutional Investors to Ms. Elizabeth Murphy, Secretary, U.S. Securities and Exchange Commission 1 (Oct. 19, 2011), https://www.sec.gov/comments/4-637/4637-9.pdf.

[31] Citizens United v. Fed. Election Comm'n, 558 U.S. 310 (2010), *available at* https://supreme.justia.com/cases/federal/us/558/310/.

[32] *See* Letter from Glenn Davis at 2 ("Developments since the adoption of the Council's policy in 2006, including the 2010 Supreme Court decision in Citizens United v. Federal Election Commission, have underscored the appropriateness of full disclosure and robust oversight of corporate political spending.").

[33] *Id.* (commenting on the "advantage to investors of having complete, uniform disclosure requirements").

answer any questions or provide additional information regarding this letter, please do not hesitate to contact me at 202.822.0800 or jeff@cii.org.

Sincerely,

Jeff Mahoney

Jeffrey P. Mahoney
General Counsel

July 9, 2019

Chairwoman Carolyn Maloney
Ranking Member Bill Huizenga
U.S. House Committee on Financial Services
Subcommittee on Investor Protection, Entrepreneurship and Capital Markets
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairwoman Maloney, Ranking Member Huizenga, and Members of the Subcommittee,

On behalf of the Financial Accountability and Corporate Transparency (FACT) Coalition we thank you for holding this important hearing on "Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social and Governance Disclosures." We appreciate the opportunity to offer these comments for the record.

The FACT Coalition is a non-partisan alliance of more than 100 state, national, and international organizations working toward a fair tax system that addresses the challenges of a global economy and promoting policies to combat the harmful impacts of corrupt financial practices.

While we support financial transparency in a number of areas, our comments today will focus on our support for income and tax disclosure on a country by country level as included in the draft legislation entitled, "H.R. ____: To require issuers required to file an annual or quarterly report under the Securities Exchange Act of 1934 to disclose the total amount of corporate tax such issuer paid in the period covered by the report, and for other purposes [PDF]."

Income and tax information at the country-by-country level is what investors need to better understand a company's financial, reputational, and economic risks, gauge their level of risk tolerance, and make informed investment decisions. We have attached a letter sent by more than two dozen investors to the Global Reporting Initiative (GRI), whose CEO is testifying at the hearing, in strong support of GRI's draft proposal in this area for publicly traded companies. We are also attaching a letter from FACT to GRI supporting its proposal. Both letters outline the urgent need for increased corporate transparency.

This hearing, the GRI proposal and the draft legislation come at a particularly important moment. As detailed in a recent FACT Coalition report, *Trending Toward Transparency: The Rise of Public Country-By-Country Reporting*, there is a growing global trend toward this type of disclosure. Additionally, the Financial Accounting Standards Board (FASB) is currently considering new income and tax transparency standards that do not adequately address the problems of corporate secrecy and aggressive tax planning. Nor does the FASB proposal conform to emerging international corporate transparency standards.

In a recent letter to FASB on its draft tax disclosure proposal, investors with more than $1 trillion in assets under management expressed these criticisms:

> *"While we appreciate the recognition by FASB that tax transparency is of growing concern to investors, we are disappointed that the new proposed standards fall far short of what we believe is needed to help us — and other investors — make sound decisions when investing in U.S. companies."*

The letter went on to call upon FASB to rethink its entire proposal:

> *"Given the global movement around tax transparency — with 80 percent of companies surveyed by Deloitte expecting public country-by-country reporting to be adopted in the next few years — failing to conform to emerging uniform global standards for those who invest in U.S. companies will put us at a competitive disadvantage, as well as likely require FASB to go back to the drawing board to re-propose these rules."*

This hearing offers an opportunity to assess pending proposals to increase corporate tax, financial, and other basic disclosures on a country-by-country basis. We urge the Committee to follow up this hearing with a markup on legislation to increase corporate tax transparency and all for members to support the proposal.

Thank you for your consideration of our views. We look forward to working with you to improve the integrity of our markets through greater transparency.

Sincerely,

Gary Kalman

Gary Kalman
Executive Director

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**"Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social and Governance Disclosures"**

House Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets
July 10, 2019, 2:00 pm

Testimony of Alison Friedman, Executive Director, International Corporate Accountability Roundtable (ICAR)

Dear Chairwoman Maloney, Ranking Member Huizenga, and esteemed members of the House Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets:

My name is Alison Friedman, and I am the Executive Director at the International Corporate Accountability Roundtable (ICAR). ICAR is a coalition of forty-five environmental, human rights, and corporate responsibility non-governmental organizations. We harness the collective power of progressive organizations to push governments to create and enforce rules over corporations that promote human rights and reduce inequality.

ICAR has long advocated for the SEC to promulgate mandatory Environmental, Social, and Governance (ESG) disclosure by public companies, specifically relating to human rights policies, practices, and impacts. This information is material to reasonable investors. The Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act of 2019 is a landmark bill aimed at providing investors with critical information on corporate human rights performance through requiring companies to conduct and disclose a human rights risk assessment. We commend the introduction of the Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act of 2019 and thank this Honorable Committee for the opportunity to speak about the importance and need for this legislation.

In our 2013 report, *Knowing and Showing: Using U.S. Securities Laws to Compel Human Rights Disclosure,* ICAR demonstrated the materiality of human rights policies, practices, and impacts, based on an analysis of increased public interest, international accords and efforts to address this information gap, and growing recognition of the current and potential effects of this information on companies' performance and operations.[1] In the last six years, the evidence base for this

[1] International Corporate Accountability Roundtable (ICAR), Knowing and Showing: Using U.S. Securities Laws to Compel Human Rights Disclosure (2013),

assessment has steadily grown stronger. The substantial increase in the number of companies voluntarily reporting on ESG factors, investors calling for increased ESG disclosure, and States and stock exchanges requiring mandatory disclosure of ESG information further bolsters our argument that the U.S. government must regulate these disclosure.

The Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act of 2019 is an opportunity to do just that.

**ESG factors, including information relating to human rights, are no longer a niche consideration.** A 2018 Ernst & Young Climate Change and Sustainability Services (CCaSS) survey of 200 institutional investors globally found that 97% of institutional investors "conduct either an information evaluation or a structured, methodical evaluation of a target company's non-financial disclosures when deciding future investments" and 96% stated that this information frequently or occasionally "played a pivotal role in decision-making."[2] And more consistent and thorough ESG information is desired. Seventy percent of these investors, 40% of whom have assets under management of US$10 billion or more, felt that "national regulators are best suited to lead efforts to close the gap between an investor's need for nonfinancial information and the information actually provided by issuers."[3]

U.S.-based investors agree. In October 2018, investors with more than $5 trillion in assets under management submitted a petition to the SEC, requesting a rulemaking on ESG disclosures. Additionally, just last year, approximately 400 shareholder resolutions were filed requesting increased disclosure on ESG issues—another sign of heightened investor interest and demand for quality and comparable ESG disclosures.[4]

**Companies and regulators have not been able to ignore this increased interest and demand for ESG disclosures.** Increasingly, companies are voluntarily reporting on ESG issues, using a variety of reporting frameworks. For example, 75% of the Global 250 utilizes the Global Reporting Initiative (GRI) standards to report on sustainability issues."[5] In the U.S., a majority of the largest companies are currently making voluntary sustainability disclosures, with 86% of S&P 500

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https://static1.squarespace.com/static/583f3fca725e25fcd45aa446/t/58657a0ef5e23172079532f9/148304539426 8/ICAR-Knowing-and-Showing-Report5.pdf.

[2] Ernst & Young, *Nonfinancial disclosures are essential to most institutional investors* (Nov. 29, 2018), https://www.ey.com/en_gl/news/2018/11/nonfinancial-disclosures-are-essential-to-most-institutional-investors.

[3] Id.

[4] As You Sow, "Proxy Preview 2019 Reveals Intensified Shareholder Pressure on Corporations Across a Wide Range of ESG Issues," (Mar. 12, 2019), https://www.asyousow.org/press-releases/proxy-preview-2019-shareholder-resolutions.

[5] *See*, U.N. Principles for Responsible Investment, PRI-11 year growth of AO (all signatories (Asset Owners [sic], Investment Managers and seride [sic] providers) and respective AUM, Excel sheet available for download at *About the PRI*, U.N. Principles for Responsible Investment, http://www.unpri.org/about.

companies producing such reports in 2018.[6] Furthermore, at least 23 countries have independently enacted legislation within the last 15 years requiring public companies to report on ESG issues.[7] All 28 member States of the European Union (EU) have transposed the Non-Financial Reporting Directive which requires wide-scale, mandatory ESG reporting into their national laws.[8] In addition to these reporting requirements, seven stock exchanges require social and/or environmental disclosure as part of their listing requirements.[9] These movements towards mandatory reporting highlight the broad-scale belief that ESG information is material and must be disclosed in order to inform investor decision-making.

**With such clear evidence of investor demand, why has the SEC been reticent to regulate?**

Information around a company's ESG policies, practices, and impacts, including human rights information, is material to a reasonable investor. This information is material both from a strictly financial viewpoint, and a broadened conceptualization of environmental or socially material information. Numerous studies have concluded that a company's performance on ESG issues is directly linked to better corporate performance in the long-term. A 2014 review of existing empirical studies that analyzed ESG data and corporate financial performance found overwhelming links between sustainability and profit: 90% of the analyzed studies showed that sound sustainability standards lowered firms' cost of capital; 80% of the studies showed that companies' stock price performance is positively influenced by good sustainability practices; and 88% of the studies showed that better ESG practices result in better operational performance.[10] Since then, additional studies have confirmed these findings, including:

- A June 2017 Bank of America Merrill Lynch study which found ESG factors to be "strong indicators of future volatility, earnings risk, price declines, and bankruptcies."[11]

[6] Sustainability Reports, *86% of S&P 500 Index Companies Publish Sustainability/Responsibility Reports in 2018* (May 17, 2019), https://www.sustainability-reports.com/86-of-sp-500-index-companies-publish-sustainability-responsibility-reports-in-2018/.
[7] *See*, Initiative for Responsible Investment, Corporate Social Responsibility Disclosure Efforts by National Governments and Stock Exchanges (Mar. 12, 2015), http://iri.hks.harvard.edu/files/iri/files/corporate_social_responsibility_disclosure_3-27-15.pdf.
[8] *See*, Directive 2014/95/EU, of the European Parliament and of The Council of 12 Oct. 2014 as regards disclosure of non-financial and diversity information by certain large undertakings and groups, 2014 O.J. (L 330) 1, http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0095&from=EN; European Commission, "Non-Financial Reporting Directive-Transposition Status (May 24, 2018), https://ec.europa.eu/info/publications/non-financial-reporting-directive-transposition-status_en.
[9] *See* Initiative for Responsible Investment, *supra* note 5. These include Australia's ASX, Brazil's Bovespa, India's Securities and Exchange Board, the Bursa Malaysia, Oslo's Børs, the Johannesburg Stock Exchange, and the London Stock Exchange.
[10] Gordon L. Clark, Andreas Feiner & Michael Viehs, From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance (2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2508281.
[11] Bank of America Merrill Lynch, Equity Strategy Focus Point—ESG Part II: A Deeper Dive (June 15, 2017), https://www.iccr.org/sites/default/files/page_attachments/esg_part_2_deeper_dive_bof_of_a_june_2017.pdf.

- A June 2017 research report by Allianz Global Investors, which concluded that heightened transparency of ESG disclosure lowered companies' cost of capital by reducing the "investment risk premium" that sophisticated investors would require.[12]
- A September 2017 Nordea Equity Research report, which found that there is "solid evidence that ESG matters, both for operational and share price performance."[13]

Investors who take a long-term approach to wealth maximization, instead of seeking short-turn returns on investments, necessarily find ESG information financially material.

Under the growing global concept of "double materiality," ESG information can be considered both financially material to investors and socially or environmentally material to investors, consumers, employees, communities, and civil society organizations.[14] Environmental or social materiality refers to the impact of a company's activities outside of itself. These two risk perspectives are increasingly likely to overlap, with environmental or social impacts leading to financial implications, which then render them financially material. Insufficient ESG policies and practices can directly affect the financial stability of a corporation. Non-compliance with national and international law can lead to financial penalties levied by the State, liability for abuse, and litigation associated with damages from corporate activities.[15] To illustrate, in 1984 a toxic fume release at a Union Carbide factory in Bhopal, India killed between 7,000 and 10,000 people, marking it as one of "the world's worst industrial disasters."[16] Union Carbide employees were later found criminally negligent by the Indian Supreme Court and ordered to pay millions in damages to both the victims and for environmental cleanup.[17]

Additionally, inadequate human rights policies and practices can cause financial instability in a number of other ways. For example, they can cause indirect impacts on a company's reputation affecting relationships with consumers, clients, employees, recruits, investors, and shareholders,

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[12] Allianz Global Investors, "Added value or a mere marketing tool? What does ESG mean for investments?" (June 1, 2017), https://uk.allianzgi.com/en-gb/b2c/insights/esg-matters/2017-06-01-added-value-or-a-mere-marketing-tool.

[13] Nordea Equity Research, "Strategy & Quant: Cracking the ESG Code" (Sept. 5, 2017), https://nordeamarkets.com/wp-content/uploads/2017/09/Strategy-and-quant_executive-summary_050917.pdf.

[14] European Commission, Consultation Document on the Update of the Non-Binding Guidelines on Non-Financial Reporting, https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/2019-non-financial-reporting-guidelines-consultation-document_en.pdf.

[15] *See* ICAR, Knowing and Showing, *supra* note 1 at 25; E&Y & Boston College Center for Corporate Citizenship, Value of Sustainability Reporting, *supra* note 2, at 2; *see generally* Economist Intelligence Unit, Corporate Citizenship: Profiting from a Sustainable Business (2008), http://graphics.eiu.com/upload/Corporate_Citizens.pdf.

[16] Salil Shetty, "Thirty years on from Bhopal disaster: Still fighting for justice," Amnesty International (Dec. 2, 2015), https://www.amnesty.org/en/latest/news/2014/12/thirty-years-bhopal-disaster-still-fighting-justice/.

[17] Alan Taylor, "Bhopal: The World's Worst Industrial Disaster, 30 years later," The Atlantic (Dec. 2, 2014), http://www.theatlantic.com/photo/2014/12/bhopal-the-worlds-worst-industrial-disaster-30-years-later/100864/.

all of whom might prefer to disassociate from operations that are complicit with adverse human rights outcomes. One such example occurred in the 1990s when Nike was accused of using child labor in its Chinese factories, paying workers less than minimum wage in Indonesia, and egregious violations of labor rights in Vietnam.[18] Since then, Nike has been further implicated in labor violations, especially in Bangladesh and other Asian countries, directly leading to significant financial repercussions and related drop in sales due to continued public protest of Nike's practices.[19] Similarly, the potential deterioration of relationships between corporations, governments and local communities caused by a company's adverse human rights impact may also have a material impact on its business by undermining or eliminating the company's ability to conduct business through a social license to operate.

**If companies are already voluntarily disclosing this information, why regulate? While a range of reporting standards exist for voluntary disclosure of ESG information, the application and consistency of these standards varies greatly.** This variability makes it difficult for investors to compare ESG data across companies or time, hindering the effectiveness of such disclosures for investment decision-making.[20] Without a regulatory mandate, voluntary disclosures are often incomplete, inconsistent, and not comparable. The SEC has recognized the value and importance of standardized disclosures for these same reasons.[21] When reporting becomes mandatory, standards necessarily become clearer, and the disclosed information more relevant and pertinent to investor needs. The United States risks falling behind the global curve in mandating the disclosure of ESG issues important to investor assessment of long-term profitability, and is now presented with an opportunity to do so—in the form of the Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act of 2019. This is an opportunity we must capitalize on.

Please find included in this testimony ICAR's *Knowing and Showing* report, and two issue briefs: "Setting the Record Straight: Common Misconceptions about Environmental, Social, and

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[18] Max Nisen, "How Nike Solved Its Sweatshop Problem," BusinessInsider(May 9, 2013), http://www.businessinsider.com/how-nike-solved-its-sweatshop-problem-2013-5.

[19] Shelly Banjo, "Inside Nike's Struggle to Balance Cost and Worker Safety in Bangladesh," The Wall Street Journal, (Apr. 21, 2014), http://www.wsj.com/articles/SB10001424052702303873604579493502231397942 (citing a loss of $100 million to pull soccer balls made with child labor, and causing the company to cease operations for 18 months until it could fix the labor issues in its factory); Max Nisen, *supra* note 23.

[20] *See, e.g.*, Jim Coburn & Jackie Cook, Cool Response: The SEC & Corporate Climate Change Reporting (2014), https://www.ceres.org/sites/default/files/reports/2017-03/Ceres_SECguidance-append_020414_web.pdf. *See also*, David Levy, Halina S. Brown, & Martin de Jong, The Contested Politics of Corporate Governance: The Case of the Global Reporting Initiative, 49 BUS. & SOC'Y 88 (2010); Carl-Johan Hedberg & Fredrik von Malmborg, The Global Reporting Initiative and Corporate Sustainability Reporting in Swedish Companies, 10 CORP. SOC. RESP. & ENVTL. MGMT. 153 (2003).

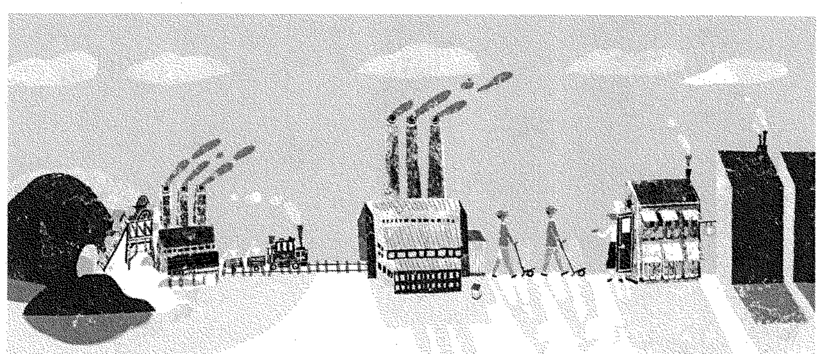
[21] *See* Chair Mary Jo White, Keynote Address at the 2015 AICPA National Conference: "Maintaining High-Quality, Reliable Financial Reporting: A Shared and Weighty Responsibility" (Dec. 9, 2015), https://www.sec.gov/news/speech/keynote-2015-aicpa-white.html.

Governance (ESG) Reporting" and "Why Enhanced Securities Disclosures Matter for Long-Termism."

Should you have any questions or wish to speak in further detail about my testimony, please do not hesitate to contact me at alison@icar.ngo.

Sincerely,

Alison Friedman
Executive Director
International Corporate Accountability Roundtable (ICAR)



# "KNOWING AND SHOWING"

## USING U.S. SECURITIES LAWS TO COMPEL HUMAN RIGHTS DISCLOSURE

A REPORT BY

THE INTERNATIONAL CORPORATE ACCOUNTABILITY ROUNDTABLE (ICAR)

ENDORSED BY

PROFESSOR CYNTHIA WILLIAMS

## Endorsement

This document has been reviewed, edited, and endorsed by Professor Cynthia A. Williams.

Professor Cynthia A. Williams joined Osgoode Hall Law School on July 1, 2013 as the Osler Chair in Business Law, a position she also held from 2007 to 2009. Before coming to Osgoode, she was a member of the faculty at the University of Illinois College of Law and, prior to that, she practiced law at Cravath, Swaine & Moore in New York City.

Professor Williams writes in the areas of securities law, corporate law, corporate responsibility, comparative corporate governance, and regulatory theory, often in interdisciplinary collaborations with professors in anthropology, economic sociology, and organizational psychology.

Professor Williams' work has been published in the Georgetown Law Journal, the Harvard Law Review, the Journal of Corporation Law, Theoretical Inquiries in Law, the University of New South Wales Law Journal, the Virginia Law Review, and the Academy of Management Review.

## Acknowledgment

ICAR would like to acknowledge the following individuals who participated in the production of this report: Stephen Winstanley, Katie Shay, Sara Blackwell, Kendall Scott, Mike Lally, and Caitlin Peruccio.

Amol Mehra, Esq.

Director, International Corporate Accountability Roundtable (ICAR)

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# Introduction

After decades of economic globalization and trade liberalization, traditional legal and regulatory enforcement systems have proved to be inadequate in holding corporations accountable for the adverse social impacts of business activities. Due partly to limitations on courts' jurisdictional authority over extraterritorial activities of corporations[1] and weaknesses in the rule of law in operating jurisdictions,[2] corporations have functioned in an environment where regulations that are intended to hold them accountable for the way in which they conduct business are insufficiently enforced.[3] Yet, public reaction to recent corporate disasters such as the factory collapse at Rana Plaza in Bangladesh,[4] the adoption of socially responsible investment policies by a broad cross-section of investors,[5] and international policy convergence on the responsibility of businesses to respect human rights[6] all indicate that human rights concerns related to business activities are relevant and material to a broad set of stakeholders.

In recent years, public attention on business-related human rights abuses has grown in a wide variety of industries. Popular disapproval of corporate complicity in human rights violations has manifested in the form of direct boycotts by consumers, as well as pressure from an investor community that is increasingly interested in social issues. For instance, the garment industry has received widespread and largely negative attention after multiple deadly factory disasters in Bangladesh, including the Tazreen Fashions fire that killed 114 workers in Dhaka on November 24, 2012[7] and the Rana Plaza factory collapse on April 24, 2013 that left more than 1100 workers dead.[8] In addition, the information and communications technology industry has struggled to effectively self-regulate and monitor labor standards in its supply chains, as demonstrated by the frequent publicity surrounding the harsh conditions facing workers at the FoxConn factory complex in China.[9] The extractives industry has similarly faced scrutiny for adverse working conditions, human rights abuses by security personnel at mines,[10] forced labor and other modern forms of slavery,[11] and the contamination of ground water supplies.[12]

In response to these types of incidents, consumers have increasingly taken direct action to boycott and encourage divestment from socially irresponsible companies.[13] Certification labels such as "Rainforest Alliance"[14] and "Fair Trade"[15] have become sought after by companies in order to market their products to socially-motivated purchasers. Moreover, investors are adopting socially responsible policies to guide their decisions and are expecting valuable returns on their outlays as a product of doing so, as indicated by the rising asset values of socially responsible investment funds in the United States over the past two decades (from $639 billion in 1995 to $3.74 trillion in 2012).[16] Mainstream institutional investors, including institutional mutual and equity funds, have also signed onto international principled investing standards, joining more than 1188 signatories to the United Nations Principles for Responsible Investment—altogether commanding a total of more than $34 trillion (or over 15% of the world's investable assets) in market capital.[17]

A company's reputational risk—the material damage to a company's reputation as a result of social missteps—can therefore result in significant business costs. As has been shown in a multitude of instances, consumer and client preferences can change dramatically upon the discovery of human rights risks. Employees, recruits, investors, and shareholders alike may seek to disassociate from a corporation that is implicated in human rights violations. This ripple effect from the discovery of human rights risks and impacts can negatively alter any competitive advantages that a business might have because of changes in public perception. For example, the rise in popularity of "fair trade" coffee illustrated this effect when major coffee shops faced backlash and demands from customers before agreeing to serve fair trade certified coffee.[18] Now, more than ever, consumers and investors are making the conscious decision to purchase from and invest in companies that utilize an ethical supply chain and are not complicit in human rights violations. As such, companies should reasonably expect consumers and investors to prefer and even demand complete and accurate information concerning human rights risks before making the decision to purchase or invest.[19]

In the absence of enforceable and uniform regulations for corporate accountability at the global level, domestic law must work to answer this call for corporate accountability. U.S. securities regulation is a key and promising area for such domestic efforts as it is based on a philosophy that uses transparency to allow market actors to hold corporations accountable for social conduct and standards.[20] This paper applies that purposeful logic to provide a road-map for how U.S. securities laws can be used to create conditions for investors to hold companies accountable for their social and human rights impacts. Market actors can and should motivate companies to act more responsibly regarding their impact on human rights by allocating capital resources to more responsible companies. However, market actors can only do so if there is transparent, clear, and comparable disclosure of those human rights risks and impacts, as well as the policies and procedures that are related to the assessment and management of such risks and impacts.

This paper argues that human rights are materially relevant to corporate securities reporting and encourages the U.S. Securities and Exchange Commission (SEC) to guide businesses in reporting material human rights information in their periodic and proxy disclosure reports. First, the paper outlines the legal framework for securities disclosure regulations that are relevant to human rights. Second, the paper explains the methodology for assessing whether information related to corporate activities is material and uses this methodology to analyze whether human rights information is material to corporate securities disclosures. Finally, the paper proposes a plan for implementing disclosure of material human rights information related to business activities, incorporating human rights due diligence standards at the global level to assess and identify material human rights risks and impacts.

As part of this proposed plan, this paper identifies two alternative and complementary actions that the SEC could take to clarify precisely how issuers should disclose material human rights information. First, given its authority to issue interpretive guidance, the SEC should provide such guidance in order to explain how material human rights information should be incorporated into

existing securities reporting items. Second, given its authority to promulgate new regulations for the public interest or the protection of investors,[21] the SEC should promulgate a new rule specifically requiring disclosures of human rights information, organized in a new reporting item for periodic reports or proxy disclosures. Interpretive guidance would facilitate mandatory reporting under existing rules by clarifying the materiality of human rights information to investors, whereas a new rule could establish clear and organized disclosure of human rights matters in a new reporting item, enabling investors to easily review this information in their capital allocation decisions.

## The Legal Framework: U.S. Securities Reporting Standards

The SEC was established by the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act").[22] Its mission is to promote the public interest by protecting investors, facilitating capital formation, and maintaining fair, orderly, and efficient markets.[23] More recently, the Sarbanes-Oxley Act of 2002[24] and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010[25] were passed in response to accounting scandals and securities market abuses that destabilized the domestic and global economy, further impacting the SEC's mission and mandate.[26]

The intellectual architects of the U.S. securities regulation system favored the use of transparency as a regulatory mechanism, not only to ensure accurate pricing of securities in the marketplace,[27] but also to motivate changes in business behaviors by exposing corporate conduct to public scrutiny.[28] Based on this foundational architecture, transparency became one of the primary mechanisms for implementing the investor protection and public interest purposes of U.S. securities regulations.[29] The debates within the U.S. House of Representatives on both the Securities Act and the Exchange Act clearly indicate that public disclosure of information was intended to affect the way business is performed, including in ways that increase the social responsibility of business conduct.[30]

This section will outline the legal framework of securities law in the United States. Corporate securities reporting essentially involves two steps: (1) identifying and collecting the type of information required for disclosure under securities regulations and (2) filtering that information by determining what is "material" for disclosure to the SEC, investors, and shareholders.

### A. The Disclosure Provisions

Securities-issuing entities are required to publicly report information to enable investors and shareholders to make informed investment decisions and allocate capital resources efficiently. Under U.S. securities law, issuers must disclose information publicly to the SEC at the following regular intervals: (1) at the initial public issuing of securities, (2) at registration of securities, (3) at quarterly and annual periodic intervals, (4) as part of proxy solicitation disclosures for the annual shareholders meeting, and (5) at the occurrence of extraordinary events such as a tender offer, merger, or sale of the business.[31] The integrated disclosure requirements for registered securities are organized in the comprehensive Regulation S-K (or Regulation S-B for small businesses).[32] Additionally, shareholders have the authority to demand disclosures beyond those required under Regulation S-K by using their power to bring resolutions during the proxy solicitation process for annual shareholders meetings.[33] These regulations are buttressed by a number of other rules: (1) Rule 408, promulgated pursuant to the authority of the Securities Act, and Rule 12b-20 of the Exchange Act, both of which require additional disclosure of material

information necessary to ensure that required disclosures are not misleading,[34] and (2) Rule 10b-5, promulgated pursuant to the authority of Section 10(b) of the Exchange Act, which establishes legal liability for those responsible for fraudulent or untrue statements or omissions in disclosures connected with the purchase or sale of securities.[35]

In order to ensure that the information disclosed in securities reports is useful to investors, issuers are only required to report information that is "material" to the users of their reports.[36] In the case of periodic securities reports, the intended users are potential investors and existing shareholders. Materiality is both an accounting and securities law concept for classifying information as significantly relevant to understanding the past, current, and future value and performance of the issuer's securities. It is judged based on factoring the quantitative and qualitative importance of the information in evaluating the issuer and in relation to the intended users of the report.[37] For securities reports, information must be disclosed that is: (1) specifically required under Regulation S-K or necessary to ensuring that required disclosures are not misleading[38] and (2) material to investors' or shareholders' decision-making processes in accurately valuing securities, in particular for the purpose of choosing to buy or sell securities.[39]

### I. Regulation S-K and Periodic Disclosure of Non-Financial Information

Regulation S-K outlines the standard instructions for corporate securities disclosures required by U.S. securities regulations. These regulations inform the initial obligation to disclose specific types of information in prospectuses for the sale of new securities, in companies' periodic and extraordinary occurrences reports, and in companies' proxy statements in conjunction with their annual meeting. In addition to a company's registration statement, there are four primary categories of disclosures for periodic reporting, including descriptions of the registrant's (1) business, (2) securities, (3) financial information, and (4) management.[40] Issuers are required to provide periodic disclosures quarterly on the SEC's Form 10-Q and annually on the Form 10-K.[41]

Several provisions of Regulation S-K require descriptive disclosures that may incorporate material non-financial information. Key provisions that require discussion of non-financial information include Item 101 (description of business), Item 103 (legal proceedings), Item 303 (management's discussion and analysis), Item 307 (disclosure controls and procedures), and Item 503(c) (risk factors).[42] The SEC occasionally issues interpretive guidance releases to clarify the information issuers are expected to disclose and how the Commission staff evaluates disclosures by issuers.[43]

*Description of Business, Item 101*

The description of business under Item 101 should indicate general developments in the business during the previous five years, including any material changes in the mode of doing business and a forward-looking description of the plan of operation for the next reporting period.[44] Depending on the timing of the report, projections must outline the plan for the remainder of the fiscal year or for that period and an additional six-months into the next fiscal year.[45] This item includes three primary disclosures: (1) general development of business, (2) financial information about business segments, and (3) a narrative description of business.[46]

The narrative description of business requires disclosures encompassing all areas of the business operations. An issuer must disclose the principal products and services involved in the issuer's business, the status of each business segment or new product (e.g. planning, prototype, design-selection, re-engineering stages), the sources and availability of raw materials, the status and importance to the business valuation of all intellectual property, and the extent to which business segments are or may be seasonal in nature.[47] There must be a description of the principal methods of competition and positive and negative factors related to the issuer's competitive position should be reported.[48] Finally, material effects on capital expenditures from compliance with federal, state and local provisions related to environmental protection must be explained appropriately.[49]

*Legal Proceedings, Item 103*

Under Item 103, issuers must disclose information relating to any pending legal proceedings involving the issuer, any of its subsidiaries, or any of their property as a party to litigation where the proceedings could have a material impact on the issuer.[50] This reporting requirement is limited in scope by the qualifications that pending litigation must be other than routine litigation incidental to the business, and it must have the potential to result in damages exceeding ten percent of the issuer's current assets.[51] Where several cases based on the same legal or factual issues are pending or are being contemplated, the amount of potential damages must be calculated by aggregating the claims.[52] These limitations do not directly apply where the proceeding arises from a law or regulation for the purpose of environmental protection or where a governmental authority is a party to the proceeding and it involves potential monetary sanctions of more than $100,000.[53] In each of these cases, an issuer may only limit their reports if the proceeding's outcome is immaterial to the business or financial condition of the issuer or if the penalty where the government is a party is unlikely to be an actual fine of $100,000 or more.[54]

### *Management's Discussion and Analysis, Item 303*

Management's Discussion and Analysis ("MD&A") under Item 303 is intended to provide a narrative description of management's views concerning the financial condition of the company and the results of business operations, with a particular emphasis on future prospects and risks.[55] This section should add value to the overall disclosures provided by the company and supply a contextual basis for investors to analyze financial information.[56] To do so, the MD&A must include reporting covering three subjects: liquidity, capital resources, and results of operations. Detailed instructions of explicit requirements in discussing each of these subjects are found in Instruction 5 to Item 303(a).[57] Essentially, the reporting requirements focus on management identifying any known trends, events, or uncertainties that will or are "reasonably likely" to result in favorable or unfavorable material effects to the issuer's liquidity, capital resources, or operating results—such as net sales, revenues, or costs from continuing operations.[58] These disclosures are intended by the SEC to be made in a meaningful, company-specific manner and should not use "boilerplate" phrasing and generalities.[59]

### *Disclosure Controls and Procedures, Item 307*

Item 307 requires an issuer's principal executive or financial officers, or the functioning equivalent, to disclose their conclusions regarding the effectiveness of internal disclosure controls and procedures.[60] This will require a short, narrative explanation of the executives' understanding of the internal processes and an affirmation of the effectiveness of the procedures that are in place. Generally, this will require disclosure outlining the due diligence and auditing measures the company uses to identify, assess, and evaluate required categories of information in preparation of the annual, quarterly, and special reports required by securities regulations.

### *Risk Factors, Item 503(c)*

Item 503 is specific to prospectus disclosure as initially promulgated, but is recently incorporated into Item 1A for quarterly and annual reporting. In Item 503, the issuer is required to briefly summarize their prospectus in plain English, including a distinct section captioned "Risk Factors" to discuss the most significant factors that make the offering speculative or risky.[61] This typically includes risks of changes in the competitive landscape or market demand, fluctuations in political stability or other operating conditions, climate change risks and associated cost increases, and other such unpredictable variations in the business environment that may damage capital formation or financial performance.[62] This narrative discussion is specifically required to be "concise and organized logically," with risks presented that are tailored to the specific issuer

and their business.[63] It must be placed immediately following the summary section or any price-related information or directly after the cover page, if there is no summary.[64]

The risk factor discussion must explain how the risk affects the issuer and clearly express each risk factor in a sub-caption that adequately describes the risk.[65] The description of Item 503(c) in Regulation S-K specifically identifies risk factor categories in a non-exhaustive list, including lack of an operating history, lack of profitable operations in recent periods, financial position, business or proposed business, and the lack of a market for the issuer's common equity securities. The list provided is suggestive, but item 503(c) is clear that all of the most significant factors that make the offering speculative or risky must be disclosed.[66]

## II. Shareholder-Demanded Disclosure Using Shareholder Resolutions, as Permitted Under Exchange Act Section 14(a), Regulating Proxy Solicitations and the SEC's General Powers Under Section 14(a)

Company-specific disclosure may also arise based on a successful shareholder resolution (also called shareholder proposals). Under state corporate law, securities owners have the power to put appropriate items on the annual meeting agenda. In Section 14(a) of the Exchange Act, the SEC is given general authority to regulate the process of soliciting proxies in conjunction with the annual meeting. In Rule 14a-8, the SEC has identified the procedural and substantive requirements for shareholders' resolutions. If a shareholder resolution asking for information from the issuer receives majority support in the proxy solicitation process, then the information may be forthcoming.[67]

Companies may seek a no-action position from the SEC staff to protect them from later SEC enforcement action if the company decides not to include certain shareholder resolutions in the company's annual proxy statement. Permissible reasons to exclude shareholder proposals are set out in Rule 14a-8, question 9.[68] Exclusion may be permissible based on the proposal violating one of the eligibility or procedural requirements of Rule 14a-8 or if it falls within one of the rule's thirteen substantive bases for exclusion.[69] If there is no basis to exclude a shareholder proposal, the issuer must include the proposal in its proxy solicitation for shareholders to consider.

Additionally, under the broad authority delegated to the SEC by Section 14(a) of the Exchange Act, the Commission is entitled to regulate the proxy solicitation process "as necessary or appropriate in the public interest or for the protection of investors."[70] It has been argued that this mandate was intentionally designed to allow the SEC to establish rules that would permit shareholders to hold companies accountable for their actions, including by promulgating proxy disclosure rules that would provide shareholders with more information about the companies' actions.[71] The challenge for any proponent of new proxy disclosure rules lies in gaining

sufficient support for any proxy disclosure request in order to instigate the SEC rule-making process under section 14(a).

### III. Rules 408 and 10b-5: Ensuring Completeness, Accuracy, and Responsibility in Disclosures

Supplementary provisions of the Securities and Exchange Acts buttress the specific disclosure requirements in Regulation S-K. First, Securities Act Rule 408 and Exchange Act Rule 12b-20 provide a "catch-all" requirement to disclose any further material information necessary to ensure the overall disclosures are not misleading.[72] Then, Rule 10b-5 attaches personal liability for fraud, misstatements, or omissions to the individuals responsible for preparing and certifying the disclosures as true, accurate, and complete. These provisions act to complement disclosure requirements and ensure that managers and internal reporters have incentives to ensure that the information they are disclosing is complete, accurate, and true.

According to Securities Act Rule 408 and Exchange Act Rule 12b-20, issuers are required to add any material information necessary to ensure their disclosures are not misleading. The specific language of both Rule 408 and Rule 12b-20 require "such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading."[73] These rules act as a "catch-all" to ensure that issuers are required to disclose any additional material information necessary to ensure that information disclosed is not misleading—in essence, to guard against half-truths.

Section 10(b) and Rule 10b-5 of the Exchange Act create liability for using deceptive or manipulative devices in connection with the purchase or sale of securities.[74] In particular, according to Rule 10b-5 (b) it is unlawful for any person to directly or indirectly "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading . . . in connection with the purchase or sale of any security."[75] This liability, in relation to periodic securities disclosures, attaches to the individuals involved in preparing the statements of material fact and to those who are required to certify that the material statements of fact are true and complete—usually the Chief Executive Officer, Chief Financial Officer, or similarly empowered high-level executive. This liability applies to materially misleading statements even where there is no affirmative duty to disclose such information.[76]

In making a claim for violation of Rule 10b-5, the plaintiff must prove several elements. They must show: (1) that the defendant is subject to Rule 10b-5, (2) that there was a misrepresentation or omission, (3) of a material fact, (4) made with the intent to deceive or recklessness in the misstatement, (5) upon which the plaintiff relied, (6) in connection with either a purchase or sale of a security (7) causing (8) damages.[77] While reliance is a part of the plaintiffs' case, it may be presumed in certain cases. In omission cases, reliance may be presumed if the omission is of a

material fact, and in misstatement cases there is a rebuttable presumption of reliance when the security is trading in an efficient market since the misstatement will operate as a "fraud on the market," affecting the market price.[78] Therefore, incentives are created to promote accuracy and completeness in periodic disclosures in part because the individuals responsible for preparing the information and certifying the disclosures may be personally liable for any fraudulent material inaccuracies or omissions.

## B. What is "Material" for Corporate Disclosures?

The first part of the disclosure process involves collecting information based on the items specifically required under Regulation S-K, any information demanded by successful shareholder disclosure proposals, and the blanket requirements to include additional material information as necessary to ensure the disclosures are not misleading. Once this information is gathered, the issuer must determine what information is "material" and thereby subject to public disclosure and what information is immaterial and thereby not required to be disclosed publicly.[79] The second part of the disclosure process requires a subjective filtering of information related to required disclosure items through a screen of materiality, with the goal of ensuring that public disclosures are useful to investors and shareholders in assessing current and prospective corporate performance.

The Supreme Court of the United States has laid out a clear legal standard for identifying what is "material" for securities reporting. The standard is driven by the rationale behind the Securities Acts to "substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry."[80] It is tempered by the judicial concern that "a minimal standard might bring an overabundance of information within its reach,"[81] and lead management to overburden the market with disclosures that did not enable "informed decision-making."[82]

A fact is material if "there is a substantial likelihood that a reasonable investor would consider it important" and would have viewed the information "as having significantly altered the 'total mix' of information made available."[83] The Court explains that assessing whether a fact is material "requires delicate assessments of the inferences a 'reasonable shareholder' would draw from a given set of facts and the significance of those inferences to him."[84] Whether a fact is material "depends on the significance the reasonable investor would place on the . . . information."[85]

Regarding speculative or contingent information, including much forward-looking information, Supreme Court precedent calls for companies to balance "the indicated probability the event will occur and the anticipated magnitude of the event in the light of the totality of company activity."[86] Adopting the reasoning from earlier cases, the Court expects the significance of each fact to be assessed in relation to all other available information.[87]

The SEC has provided additional guidance in recent years to assist companies with determining materiality. In Staff Accounting Bulletin No. 99 ("SAB 99"), the SEC clarifies that materiality cannot be determined based on a bright-line quantitative criterion alone and that even information that is purely qualitative could, in the context of all other available information, be material to corporate securities disclosures.[88] In particular, SAB 99 dispelled the popular rule-of-thumb that any fact which could not result in a financial impact of at least 5% on any quantitative category was not material.[89] SAB 99 provided some guidance for accountants to consider qualitative characteristics in determining materiality by listing hypothetical situations where qualitative information would be considered material by SEC staff.[90]

Materiality determinations require the accountants and managers preparing securities reports to assess the qualitative and quantitative characteristics of information to identify information that a reasonable investor would consider important enough to significantly alter the "total mix" of information available.[91] The certainty or uncertainty of a fact, trend, or event's occurrence—and the nature and scope of the impact on corporate performance of that occurrence—will all affect whether it is material.[92] These subjective determinations should be guided by balancing the purposes of securities regulation in providing sufficiently accurate, detailed, and comparable information to protect investors and ensure fair, orderly, and efficient markets against a judicious temperance to refrain from overwhelming the market with a flood of useless information.[93]

# Demonstrating Materiality: Human Rights Impacts, Risk Assessments, and Procedures Are Material for Corporate Securities Disclosures to the S.E.C.

Materiality derives from the general public, international and national governments, and businesses treating a particular area or impact of business activity with heightened interest.[94] In 2010, the SEC re-evaluated the materiality of information related to climate change in light of increasing interest from the public, academics, businesses, domestic and international government, and other stakeholders.[95] In doing so, the Commission outlined the process for considering whether a topic has become popularly relevant to the level of "material" to corporate reporting. Key factors considered include: heightened public interest in recent years (including academic, government, business, investors, analysts, or the public at large); international accords and efforts to address a topic of concern on a global basis; federal regulations or state and local laws in the United States; and voluntary recognition of the current and potential effect of the category of information on companies' performance and operations by business leaders.[96] The SEC addresses these key factors by analyzing the level of interest in climate change according to three primary elements: (1) recent regulatory, legislative, and other developments; (2) the potential impact of climate change related matters on public companies; and (3) current sources of climate change-related disclosures regarding public companies.[97] Within each element, the materiality of any category of information is supported by trends of public interest, international community action, domestic legislative action, and voluntary business action expressing an acknowledgment of material significance.

This section provides evidence that the significance of human rights information to investors and the public has evolved to a level that requires its disclosure as material information in securities reports. First, recent regulatory, legislative, and other developments in the US and international spheres are presented. Second, the potential impacts of human rights-related matters on public companies are outlined using examples from recent years. Finally, current sources of human rights-related disclosures regarding public companies are outlined. This evidence supports the conclusion that human rights are material to investors. Securities regulations must recognize this materiality by providing guidance for issuers to disclose information related to human rights risks and impacts in a clear, consistent, and comparable manner in their reports to the SEC.

## A. Recent Regulatory, Legislative, and Other Developments

Legislators, regulators and international policy-makers have indicated that the human rights risks and impacts arising from globalized business activities require concerted global action. Domestic

legislators and regulators in the United States have adopted public policies and rules at the federal, state, and local levels that address corporate social responsibility and enhance corporate transparency relating to human rights.[98] The international community has endorsed defined roles for States and businesses in the UN's "Protect, Respect, Remedy Framework"[99] and the "Guiding Principles" for implementing this framework in the business and human rights context.[100] Furthermore, the United States government has endorsed the Guiding Principles and has been encouraged by members of civil society to develop a plan for national implementation.[101] Stakeholders in business and civil society have come together with initiatives to develop particular standards and processes for addressing human rights risks and impacts through voluntary action.[102]

## I. Federal Government Regulatory Efforts

Federal legislators and administrative agencies in the United States have used their authority to promote corporate respect for human rights and to provide greater transparency to investors and the public on human rights risks and impacts related to business activities. In the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Congress required transparency from companies in special securities disclosures to address corruption and bribery, mine safety, and conflict minerals sourcing.[103] The SEC interpretive guidance for disclosures related to climate change[104] and to cyber-security information[105] has directed companies to disclose socially important information similar to human rights concerns under existing securities disclosure rules in Regulation S-K. Finally, the State Department issued rules requiring transparency for new investments in Burma in May 2013.[106]

### *Dodd-Frank Special Disclosure Provisions*

In the Dodd-Frank Act of 2010, the U.S. Congress employed the mechanism of securities disclosures to require transparency regarding mine safety,[107] payments by resource extraction companies to governments,[108] and supply chain due diligence by manufacturers who source minerals from the Congo region of Africa.[109] These provisions directed the SEC to issue rules requiring issuers to disclose information related to these three activities with the apparent goals to enhance awareness about dangerous mining conditions, combat corruption in foreign governments, and eliminate funding for armed groups perpetuating conflict and human rights violations in the Congo.[110] Although Congress determined that these purposes fit within the mandate of the SEC, some observers have questioned the role of the SEC in compelling disclosures of this information and the materiality to investors.[111] Investors, meanwhile, have commented on the rule-making processes for each section and provided considerably favorable

feedback as they seek access to information regarding the social and human rights impacts of business activities of issuers conducting operations in conflict-affected and weak governance areas.[112]

Section 1502 of the Dodd-Frank Act mandates that the SEC issue a rule requiring companies to determine whether certain minerals used in the production of their manufactured goods originated in the Democratic Republic of Congo (DRC) or neighboring countries and whether the trade in those minerals has financed or benefitted armed groups. The SEC rule implementing Section 1502 requires companies that file reports with the SEC to determine whether they source designated minerals from this region. If they do, and those minerals are necessary to the functionality of the manufactured goods they are used to produce, the company should be required to conduct supply chain due diligence to determine whether their mineral purchases are providing funding directly or indirectly to armed groups perpetuating conflict and violence in the DRC. [113] As part of the required disclosures, companies must describe the specific measures taken to exercise due diligence.[114] The rule follows a "comply or explain" philosophy, requiring companies to comply and show their efforts or explain their non-compliance and show what efforts they have undertaken to comply.

Section 1503 of the Dodd-Frank Act calls for the SEC to require specific periodic disclosure by issuers operating coal or other mines of information detailing health and safety violations or a pattern of such violations in their operations.[115] The SEC rule implementing this disclosure is based on the Federal Mine Safety and Health Act of 1977 (Mine Safety Act) and expands the level of detailed information about mine safety issues that must be publicly disclosed.[116] This rule requires issuers to report the receipt of certain notices from the Mine Safety and Health Administration (MSHA) on current report disclosure Form 8-K, which must be filed within four business days of specific material events to provide an update to quarterly or annual reports.[117] Further, the rule requires that quarterly and annual reports include aggregated totals for: (1) health and safety violations, orders, or citations under the Mine Safety Act; (2) the potential costs of proposed assessments from the MSHA under the Mine Safety Act; and (3) mining-related fatalities during the reporting period.[118]

Finally, Section 1504 authorizes the SEC to demand resource extraction companies disclose any and all payments made to domestic or foreign government officials. Under this requirement, companies are expected to submit information to the SEC in interactive data format, detailing: (1) total amounts of payments by category, (2) the business segment that made the payments, (3) the government that received the payments, (4) the country in which they are located, and (5) the project of the issuer to which the payments relate.[119] The SEC is given authority to require any other information considered "necessary or appropriate in the public interest or for the protection of investors."[120] This rule may be limited by a *de minimus* exemption, allowing companies to refrain from disclosing very minimal payments, but the statute indicates the Commission should be guided in its rulemaking by the guidelines set out in the Extractive Industries Transparency

Initiative—a voluntary international multi-stakeholder initiative for extractive companies and governments to publish payments made and received related to resource extraction projects.[121]

Critics of these specialized disclosure requirements argue that they go beyond the scope of the SEC's authority by targeting public policy goals unrelated to investor protection, market efficiency, or capital formation.[122] They argue that the original purpose of the SEC is being manipulated for federal policy-making goals because the SEC is the only regulatory body capable of commanding regulatory compliance across all industries.[123] However, these criticisms appear to fail to consider the legislative mandate to the SEC to regulate "as necessary or appropriate in the public interest or for the protection of investors," as in Section 14(a) of the 1934 Act.[124] These criticisms also fail to consider the legislative history describing the original intended purposes of federal securities regulation, which have been argued to include establishing greater social responsibility in corporate conduct.[125] Congress has the authority to mandate rulemaking on specific items where it is deemed in the public interest.[126] Further, investor groups have actively advocated for the materiality of the information to be disclosed under these provisions for their decision-making processes.[127]

### *SEC Guidance on Climate Change and Cyber-Security*

The SEC has recently been engaged in clarifying the disclosure requirements of non-financial information related to climate change and cyber-security in securities reports. Each of these releases has indicated how existing securities regulations may require disclosure of information related to climate change or cyber-security matters where they are material to the issuer or any of its business segments.[128] Both discuss how the costs of compliance with laws and regulations to prevent and mitigate risks related to climate change or cyber-security may result in material expenses necessary to report in financial disclosures. Further, both detail how the description of business, legal proceedings, MD&A, and risk factors items in Regulation S-K may compel issuers to address cyber-security or climate change risks or incidents.[129] The climate change guidance identifies specific provisions in Regulation S-K that have been enacted during the past four decades of rulemaking and interpretive guidance on disclosures related to environmental protection or climate change matters.[130] The cyber-security guidance also details how the disclosure controls and procedures section may require disclosure of the effectiveness of cyber-security measures or any deficiencies that could render them ineffective.[131]

### *State Department Responsible Investment in Burma Reporting Standards*

The U.S. Department of State recently released their Responsible Investment Reporting Requirements for all U.S. businesses investing more than US$500,000 in Burma, effective May

23, 2013.[132] Companies must publicly provide summaries or copies of the policies and procedures relating to operational impacts on human rights, community and stakeholder engagement in Burma, and grievance processes.[133] They must outline their human rights, worker rights, anti-corruption, and environmental due diligence policies and procedures, including those related to risk and impact assessments.[134] Further, they must report to the State Department their policies and procedures relating to security service provision and military communications.[135]

### *Foreign Corrupt Practices Act*

Congress has been involved in regulating corporate conduct in transactions and business activities abroad at least since 1977, when it passed the Foreign Corrupt Practices Act[136] (FCPA), prohibiting the use of bribery to foreign government officials to assist in obtaining or retaining business.[137] The prohibition of promises, offers, or payments of bribes to foreign officials applies anywhere in the world and extends to public companies and their officers, directors, employees, stockholders, and agents—including consultants, distributors, joint-venture partners, and others.[138] The FCPA also requires that issuers (1) make and keep books and records that accurately reflect the corporation's transactions and (2) put in place a system of internal accounting controls to adequately oversee and account for corporate assets and transactions.[139] These records and internal controls help the issuer identify, prevent, mitigate, and remedy any offending conduct.

## II. State and Local Government Regulations or Laws

States have the primary legislative authority to regulate corporate governance and liability in U.S. law. Several states have engaged their legislative authority or are considering laws to address human rights risks and impacts arising from business activities. In 2011, California became the first state to pass a law preventing companies under scrutiny for ineffective compliance with the Dodd-Frank conflict minerals supply chain reporting requirements from eligibility to bid on state procurement contracts.[140] Maryland passed a similar law in 2012, and Massachusetts is presently considering legislation to follow suit.[141] Additionally, California has enacted the Transparency in Supply Chains Act of 2010, requiring transparency related to corporate efforts to monitor supply chains to combat slavery or human trafficking.[142] Through these laws, legislators in California, Maryland, and Massachusetts are clearly indicating that they are interested in holding corporations accountable for their conduct abroad, including the direct or indirect financing of conflict and crimes against humanity in their supply chains for mineral resources.

## III. International Community Actions to Address Business and Human Rights Concerns on a Global Basis

The international community has taken actions at several levels to address business and human rights concerns on a global basis. The United Nations has engaged stakeholders and developed frameworks for global action through defined roles of governments and businesses in upholding human rights, standards for responsible and principled investing, and guiding principles for businesses to implement their responsibilities to respect human rights.[143] International organizations such as the Organization for Economic Co-operation and Development ("OECD") and the International Organization for Standardization ("ISO") have also released guidelines for businesses to implement their social and human rights responsibilities that incorporate and expand upon the standards of the Guiding Principles.[144] The European Union is currently preparing legislation to require corporations to publicly disclose information related to human rights and other non-financial social and environmental impacts of business activities.[145] Additionally, businesses, governments and civil society groups have come together voluntarily in multi-stakeholder initiatives ("MSIs") to address particular concerns and create best practices approaches in the form of standards and mechanisms to protect against adverse human rights risks and impacts of business activities.[146] Each of these international mechanisms will be discussed in turn.

### *UN Frameworks and International Standards*

The United Nations has progressed from voluntary multi-stakeholder initiatives—such as the UN Global Compact[147]—to consultative approaches seeking to develop international standards that can be incorporated into domestic laws and that follow the "Protect, Respect Remedy" Framework[148] and the Guiding Principles for Business and Human Rights.[149] These frameworks provide a "common global platform for action" for governments and businesses to act to prevent and remedy adverse human rights risks and impacts related to business activities and operations.[150] The OECD has provided insight and standards with its Guidelines for Multinational Enterprises (OECD Guidelines),[151] and the ISO has introduced direction with its Standard 26000 for "Social Responsibility."[152]

The UN Global Compact was launched in July 2000 as a "platform for the development, implementation, and disclosure of responsible and sustainable corporate policies and practices."[153] It is a voluntary initiative which calls on corporations and interested stakeholders to join the Compact and commit to embracing, supporting, and enacting—within their spheres of influence—its Ten Principles, covering human rights, labor, environment, and anti-corruption standards.[154] The Ten Principles are derived from the Universal Declaration of Human Rights, the International Labour Organization's Declaration of Fundamental Principles and Rights at

Work, the Rio Declaration on Environment and Development, and the UN Convention Against Corruption.[155] Since its inception, it has grown to contain over 10,000 corporate participants and to include stakeholders from over 130 countries.[156]

Building from the "Protect, Respect, Remedy" framework that was passed in 2008, the UN Special Representative on Business and Human Rights developed the Guiding Principles on Business and Human Rights.[157] The Guiding Principles provide a "common global platform for action, on which cumulative progress can be built" towards realizing the protection of, and respect for, human rights through State and business actions.[158] They are a series of 31 practical principles to guide the implementation of the State duty to protect human rights, the business responsibility to respect human rights, and the provision of access to remedy for human rights abuses and violations.[159] Businesses are encouraged to apply these principles appropriately according to their size, complexity, and operating contexts to ensure that they are respecting human rights.[160]

In particular, the Guiding Principles call for businesses to adopt policies and build a corporate culture that respects human rights. They are advised to do this by implementing human rights due diligence processes to identify, prevent, mitigate, and account for how they address adverse human rights impacts arising from their business.[161] This due diligence should include "assessing actual and potential human rights impacts, integrating and acting upon the findings, tracking responses, and communicating how impacts are addressed."[162] Businesses are advised to engage with stakeholders throughout the process and to be prepared to communicate their human rights impacts externally when concerns are raised or when risks of severe human rights impacts are identified.[163]

Additionally, the UN has developed widely accepted Principles for Responsible Investing ("UN PRI"). These principles were launched in 2006 and now have almost 1200 investor signatories, with assets under management standing at more than $34 trillion—or more than 15% of the world's investable assets.[164] The rapid growth of the UN PRI shows that investors—in particular large, institutional investors—are quickly integrating responsible investment policies and criteria into their decision-making calculus. The UN PRI emphatically believes that environmental, social, and governance issues are materially relevant to investors and, although it recognizes the limitations of available research data, it is firm in its confidence that these issues are financially significant.[165]

The OECD Guidelines for Multinational Enterprises ("OECD Guidelines") provide a set of non-binding principles and standards for responsible business conduct in the global context that follow applicable local laws and internationally recognized standards.[166] These standards are implemented through the National Contact Points (NCPs) mechanism, which are government agencies tasked with promoting the OECD Guidelines and assisting MNEs and their stakeholders in implementing the standards.[167]

Under the Guidelines, MNEs are required to disclose material information regarding their: (1) policies and codes of conduct; (2) performance in relation to those statements and codes; (3) internal audit, risk management, and legal compliance systems; and (4) relationships with workers and other stakeholders.[168] The "Commentary on Disclosure" indicates that the purpose of transparency should be to address the increasingly sophisticated public demands for information, including social, environmental, and risk reporting.[169] The 2011 edition of the Guidelines aligns its human rights standards with the UN Framework and Guiding Principles.[170] They require companies to "respect human rights" through: (1) policy commitments; (2) actions to prevent or mitigate adverse human rights impacts directly linked to their operations, products, or services; (3) carry out human rights due diligence appropriate to their circumstances, and (4) empower legitimate processes for the remediation of human rights impacts where they are implicated.[171]

The OECD has developed sector-specific standards in the Due Diligence Guidance for Responsible Supply Chains from Conflict-Affected and High Risk Areas[172] (OECD Due Diligence Guidance). The OECD Due Diligence Guidance provides a five-step process for companies to conduct due diligence, undertake risk assessments, mitigate and monitor risks in the supply chain, and participate in audit programs for external, independent assurance.[173] Finally, the process requires annual disclosure of risk assessment reports, detailed descriptions of how due diligence processes have been reviewed and verified, and what steps are taken to regularly monitor changing circumstances of supply chains.[174]

The ISO has developed a standard to reflect consensus, state-of-the-art standard best practice for social responsibility to assist organizations in contributing to sustainable development.[175] Through a holistic approach that incorporates seven core subjects, the ISO 26000 standard provides practical guidance on how to adopt principles of social responsibility, recognize that responsibility, and engage with stakeholders to integrate that responsibility throughout an organization.[176] For human rights, ISO 26000 guides organizations to implement due diligence, monitor and mitigate risks, avoid complicity, and support the resolution of grievances.[177] It describes these issues in relation to broad categorization of human rights, including civil, political, economic, social, cultural, and labor rights.[178]

### *European Union Legislation*

The European Commission (EC) has recently proposed a directive on non-financial disclosure requirements that would, in part, require corporations to report publicly their respect for human rights. The proposed standards would require companies to report relevant and material information on policies, results, risks, and risk management efforts pertaining to respect for human rights, as well as other environmental, social, and governance issues.[179] The proposal is currently awaiting a vote in the European Parliament, after which it would come into force in 18

months. At that time, EU member-state governments would be required to begin the process of implementing the standards into national domestic law. The actual standards of non-financial disclosure required regarding specific types of information may vary from State-to-State but the EU directive will provide the basic requirements.

### *Multi-Stakeholder Initiatives (MSIs)*

There are a number of MSIs developed through business and civil society leadership to address sector-specific or issue-specific concerns relating to the intersection of business and human rights. Through these platforms, stakeholders have worked together to formulate strategies and exchange feedback to develop operational approaches to address adverse human rights risks and impacts. Examples of MSIs include the Extractives Industry Transparency Initiative ("EITI") and the Global Network Initiative ("GNI").

The EITI is a global standard to promote revenue transparency and accountability in the extractive sector.[180] It requires companies to report payments to governments and governments to disclose their receipts of payments to the EITI multi-stakeholder oversight group, which verifies and reconciles tax and royalty payments from resource extraction operations. A multi-stakeholder group representing business, civil society, and governments oversees the process and communicates the EITI Report findings.[181] The goal is that, by requiring both sides to transparently report their exchange, the independent verification will prevent under-reporting and combat corruption and bribery in resource rich countries with poor governance, which can often contribute to conflict and a high risk of human rights violations.[182] Governments are required to apply to be a member of EITI and must effectively implement all aspects of the EITI requirements in order to become a member.[183] Failure to effectively implement the requirements can result in EITI suspending operations, as recently occurred in the DRC.[184]

The GNI is a sector-specific, multi-stakeholder initiative for the information and communications technology ("ICT") industry that requires participating companies to implement its Principles on Freedom of Expression and Privacy to protect and advance the enjoyment of these human rights globally.[185] Implementation of the Principles includes a Governance, Accountability, and Learning process that requires participating companies to submit to independent compliance monitoring and transparent reporting that outlines compliance activities, results of independent assessments, impacts on freedom of expression and privacy, and the path forward.[186]

Recent legislative, regulatory, and other developments clearly indicate that policy-makers at the federal, state, and international levels are increasingly interested in taking action to address adverse human rights risks and impacts related to globalized business activities. Domestic legislators have enacted transparency requirements to address public interest in eliminating direct

or indirect support for corrupt governance, violent conflict, and human trafficking. International organizations have been engaged in creating consensus and global standards for business responsibilities related to human rights and have gathered global support for concerted action to implement those principles. Business and civil society actors have engaged with the international community to take direct action on specific concerns and in specific contexts through practical operational frameworks. Altogether, these recent developments indicate the increasing materiality of human rights-related matters to corporate activities.

## B. Potential Impact of Human Rights-Related Matters on Public Companies

The "business case" for disclosure of human rights information rests on growing evidence that human rights performance has a real impact on long-term corporate value.[187] As investors learn how companies predict, mitigate, and manage risks and impacts, capital should be allocated efficiently to businesses with stronger capacities to overcome challenges. Therefore, in an efficient market, the potential direct and indirect impacts of human rights-related matters are material to investor decision-making.

Direct impacts—such as capital costs related to compliance with laws and regulations, financial penalties for non-compliance, or damages related to liability for abuses or violations—are material risks that affect the future corporate outlook. Indirect impacts—such as the market effects of rising supply chain costs, increasing prices of raw materials, or changes in the competitive advantage based on varying capability to attract and retain workers, customers, clients, or users—could materially affect corporate performance. Finally, political effects—arising from human rights risks and impacts connected to business activities, operations, or relationships—may have a material impact on business and the social license to operate.

### I. Direct Impacts

Dealing with human rights-related matters directly impacts corporate performance through additional costs, changes in operating conditions, and unpredictable delays in production and revenue generation.[188] Investors are materially interested in the potential and actual costs that a company faces related to human rights risks and impacts because these directly impact corporate financial performance and securities valuations.[189] Where new laws or regulations add compliance requirements, there are costs associated with complying. Where a company is implicated in human rights abuses or violations, they will face costs in mitigating the impacts, additional expenses in public relations, and potentially for litigation, mediation, or some other grievance or remediation process. Where human rights abuses or violations occur in one operating context, a company may face extra costs in re-assuring its stakeholders that its other

operations are not subject to the risk of similar incidents. Based on the potential for these direct impacts—where a human rights risk or change in political environment resulting in stronger human rights regulation is a possibility—the expected direct costs of those eventualities are material to investors' valuations of securities.[190]

### II. Indirect Impacts

The indirect costs related to human rights risks are more difficult to predict and are much more costly to business. These can arise in the form of reputational damage, changes in consumer preferences that alter the definition of competitive advantages in the marketplace, or unexpected changes in local upstream conditions that cause price and cost fluctuations in the supply chain. Other indirect impacts may occur, and each of these is material to corporate performance as a result of human rights risks or impacts.

One of the most powerful costs from implication with human rights risks or impacts related to business activities is the reputational cost.[191] This affects relationships with consumers or clients,[192] employees and recruits,[193] and investors and shareholders[194] who prefer to disassociate from operations that are complicit with adverse human rights outcomes.

If human rights risks and impacts are discovered by one actor in a particular sector, the ripple effect can re-define competitive advantage by changing public perception of the consequences of their consumer decisions.[195] This can radically alter the landscape for strategy to gain market share and consumer confidence and leave companies unprepared to show that they respect human rights risks at the back of the pack. As was witnessed with the growth of the fair trade coffee campaign, the major chain coffee shops faced pressure from consumers to carry fair trade coffee, reflecting their new understanding of the indirect costs of their purchasing decisions.[196] Some consumers were no longer satisfied with their previous criteria for coffee and instead chose to shop based on ethical supply chain practices of coffee merchants.

Finally, human rights risks in the supply chain can result in sudden changes to supply costs or prices for raw materials where conditions deteriorate or where regulation gets stronger to improve conditions. As conditions improve and regulations get stronger in countries where low labor standards keep supply chain costs low, the increase in costs will necessarily be passed up the supply chain and increase costs on the end-producer.[197] If conditions in supply chains change rapidly, for better or for worse, the resulting impact on manufacturing costs or raw materials prices may have a material impact on corporate performance.

### III. Political Effects That Could Have a Material Impact on Business and Operations

Companies that are implicated in human rights abuses or violations may face greater scrutiny from government licensing agencies, and popular pressure could force the government to revoke or deny business licenses necessary to operate within the country.[198] This is a particular risk for major foreign multinational enterprises engaged in high-risk activities such as resource extraction, where public relations are strained by the nature of exporting natural resources from the land for a limited return to local populations.[199] Where society becomes passionately inflamed against a company that is complicit with human rights abuses, the government may have no choice but to follow the revocation of the social license to operate with a revocation or denial of the official business license to operate.[200] Alternative scenarios could include changes in government, resulting in the nationalization of particular industries or a rapid descent into civil conflict.[201]

## C. Current Sources of Human Rights-Related Disclosure Regarding Public Companies

Business managers and accountants have voluntarily recognized the materiality of human rights-related information in some cases and have generally recognized the value of reporting social sustainability information informally as a public relations practice.[202] Auditing firms have directly recognized that human rights and other environmental, social and governance factors are material to investors and that businesses should investigate, assess, and disclose their risks and impacts where these are material to business performance.[203] Market analysts are gathering information on businesses' social and human rights records and risks,[204] and investment news services are providing analysis to the market in recognition of the materiality of these factors to decision-making.[205]

Voluntary disclosures by business and marketplace aggregation and publication of environmental, social, and governance factors show that this information is material to investment decision-making. The SEC considers the availability and current sources of disclosures in determining whether information is material. First, the SEC considers whether shareholders are demanding the information from public companies through the shareholder proxy proposal process. Second, it considers whether institutional investors or other groups are petitioning the SEC for interpretive advice for disclosing the information. Finally, it evaluates the existing public disclosures available through alternative sources.

### I. Increasing Calls for Human Rights-Related Disclosure by Shareholders of Public Companies

Shareholder resolution proposal powers have been a primary tool to engage corporations in dialogue relating to human rights policies and practices for decades, and resolutions have frequently been advanced where dialogue has been unsuccessful. In 2013 alone, thirteen of the biggest corporations in America faced shareholder resolutions relating to human rights.[206] Many social-issue proposals brought by shareholders are withdrawn prior to the annual meeting because an agreement is reached with the company.[207] The majority of human rights proposals over the past four decades have been filed by institutional investors, such as the Interfaith Center on Corporate Responsibility (ICCR), the California Public Employees Retirement System,[208] or the New York State Common Retirement Fund.[209]

Shareholder proposals—and even just the potential to bring proposals—have been a useful tool for engaging corporations in dialogue to enhance their transparency regarding human rights issues, although few have achieved majority support as Boards routinely advocate voting against any social disclosure proposals.[210] The As You Sow Foundation has used shareholder advocacy to lead or participate in hundreds of shareholder dialogues and resolutions to impact policies and practices at companies, including Chevron, ExxonMobil, Dell, HP, PepsiCo, Starbucks, Target, Home Depot, and Walt Disney.[211] As You Sow generally operates by building coalitions with shareholder allies and engaging companies in proactive dialogue—resorting to active resolution proposals where dialogue alone is not enough to spur companies to action.[212] Other groups, such as Investors Against Genocide, advocate similar tactics for institutional investors to bring companies to align with their principles for responsible investment and have successfully promoted a shareholder resolution at ING Emerging Countries Fund to a wide 59.8% passing margin.[213] Additionally, shareholder activism by the New York State Comptroller has recently resulted in settlement agreements that require companies to disclose human rights risks and impacts related to their business activities.[214]

The New York State Comptroller also acts as trustee of the New York State Common Retirement Fund and has incorporated social and human rights considerations into investment decisions and long-term valuations in recent years.[215] Similar actions have been taken by institutional pension funds, such as the American Federation of State, County, and Municipal Employees (AFSCME) Pension Plan, which has sought to protect and enhance the economic value of its long-term investments by proposing heightened accountability and transparency by management to shareholders on issues including human rights risks arising out of companies' operations.[216] The U.S. Presbyterian Church also recently proposed that Caterpillar review and amend its human rights policies to conform more closely to international human rights and humanitarian standards.[217]

**II. Petitions for Interpretive Advice Submitted to the SEC by Large Institutional Investors or Other Investor Groups**

The SEC has only a few petitions on record that it has received from a large institutional or other investor group, demanding interpretive advice regarding disclosure relating to human rights matters.[218] However, this does not mean that investors are not interested in these issues. In fact, investor interest in human rights and other social impacts related to business activities has increased dramatically in recent years.

The socially responsible investment (SRI) industry has expanded in the United States, from controlling assets worth $639 billion in 1995 to $3.74 trillion in 2012.[219] This expansion is mirrored internationally by the wide acceptance of the UN PRIs, which now command assets of over $32 trillion—approximately 15% of the global market for securities—after launching in 2006 with signatories managing only $4 trillion in assets. SRI has grown to command significant market share and several large institutional investor groups, including pension funds and mutual funds. Even Goldman Sachs has developed its own fund based in sustainability metrics, known as GS Sustain.[220]

EIRIS Conflict Risk Network is a prime example of a coalition of almost 80 institutional investors, financial service providers, and other stakeholders calling upon corporate actors to fulfill their responsibility to respect human rights and to take steps that support peace and stability in areas affected by genocide and mass atrocities, such as Sudan and Burma.[221] The Network leverages the investment power of more than $6 trillion in assets under management in this mission to advocate for the corporate fulfillment of the responsibility to respect human rights in conflict environments, and coordinates groundbreaking research methods for the implementation of responsible investment policies relating to these challenging locations.[222] In May 2013, the Network became a part of EIRIS—a leading global provider of research into corporate environmental, social, and governance performance.[223]

This is reflected in other components of investment valuation, such as the change in metrics used to evaluate corporate market value. In 1975, tangible assets accounted for up to 80% of the valuation assessment for corporate securities' market value. In 2005, tangible assets accounted for only 20% of that valuation assessment, as intangible assets—including risk management, intellectual property, human and social capital—have come to be used to calculate 80% of the market valuation equation for corporations.[224]

**III. Existing Public Disclosures Available Through Other Sources**

Businesses, traditional financial accounting firms, and marketplace analyst research services have recognized that human rights-related matters are material to investors. Businesses have

demonstrated this through voluntary disclosures in securities reports and participation in social sustainability reporting systems or social auditing frameworks.[225] Over the past few years, financial accounting firms have expressed the materiality of human rights to investors in several reports from Deloitte, Ernst & Young, and others that have engaged in research collaborations with business schools and institutional investor groups.[226] Finally, market analysts and research companies have developed indices for measuring social impacts, including human rights risks and impacts, of business activities and offer these for investors who are seeking to apply the information in their decisions.

***Voluntary Reporting in Periodic SEC Securities Disclosures***

Many businesses are already voluntarily disclosing information regarding human rights-related matters,[227] and both accounting and law firms have published their acknowledgment that these matters are material to investors.[228] Certain companies, including Coca-Cola, have already begun to report human rights risks under their "Risk Factors" disclosures in item 1A of their annual Form 10-K securities reports to the SEC.[229] As companies proceed to identify, monitor, and address human rights risks and impacts in their activities, the acknowledged materiality of these matters by accounting firms may result in those firms and in-house corporate auditors deciding to report human rights-related matters when they pass the in-house materiality filter for significant relevance to investors and shareholders.

In their 2012 annual report, Coca-Cola specifically details concerns that negative publicity related to human rights, even if unwarranted, could damage their brand image and corporate reputation and cause the business to suffer.[230] This risk factor disclosure rests on Coke's recognition that their success "depends on our ability to maintain the brand image" and "maintain our corporate reputation."[231] Coke addresses their responsibility to respect human rights under the Guiding Principles and acknowledges that—based on their Human Rights Statement, including a Workplace Rights Policy and Supplier Guiding Principles—any allegations of a failure to respect internationally accepted human rights could have a significant impact on their corporate reputation.[232] They conclude that the reputational harm attached to any allegations of human rights violations, even if untrue, could significantly impact corporate reputation and long-term financial results.[233]

The analysis provided by Coca-Cola of the risks related to human rights violations, or even untrue allegations, to long-term financial results are consistent with the views emerging from accounting and auditing firms acknowledging that human rights issues are material to investors. Deloitte has proposed that environmental, social, and governance information, including information related to human rights matters, are material where disclosure informs an understanding of changes in company valuation.[234] They indicate that the materiality filter should capture these topics by considering how stakeholder actions related to reported

information regarding topics such as human rights risks and impacts—including boycott, activism, divestiture, seeking employment, or changing purchasing habits—yield potential impacts for company valuations within a relevant time frame.[235]

Ernst & Young, in collaboration with the Boston College Center for Corporate Citizenship, has also recently identified the benefits of corporate transparency for financial performance. Their research shows that informally reporting social sustainability performance has demonstrated direct benefits to the corporate balance sheet—a conclusion that implies information such as human rights risks and impacts are material to corporate performance.[236] The conclusions of both Deloitte and Ernst & Young's research shows that traditional accounting firms are finding that non-financial information, such as human rights risks and impacts, may be material to investors as they impact corporate performance financially or, in the alternative, lead to intangible advantages to reputation and image.[237]

### *Voluntary Informal Social Sustainability or Responsibility Reporting*

There has been a proliferation of voluntary social sustainability reporting frameworks, and a significant majority of businesses are participating by voluntarily releasing informal corporate social responsibility or sustainability reports. The Global Reporting Initiative (GRI)[238] and the International Integrated Reporting Council (IIRC)[239] are the most popular frameworks, and the Sustainability Accounting Standards Board (SASB)[240] is also developing human rights and sector-specific disclosure standards to guide companies. Companies have subscribed to these standards in order to grant their reports a level of credibility, but most of the standards have still allowed companies considerable discretion in reporting details. These standards have made more information available, but the quality, comparability, and usefulness of the information varies across sectors and between businesses. Therefore, informal voluntary sustainability reports have been useful in making some information available to investors, but they have failed to allow investors to clearly understand, evaluate, and compare how different companies are identifying, reviewing, mitigating, and remedying human rights risks and abuses.[241]

The GRI was initiated in 1990 and the first reporting standard was announced in 2000, providing companies with a framework for reporting on sustainability topics. The standard has evolved over time, with the fourth "G4" guidelines released in May 2013.[242] The guidelines have been designed to harmonize with existing sustainability standards, including the OECD Guidelines for Multi-National Enterprises (MNEs), ISO 26000, and the UN Global Compact. In 2011-2012, more than 3900 companies participated in GRI certification training.[243]

Under the G4 Guidelines, companies may prepare a sustainability report "in accordance" with the standard by reporting only the "Core" elements or by preparing a "Comprehensive" report, including additional "Standard Disclosures" and more extensive performance analysis of

identified material "Aspects."[244] The determination of aspects of the GRI reporting standard that are material to the specific company is instrumental in determining what disclosures are made under the standard, since only aspects that are material to the company must be reported under the GRI standard.[245] Under the G4 guidelines, material aspects are those that: (1) "reflect the organization's significant economic, environmental, and social impacts" or (2) "substantively influence the assessments and decisions of stakeholders."[246]

The IIRC is an international standard for integrated corporate reporting that is currently piloting a program to result in communication by companies about how their "strategy, governance, performance and prospects lead to the creation of value over the short, medium, and long term."[247] The integrated reports are intended to target investors and decision-makers in capital markets by communicating the full range of factors that materially affect the issuer's ability to create value over time.[248] The IIRC envisions its standard as building on financial and other reporting to evolve corporate reporting to consider all aspects that interested stakeholders find relevant in capital allocation decisions.[249] These integrated reports will identify the factors that the organization believes are most important for their value creation over time and will provide additional details including financial statements and sustainability reports.[250] In that way, it complements and works with the GRI standards to incorporate sustainability reports alongside financial statements to reflect the integrated information that is material to investors.

The SASB is a standards organization that is developing sector-specific accounting standards related to material issues in those sectors for corporate reporting of non-financial information. SASB aims to provide relevant, useful, applicable, cost-effective, comparable, complete, directional, and auditable standards to improve the quality of corporate reporting for investors.[251] In developing their standards, they seek to support the convergence of international accounting standards and support the shift to integrated reporting of material sustainability issues in SEC reports such as the Form 10-K.[252] They are in the process of developing standards related to accounting and reporting human rights issues in order to continue towards meeting their vision where industry-specific standards enable companies to compete and improve performance on sustainability issues—such as respect for human rights—so that investors can capitalize the most sustainable companies.[253]

***Marketplace Information Analysis and Investor Analytical Services***

The marketplace has naturally organized to provide analytical services, information aggregation, and dedicated news categories to sustainability and human rights matters relating to business activities. Investor analytics and research database firms have been providing and refining indices and collections of information relating to environmental, social, and governance business practices, including human rights, for years. Investor-focused news services are dedicating web pages to reporting social impacts of business and sustainability issues.[254]

The MSCI risk and investment analytics firm produces indices for its clients related to environmental, social, and governance analysis and is related to socially-responsible investment criteria.[255] MSCI has consolidated many of the competing databases and indices under its umbrella with the KLD Research & Analytics, RiskMetrics, and Barra analytical methods offered to clients as part of their investment support tools.[256] These tools can be customized to meet particular investors' interests in analyzing performance related to specific categories, including human rights. Goldman Sachs has developed its own analytical approach to sustainability metrics, and incorporated it into a sustainable and principled investment fund.[257]

Bloomberg, the investment news provider, has a dedicated category for sustainability news, where human rights matters related to business activities are reported regularly.[258] Bloomberg has maintained a database that integrates sustainability into its market analytics since 2008 and has expanded its commitment to providing investors transparent information on these issues by offering a sustainability section in its news services since 2010.[259] However, the fact that this information is being provided by the information services marketplace does not mean that it is equally reliable, comparable, or useful to investors—SEC action to specifically require human rights disclosures could vastly improve the quality of information available to investors and stakeholders.[260]

The problem with these marketplace information and analytical resources for investors is that they are relying on incomplete, inconsistent, and sometimes incomparable information from companies. The data deficiency holds back the measurement of financial impacts from socially responsible corporate policies and processes and prevents investors from adequately incorporating this information into their decision-making process.[261] Although business, institutional investment funds, and marketplace information services providers have recognized that this information significantly alters the total mix of information available to investors, there is no standardized practice for delivering useful, objective data.[262]

The availability of current sources of human rights-related disclosure shows that businesses, accounting firms, civil society, news services, and other stakeholders expect investors to be interested in human rights for making capital allocation decisions. As shareholders and investors are demanding increasingly detailed and sophisticated disclosures related to human rights matters using shareholder resolutions, information providers are filling the gap in available information as best they can. Investors are demanding information by adhering to international standards of socially responsible investment principles and criteria. Businesses are voluntarily disclosing information by including it in existing items of their SEC formal reports or by informally providing public sustainability or corporate social responsibility reports. International standards for these sustainability reports have developed in order to guide companies to report material information in a clear, useful manner. Finally, marketplace information analysis providers, major investment and brokerage houses, and business news publications are including sustainability and human rights information prominently in their metrics and news services.

Unfortunately, this information is not consistent, comparable, or reliable across industries and even individual businesses—making it less useful to investors.[263]

# Reporting Material Human Rights Information to the S.E.C.

Broad human rights disclosure allows shareholders to access comparable information about corporate activities and to more adequately assess risks to their portfolio companies.[264] This section outlines the two steps involved in implementing securities disclosure in the context of this type of broad human rights disclosure: (1) assessing business-related human rights risks and impacts through human rights due diligence and disclosure of such processes and (2) disclosing material human rights risks and impacts.

Under the second step of broad human rights disclosure, this section proposes two ways in which the SEC should act to require companies to disclose material human rights information under Regulation S-K. First, the SEC should issue interpretive guidance, clarifying the responsibilities of issuers to disclose material human rights risks, impacts, and due diligence processes and results under existing Regulation S-K reporting items. Second, the SEC should engage in a comprehensive rulemaking process to develop rules for disclosing human rights risks, impacts, and due diligence processes and results in a distinct reporting item. Engaging in either or both of these approaches will allow the SEC to enable investors to access key information that addresses management's integrity and a corporation's capacity to manage risks and create long-term, sustainable value through respect for human rights in business activities and relationships. Any clarification from the SEC, whether in the former of interpretive guidance or a new rule, should clearly extend disclosures to include the activities of a company's subsidiaries, contractors, and business partners, in line with the standards of the UN Guiding Principles and the OECD Guidelines for MNEs.[265]

## A. Assessing Human Rights Risks and Impacts Related to Business Activities: Human Rights Due Diligence

The first step in securities disclosure always involves gathering, reviewing, and assessing information that fits within specifically required disclosure items. In this case, human rights risks and impacts related to business activities can arise from a variety of sources and may develop from supply chain or other business relationships, as well as directly in principal business operations. In order for issuers to effectively identify, review, mitigate, and report human rights risks and impacts related to their activities, they should conduct human rights due diligence.[266]

Generally, human rights due diligence should involve several steps to: (1) identify risks and impacts, (2) review and integrate findings, (3) track responses and mitigate potential impacts, (4) remedy any existing adverse impacts, and (5) communicate to stakeholders how impacts are addressed.[267] The UN Guiding Principles, in Principles 17-20, provide a flexible framework for

issuers to adapt based on their size, complexity, risk environment, and operational context.[268] By referencing these existing and developing standards, companies can provide clarity to investors while having the flexibility to adapt best practices (or not) as they emerge over time. Sector specific guides—like the OECD Due Diligence Guidance, which is geared towards supply chain due diligence in conflict-affected and high-risk areas—also provide a framework for human rights due diligence that could be used as an illustration by the SEC, while leaving the exact parameters of due diligences processes, if any, to issuers.[269]

## B. Disclosing Material Human Rights Risks and Impacts

The second step for making securities disclosures is filtering and appropriately organizing the gathered information in material disclosures to allow investors and shareholders to understand corporate performance and prospects. The material information must be disclosed and organized in reports according to required disclosure items. In this case, material human rights information could be required to be disclosed based on: (1) existing securities regulation disclosure items or (2) the implementation of a new rule providing for a new item sub-heading for human rights-related risks and impacts.

### I. Interpretive Guidance on Existing Securities Reporting Item Requirements for Human Rights-Related Matters

Material human rights risk and impacts should already be being disclosed by issuers under existing requirements in Regulation S-K, but the SEC should clarify these requirements using an interpretive guidance for human rights-related matters. Following the approach recently used to clarify reporting requirements for climate change matters and cyber-security information, the SEC should identify how issuers are required to disclose material human rights information under existing rules.[270] In particular, the description of business (Item 101), legal proceedings (Item 103), reporting of disclosure controls and procedures (Item 307), MD&A (Item 303), and risk factors (Item 503(c)) may already require disclosure of material human rights information.

Human rights risks and impacts are relevant to disclosures under item 101, the description of business, because they are a significant element of operating contexts where they exist. Further, any policies and processes in place to identify, assess, mitigate, and remedy human rights risks and impacts will be relevant to investors' understanding of an issuer's risks management strategies and capacities. These should be outlined and described in detail, and any known or potential risks should be disclosed in the description of business as part of the description of the plan of operation for the next period.

Legal proceedings related to human rights risks and impacts should be disclosed under item 103. The SEC should clarify that legal proceedings involving allegations of human rights abuses or violations are not "ordinary routine litigation incidental to the business" and thus are material to investors. As has been suggested by Coca-Cola and stakeholder research, even untrue allegations of human rights violations can have a material impact on corporate reputation and long-term value.[271] Similar to legal proceedings related to climate change, there is sufficient evidence to support disclosure of legal proceedings implicating a corporation or any subsidiary or business segment in human rights violations at a lower standard of materiality than is generally required for item 103 disclosures.[272]

Further, as management is required to provide a narrative perspective of business performance, including trends, uncertainties, and future prospects, there should be some discussion of human rights risks and impacts in the MD&A under item 303. Any known or uncertain trends relating to human rights risks and impacts should be described and management should provide a narrative explanation of how the issuer is prepared to identify, prevent, and mitigate potential or existing occurrences.

Human rights due diligence policies and procedures should be disclosed as part of the item 307 reporting of disclosure controls and procedures.[273] These reports should include: (1) the concrete steps taken to identify risks to human rights; (2) the results of the company's inquiry, including risks and impacts identified; and (3) steps actually taken to mitigate the risks and prevent human rights abuses. This would require senior management to assess and take responsibility for the effectiveness of these internal controls and procedures and vouch for the resulting human rights disclosures.

The direct and indirect effects to securities valuations, corporate reputation, and competitive advantage related to human rights risks and impacts should result in material disclosures under item 503(c) as risk factors for corporate performance. Coca-Cola has led the way with their recognition that the potential for damage to their reputation and resulting stakeholder actions could significantly affect their bottom line.[274] It is clear from the consistent findings of research on the impact of sustainability reporting that social responsibility issues, including human rights, are important sources of risk and potential value.[275] The SEC should clarify that issuers need to be assessing their human rights risks and impacts to identify risk factors for disclosure under item 503(c) that could affect corporate performance.

## II. The Development of a New Rule for Human Rights Reporting

The SEC may engage in rulemaking related to required disclosures where it is mandated by Congress under existing securities laws (such as the Exchange Act or Dodd-Frank Act[276]), according to a fresh congressional mandate, or following rule-making petitions proposed by the

public.[277] According to Section 14(a) of the Securities Act, Congress has delegated broad authority to the SEC to engage in rulemaking relating to proxy solicitations "as necessary or appropriate in the public interest, or for the protection of investors."[278] As this paper has documented, human rights risks and impacts are a matter of domestic and global public interest, and are relevant to corporate performance and the protection of investors. Interested stakeholders should petition the SEC to promulgate a new mandatory disclosure rule related to human rights in periodic disclosures, including through annual proxy disclosures and through updates in periodic disclosures regarding material changes.

In developing a new rule, the SEC should consider how to incorporate disclosures of human rights-related matters in order to provide clear, consistent, and comparable information between issuers. Certain sectors will, due to the nature and context of their operations, be more prone to risks and impacts related to human rights. Disclosure of their policies and processes for identifying, tracking, mitigating, and remedying those risks and impacts are materially relevant to investors' understanding of management's integrity, and capability to manage risks.

A new rule—and the rulemaking process—could investigate the value of consolidating human rights risk and impact disclosures under one item heading or sub-heading. This "Human Rights Due Diligence" section would provide transparent and accountable disclosure of all material information and allow stakeholders to engage the corporation to improve or assist with issues related to human rights. Finally, this rule could be used to meet part of the U.S. government's duty to protect human rights-related to business activities, under the UN Guiding Principles, which it has already endorsed. This would require, at minimum, that the rule include a disclosure of the issuer's human rights policies and details of the human rights due diligence process and results.

## Conclusion

Heightened interest from the public, policy-makers, academics, investors, and businesses indicate that information relating to human rights matters is in fact material to investor decision-making. Domestic and international legislative and policy action have built—and continue to build—a global consensus around the need to tackle the adverse social and human rights impacts of globalized business activities. Investors are increasingly demanding corporate transparency through shareholder resolutions and endorsement of responsible investment principles. In turn, businesses are recognizing the importance of their performance relating to social responsibility issues and are publishing both formal and informal reports to gain positive publicity and investor support for their efforts in meeting these changing global standards. At the same time, marketplace information analysts and investor support service providers are gathering and integrating available information into useful analyses for investors' capital allocation decisions.

The UN Guiding Principles provide a set of foundational benchmarks for building human rights considerations into internal auditing and risk mitigation processes through human rights due diligence and reporting. Since the United States government has endorsed the Guiding Principles, it should examine implementation of these Principles through its own existing laws and regulations. Furthermore, the OECD Guidelines for MNEs and ISO 26000 have entrenched and expanded upon the Guiding Principles to formulate best practices standards for corporations around the world to tackle the challenges of business impacts relating to human rights. These systems have developed as legislators, civil society, and businesses have converged on a common understanding of the responsibility for businesses to respect human rights. The implementation of the responsibility to respect human rights demands that corporations conduct human rights due diligence to investigate their operations for adverse human rights risks and impacts and communicate those findings to stakeholders and the public.

In order to promote orderly, efficient capital markets and protect investors from misleading or inaccurate information that affects the value of the securities on the market (such as in stand-alone social reports), the SEC should act to require issuers to disclose their human rights due diligence processes and findings regarding risks and impacts related to their business activities. Under existing securities regulations, issuers may have an obligation to disclose human rights risks and impacts related to their operations, and the SEC should provide interpretive guidance clarifying those items where material human rights issues should be reported. Based on the heightened interest from the public, legislators, the international community, and voluntary business disclosures, the SEC should provide interpretive guidance and engage in a comprehensive rulemaking process to establish clear, consistent, and comparable disclosure requirements that will allow investors to effectively consider the human rights risks and impacts connected to investment in certain companies. This information is highly important as it significantly alters the total mix of available information to investors. It should therefore be provided in a manner that adequately allows investors to usefully decide how to allocate their resources.

## Endnotes

[1] The United States does have several statutes that apply certain laws and standards to U.S. companies in their activities abroad. These include the Foreign Corrupt Practices Act, Pub. L. 95-213 (1977), the Torture Victim Protection Act, Pub. L. 102-256 (1991), and the Trafficking Victims Protection Reauthorization Act, H.R. 7311 (2008). The Alien Tort Claims Act, 28 U.S.C. § 1350 (2013) has been used in recent decades to hold companies liable for violations of the law of nations committed abroad.
[2] Many human rights violations resulting from business activities occur in challenging political environments, where conflict or other high-risk factors have limited the capacity or willingness of the State to effectively establish the rule of law or to operate a functioning judiciary.
[3] Profits are at an all-time high for the world's largest, most powerful corporations. *See* Henry Blodget, *Corporate Profits Just Hit an All-Time High, Wages Just Hit an All-Time Low*, BUS. INSIDER (June 22, 2013), http://www.businessinsider.com/corporate-profits-just-hit-an-all-time-high-wages-just-hit-an-all-time-low-2012-6. The example of the lack of enforcement for clear violations of law and regulation by financial institutions in the "too big to fail" category highlights this phenomenon in the context of the 2008/09 financial system collapse. *See, e.g.*, Peter Schroeder, *Holder: Big Banks' Size Complicates Prosecution Efforts*, HILL (June 3, 2013), http://thehill.com/blogs/on-the-money/banking-financial-institutions/286583-holder-big-banks-size-complicates-prosecution-efforts.
[4] *E.g.*, Andrew North, *Dhaka Rana Plaza Collapse: Pressure Tells on Retailers and Government*, BBC NEWS ASIA (May 14, 2013), http://www.bbc.co.uk/news/world-asia-22525431; *Bangladesh Accord on Fired and Building Safety released*, IndustriALL Global Union (May 15, 2013), http://www.industriall-union.org/bangladesh-accord-on-fire-and-building-safety-released.
[5] *E.g.*, United Nations, *Principles for Responsible Investment*, http://www.unpri.org/ (last visited July 18, 2013).
[6] Human Rights Council, *Report of the Special Representative to the Secretary-General on the Issue of Human Rights and Transnational Corporations and Other Business Enterprises, John Ruggie: Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework*, U.N. Doc. A/URC/17/31 (Mar. 21, 2011), *available at* http://www.business-humanrights.org/media/documents/ruggie/ruggie-guiding-principles-21-mar-2011.pdf [hereinafter Guiding Principles].
[7] Chris Power & Arun Devnath, *Bangladesh's Tazreen Fire is Followed by Further Garment Factory Blazes*, BLOOMBERG BUS. WEEK (Dec. 27, 2012), http://www.businessweek.com/articles/2012-12-27/after-the-tazreen-fire-in-bangladesh-more-fires-in-garment-factories; Declan Walsh & Steven Greenhouse, *The Human Price: Certified Safe, a Factory in Karachi Still Quickly Burned*, N.Y. TIMES (Dec. 7, 2012), http://www.nytimes.com/2012/12/08/world/asia/pakistan-factory-fire-shows-flaws-in-monitoring.html?pagewanted=all.
[8] Julfikar Ali Manik & Jim Yardley, *Building Collapse in Bangladesh Leaves Scores Dead*, N.Y. TIMES (Apr. 24, 2013), http://www.nytimes.com/2013/04/25/world/asia/bangladesh-building-collapse.html?smid=fb-nytimes&WT.z_sma=WO_BBC_20130424&_r=0; *Disaster in Bangladesh: Rags in the Ruins*, ECONOMIST (May 4, 2013), http://www.economist.com/news/asia/21577124-tragedy-shows-need-radical-improvement-building-standards-rags-ruins; Dan Viederman, *Supply Chains and Forced Labour After Rana Plaza: Lessons Learned*, GUARDIAN (May 30, 2013), http://www.guardian.co.uk/global-development-professionals-network/2013/may/30/rana-plaza-bangladesh-forced-labour-supply-chains.
[9] *See* Rebecca Greenfield, *Apple is Breaking Up with Foxconn for a New iPhone Builder with Labor Problems*, ATLANTIC WIRE (May 29, 2013), http://www.theatlanticwire.com/technology/2013/05/apples-foxconn-pegatron/65706/; Christina Bonnington, *Probe Finds 'Serious and Pressing' Violations at Foxconn Plants*, WIRED.COM: GADGET LAB (May 29, 2012), http://www.wired.com/gadgetlab/2012/03/apple-foxconn-audits/.

[10] *E.g.*, *Papua New Guinea: Serious Abuses at Barrick Gold Mine*, HUMAN RIGHTS WATCH (Feb. 1, 2011), http://www.hrw.org/news/2011/02/01/papua-new-guinea-serious-abuses-barrick-gold-mine.
[11] *See* FREE THE SLAVES, *Congo's Mining Slaves: Enslavement at South Kivu Mining Site* (2013), *available at* https://www.freetheslaves.net/Congo.
[12] *E.g.*, *Pinera Blasts Environmental Licensing for Giant Pascua-Lama Gold Mine Project*, MERCOPRESS (June 8, 2013), http://en.mercopress.com/2013/06/08/pinera-blasts-environmental-licensing-for-giant-pascua-lama-gold-mine-project; Julie Gordon, *Barrick Gold to Submit Water Plan for Pascua Lama to Chile Authorities Soon*, GLOBE & MAIL (June 5, 2013), http://www.theglobeandmail.com/report-on-business/international-business/latin-american-business/barrick-gold-to-submit-water-plan-for-pascua-lama-to-chile-authorities-soon/article12360914/; Alexandra Ulmer & Fabian Cambero, *Barrick's Pascua-Lama Gold Project Frozen for at Least 1-2 Years: Chile Regulator*, REUTERS (May 30, 2013), http://www.reuters.com/article/2013/05/31/us-chile-pascualama-regulator-idUSBRE94T14X20130531.
[13] *E.g.*, CONE COMMUNICATIONS/ECHO, 2013 GLOBAL CSR SURVEY 25, *available at* http://www.conecomm.com/2013-global-csr-study-report (last visited July 18, 2013) (citing results that 55% of respondents have boycotted and refused to purchase products from companies they know to have behaved irresponsibly); Jayne O'Donnell, *Survey: Most Would Boycott Irresponsible Company*, USA TODAY (May 21, 2013), http://www.usatoday.com/story/money/business/2013/05/21/consumers-boycott-companies-bad-behavior-gap-protests/2343619/; *Boycotts List*, ETHICAL CONSUMER (Mar. 25, 2013), http://www.ethicalconsumer.org/boycotts/boycottslist.aspx.
[14] *See* RAINFOREST ALLIANCE, http://www.rainforest-alliance.org/ (last visited July 24, 2013) (certifying products as responsibly mitigating their impact on the rainforest).
[15] *E.g.*, FAIR TRADE USA, http://www.fairtradeusa.org/ (last visited July 24, 2013) (assuring consumers "that the farmers and workers behind the product got a better deal . . . [and] that their purchases are socially and environmentally responsible").
[16] U.S. SOCIAL INVESTMENT FORUM FOUNDATION, EXECUTIVE SUMMARY: REPORT ON SUSTAINABLE AND RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES (2012) at 11, *available at* http://www.ussif.org/files/Publications/12_Trends_Exec_Summary.pdf.
[17] *See PRI Fact Sheet*, UN Principles for Responsible Investment (May 2013), http://www.unpri.org/news/pri-fact-sheet/ (last visited July 18, 2013).
[18] *See* Margaret Levi & April Linton, *Fair Trade: A Cup at a Time?*, 31 POL. & SOC'Y 407, 424 (2003) (highlighting the success of activists who, in the early 1990s, challenged Starbucks to stop buying from plantatiations where workers were not paid fair wages); DOUGLAS HOLT & DOUGLAS CAMERON, CULTURAL STRATEGY: USING INNOVATIVE IDEOLOGIES TO BUILD BREAKTHROUGH BRANDS 104-05 (2010) (citing the pressure exerted on Starbucks by Transfair USA before Starbuck's decision to purchase a small percentage of fair trade coffee, to which customers responded positively); Colleen Haight, *The Problem with Fair Trade Coffee*, 9 STAN. SOC. INNOVATION REV. 74, 77 (2011) (discussing Whole Foods Market's evolution from initially rejecting the fair trade model based on concern over the quality of fair trade coffee to more recently purchasing fair trade coffee due to customers' demands).
[19] Conflict Risk Network, *CRN Letter to the Burman Human Rights Officer on Title of Information Collection: Reporting Requirements on Responsible Investment in Burma* (Oct. 4, 2012), *available at* http://crn.eiris.org/files/Burma%20Reporting%20Requirements%20-%20Investor%20Comment_4%20Oct%202012.pdf/.
[20] *See* Cynthia Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1211-35 (1999) (discussing the brain trust relied upon by President Roosevelt and the legislative drafters in forming the SEC, its purposes, philosophical foundation, and design).
[21] U.S. Securities & Exchange Comm'n, *Rulmaking: How It Works*, http://www.sec.gov/answers/rulemaking.htm (last visited July 26, 2013) [hereinafter *Rulemaking: How It Works*].

[22] *See* Securities Act of 1933, Pub. L. 112-106 (2012); Securities Exchange Act of 1934, Pub. L. 112-158 (2012).
[23] *See id.*; Trust Indenture Act of 1939, Pub. L. 111-229 (2010); Investment Company Act of 1940, Pub. L. 112-90 (2012); Investment Advisers Act of 1940, Pub. L. 112-90 (2012).
[24] Sarbanes Oxley Act of 2002, 116 Stat. 745 (2002).
[25] Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 §§1502-04, 15 U.S.C. §78a et seq. (2013) [hereinafter Dodd-Frank Act].
[26] *See* Steven J. Markovich, *The Dodd-Frank Act*, COUNSEL ON FOREIGN RELATIONS (July 23, 2012), http://www.cfr.org/united-states/dodd-frank-act/p28735; Donald C. Langevoort, *The Social Construction of Sarbanes-Oxley*, 105 MICH. L. REV. 1817 (2007), *available at* http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=1136&context=facpub; Allison Fass, *One Year Later: The Impact of Sarbanes-Oxley*, FORBES.COM (July 22, 2003), http://www.forbes.com/2003/07/22/cz_af_0722sarbanes.html.
[27] *See* Edmund W. Kitch, *The Theory and Practice of Securities Disclosure*, 61 BROOK. L. REV. 763, 764-65 (1995).
[28] *See* Williams, *supra* note 20, at 1211-35 (discussing the writings of Louis D. Brandeis, Adolf A. Berle, and Gardiner C. Means that champion disclosure as a regulatory method "to bring to bear public pressure to change the actions and attitudes of corporate managers, bankers, and other insiders" and their roles in influencing President Roosevelt, as well as Representative Rayburn and Senator Fletcher, the key drafters of the Securities Act (1933) and the Securities and Exchange Act (1934)).
[29] *See id.* at 1228.
[30] *See id.* at 1234 (discussing the House Committee Reports and introductory statements of Representative Rayburn and the general tone of the debate—which was overwhelmingly positive, with the only criticism being that the bill perhaps did not go far enough to regulate corporate conduct—and attesting to the belief of legislators that they had a right to demand that the people who run businesses operate according to clean, fair, and honorable standards) (citing the statement of Rep. Rayburn of the House Commerce Committee, 77 Cong. Rec. 2910-55, 2919 (1933)); *id.* at 1241 (citing the statement of Sen. Fletcher, 78 Cong. Rec. 8161 (1934)), where he re-introduced the second draft of the Securities and Exchange Act of 1934, where he identified the "cardinal principles [he] conceived to be, first, restoring as a rule of moral and economic conduct, a sense of fiduciary obligation; and, second, establishing social responsibility, as distinguished from individual gain, as the goal").
[31] Securities Exchange Act of 1934, *supra* note 22, §§12-15.
[32] 17 C.F.R. § 229 (2012); *see* Securities Exchange Act of 1934, *supra* note 22, §§12-15.
[33] *See* 17 C.F.R. § 240.14a-1 (2012).
[34] 17 C.F.R. § 230.408 (2012).
[35] 17 C.F.R. § 240.10b-5 (2012); 15 U.S.C. § 78j (2013).
[36] *See* 17 C.F.R. § 229 (2012).
[37] *See* SIMON ZADEK & MIRA MERME, ACCOUNTABILITY, REDEFINING MATERIALITY: PRACTICE AND PUBLIC POLICY FOR EFFECTIVE CORPORATE REPORTING, 12-13 (July 2003), *available at* http://www.accountability.org/images/content/0/8/085/Redefining%20Materiality%20-%20Full%20Report.pdf.
[38] *See* 17 C.F.R. § 229 (2012); 17 C.F.R. § 230.408 (2012).
[39] *See* Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 448-49 (1976).
[40] 17 C.F.R. § 229 (2012).
[41] U.S. SECURITIES & EXCHANGE COMM'N, FORM 10-Q, OMB NO. 3235-0070, *available at* http://www.sec.gov/about/forms/form10-q.pdf; U.S. SECURITIES & EXCHANGE COMM'N, FORM 10-K, OMB NO. 3235-0063, *available at* http://www.sec.gov/about/forms/form10-k.pdf. Foreign private issuers must file an annual report using Form 20-F, which requires essentially the same information. *See* U.S.

SECURITIES & EXCHANGE COMM'N, FORM 20-F, OMB NO. 3235-0288, *available at* http://www.sec.gov/about/forms/form20-f.pdf.

[42] 17 C.F.R. § 229 (2012).

[43] *E.g.*, U.S. SECURITIES & EXCHANGE COMM'N, COMPLIANCE AND DISCLOSURE INTERPRETATIONS: REGULATION S-K (2013), *available at* www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm; U.S. SECURITIES & EXCHANGE COMM'N, INTERPRETATION: COMMISSION GUIDANCE REGARDING MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS, SECURITIES ACT, RELEASE NO. 33-8350 (Dec. 19, 2003), *available at* http://www.sec.gov/rules/interp/33-8350.htm [hereinafter Securities & Exchange Comm'n, Release No. 33-8350].

[44] 17 C.F.R. § 229.101 (2012).

[45] 17 C.F.R. § 229.101(a)(2)(iii)(B) (2012).

[46] 17 C.F.R. § 229.101 (2012).

[47] 17 C.F.R. § 229.101(c) (2012).

[48] 17 C.F.R. § 229.101(c)(x) (2012).

[49] 17 C.F.R. § 229.101(c)(xii) (2012).

[50] *See* 17 C.F.R. § 229.103 (2012).

[51] *See* 17 C.F.R. § 229.103 (2012); 17 C.F.R. § 229.103, Instr. 2 (2012).

[52] *See* 17 C.F.R. § 229.103, Instr. 2 (2012).

[53] 17 C.F.R. § 229.103, Instr. 5 (2012).

[54] 17 C.F.R. § 229.103, Instr. 5 (2012).

[55] *See* U.S. SECURITIES & EXCHANGE COMM'N, INTERPRETATION: COMMISSION GUIDANCE REGARDING MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS; CERTAIN INVESTMENT COMPANY DISCLOSURES, RELEASE NO. 33-6835 (May 18, 1989), *available at* http://www.sec.gov/rules/interp/33-6835.htm.

[56] *See* Securities & Exchange Comm'n, Release No. 33-8350 (Dec. 19, 2003), *supra* note 43.

[57] 17 C.F.R. § 229.303a, Instr. 5 (2012).

[58] *See generally, id.*

[59] *See* Securities & Exchange Comm'n, Release No. 33-6835 (May 18, 1989); Securities & Exchange Comm'n, Release No. 33-8350 (Dec. 19, 2003), *supra* note 43; *see also* John D. Moore, *SEC Calls for a Clearer View From Management*, 23 INT'L FIN. L. REV. 25, 26-7 (2004).

[60] 17 C.F.R. § 229.307 (2012).

[61] 17 C.F.R. § 229.503 (2012).

[62] *See, e.g.*, DEERE & CO., ANNUAL REPORT (FORM 10-K), at 11-16 (2012), *available at* http://www.deere.com/en_US/docs/Corporate/investor_relations/pdf/financialdata/reports/2013/10kreport2012.pdf.

[63] 17 C.F.R. § 229.503(c) (2012).

[64] *Id.*

[65] *Id.*

[66] *Id.*

[67] 17 C.F.R. § 240.14a-8 (2013).

[68] *Id.*

[69] *See* 17 C.F.R. § 240.14a-8(f)-(i) (2013) (identifying the reasons why an issuer may be permitted to exclude a proxy disclosure request, including: eligibility or procedural deficiencies, impropriety under state law, violation of law, violation of proxy rules, personal grievance or special interest, irrelevance (measured by the proxy request relating to something that accounts for less than 5% of the companies' total assets at the end of the last fiscal year), absence of power/authority, overriding management functions, director elections, conflict with company's proposal, substantial implementation having been achieved already, duplication of request, resubmission of significantly unpopular proposal over time, or relation to a specific amount of dividends.); David M. Lynn, *The Dodd-Frank Act's Specialized*

*Corporate Disclosure: Using the Securities Laws to Address Public Policy Issues*, 6 J. BUS. & TECH. L. 327 (2011), *available at* http://digitalcommons.law.umaryland.edu/jbtl/vol6/iss2/3.
[70] *See* Exchange Act §14(a); 15 U.S.C. §78n (2013).
[71] *See generally*, Williams, *supra* note 20.
[72] *See* 17 C.F.R. §230.408 (2012); 17 C.F.R. §240.12b-20 (2012).
[73] *See* 17 C.F.R. §240.12b-20 (2013).
[74] *See* 17 C.F.R. §240.10b-5 (2013).
[75] 17 C.F.R. §240.10b-5(b) (2013); 15 U.S.C. 78j (2013).
[76] *See* Rachel Cherington, *Securities Laws and Corporate Social Responsibility: Toward An Expanded Use of Rule 10b-5*, 25 U. PA. J. INT'L. ECON. L. 1439, 1449 (2004).
[77] *See id.* at 1449-50.
[78] *See id.* at 1451 (citing SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 862 (2d Cir. 1968)). For omission cases, *see* Affiliated Ute Citizens of Utah v. U.S., 406 U.S. 128, 153-54 (1972). For misstatement and fraud-on-the market cases, *see* Basic Inc. v. Levinson, 485 U.S. at 246-47.
[79] *See* American Petroleum Institute et al. v. Securities & Exchange Comm'n et al., Civil Action No. 12-1668 (JDB) (D.C. Dist. 2013) (noting how the judge identified that there are exceptions under 78m, n, etc., where the SEC may make exemptions for requiring all disclosures made to the agency be public and identifying the bases for that); *see also* Basic Inc., 485 U.S. at 231-32 (highlighting the Court's "materiality requirement" requiring the disclosure of the seemingly immaterial fact if there was a substantial likelihood that the omitted fact would have been viered by the reasonable invester as having significantly altered the totality of all information made available).
[80] SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 186 (1963) (cited in Basic, Inc., 485 U.S. at 234.).
[81] TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 448-49 (1976).
[82] *Id.*
[83] *Id.* at 449 (defining the "total mix" standard of materiality in the context of a controversy relating to proxy statement disclosure under section 14a-9 of securities law); *see also* Basic, Inc. v. Levinson, 485 U.S. 224, 231-32 (1988) (adopting the *TSC Industries* "total mix" standard of materiality for the section 10(b) and Rule 10(b)5 context of securities law).
[84] TSC Industries, Inc., 426 U.S. at 450; *see also* Basic, Inc., 485 U.S. at 236.
[85] Basic, Inc., 485 U.S. at 238.
[86] *Id.* at 238 (citing SEC v. Texas Gulf Sulphur Co., 401 F.2d at 849 (2d Cir. 1968)).
[87] *Id.* at 236 (citing TSC Industries, Inc., 426 U.S. at 450).
[88] SEC Staff Accounting Bulletin No. 99, 64 Fed. Reg. 45 (1999).
[89] *Id.*
[90] *Id.*
[91] *See* Basic, Inc., 485 U.S. at 231-32; TSC Industries, Inc., 426 U.S. at 449-50.
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[233] *See id.* at 18.
[234] *See Disclosure of Long-Term Business Value: What Matters*, *supra* note 190, at 10.
[235] *See id.* at 10.
[236] *See Value of Sustainability Reporting*, *supra* note 187, at 12.
[237] *See Value of Sustainability Reporting*, *supra* note 187, at 10-11. For an example of an organization of shareholders lobbying for a corporation to adopt and disclose its country selection guidelines for investment, *see* Letter from the International Brotherhood of Teamsters to John Watson, Chairman and CEO of Chevron Corporation (Feb. 23, 2012), *available at* http://business-humanrights.org/media/documents/chevron-post-dialogue-shareholder-letter-23-feb-2012.pdf.
[238] GLOBAL REPORTING INITIATIVE (GRI), https://www.globalreporting.org/ (last visited July 26, 2013).
[239] INT'L INTEGRATED REPORTING COUNCIL (IIRC), http://www.theiirc.org/ (last visited July 26, 2013).
[240] SUSTAINABILITY ACCOUNTING STANDARDS BOARD (SASB), http://www.sasb.org (last visited July 26, 2013).
[241] *See generally* Aaron Bernstein, *Incorporating Labor and Human Rights Risk into Investment Decisions, Pensions and Capital Stewardship Project Labor and Worklife Program*, HARV. L. SCH., Occ. Paper Series, No.2 (Sept. 2008), *available at* http://www.law.harvard.edu/programs/lwp/pensions/publications/occpapers/occasional_paper2.pdf.
[242] *See* G4 Sustainability Reporting Guidelines, GRI (May 2013), *available at* https://www.globalreporting.org/resourcelibrary/GRIG4-Part1-Reporting-Principles-and-Standard-Disclosures.pdf.
[243] *See* GRI ANNUAL REPORT 2011/2012, at 41 (2012), *available at* https://www.globalreporting.org/resourcelibrary/GRI-Annual-Report-2011-2012.pdf.
[244] *See* G4 Sustainability Reporting Guidelines, *supra* note 242, at 11.
[245] *See id.* at 12.
[246] *See id.* at 17.
[247] *About <IR>*, IIRC, http://www.theiirc.org/about/ (last visited July 26, 2013).
[248] *See id.*
[249] *See id.*
[250] *See id.*

[251] *See Principles*, SASB, http://www.sasb.org/approach/principles/ (last visited June 15, 2013).
[252] *See id.*
[253] *See Vision and Mission*, SASB, http://www.sasb.org/sasb/vision-mission/ (last visited July 10, 2013).
[254] *See Sustainability*, BLOOMBERG.COM, http://www.bloomberg.com/sustainability/ (last visited July 18, 2013).
[255] *See e.g., Fact Sheet: Human Rights Custom Index on MSCI ACWI (USD)*, May 31, 2013, http://www.msci.com/resources/factsheets/index_fact_sheet/human-rights-custom-index-on-msci-acwi.pdf.
[256] MSCI, http://www.msci.com (last visited June 14, 2013).
[257] *See Introducing GS Sustain*, *supra* note 204.
[258] *Sustainability*, *supra* note 254.
[259] *Id.*
[260] *See* Bernstein, *supra* note 241, at 13-22.
[261] *See id.* at 13-22.
[262] *See id.* at 22-30.
[263] *See* Bernstein, *supra* note 241, at 13-22.
[264] *Id.* at 45.
[265] *See* Guiding Principles, *supra* note 6, at Principle 17; OECD Guidelines, *supra* note 144, at 31.
[266] *See* Guiding Principles, *supra* note 6, at Principle 17.
[267] *Id.*, at Principle 17; *see also* OECD Due Diligence Guidance, *supra* note 113, at 31.
[268] *See* Guiding Principles, *supra* note 6, at Principles 17-21.
[269] *See* Guiding Principles, *supra* note 6, at Principle 17; OECD Due Diligence Guidance, *supra* note 113, at 31.
[270] *See* Sarfaty, *supra* note 124.
[271] *See* COCA-COLA CO., *supra* note 202, at 17.
[272] *See* 17 C.F.R. §229.103 (2012) (regarding climate change legal proceedings as requiring disclosure that might otherwise not be required for legal proceedings on other issues).
[273] 17 C.F.R. §229.307 (2012).
[274] *See* COCA-COLA CO., *supra* note 202, at 17; *see also Disclosure of Long-Term Business Value: What Matters*, *supra* note 190, at 10.
[275] *See Value of Sustainability Reporting*, *supra* note 187, at 12-15; *Disclosure of Long-Term Business Value: What Matters*, *supra* note 190, at 8.
[276] *See Rulemaking: How It Works*, *supra* note 21.
[277] *See* SEC, Petitions for Rulemaking Submitted to the SEC, http://www.sec.gov/rules/petitions.shtml (last visited July 18, 2013).
[278] Securities Act (1933) §14(a) (2012); Williams, *supra* note 20.

## Setting the Record Straight

**Common Myths about Environmental, Social, and Governance (ESG) Reporting**

Over the past few decades, investors have become increasingly concerned not only with the short term profits of their investments, but also the long-term viability of the public companies in which they invest. As a result, investor calls for corporate disclosures of a company's environmental, social, and governance (ESG) policies, practices, and impacts as a means to assess the long-term health, profitability, and viability of companies have also increased. In response, public companies have begun voluntarily disclosing ESG information, and U.S. allies and peer countries have begun to, or have already enacted, mandatory reporting on ESG issues. The United States' lack of action puts the country at risk of falling behind the global curve in mandating the disclosure of ESG issues important to investor assessment of long-term profitability. Common misconceptions about ESG reporting must be addressed in order to push forth meaningful reporting requirements that respond to investor needs.

MYTH 1: ***Only socially responsible or impact investors care about ESG issues***

Today, a wide array of investors are looking towards ESG factors as an integral part of their decision-making processes. Worldwide, investors with $68.4 trillion of capital are committed to incorporating ESG factors in their investing and voting decisions as part of the U.N. Principle for Responsible Investment ("PRI").[1] According to a recent Ernst & Young report, ESG factors are no longer a niche consideration, with "investor interest in non-financial information span[ning] across all sectors," and 61.5% of investors consider non-financial information relevant to their investments overall.[2] Accordingly, some ESG issues such as climate change or human rights are of increasing concern to investors. For example, investors with $95 trillion in invested capital support the Carbon Disclosure Project's ("CDP") annual survey of global companies regarding their greenhouse gas emissions and strategies for addressing climate change.[3] In relation to human rights, an Ernst and Young report found that 19.1% of investors would rule out an investment immediately and 63.2% would reconsider investing if there were significant human rights risks associated with the investment.[4]

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[1] *See, PRI-11 year growth of AO (all signatories (Asset Owners [sic], Investment Managers and seride [sic] providers) and respective AUM*, Excel sheet available for download at *About the PRI*, U.N. Principles for Responsible Investment, http://www.unpri.org/about.

[2] Value of Sustainability Reporting, Ernst & Young Boston Coll. Ctr. For Corporate Citizenship 18 (May 2013), *available at* http://www.ey.com/Publication/vwLUAssets/ACM_BC/$FILE/1304-1061668_ACM_BC_Corporate_Center.pdf.

[3] *Catalyzing business and government action*, Carbon Disclosure project, https://www.cdp.net/en-US/Pages/About-Us.aspx.

[4] Ernst & Young, Value of Sustainability, *supra* note 2 at 16.

**MYTH 2: *ESG issues are not financially material***

ESG information is critical to assessing the long-term investment success of a company, especially in relation to assessing risks, and is therefore financially material. Numerous studies, including a June 2017 Bank of America Merrill Lynch study, found ESG factors to be "strong indicators of future volatility, earnings risk, price declines, and bankruptcies."[5] A 2014 review of empirical studies analyzing ESG data and corporate financial performance found overwhelming links between sustainability and profit: 90% of the analyzed studies showed that sound sustainability standards lowered firms' cost of capital; 80% of the studies showed that companies' stock price performance is positively influenced by good sustainability practices; and 88% of the studies showed that better ESG practices result in better operational performance.[6] These reports and statistics, coupled with the support of investors with trillions of dollars in assets under management, help to illustrate that ESG information is financially material to a reasonable investor. Furthermore, information need not be financially material, to be material to a reasonable investor.[7] There is growing global consensus that ESG disclosures should be seen from a "double materiality" perspective, as they provide both financially and environmentally/socially material information to investors.[8]

**MYTH 3: *The SEC doesn't have the mandate to require ESG disclosures***

The SEC was granted broad authority by both the Securities Act and the Exchange Act to promulgate disclosure rules "as necessary or appropriate in the public interest or for the protection of investors."[9] As discussed above, ESG disclosures are material to investors, and therefore fall under the SEC's mandate of investor protection. In addition, disclosure of ESG information is also in the public interest, as it "promote[s] efficiency, competition, and capital formation."[10] Mandatory ESG disclosures would increase both informational efficiency, through the creation of consistent, comparable, and complete ESG reporting, and allocative efficiency, as investors would have a better understanding of the long-term profitability of their potential investments. These disclosures would also help U.S. markets keep their competitive edge. Today, more than twenty countries have mandated public company disclosures of certain ESG issues, and seven stock exchanges require social or environmental disclosures as a listing requirement.[11] As global investors increasingly demand and expect these types of disclosures, the SEC should also require the same in order to stay competitive. Such disclosures would increase investor confidence in the long-term profitability of U.S. markets and encourage increased capital formation in the form of new investments.

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[5] Bank of America Merrill Lynch, Equity Strategy Focus Point—ESG Part II: A Deeper Dive (June 15, 2017).

[6] *See* Gordon L. Clark, Andreas Feiner & Michael Viehs, *From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance* (2015), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2508281.

[7] *See, e.g.* Cynthia Williams, et. al, "Knowing and Showing" Using U.S. Securities Laws to Compel Human Rights Disclosure (Oct. 2013), https://bit.ly/2FEyCSZ.

[8] European Commission, Consultation Document on the Update of the Non-Binding Guidelines on Non-Financial Reporting, https://ec.europa.eu/info/sites/info/files/business_economy_euro/banking_and_finance/documents/2019-non-financial-reporting-guidelines-consultation-document_en.pdf.

[9] Securities Act of 1933 §§ 7, 10, and 19(a); Securities and Exchange Act of 1934 §§ 3(b), 12, 13, 14, 15(d), and 23(a).

[10] Securities Act of 1933, §2(b); Securities and Exchange Act of 1934, § 23(a)(2).

[11] *See* Initiative for Responsible Investment, *Corporate Social Responsibility Disclosure Efforts by National Governments and Stock Exchanges* (March 12, 2015), *available at* http://hausercenter.org/iri/wp-content/uploads/2011/08/CR-3-12-15.pdf.

MYTH 4: ***ESG disclosures would be too costly for reporting companies***

The value of complete, comparable, and consistent ESG disclosures far outweighs any related costs. Studies have shown that companies with strong disclosure practices have positive shareholder returns and better stock returns.[12] Additionally, a majority of the largest companies are currently making voluntary sustainability disclosures, with 85% of S&P 500 companies producing such reports in 2017.[13] Costs associated with larger companies are usually higher given complex supply chains and global operations. That a number of large companies are already disclosing ESG information voluntarily reinforces the notion that the benefits of ESG reporting outweigh the associated costs and that the cost of shifting from voluntary to mandatory reporting would be minimal.

MYTH 5: ***Voluntary ESG disclosures already provide investors what they need to know***

While a range of reporting standards exist for voluntary disclosure of ESG information, the application and consistency of these standards varies greatly. This variability makes it difficult for investors to compare ESG data across companies or time, hindering the effectiveness of such disclosures for investment decision-making.[14] Without a regulatory mandate, voluntary disclosures are often incomplete, inconsistent, and not comparable. The SEC has recognized the value and importance of standardized disclosures for these same reasons.[15] When reporting becomes mandatory, standards necessarily become clearer, and the disclosed information more relevant and pertinent to investor needs.

*For more information, please contact Jana Morgan, Director of Campaigns and Advocacy, at Jana@icar.ngo.*

*The International Corporate Accountability Roundtable (ICAR) harnesses the collective power of progressive organizations to push governments to create and enforce rules over corporations that promote human rights and reduce inequality.*

*Visit www.icar.ngo to learn more.*

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[12] See, Andy Green & Andrew Schwartz, Corporate Long-Termism, Transparency, and the Public Interest (2018); Gordon L. Clark, et. al, *From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance, supra* note 6.

[13] Governance and Accountability Institute Inc., "85% of the S&P 500 Index Companies Publish Sustainability Reports in 2017" (2018), available at https://www.ga-institute.com/press-releases/article/flash-report-82-of-the-sp-500-companies-published-corporate-sustainability-reports-in-2016.html.

[14] See, e.g. Jim Coburn & Jackie Cook, Cool Response: The SEC & Corporate Climate Change Reporting (2014). See also, David Levy, Halina S. Brown, & Martin de Jong, The Contested Politics of Corporate Governance: The Case of the Global Reporting Initiative, 49 BUS. & SOC'Y 88 (2010); Carl-Johan Hedberg & Fredrik von Malmborg, The Global Reporting Initiative and Corporate Sustainability Reporting in Swedish Companies, 10 CORP. SOC. RESP. & ENVTL. MGMT. 153 (2003).

[15] See Chair Mary Jo White, Keynote Address at the 2015 AICPA National Conference: "Maintaining High-Quality, Reliable Financial Reporting: A Shared and Weighty Responsibility," Dec. 9, 2015, available at http://www.sec.gov/news/speech/keynote-2015-aicpa-white.html

## Why Enhanced Securities Disclosures Matter for Long-Termism

Environmental, social, and governance (ESG) reporting provides critical information to investors that helps to guide their investment decisions, and as such is critical for the long-term health and well-being of a public company. These disclosures are essential for companies that want to be seen as good corporate citizens. When a company is transparent around these important issues it often receives a reputational boost and greater access to capital. ***The Securities and Exchange Commission should initiate a rulemaking to ensure that ESG disclosures are comprehensive, consistent, and comparable.***

**1) Strong disclosure reporting is the new normal, and a smart business strategy**

ESG reporting has become a common practice of the twenty-first century business. In 2013, 44% of investors in stock markets worldwide either mandated or strongly encouraged corporate ESG reporting. This drove ESG disclosure to become standard practice – today, 75% of 4,900 companies studied by KPMG issue ESG reports and 78% of the world's 250 largest companies disclose such data in their annual financial reports. Some countries also require pension funds to consider ESG factors as a part of their fiduciary responsibilities. Choosing not to align reporting is choosing the path to less competitiveness, or worse, it is choosing to be presumed a laggard in global best practices, which could hurt corporate brands with investors and the consumers. As Christopher Meyer said: "we now live in the age of transparency where companies that do not own up to their responsibilities will find themselves in the worst of all worlds where they will be *made* responsible and still not *considered* responsible."

**2) Enhanced reporting of environmental, social, and governance risks boosts corporate reputation and creates a competitive *advantage***

Major scandals such as the Rana Plaza collapse in Bangladesh, Target's political donations, and BP's Deepwater Horizon oil spill in the Gulf of Mexico have yielded ever-growing consumer demands that corporations be honest with their consumers and investors, who clearly care about ESG reporting. Nearly 9-in-10 consumers in the richest countries in the world believe corporations should make clear, searchable disclosures and be held accountable for reporting and communicating the findings. Corporations that do are rewarded: more than 50% of corporations engaging in ESG reporting noticed it helped boost company reputation. ESG reporting indeed permits corporations to brand themselves as good corporate citizens and ensures that they are not unfairly linked to abuses.

**3) ESG information is *material* to a broad range of investors and provides corporations with increased access to capital[1]**

Today investors worth nearly $30 trillion in financial assets have signed the United Nations Principles for Responsible Investment, and are actively looking to invest in companies with high ESG performance - ESG disclosure and financial returns go hand in hand. As the responsible investment space is growing, good corporate citizens stand to benefit from additional access to capital, whereas corporations that do not may miss out. ESG disclosure plays an ever-increasing pivotal role in 320 global investors' decision-making processes. In 2016, 68% affirmed having frequently made an investment decision based on ESG information during the year. Larry Fink, the CEO of BlackRock, with $6 trillion under management recently strongly encouraged companies to make long-term planning a priority, focusing on ESG factors, and also indicated BlackRock would not hesitate to back activists in proxy ballot fights on these issues if corporations resist. ESG reporting in this context is especially important as responsible investors need "measurable and comparable" indicators as benchmarks against which to compare a wide range of companies.

Please contact Jana Morgan, International Corporate Accountability Roundtable (ICAR) at jana@icar.ngo
or 703-795-8542 with any questions.

[1] *TSC v. Northway* 426 U.S. 438, 449 (1976): a "reasonable shareholder would consider important in deciding how to vote."

March 23, 2018

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July 10, 2019

Representative Carolyn B. Maloney
Chair, Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets
2308 Rayburn House Office Building
Washington, DC 20515-0001

Representative Bill Huizenga
Ranking Member, Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets
2232 Rayburn House Office Building
Washington, D.C. 20515

Re: Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social, and Governance Disclosures

Dear Chair Maloney and Ranking Member Huizenga:

Morningstar welcomes this opportunity to comment on the value of environmental, social, and governance disclosures and the state of sustainable investing, the success of which relies on these disclosures. Morningstar is committed to advancing the interests of investors, and ordinary investors have shown a heightened interest in ESG factors and sustainable investing.

Morningstar tracks, aggregates, and analyzes data on thousands of mutual funds for individual investors and the investment community. We find that investors increasingly express interest in funds' and companies' sustainability scores. In our business lines supporting financial advisors, we hear increasing interest in integrating sustainable investing strategies. We have started to publish sustainability indexes to meet investor demand, including the Morningstar "Low Carbon Risk Index Family," which informs our perspective on how to use ESG factors in designing investment strategies.

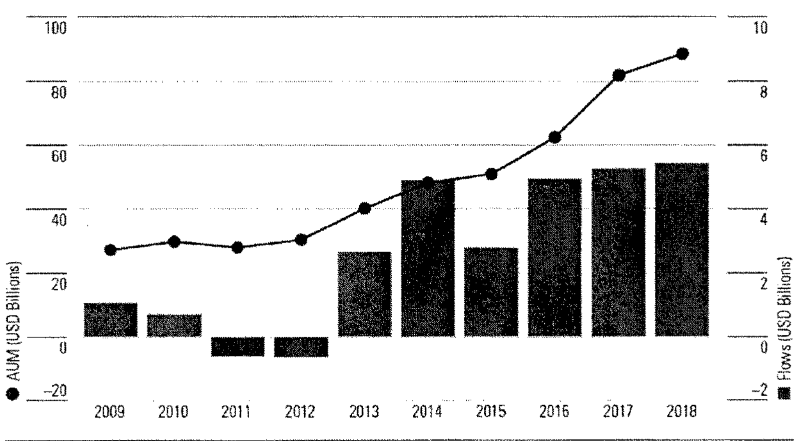
**Informed by ESG Factors, the Sustainable Investing Industry Is Burgeoning**

Sustainable investing includes any investment process that uses environmental, social, and governance criteria to evaluate investments or to assess the societal impact of investments; therefore, these strategies rely on adequate disclosures on these factors. Funds use ESG in many ways. Fund managers may consider ESG alongside other relevant financial factors to assess their investments' likely long-term returns. Some fund managers fully integrate ESG factors into all facets of their process and seek to deliver a portfolio that is tilted toward companies with strong sustainability profiles. Others attempt to deliver measurable societal and environmental impact, in addition to financial returns, by pursuing investments such as

focusing on companies committed to reducing their carbon footprint or enhancing gender equity in the workplace. Finally, some funds focus on sustainable sectors of the economy, investing in renewable energy, energy efficiency, clean technology, green real estate, and green transportation.

Sustainable investing has reached an inflection point where it is entering the mainstream. The universe of sustainable investments available to ordinary investors continues to grow as asset managers launched a record number of new ESG-oriented open-end funds and ETFs last year (37), while assets under management in such funds have more than doubled from approximately $40 billion in 2013 to almost $90 billion in 2018, as shown in Figure 1.[1] Asset flows to ESG-oriented funds remain strong and are poised to continue to grow. The organic growth rate of ESG investments far outpaces the organic growth of the U.S. market as a whole.

**Figure 1: ESG-Oriented Fund Flows and Assets Under Management**




Source: Morningstar Direct. Data as of 12/31/2018

In addition to all the new product development, an increasing number of existing mutual funds added ESG criteria to their prospectuses. In fact, a recent survey of asset managers conducted by Harvard Business School professors showed that more than 80% now consider ESG criteria when making investment decisions and do so not only because of growing client demand but because they believe "ESG information is material to investment performance."[2] This momentum remains strong as 51 U.S. funds added ESG criteria to their prospectuses in 2018 according to our data, indicating that they are formally considering ESG issues as one

[1] Hale, J. 2019. "Sustainable Funds U.S. Landscape Report: More Funds, More Flows, and Strong Performance in 2018." Morningstar White Paper. https://www.morningstar.com/lp/sustainable-funds-landscape-report?con=15987&elqCampaignId=6282

[2] Amel-Zadeh, A., & Serafeim, G. 2018. "Why and How Investors Use ESG Information: Evidence from a Global Survey." *Financial Analysts J.*, Vol. 74, No. 3, P. 87. https://ssrn.com/abstract=2925310

component of their security-selection process. These changes are an indication that ESG factors are becoming a standard part of many investment processes.

Many institutional investors are also acknowledging the importance of ESG investing by embracing the Principles for Responsible Investment, or PRI. Broadly, signatories to the PRI recognize the potential impact of ESG issues on the performance of investment portfolios; they acknowledge that in order to be effective fiduciaries, they must integrate these factors into their investment analysis, seek appropriate disclosures, and incorporate ESG issues into their ownership and voting practices.[3]

In fact, a growing body of research shows that sustainability can lead to better business practices and investment returns. Studies have found that management's failure to understand and respond to ESG risks can hurt a company's long-term financial performance, while monitoring ESG issues can help management identify such risks as well as new opportunities to generate long-term shareholder wealth.[4] Another study concludes that "by incorporating ESG issues into a corporate sustainability framework, corporations will ultimately be able to realize cost savings through innovation, resource efficiency, and revenue enhancements via sustainable products."[5]

**Although Many Companies Provide Varying Kinds of ESG Disclosures, Investors Continue to Request Additional ESG Information**

Investor demand for ESG disclosure is rapidly growing, and standard-setting groups have been working to develop standards to ensure disclosures are comparable and consistent. For example, the Sustainable Accounting Standards Board and the Taskforce on Climate-Related Financial Disclosures have developed standard taxonomies for ESG and climate-risk disclosures based on industry-specific considerations of financial materiality. More than 580 orgainizations have expressed support for the TCFD disclosures as of February 2019,[6] and a number of large companies have started integrating the SASB framework into their annual disclosures.[7]

One way to learn about information investors would like disclosed is by analyzing shareholder resolutions, which reveals strong investor demand for disclosure of certain ESG issues.

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[3] See the PRI mission statement here: https://www.unpri.org/download?ac=5981

[4] Ho, V.E. 2010. "Enlightened Shareholder Value: Corporate Governance Beyond the Shareholder – Stakeholder Divide." *J. Corporation Law,* Vol. 36, No. 1, p. 59. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1476116

[5] Clark, G.L., Feiner, A., & Viehs, M. 2015. "From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance." Oxford University. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2508281

[6] See TCFD supporter list: https://www.fsb-tcfd.org/tcfd-supporters/

[7] See SASB company use document: https://www.sasb.org/company-use/

Shareholder resolutions have been an integral part of how shareholder democracy works in the United States for more than half a century, and in recent years, shareholders have used these resolutions to elevate risks engendered by ESG issues. For example, shareholder resolutions requesting a sustainability report on greenhouse gas emissions get unusually high levels of support—47% support on average. Part of the reason for this interest from investors is that the SEC's guidance regarding disclosure related to climate change, issued in 2010, did not have a significant impact on the usefulness of companies' climate-related disclosures in their annual 10-K, 20-F, and 40-F filings.

Owing to this high level of shareholder support, company managements often adopt key features from shareholder resolutions on ESG disclosure without the need for a vote. According to the Sustainable Investments Institute's 2018 report on Social, Environmental & Sustainable Governance Shareholder Proposals, 212 proposals on ESG disclosure as companies engaged with shareholders and simply adoped the disclosure requested in the shareholder resolution obviating the need for a vote. Another 177 resolutions made it to a proxy vote.

While these shareholder resolutions reveal investor interest in ESG disclosures and a growing willingness of companies to issue requested disclosures, these efforts do little to ensure that companies will adopt comparable, standardized, and complete ESG disclosures. This, in turn, makes it difficult for investors to interpret the disclosed information without doing additional analysis and data collection from a variety of sources.

To take one example, governance data on corporate board diversity is not standardized, which means that even as some corporations have touted data that suggests boards are becoming more gender diverse, deeper analysis with a wider set of difficult-to-compile data reveals that progress is far slower than it might first appear. To study gender equity in corporate America, Morningstar analysts use a variety of time-consuming techniques to match a listed name to a gender, including manually reviewing gender-neutral names. Using these techniques, Morningstar found that smaller companies have been much slower to achieve the levels of gender diversity found on S&P 500 company boards. In fact, women make up one fourth of the average corporate board of the 500 largest publicly traded companies in America. However, women comprise just under 13% of all other corporate boards.[8]

More-standardized disclosure would make it easier to fully understand diversity disclosures and their implications for investors. For example, the increase in women on corporate boards has, in practice, meant that the same women are serving on multiple boards rather than additional women being appointed to serve on corporate boards. In fact, our researchers found that, of women who sit on boards, 24% sit on more than one. Comparatively, only 18% of men serve on multiple boards. While the difference is relatively small, the finding is significant and carries important implications: Women on boards are spread thin and may not be able to serve as effectively as men. Further, the value of gender-diverse boards comes in having a diversity

[8] Sargis, M. 2019. "Corporate Board Gender Diversity is Increasing, but With Caveats." Morningstar White Paper. https://www.morningstar.com/blog/2019/02/28/board-diversity.html

of opinions and what this means for the quality of corporate leadership. While Morningstar analysts could piece this story together from other publicly available data, better disclosures would lead to more insights on diversity in corporate America.

Last, enhanced diversity disclsoure could make it easier for investors to gain insight into the overall diversity of a board, rather than just gender diversity. In its requirements for company disclosure on board diversity, the SEC allows companies a good deal of leeway in how they define diversity, leading to variation in how much information companies provide. The U.S. Government Accountability Office reports that only about half of the companies reported defining diversity to include demographic factors such as gender, race, or ethnicity.[9] Updated SEC guidance continues to maintain a definition of diversity that is too broad to be useful or comparable.

To conclude, sustainable investing, powered by ESG analysis, has gone mainstream, and its importance will only continue to grow. As the subcommittee examines the issue, it is critical to understand that asset managers increasingly consider ESG alongside other relevant financial factors to assess investments and, in some cases, to evaluate the broader societal and environmental impact of their investments. To further this rapid momemtum, we commend the committee for reviewing the state of ESG disclosures and examining areas where disclosures have not completely caught up with investor demand.

Sincerely,

Aron Szapiro
Director of Policy Research
Morningstar, Inc.

Jon Hale, Ph.D., CFA
Director, Sustainability Investing Research
Morningstar, Inc.

[9] U.S. Government Accountability Office. 2016. "Strategies to Address Representation of Women Include Federal Disclosure Requirements." GAO-16-30. https://www.gao.gov/products/GAO-16-30

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July 3, 2019

Chairwoman Carolyn Maloney
Ranking Member Bill Huizenga
Members of the Subcommittee
U.S. House Committee on Financial Services
Subcommittee on Investor Protection, Entrepreneurship and Capital Markets
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Dear Chairwoman Maloney, Ranking Member Huizenga, and Members of the Subcommittee,

Public Citizen respectfully offers the following comments to the record for the hearing titled "Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social and Governance Disclosures." We applaud the committee for looking closely at this issue, and we enclose the public petition for a rulemaking that has been submitted to the Securities and Exchange Commission (SEC) calling for the agency to issue a standard disclosure framework on all environmental, social, and governance (ESG) issues for public companies. The rulemaking petition was submitted by investors representing more than $5 trillion in assets under management including:

- California Public Employees' Retirement System (CalPERS)
- New York State Comptroller Thomas P. DiNapoli
- Illinois State Treasurer Michael W. Frerichs
- Connecticut State Treasurer Denise L. Nappier
- Oregon State Treasurer Tobias Read
- U.N. Principles for Responsible Investment

The petition was drafted with the guidance of American securities law experts Professor Cynthia Williams, who is currently at Toronto's Osgoode Hall Law School, and Professor Jill Fisch of the University of Pennsylvania Law School.

For years, investors have been calling upon the SEC to require companies to disclose various types of ESG risks from climate, to human capital management, to political spending, to tax, to human rights, to gender pay ratios. Moreover, in response to increasing demands from investors for this information as connected to long- term performance and risk management, many companies have been attempting to provide this information voluntarily. However, the lack of parameters for the nature, timing, and extent of these voluntary disclosures makes it impossible for investors to compare companies and make smart investment decisions. The only way to fill this void is for the SEC to issue comprehensive,

standard guidance for public companies' disclosure of ESG risk, which would create a uniform requirement, as called for in the submitted petition.

The SEC has clear statutory authority to require this type of disclosure, and doing so will promote market efficiency, protect the competitive position of American public companies and the U.S. capital markets, and enhance capital formation.

While we applaud the companies that do choose to volunteer ESG information, they often do so in a manner that is episodic, incomplete, incomparable, and inconsistent. By issuing standard disclosure rules, the SEC will reduce the current burden on public companies, allowing them to plan for providing information that is relevant, reliable, and decision-useful. This will provide a level playing field for the many American companies engaging in voluntary ESG disclosure.

ESG information is material to a broad range of investors. Today, investors with $68.4 trillion of capital are committed to incorporating ESG factors in their investing and voting decisions as part of the U.N. Principles for Responsible Investment. Moreover, global assets under management utilizing sustainability screens, ESG factors, and comparable SRI corporate engagement strategies were valued at $22.89 trillion at the start of 2016, which comprised 26% of all professionally managed assets globally.

While Public Citizen takes the stance that investors have a right to a broad range of ESG disclosure, one issue that we have focused on specifically for almost a decade is corporate political activity, which is addressed in the Shareholder Protection Act legislation introduced as a discussion draft for this hearing.

A company's political activity- both its election spending and lobbying- is relevant to its shareholders because it can present significant reputational risk if not disclosed and managed properly. Many customers and the purchasing public are paying close attention to whether a company's political activity lines up with its corporate values. If there is a disconnect companies can face bad press, boycotts, or targeted social media campaigns.

For example, AT&T came under public scrutiny after it was revealed that the company paid attorney Michael Cohen--who has since been sentenced to three years in prison for campaign finance violations and fraud--$600,000 to consult on policy matters without disclosing that information to shareholders. This was following five years of calls from AT&T's shareholders to disclose the full extent of its lobbying activity and oversight policies, including payments for direct and indirect lobbying. Clearly shareholders were right to make this demand. It is important for companies to be transparent in order to prove corporate integrity and reputational soundness.

Shareholder proposals calling on companies to be honest about their political activity are one of the most frequently filed proposals every year, with 93 filed at the start of the 2019 proxy season.

Further, more and more companies are adopting accountability and transparency policies because they see this demand. Currently, more than half of the S&P 100 companies are disclosing some or all of their election- related contributions with corporate money.

In 2011, a group of securities law experts filed a petition with the SEC calling for a rulemaking on corporate political spending disclosure. Since being filed the petition has received more than the 1.2 million comments from significant experts and stakeholders such as John C. Bogle, founder and former CEO of the Vanguard Group; five state treasurers; a bipartisan group of former SEC Commissioners and Chairs; members of Congress; and 79 charitable foundations.

In addition to the comments that have poured in to the political spending disclosure petition, the SEC received over 26,500 comments in response to its 2016 Concept Release on Business and Financial Disclosure Required by Regulation S-K, the overwhelming majority of which expressed a demand for more and better disclosure in general. Additional petitions and stakeholder engagement seeking different kinds of ESG information suggest, in aggregate, that it is time for the SEC to regulate in this area.

Public Citizen disagrees with the notion that investors experience "information overload" in the current disclosure regime. While it is incredibly important that corporate disclosures are clear, concise, and decision-useful for investors, they have the right to the material information they demand. To cite Commissioner Peirce in her speech at the University of Michigan Law School on September 24th, 2018, "the Commission serves the public interest not by making decisions for people, but by enabling them to make decisions for themselves." Having access to a broad range of information about a company is a key way for investors to make smart decisions. Furthermore, if a company already has strong oversight of its political activity, for example, why wouldn't it share that information with its shareholders?

Public Citizen is encouraged to see other critical ESG topics covered in this hearing and introduced as discussion draft bills including:

- **Human Rights Disclosure** (found within the Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act of 2019)
- **Country by Country Tax Reporting** (found within the legislation to require issuers required to file an annual or quarterly report under the Securities Exchange Act of 1934 to disclose the total amount of corporate tax such issuer paid in the period covered by the report, and for other purposes); and
- **Climate Risk Disclosure** (found within the Climate Risk Disclosure Act of 2019).

We believe that all these issues should be required to be disclosed by public companies along with human capital management, which was discussed at the hearing entitled "Promoting Economic Growth: A Review of Proposals to Strengthen the Rights and Protections for Workers." We applaud members of the committee for taking steps to ensure that the SEC mandates these important disclosures. We look forward to working with members of the committee and their staff on the legislation in the coming months.

Public Citizen has been encouraging the Commission to promptly initiate a rulemaking to develop mandatory rules for public companies to disclose high-quality, comparable, decision-useful

environmental, social, and governance information, and we applaud members of the House for drawing attention to this critical issue.

Sincerely,

Lisa Gilbert
Vice President of Legislative Affairs
Public Citizen

Rachel Curley
Democracy Associate
Public Citizen's Congress Watch Division

Madelyn Antoncic, Ph.D.
CEO
The SASB Foundation
madelyn.antoncic@sasb.org

July 23, 2019

Rep. Carolyn B. Maloney
Chair, House Financial Services Subcommittee on Investor Protection, Entrepreneurship and Capital Markets
2308 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairwoman Maloney:

The Sustainability Accounting Standards Board (SASB) appreciates this opportunity to supplement the record of the Subcommittee's hearing on "Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social and Governance Disclosures," held on July 10, 2019.

**Background on SASB:** SASB is an independent nonprofit organization that sets standards for companies to use when disclosing Environmental, Social, and Governance (ESG) information to investors. SASB standards help companies publicly report consistent and comparable information about how they manage issues related to climate change, natural resource constraints, technological innovation, human capital, and other matters that may have a material impact on the company's financial condition. As a result, the SASB standards enable investors globally to better understand how a company's financial performance could be impacted by a changing world. With this information in hand, investors can direct their capital to those companies — both within and outside of the United States — that are being managed most effectively for the long term.

There is a great deal of evidence that investors are increasingly focused on sustainability, with a rapidly growing share of institutional assets being managed with ESG issues in mind. Historically, companies have disclosed ESG information to their investors and other stakeholders in a variety of ways and channels. Thus, even when reporting on similar topics, two companies in the same industry might use different performance metrics or time periods, making it difficult for investors to analyze and compare or normalize that information. SASB was formed to address this problem by helping companies report ESG information to investors in a way that is more consistent, comparable, and reliable by focusing on those ESG issues that are core to a company's business model.

SASB was formed as an organization in 2011 and has modeled its governance and organizational structure after the Financial Accounting Standards Board and the International Accounting Standards Board. The standard-setting process SASB follows is outlined in two governing documents: Rules of Procedure and a Conceptual Framework. SASB's due process is characterized by evidence-based research, broad and balanced market input, public transparency, and independent oversight. It is

designed to be driven by input from capital market participants such as corporations, investors, and other subject matter experts.

The sustainability issues that most significantly impact a company's financial performance manifest differently depending on the type of business a company is pursuing. Accordingly, SASB takes an industry-specific approach to sustainability accounting, establishing standardized performance metrics for sustainability factors that are most relevant to companies in a given industry. The ability to identify business relevant ESG issues for each industry is driven by the concept of financial materiality. Generally speaking, material information is that which is important to a reasonable investor. By viewing sustainability through a financial materiality lens, SASB standards bring key business-critical sustainability risks and opportunities into sharper focus for companies and investors.

In order to group companies based on their shared sustainability-related risks and opportunities, a new approach to industry classification was needed. SASB created the Sustainable Industry Classification System® (SICS®), which contains 77 industries. By providing a new lens through which to view peer groups, SICS enables investors to more effectively identify and manage under- or overexposure to key sustainability risks and opportunities, enhancing their assessments of fundamental and relative valuations, and to construct diversified portfolios and indices around sustainability factors.

SASB's sustainability topics are organized under five broad sustainability dimensions:

1. *Environment*. This dimension includes environmental impacts, such as using nonrenewable natural resources as a major production input or releasing significant pollutants into the environment.
2. *Social Capital*. This dimension addresses the management of a company's key relationships with outside parties, such as customers, local communities, the public, and the government. It includes issues related to human rights, the protection of vulnerable groups, local economic development, access to and quality of products and services, affordability, responsible business practices in marketing, and customer privacy.
3. *Human Capital*. This dimension addresses the management of a company's human resources (employees and individual contractors) as key assets to delivering long-term value. It includes issues that affect labor relations as well as the health, safety, and productivity of employees.
4. *Business Model and Innovation*. This dimension addresses the integration of environmental, human, and social issues in a company's value-creation process, including product innovation, operational efficiency, and the responsible design and disposal of products. It also includes supply chain management and materials sourcing.
5. *Leadership and Governance*. This dimension involves the management of issues that are inherent to the business model or common practice in the industry or that are in potential conflict with the interest of broader stakeholder groups. This includes regulatory compliance, risk management, safety management, conflicts of interest, anticompetitive behavior, and corruption and bribery.

In developing its standards, SASB identified sustainability topics from a set of 26 broadly relevant sustainability issues organized under these five sustainability dimensions. After almost seven years of research and market consultation, SASB published sustainability accounting standards for 77 industries in November 2018. Because not all matters of interest to investors are financially material, the average SASB standard contains six industry-specific topics and 14 associated performance metrics.

**Proposed Legislation:** SASB is encouraged by the interest being expressed by Chairwoman Maloney and other members of the Subcommittee in seeking better corporate ESG disclosure. Surveys and studies have shown repeatedly that although most large companies issue various types of ESG reports, often pursuant to other sustainability frameworks (as described at the hearing), this information generally is targeted to multiple audiences. SASB standards focus on a single audience, investors. The standards are designed to meet the unique needs of financial markets for better information about the connection between ESG issues and long-term financial performance. There is a clear need for this type of disclosure. For example, in a 2017 survey of its members conducted by the CFA Institute, when asked what factors limit their ability to use non-financial information in investment decisions, 54% of US respondents cited lack of appropriate quantitative ESG information, and 51% cited lack of comparability across companies.

We have two comments regarding the legislative proposals and the recent hearing. First, although SASB fully supports any legislation that would lead to more fulsome corporate disclosures with respect to material ESG and related types of risk accumulation and exposure, we have not taken the position that the government, such as the Securities and Exchange Commission, should develop specific disclosure requirements. This is because SASB focuses on what is reasonably likely to be material to investors — helping to guide the analysis of those persons who know the company best, namely, its management – and existing SEC disclosure requirements generally compel companies to make disclosures of material information.

Many companies are indeed acknowledging the need to make better ESG disclosure and are looking to the SASB standards. Although the standards were only finalized late last year, approximately 75 public companies are reporting on SASB metrics, in whole or in part. In addition, over 200 companies reference the SASB standards in their public disclosures, including recognizing SASB as a useful framework and/or stating their use of SASB as an input for their disclosure topic materiality assessments. Companies are doing so in large part because of strong investor support for SASB's work — currently there are 44 global asset owners and asset managers, with $33 trillion in assets, who are members of SASB's Investor Advisory Group, where they are committed to encouraging companies to use the SASB standards to guide disclosure to investors.

At the same time, however, many companies are resistant to making ESG disclosures in the absence of regulatory pressure. Accordingly, we think that legislation could be helpful. Congress might require the SEC to issue guidance reminding companies of their disclosure obligations in this area and referring to globally-accepted disclosure frameworks that would facilitate this process. Another approach would be requiring the SEC to establish a task force to explore how ESG disclosure might be improved; in this regard we believe that a task force should consider the possibility of safe harbors from liability for certain ESG disclosures. A further suggestion is for Congress to mandate the consideration by the SEC of the issuance of a principles-based rule that would make explicit the obligation of boards and management to consider the materiality of ESG factors when issuing their disclosures. Such legislation might also require companies to adopt a system of governance around developing and disclosing sustainability information, including management involvement, board oversight and internal control, that is substantially similar to what it uses for traditional financial reporting. This legislation could also urge companies to use an existing global disclosure framework for those disclosures.

We note that any of these legislative approaches — mandating the issuance of SEC guidance, requiring the SEC to establish a task force in this area, and requiring SEC consideration of a principles-based ESG rule — would likely result in a company's management making the ultimate disclosure determinations, including decisions as to the materiality of specific ESG matters. It seems possible that such an approach could achieve support across divergent members of Congress.

Second, concern was expressed at the hearing by some members of the subcommittee as to the burdens that would be imposed on public companies if they were required to comply with a broad set of specific ESG disclosure rules. But, again, SASB's approach addresses this concern. SASB standards are generally not overly burdensome, because they only relate to material information and therefore have a limited number of disclosure topics and metrics. Moreover, wherever possible SASB has used metrics that are already in use, pursuant to various regulatory or other requirements, thereby lowering costs. In this regard, SASB establishes the basic elements of ESG information companies should disclose; companies in many cases could be expected to supplement their SASB disclosures with other information that, while not material to investors, would be important to stakeholders such as communities, employees, NGOs, and others.

Again, we appreciate the Subcommittee's consideration of our views and we would welcome discussion of any of our comments and suggestions.

Sincerely,

M. Antoncic

Madelyn Antoncic, PhD.

Cc: Rep. Bill Huizenga, 2232 Rayburn HOB

**Amy M. O'Brien**
Senior Managing Director |
Head of Responsible Investment

730 Third Avenue
New York, NY 10017

T 212.916.5178
E amy.obrien@nuveen.com

July 10th, 2019

Dear Chair Waters:

Teachers Insurance and Annuity Association of America ("TIAA") appreciates the House Committee on Financial Services' interest in encouraging responsible investing ("RI") and greater disclosure of environmental, social, and governance ("ESG") factors by public companies. As the leading provider of retirement services for those in academic, research, medical, and cultural fields, TIAA's mission has always been to aid and strengthen the institutions and participants it serves and to provide financial products that meet their needs. Since 1970, TIAA has been a leader in RI, a constantly evolving discipline that incorporates the consideration of ESG factors into investment research, due diligence, portfolio construction, and ongoing monitoring. Through our investment management arm, Nuveen, LLC ("Nuveen"), TIAA's commitment to RI is realized in the way our engagement, integration, and impact principles inform the investment management services we provide. Drawing from TIAA's decades-long experience, Nuveen has implemented RI principles throughout the enterprise that support well-functioning markets in order to preserve financial, social, and environmental capital. We believe this approach benefits our long-term performance and helps reduce risk in our investments.

To that end, TIAA commends the Committee for considering how the existing ESG disclosure ecosystem for investors can be improved, specifically through the *ESG Disclosure Simplification Act*. The proposed legislation would empower the Securities and Exchange Commission to determine the appropriate, material ESG factors for issuers to disclose in a uniform manner, allowing investors to better integrate ESG and sustainability factors into investment decisions and improve engagement with portfolio companies. The legislation also takes care to balance investors' need for high quality, consistent information with the burden of additional disclosure on issuers – especially smaller companies that may need more time to gather and report ESG information for the first time.

We appreciate your leadership on this issue. TIAA and Nuveen stand ready to assist your efforts to improve ESG disclosures for issuers and investors alike.

Sincerely,

Amy O'Brien

Amy O'Brien

US | SIF

The Forum for Sustainable and Responsible Investment

U.S. House Committee on Financial Services

Subcommittee on Investor Protection, Entrepreneurship and Capital Markets

Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social and Governance Disclosures

July 10, 2019

Submitted testimony by Lisa Woll, CEO
US SIF: The Forum for Sustainable and Responsible Investment[1]

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On behalf of US SIF: The Forum for Sustainable and Responsible Investment, I would like to thank the Subcommittee for holding this historic hearing on the vital role environmental, social and governance (ESG) disclosure plays in ensuring transparency and accountability in our capital markets.

ESG disclosure is important to investors because it helps them assess whether companies have the policies and practices in place to ensure that they can remain profitable not only in the the short term but for many years to come. An example of such ESG concerns include:

- Are they using natural resources as efficiently as possible and minimizing waste?
- Are they able to attract and retain talent?

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[1] https://www.ussif.org

- Are they engaged in operations that will alienate the communities in which they operate or that violate human rights? Do their activities harm their reputation?
- Do their boards of directors offer sufficient expertise and diversity of opinion to management?

US SIF is the leading voice advancing sustainable, responsible and impact investing across all asset classes. Our mission is to rapidly shift investment practices toward sustainability, focusing on long-term investment and the generation of positive social and environmental impacts. Our membership represents more than $3 trillion in assets under management.

However, the breadth of investors in the United States who are examining ESG issues and corporate sustainability extends well beyond US SIF members. The US SIF Foundation's *Report on US Sustainable, Responsible and Impact Investing Trends 2018* found that US-domiciled assets under management using sustainable investment strategies grew from $8.7 trillion at the start of 2016 to $12.0 trillion at the start of 2018, an increase of 38 percent.[2] The money managers who responded to the report's survey cited client demand, their fiduciary duty, their desire to minimize investment risk and their desire to improve financial returns and generate social benefit as the leading reasons why they consider ESG factors.[3]

US SIF has been a leading advocate for ESG disclosure since 2009 when we, along with scores of other investors, sent a letter petitioning the SEC to initiate a rulemaking to create a comprehensive ESG disclosure framework[4]. The letter asked that the SEC:

[2] *Report on US Sustainable, Responsible and Impact Investing Trends 2018* US SIF Foundation, Washington, DC. www.ussif.org/trends
[3] Ibid, p. 28, fig. 2.13
[4]https://www.ussif.org/files/Public_Policy/Comment_Letters/SIF_SEC_ESG_Disclosure_Policy_Letter_and_Submission%2008142009.pdf

1) mandate that companies report annually on a comprehensive set of sustainability indicators comprised of both universally applicable and industry-specific components and;

2) issue interpretative guidance to clarify that issuers are required to disclose short- and long-term sustainability risks in the Management Discussion and Analysis section of the 10-K (MD&A).

Since the 2009 letter, sustainable investing has undergone tremendous growth. Concurrently, there have been multiple calls from a broad range of investors for enhanced disclosure:

- The Dodd Frank Wall Street Reform Act included several provisions for disclosure including conflict minerals, resource extraction payments, executive compensation and board diversity.
- The SEC issued guidance on climate change disclosure in 2010, but enforcement ebbed during the Obama Administration and has been non-existent since 2016.
- SEC Chair Mary Jo White launched the "Disclosure Effectiveness" review in 2014, which led to the Regulation S-K Concept Release in 2016. Of the 278 non-form letter responses, two-thirds of the public comments addressed sustainability issues and most of these supported sustainability-related disclosures in SEC filings.[5] No further action has happened on this matter to date.

Investors are demanding and often utilizing multiple data sources to assess the environmental, social and governance priorities and risk management strategies of publicly traded companies. Additionally, some public companies are voluntarily producing "sustainability reports" designed to explain how they are addressing ESG risks and opportunities and creating long-term value for

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[5] *Business and Financial Disclosure Required by Regulation S-K – the SEC's Concept Release and Its Implications*, Sustainability Accounting Standards Board, (September 2016), https://www.sasb.org/wp-content/uploads/2016/09/Reg-SK-Comment-Bulletin-091416.pdf

shareholders. However, there are substantial problems with the nature, timing, comparability and extent of these voluntary disclosures. Also, voluntary reporting leads to significant data gaps, especially among medium- and small-sized companies.

There is a need to develop a comprehensive framework to help ensure that companies report more consistent, complete and comparable information relevant to their long-term risks and performance.

US SIF supports legislation that will advance the reporting of uniform, consistent, and comparable information on a broad range of environmental, social and governance risks and opportunities. While we are not opposed to single-issue disclosure bills in and of themselves, they are not a substitute for one bill focused on broad ESG disclosure.

To this end, US SIF has developed principles to guide effective policymaking on ESG disclosure. A broad range of practitioners in the sustainable investment industry contributed to the development of these principles, including asset management firms, financial advisory and consulting firms and data service providers. We ask that the Committee consider these principles as it moves forward with its work on ESG disclosure.

**Mandatory Disclosure** – ESG (environmental, social and governance) disclosure must be mandatory for all reporting issuers in the United States. Such disclosure should include a qualitative management discussion of ESG issues and quantitative ESG data comprised of both universally applicable and industry-specific components. Companies should present their sustainability management policies and strategies, ESG performance data and management's analysis for investors of the key conclusions from this information. Reporting must be submitted annually in Form 10-K and be auditable.

**Comprehensive Reporting** – The reporting framework should be comprehensive and include, at a minimum, the environmental, social and governance issues defined by the Global Reporting

Initiative (GRI), the most widely adopted global standard for sustainability reporting. The framework should require companies to disclose the specific risks they face related to ESG issues.

**Comparability of Data** – The reporting framework should assure that data are comparable across companies.

**Board Approval** – The Board of Directors must review and approve the firm's reporting submission.

**Ability to Evolve** – The reporting standards within the framework should be adjusted over time as new environmental, social and governance issues emerge. This will require an established process for updating standards in response to investor (and other stakeholder) demands.

**Structured Data** – The data submitted in this reporting framework should be in a format that is compliant with inline-XBRL or a successor technology and be machine-readable to leverage modern data analysis techniques.

**Publicly Available** – Reporting must be accessible to the public through the SEC and reporting company websites.

**Enforcement** – Congress should hold the SEC accountable for enforcing the disclosure rule, such as biennial reporting to Congress on reporting compliance, enforcement actions or other relevant methods for oversight. The SEC should be appropriately funded and resourced and, where additional expertise is needed, should work with other federal agencies to obtain such expertise.

Thank you for the opportunity to share these comments with the Committee.

July 17, 2019

Chairwoman Carolyn Maloney
Ranking Member Bill Huizenga
Members of the Subcommittee
U.S. House Committee on Financial Services
Subcommittee on Investor Protection, Entrepreneurship and Capital Markets
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Chairwoman Maloney, Ranking Member Huizenga, and Members of the Subcommittee,

The undersigned organizations respectfully offer the following comments to the record for the hearing titled "Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social and Governance Disclosures." We applaud the committee for looking broadly at ESG disclosure and, in particular, at corporate political spending disclosure, which is addressed in the Shareholder Protection Act legislation introduced as a discussion draft for this hearing.

Since the U.S. Supreme Court's decision in *Citizens United v. FEC* came down in 2010, corporations have been allowed to spend unlimited undisclosed amounts of money to influence American elections and in turn affect policy outcomes. Noting the danger of "dark money" for both American democracy and the shareholders of the companies that are spending in secret, a strong coalition of diverse allies has been working together since the decision to bring corporate spending in politics into the light.

We, the undersigned organizations, believe the Securities and Exchange Commission (SEC) should be allowed to and encouraged to move forward with the rulemaking that would require public companies to disclose to their shareholders and the public how they spend money in politics. This information is material to investors- the constituency the SEC is responsible for protecting.

The Supreme Court's decision to give corporations the right under the First Amendment to spend unlimited funds from their corporate treasuries to support or attack candidates is troubling for several reasons, and investors concerned about the value of their investments and citizens concerned about the future of American democracy are looking to the SEC to take the action that so many investors have demanded and require disclosure of political spending.

Without direction from the SEC, there are no rules or procedures established in the United States to ensure that shareholders – those who actually own the wealth of corporations – are informed of, or have the right to approve, decisions on spending their money on politics. Investors want more disclosure in order to make sound investment decisions. That is why 1.2 million comments- the most in the agency's history- have come into the SEC on this rulemaking petition from

diverse stakeholders including the founder of Vanguard, John Bogle, five state treasurers, a bi-partisan group of former SEC chairs and commissioners, and investment professionals representing $690 billion in assets.

A company's political activity- both its election spending and lobbying- is relevant to its shareholders because it can present significant reputational risk if not disclosed and managed properly. Many customers and the purchasing public are paying close attention to whether a company's political activity lines up with its corporate values. If there is a disconnect companies can face bad press, boycotts, or targeted social media campaigns.

For example, AT&T came under public scrutiny after it was revealed that the company paid attorney Michael Cohen--who has since been sentenced to three years in prison for campaign finance violations and fraud--$600,000 to consult on policy matters without disclosing that information to shareholders. This was following five years of calls from AT&T's shareholders to disclose the full extent of its lobbying activity and oversight policies, including payments for direct and indirect lobbying. Clearly shareholders were right to make this demand. It is important for companies to be transparent in order to prove corporate integrity and reputational soundness.

Shareholder proposals calling on companies to be honest about their political activity are one of the most frequently filed proposals every year, with 93 filed at the start of the 2019 proxy season.

The undersigned organizations have been encouraging the Commission to promptly initiate a rulemaking to develop mandatory rules for public companies to disclose their political activity and we applaud members of the House for drawing attention to this critical issue.

Sincerely,

Common Cause

Democracy 21

End Citizens United Action Fund

Interfaith Center on Corporate Responsibility

New Progressive Alliance

OIP Trust/Missionary Oblates

Pax World Funds

Public Citizen

Sierra Club

Sisters of Charity of Saint Elizabeth

The Union of Concerned Scientists

October 1, 2018

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, Northeast
Washington, DC 20549

Dear Mr. Fields:

Enclosed is a petition for a rulemaking on environmental, social, and governance (ESG) disclosure authored by Osler Chair in Business Law Cynthia A. Williams, Osgoode Hall Law School, and Saul A. Fox Distinguished Professor of Business Law Jill E. Fisch, University of Pennsylvania Law School, and signed by investors and associated organizations representing more than $5 trillion in assets under management including the California Public Employees' Retirement System (CalPERS), New York State Comptroller Thomas P. DiNapoli, Illinois State Treasurer Michael W. Frerichs, Connecticut State Treasurer Denise L. Nappier, Oregon State Treasurer Tobias Read, and the U.N. Principles for Responsible Investment.

The enclosed rulemaking petition:

- Calls for the Commission to initiate notice and comment rulemaking to develop a comprehensive framework requiring issuers to disclose identified environmental, social, and governance (ESG) aspects of each public-reporting company's operations;
- Lays out the statutory authority for the SEC to require ESG disclosure;
- Discusses the clear materiality of ESG issues;
- Highlights large asset managers' existing calls for standardized ESG disclosure;
- Discusses the importance of such standardized ESG disclosure for companies and the competitive position of the U.S. capital markets; and
- Points to the existing rulemaking petitions, investor proposals, and stakeholder engagements on human capital management, climate, tax, human rights, gender pay ratios, and political spending, and highlights how these efforts suggest, in aggregate, that it is time for the SEC to bring coherence to this area.

If the Commission or Staff have any questions, or if we can be of assistance in any way, please contact either **Osler Chair in Business Law Cynthia A. Williams**, Osgoode Hall Law School, who can be reached at (416) 736-5545, or by electronic mail at cwilliams@osgoode.yorku.ca; or **Saul A. Fox Distinguished Professor of Business Law Jill E. Fisch**, University of Pennsylvania Law School, who can be reached at (215) 746-3454, or by electronic mail at jfisch@law.upenn.edu.

October 1, 2018

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, Northeast
Washington, DC 20549

Dear Mr. Fields,

We respectfully submit this petition for rulemaking pursuant to Rule 192(a) of the Securities and Exchange Commission's (SEC) Rule of Practice.[1]

Today, investors, including retail investors, are demanding and using a wide range of information designed to understand the long-term performance and risk management strategies of public-reporting companies. In response to changing business norms and pressure from investors, most of America's largest public companies are attempting to provide additional information to meet these changing needs and to address worldwide investor preferences and regulatory requirements. Without adequate standards, more and more public companies are voluntarily producing "sustainability reports" designed to explain how they are creating long-term value. There are substantial problems with the nature, timing, and extent of these voluntary disclosures, however. Thus, we respectfully ask the Commission to engage in notice and comment rule-making to develop a comprehensive framework for clearer, more consistent, more complete, and more easily comparable information relevant to companies' long-term risks and performance. Such a framework would better inform investors, and would provide clarity to America's public companies on providing relevant, auditable, and decision-useful information to investors.

**Introduction**

In 2014, the Commission solicited public comments to its "Disclosure Effectiveness" initiative, which sought to evaluate and potentially reform corporate disclosure requirements. Over 9,835 commenters have responded to that initiative.[2] As part of that initiative, the 2016 Concept Release on Business and Financial Disclosure Required by Regulation S-K ("Concept Release")[3] solicited public opinions on the frequency and format of current disclosure, company accounting practices and standards, and the substantive issues about which information should be disclosed. In that Concept Release, the SEC asked a number of questions about whether it should require disclosure of sustainability matters, which it defined as "encompass[ing] a range of topics, including climate change, resource scarcity, corporate social responsibility, and good

[1] Rule 192. Rulemaking: Issuance, Amendment and Repeal of Rules, Rule 192(a), *By Petition*, *available at* https://www.sec.gov/about/rules-of-practice-2016.pdf.
[2] *See* Tyler Gellasch, *Joint Report: Towards a Sustainable Economy: A review of Comments to the SEC's Disclosure Effectiveness Concept Release*, 14 (Sept. 2016), [hereinafter "Gellasch Joint Report"], *available at:* https://static1.squarespace.com/static/583f3fca725e25fcd45aa446/t/5866d3c0725e25a97292ae03/1483133890503/Sustainable-Economy-report-final.pdf.
[3] Business and Financial Disclosure Required by Regulation S-K, Release No. 33-10064; 34-77599; File No. S7-06-16, April 16, 2016, *available at* https://www.sec.gov/rules/concept/2016/33-10064.pdf [hereinafter "Concept Release"].

corporate citizenship. These topics are characterized broadly as ESG [Environmental, Social, and Governance] concerns."[4]

The SEC received over 26,500 comments in response to the 2016 Concept Release, making it one of only seven major proposals by the SEC since 2008 to garner more than 25,000 comments.[5] As noted in a report reviewing comments to the Concept Release, "the overwhelming response to the Concept Release seems to reflect an enormous pent up demand by disclosure recipients for more and better disclosure" generally.[6] The Concept Release also provided the first formal opportunity since the mid-1970s for both reporting companies and disclosure recipients to convey their views to the SEC concerning what additional environmental or social information should be disclosed to complement the governance disclosure already required.

An analysis of the comments submitted in response to the Concept Release, a significant majority of which supported better ESG disclosure, can be found in the report referenced in footnote 2. Across the board, commenters noted how they were using those disclosures to understand companies' potential long-term performance and risks. The response to the Concept Release strongly suggests that it is time for the Commission to engage in a rulemaking process to develop a framework for public reporting companies to use to disclose specific, much higher-quality ESG information than is currently being produced pursuant either to voluntary initiatives or current SEC requirements.

We briefly set out six arguments supporting this petition:

(1) The SEC has clear statutory authority to require disclosure of ESG information, and doing so will promote market efficiency, protect the competitive position of American public companies and the U.S. capital markets, and enhance capital formation;

(2) ESG information is material to a broad range of investors today;

(3) Companies struggle to provide investors with ESG information that is relevant, reliable, and decision-useful;

(4) Companies' voluntary ESG disclosure is episodic, incomplete, incomparable, and inconsistent, and ESG disclosure in required SEC filings is similarly inadequate;

(5) Commission rulemaking will reduce the current burden on public companies and provide a level playing field for the many American companies engaging in voluntary ESG disclosure; and

(6) Petitions and stakeholder engagement seeking different kinds of ESG information suggest, in aggregate, that it is time for the SEC to regulate in this area.

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[4] *See id.* at 206.
[5] *Id.*
[6] *See* Joint Report, *supra* note 2, at 10.

1. ***The SEC has Clear Statutory Authority to Require Disclosure of ESG Information***

As acknowledged by the SEC in its Concept Release, its statutory authority over disclosure is broad. Congress, in both the Securities Act and the Exchange Act, "authorize[d] the Commission to promulgate rules for registrant disclosure 'as necessary or appropriate in the public interest or for the protection of investors.'"[7] In an early defense of its power to require disclosure of corporate governance information such as the committee structure and composition of boards of directors—disclosure now considered standard, but which was controversial when the requirements were first promulgated—the SEC was explicit about the broad scope of its power over disclosure:

> The legislative history of the federal securities laws reflects a recognition that disclosure, by providing corporate owners with meaningful information about the way in which their corporations are managed, may promote the accountability of corporate managers. . . . Accordingly, although the Commission's objective in adopting these rules is to provide additional information relevant to an informed voting decision, it recognizes that disclosure may, depending on determinations made by a company's management, directors and shareholders, influence corporate conduct. This sort of impact is clearly consistent with the basic philosophy of the federal securities laws.[8]

In 1996, Congress added Section 2(b) to the Securities Act of 1933, and Section 23(a)(2) to the Securities and Exchange Act of 1934. These parallel sections provide that:

> Whenever pursuant to this title the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[9]

These statutory policy goals underscore the SEC's authority to require disclosure of better, more easily comparable, and consistently presented ESG information. Generally, the SEC seeks to protect investors through requirements for issuers to disclose material information at specified times.[10] Thus, the investor protection aspect of the SEC's statutory authority will be discussed in Part Two, below, in conjunction with the discussion of the materiality of ESG information. Here we discuss why requiring issuers to disclose specified ESG information would promote market efficiency, competition, and capital formation.

[7] Concept Release, *supra* note 3, at 22-23 & fn. 50, *citing* Sections 7, 10, and 19(a) of the Securities Act of 1933, 15 U.S.C. §§ 77g(a)(10), 77j, and 77s(a); and Sections 3(b), 12, 13, 14, 15(d), and 23(a) of the Securities and Exchange Act of 1934, 15 U.S.C. §§ 78c(b), 78l, 78m(a), 78n(a), 78o(d), and 78w(a).

[8] Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally, Exchange Act Release No. 15,384, 16 Docket 348, 350 (Dec. 6, 1978).

[9] Securities Act of 1933, §2(b), 15 U.S.C.§ 77b(b); Securities and Exchange Act of 1934, § 23(a)(2), 15 U.S.C. §78w(a)(2)(2012).

[10] *See* Concept Release, *supra* note 3, at 23 (stating that "our disclosure rules are intended not only to protect investors but also to facilitate capital formation and maintain fair, orderly and efficient capital markets.").

### A. Promoting Efficient Capital Markets

The concept of "efficient capital markets" includes informational efficiency (market mechanisms able to process new information quickly and with broad distribution)[11] and allocative efficiency (distributing capital resources to their highest value use at the lowest cost and risk).[12] Disclosure is obviously relevant to both efficiency goals, the latter being particularly relevant to the discussion of the need for better sustainability disclosure. As Mark Carney, Governor of the Bank of England and Chair of the Financial Stability Board, said with respect to climate change, with "consistent, comparable, reliable, and clear disclosure" of firms' forward-looking strategies, both "markets and governments" can better manage the transition to a low-carbon future by supporting the allocation of capital to its risk-adjusted highest-value use in that transition.[13] Climate change is not a purely environmental issue, of course: It is also an issue that poses material risks and opportunities to companies in most industries. The Sustainability Accounting Standards Board ("SASB")'s conclusion, developed in conjunction with industry leaders, is that 72 of 79 industries, representing 93% of U.S. capital market valuations, are vulnerable to material financial implications from climate change.[14] The point is that without consistent, comparable, reliable, and complete information, capital markets are constrained in promoting allocational efficiency as many industries embark on the transition to a low-carbon economy. Similarly, other substantial social and economic challenges in the United States, such as increasingly precarious work environments, rising economic inequality, or the security of private information, can be better perceived by investors and assets allocated to high-performance workplaces and firms with better human capital management and cybersecurity arrangements if investors are provided with clear and comparable information about these matters.

Requiring firms to disclose more ESG information is thus consistent with the SEC's authority to promote market efficiency, and within its broad mandate "to promulgate rules for registrant disclosure as necessary or appropriate in the public interest or for the protection of investors."[15]

### B. Ensuring the global competitiveness of America's public companies and the U.S. capital markets

The SEC will also be ensuring the competitiveness of U.S. capital markets and America's public companies by requiring more ESG disclosure. Many other developed countries have already promulgated such requirements, shaping the expectations of global investors. A 2016 study by the U.N. PRI (Principles for Responsible Investment) and MSCI (a global data and investment research provider) identified 300 policy initiatives promoting sustainable finance in the world's 50 largest economies, of which 200 were corporate reporting requirements covering

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[11] *See* Edmund W. Kitch, *The Theory and Practice of Securities Disclosure*, 61 BROOK L.REV. 763, 764–65 (1995).
[12] *See* Alicia J. Davis, *A Requiem for the Retail Investor?*, 95 VA. L. REV. 1105, 1116 (2009) (recognizing that "[p]ublic markets perform a vital economic role, since accurate share prices lead to the efficient allocation of capital.").
[13] Mark Carney, Governor, *Breaking the tragedy of the horizon: Climate change and financial stability*, Bank of England 14 (Sept. 29, 2015), *available at* http://www.BankofEngland.co.uk/publications/Pages/speeches/2015/844.asp#.
[14] Sustainability Accounting Standards Board, *Climate Risk—Technical Bulletin*, SASB Library 2017, *available at* https://library.sasb.org/climate-risk-technical-bulletin/.
[15] Concept Release, *supra* note 3, at 22.

environmental, social, and governance factors.[16] According to a 2015 report by the Initiative for Responsible Investment of the Hauser Institute for Civil Society at the Kennedy School, Harvard University, 23 countries have enacted legislation within the last 15 years to require public companies to issue reports including environmental and/or social information.[17]

In addition to these reporting initiatives, seven stock exchanges require social and/or environmental disclosure as part of their listing requirements: Australia's ASX, Brazil's Bovespa, India's Securities and Exchange Board, the Bursa Malaysia, Oslo's Børs, the Johannesburg Stock Exchange, and the London Stock Exchange.[18]

Moreover, seven countries have enacted policies following those of the U.K. and Sweden, which since 2000 have required public pension funds to disclose the extent to which the fund incorporates social and environmental information into their investment decisions.[19] Regulations such as these support the trend of increasing institutional investor demand for high-quality ESG data, as discussed below. Currently the European Union is developing a taxonomy of environmentally sustainable activities, as well as developing benchmarks for low-carbon investment strategies, and regulatory guidance to improve corporate disclosure of climate-related information.[20] To the extent that US companies fail to disclose information which global investors are being encouraged, and in some cases required, to consider, they will be at a disadvantage in attracting capital from some of the world's largest financial markets. This highlights that US corporate reporting standards will soon become outdated if they are not revised to incorporate global developments regarding the materiality and disclosure of ESG information.

**C. Facilitating Capital Formation**

Additionally, promulgating a regulatory framework for the disclosure of ESG information would promote capital formation. By providing more information to investors, giving better information about risks and opportunities, and standardizing what is currently an uncoordinated and irregular universe of ESG disclosures, the SEC would act to increase confidence in the capital markets. This confidence may well mobilize sources of capital from investors who are currently unwilling to invest given knowledge gaps or information asymmetries. Particularly retail investors, who are important as long-term investors and investors in small and medium enterprises, may be emboldened by a clearer sense of the social and environmental aspects of

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[16] PRI and MSCI, *Global Guide to Responsible Investment Regulation,* 2016, *available at* https://www.unpri.org/page/responsible-investment-regulation.

[17] *See* Initiative for Responsible Investment, *Corporate Social Responsibility Disclosure Efforts by National Governments and Stock Exchanges* (March 12, 2015), *available at* http://hausercenter.org/iri/wp-content/uploads/2011/08/CR-3-12-15.pdf. These countries include Argentina, China, Denmark, the EU, Ecuador, Finland, France, Germany Greece, Hungary, India, Indonesia, Ireland (specific to state-supported financial institutions after the 2008 financial crisis), Italy, Japan, Malaysia, The Netherlands, Norway, South Africa, Spain, Sweden, Taiwan, and the U.K.

[18] *See id.*

[19] *See* Initiative for Responsible Investment report, *supra* note 63. These countries include Australia, Belgium, Canada, France, Germany, Italy, and Japan.

[20] Technical Expert Group on Sustainable Finance (TEG), *State-of-play, July 2018*, *available at* https://ec.europa.eu/info/publications/sustainable-finance-technical-expert-group_en.

companies' activities as a guide to companies' longer-term risks and opportunities.[21] As we highlight below, the value of assets under management based on ESG-influenced guidelines has grown considerably in the past two decades. We ask the SEC to act to facilitate the provision of information to this rapidly growing sector. In so doing, additional capital may become available to support America's enterprises, particularly its smaller and medium-sized enterprises.

**2. *ESG Information is Material and Decision Useful***

In advancing its over-arching goals of investor protection and promoting market efficiency, the SEC has relied upon the concept of materiality to determine what information issuers should be required to disclose and in what format.[22] As defined by the U.S. Supreme Court in *TSC v. Northway,* material information is information that a "reasonable shareholder would consider important in deciding how to vote."[23] As the Court said, "[p]ut another way, there must be 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."[24] Thus, what is material depends on reasonable investors' perceptions of what information is already available in the market, and how any new or omitted information changes those perceptions of the quality of management, when voting or engaging with management, or the value of a company or its shares, when investing or selling.

In promulgating disclosure regulations under Regulation S-K, the SEC has predominantly, but not exclusively, sought to require the disclosure of information it construes as financially material.[25] Recent investment industry analyses are confirming the financial materiality of much ESG information. For instance, a June, 2017, Bank of America Merrill Lynch study highlighted by the Sustainability Accounting Standards Board found sustainability factors to be "strong indicators of future volatility, earnings risk, price declines, and bankruptcies."[26] Also in June of 2017, Allianz Global Investors produced a research report with similar findings, concluding that the heightened transparency of ESG disclosure lowered companies' cost of capital by reducing the "investment risk premium" that sophisticated investors would require.[27] In September of 2017, Nordea Equity Research published an analytic research report concluding that there is "solid evidence that ESG matters, both for operational and share price performance."[28] Goldman Sachs concluded in April of 2018 that "integrating ESG factors allows for greater insight into

[21] *See* Davis, *supra* note 12, at 116-1120 for evidence on the importance of retail investors to small and medium enterprises, versus institutional investors which predominantly invest in large-capitalization companies; and for evidence of retail investors generally longer holding periods for shares of stock.
[22] Concept Release, *supra* note 3, at 33-34.
[23] 426 U.S. 438, 449 (1976).
[24] *Id.*
[25] *See* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1264-66 (1999) (discussing SEC's requirements for public companies to disclose certain corporate governance information without a showing of economic materiality).
[26] Bank of American Merrill Lynch, *Equity Strategy Focus Point—ESG Part II: A Deeper Dive* (June 15, 2017), *cited in* Sustainability Accounting Standards Board (SASB), *The State of Disclosure Report 2017* (December 2017).
[27] Allianz Global Investors, *ESG matters, Part 2: Added value or a mere marketing tool?What does ESG mean for investments?,* (June 2017).
[28] Nordea Equity Research, *Strategy & Quant: Cracking the ESG Code,* 5 Sept. 2017, *available at:* https://nordeamarkets.com/wp-content/uploads/2017/09/Strategy-and-quant_executive-summary_050917.pdf.

intangible factors such as culture, operational excellence and risk that can improve investment outcomes."[29]

These industry studies are consistent with, and indeed rely upon, a number of influential academic studies that have analyzed the over 2,000 research studies also showing the economic materiality of ESG information. Two such studies are of particular note. Deutsch Asset & Wealth Management, in conjunction with researchers from the University of Hamburg, analyzed 2,250 individual studies of the relationship between ESG data and corporate financial performance. From this analysis, the researchers concluded that improvements in ESG performance generally lead to improvements in financial performance.[30] A comprehensive review published in 2015 of empirical studies found that 90% of studies show that sound sustainability standards lower firms' cost of capital; 80% of studies show that companies' stock price performance is positively influenced by good sustainability practices; and 88% of studies show that better E, S, or G practices result in better operational performance.[31]

In addition, the SEC has promulgated disclosure requirements for the production of qualitatively material information. For instance, it has required disclosure concerning corporate governance, such as statistics on board members' attendance at meetings, and information on the committee structure of the board of directors, with the stated purpose of encouraging the board to be more active and independent in monitoring management's actions.[32] It has required extensive disclosure of executive compensation, starting in the early 1990s, as a response to public frustration with the levels of executive compensation.[33] Indeed, with respect to illegal actions by members of management or the company, the SEC has established an almost *per se* materiality standard even where the economic consequences of management's illegal actions were trivial.[34] This qualitative approach to the materiality of information concerning the honesty of management or its approach to law compliance, among other matters, was the basis for the SEC's Division of Corporation Finance and the Office of the Chief Accountant to reject

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[29] Goldman Sachs Equity Research, *GS Sustain ESG Series: A Revolution Rising-From Low Chatter to Loud Roar [Redacted]*, 23 April 2018 (analyzing earnings call transcripts, social media, asset manager initiatives, and rising assets under management utilizing ESG screens to conclude that "the ESG Revolution is just beginning, as the logical, empirical and anecdotal evidence for its importance continue to mount.").

[30] Deutsche Asset & Wealth Management, *ESG and Corporate Financial Performance: Mapping the Global Landscape*, December, 2015, *available at* https://institutional.deutscheam.com/content/_media/K15090_Academic_Insights_UK_EMEA_RZ_Online_151201_Final_(2).pdf.

[31] *See* Gordon L. Clark, Andreas Feiner & Michael Viehs, *From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance* (2015), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2508281. This report is an excellent resource because it analyzes the empirical literature on the financial effects of sustainability initiatives by type of initiative (E, S or G) and by various financial measures of interest (cost of debt capital; cost of equity capital; operating performance; and effect on stock prices).

[32] *See* Williams, *supra* note 24, at 1265 & fn. 359, *citing* Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally, Exchange Act Release No. 15,384, 16 Docket 348 (Dec. 6, 1978).

[33] *See id.* at 1266 & fn. 363, *citing* Executive Compensation Disclosure, Securities Act Release No. 6962, Exchange Act Release No. 31,327, 52 SEC Docket 1961 (Nov. 4, 1992).

[34] *See id.* at 1265 & fn. 361, *citing* Division of Corporation Finance's Views and Comments on Disclosure Relating to the Making of Illegal Campaign Contributions by Public Companies and/or their Officers and Directors, Securities Act Release No. 5466, Exchange Act Release No. 10673, 3 SEC Docket 647 (Mar. 19, 1974); *In re* Franchard Corp., 42 S.E.C. 163, 172 (1964) (Cary, Chair)(stating that the integrity of management "is always a material factor.").

quantitative benchmarks as the sole determinant to assess materiality in preparing financial statements.[35]

The Commission has often developed new disclosure requirements in response to increased investor interest in emerging systemic environmental or social risks, such as its 2011 guidance on disclosure of risks related to cybersecurity.[36] We thus conclude that the SEC properly recognizes that there can be material information which is not yet required to be reflected in financial statements but which may be decision-relevant to investors. As stated by Alan Beller, former Director of the Division of Corporation Finance, "[i]n today's rapidly changing business landscape, investors often look beyond financial statement to understand how companies create long-term value. Financial reporting today has not kept pace with both company managers and investors' interest in broader categories of information that are also material to operations and financial performance." [37] The touchstone is the "reasonable investor," and what information the reasonable investor relies upon in voting, investing, and engagement with portfolio companies.

Today, investors with $68.4 trillion of capital are committed to incorporating ESG factors in their investing and voting decisions as part of the U.N. PRI.[38] Institutions, pension funds, sovereign wealth funds, and mutual funds with $95 trillion of invested capital support the Carbon Disclosure Project's ("CDP") annual survey of global companies regarding their greenhouse gas emissions and strategies for addressing climate change.[39] According to a recent Ernst & Young report, "investor interest in non-financial information spans across all sectors," and 61.5% of investors consider non-financial information relevant to their investments overall.[40]

Global assets under management utilizing sustainability screens, ESG factors, and comparable SRI corporate engagement strategies were valued at $22.89 trillion at the start of 2016, comprising 26% of all professionally managed assets globally.[41] Moreover, U.S.-domiciled assets using SRI strategies in 2016 were valued at $8.72 trillion, comprising more than 21% of the assets under professional management in the U.S. in that year.[42] These latter data starkly contrast with the facts when the SEC last considered the issue of expanded social and environmental disclosure in comprehensive fashion, between 1971 and 1975. Then, there were two active "ethical funds" in the United States, which by 1975 collectively held only $18.6 million assets under management, or 0.0005% of mutual fund assets.[43]

The data in the last two paragraphs indicate that substantial assets under management are

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[35] *See* SEC Staff Accounting Bulletin 99-Materiality (Aug. 12, 1999).
[36] Securities & Exchange Comm'n, *Commission Guidance Regarding Disclosure Related to Topic No. 2 Cybersecurity* (Oct. 13, 2011), *available at* http://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic2.htm.
[37] Alan Beller, Foreword to SASB's Inaugural Annual State of Disclosure Report, December 1, 2016, *available at* https://www.sasb.org/blog-alan-beller-pens-forward-inaugural-annual-state-disclosure-report.
[38] *See PRI-11 year growth of AO, all signatories (Asset Owners, Investment Managers and service providers) and respective AUM,* Excel sheet available for download at *About the PRI*, U.N. Principles for Responsible Investment, http://www.unpri.org/about.
[39] *Catalyzing business and government action,* Carbon Disclosure project, https://www.cdp.net/en-US/Pages/About-Us.aspx.
[40] *Id.* at 18.
[41] *See* Global Sustainable Investment Alliance, *The Global Sustainable Investment Review 2016* 3, 7-8, *available at* http://www.gsi-alliance.org/wp-content/uploads/2017/03/GSIA_Review_2016.pdf.
[42] *Sustainable and Impact Investing in the United States: Overview,* US SIF, http://www.ussif.org/files/Infographics/Overview%20Infographic.pdf (last visited Nov. 9, 2017).
[43] *See* Williams, *supra* note 24, at 1267 (citing SEC data).

using what ESG data is available, clearly demonstrating that investors consider this information material.[44] And yet, as discussed below, leading U.S. asset managers and executives emphasize that the poor quality of ESG data does not meet investors' needs, and support regulatory mandates to require companies to produce better ESG data.

**3. *Companies struggle to provide investors with ESG information that is relevant, reliable, and decision-useful***

Over the last twenty-five years, voluntary disclosure of ESG information, and voluntary frameworks for that disclosure, have proliferated to meet the demands for information from investors, consumers, and civil society. The most comprehensive source of data on ESG reporting is that done by KPMG in the Netherlands. KPMG published its first ESG report in 1993, and its most recent report in 2017. In 1993, 12% of the top 100 companies in the OECD countries (excluding Japan) published an environmental or social report.[45] By 2017, 83% of the top 100 companies in the Americas publish a corporate responsibility report, as do 77% of top 100 companies in Europe and 78% in Asia.[46] Of the largest 250 companies globally, reporting rates are 93%.[47] The Global Reporting Initiative's (GRI) voluntary, multi-stakeholder framework for ESG reporting has emerged as the clear global benchmark: 75% of the Global 250 use GRI as the basis for their corporate responsibility reporting.[48] Of particular note, 67% of the Global 250 now have their reports "assured," most often by the major accontancy firms.[49]

Although 75% of the Global 250 use GRI as the basis for reporting, academic studies of reporting according to GRI have found serious problems with the quality of the information being disclosed. One study comparing GRI reports in the automotive industry concluded that "the information . . . is of limited practical use . . .Thus, quantitative data are not always gathered systematically and reported completely, while qualitative information appears unbalanced."[50] Markus Milne, Amanda Ball, and Rob Gray surveyed the existing literature on GRI as a preeminent example of triple bottom line reporting, and concluded in 2013 that "the quality— and especially the *completeness*—of many triple bottom line reports are not high. . . With a few notable exceptions, the reports cover few stakeholders, cherry pick elements of news, and generally ignore the major social issues that arise from corporate activity. . . ."[51] Other studies have observed similar problems, particularly with the lack of comparability of the information

[44] For further evidence of investors' views on the materiality of ESG data, *see* Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, GEO. L. J. (forthcoming 2018), *available at* https://ssrn.com/abstract=3233053.
[45] *See* Ans Kolk, *A Decade of Sustainability Reporting: Developments and Significance*, 3 INT'L J. ENVIR. & SUSTAINABLE DEVELOPMENT 51, 52 Figure 1 (2004). KPMG has changed the format of the report since its original 1993 report, so direct comparisons are not possible between the Global 250 in 1993 and the Global 250 in 2017.
[46] KPMG, The KPMG Survey of CR Reporting 2017, at 11, available *at* https://home.kpmg.com/content/dam/kpmg/campaigns/csr/pdf/CSR_Reporting_2017.pdf.
[47] *Id.*
[48] *See id.* at 28. The Global Reporting Initiative is now in its fourth iteration. It has been developed by, and is used by, thousands of companies, governments, and non-profit entities around the world to report on the economic, environmental, social and governance effects of entities' actions. *See* Global Reporting Initiative, *available at* http://www.globalreporting.org.
[49] *See* KPMG 2017 Report, *supra* note 42, at 26.
[50] Klaus Dingwerth & Margot Eichinger, *Tamed Transparency: How Information Disclosure under the Global Reporting Initiative fails to Empower,* 10:3 GLOBAL ENV. POL. 74, 88 (2010).
[51] Markus J. Milne, Amanda Ball & Rob Gray, *Wither Ecology? The Triple Bottom Line, the Global Reporting Initiative, and the Institutionalization of Corporate Sustainability Reporting,* 188 (1) J. BUS. ETHICS 1 (2013).

being reported.[52] These conclusions should not be taken as a criticism of GRI *per se*, or of companies' efforts to provide expanded ESG information. Rather, these conclusions are an indication of the weaknesses of voluntary disclosure: without a regulatory mandate, the information being produced is often incomplete, lacks consistency, and is not comparable between companies. In contrast, when ESG disclosure becomes mandatory, standards become clearer and reporting becomes more consistent and comparable.[53] In analogous circumstances, the SEC has recognized the importance of standardized disclosure frameworks for financial information, expressing concerns about the use of non-GAAP accounting, concluding that information being disclosed without adherence to the standardized disclosure framework of U.S. GAAP may be confusing and even deceptive.[54]

**4. *Companies' Voluntary Disclosure is Insufficient to Meet Investors' Needs***

Given these problems with the quality of voluntary ESG disclosure, notwithstanding the efforts of public companies to meet investors' needs, a wide range of capital market participants have come out in favor of required ESG disclosure. In response to the Concept Release, the SEC received comments from asset managers, institutional investors, individual investors, foundation executives, and public pension funds, among others. These users of corporate disclosure "overwhelmingly expressed support" for more required ESG disclosure.[55] BlackRock, the world's largest asset manager, with assets under management of $6.317 trillion as of March 31, 2018, has recognized the strategic value of ESG information:

> Environmental, social, and governance issues are integral to our investment stewardship activities, as the majority of our clients are saving for long-term goals. It is over the long-term that ESG factors – ranging from climate change to diversity to board effectiveness – have real and quantifiable financial impacts. Our risk analysis extends across all sectors and geographies, helping us identify companies lagging behind peers on ESG issues.[56]

And yet, BlackRock asserts that current reporting practices are insufficient for the kinds of in-depth investment analysis that it seeks with its ESG integration, making it "difficult to identify investment decision-useful data." As a result, it has advocated for public policy

[52] *See* David Levy, Halina S. Brown, & Martin de Jong, *The Contested Politics of Corporate Governance: The Case of the Global Reporting Initiative*, 49 BUS. & SOC'Y 88 (2010); *see also* Carl-Johan Hedberg & Fredrik von Malmborg, *The Global Reporting Initiative and Corporate Sustainability Reporting in Swedish Companies*, 10 CORP. SOC. RESP. & ENVTL. MGMT. 153 (2003).

[53] *See generally*, Jody Grewal, Edward J. Riedl & George Serafeim, *Market Reactions to Mandatory Nonfinancial Disclosure*, at 27 (Harvard Business School Working Paper, No. 16-025, 2015), http://www.ssrn.com/abstract=2657712 (stating that "firms having high ESG disclosure and stronger governance performance will be able to institute the [EU Directive on non-financial reporting] more efficiently and cost-effectively" because the reporting is mandatory, thus creating consistency).

[54] *See* Chair Mary Jo White, *Keynote Address at the 2015 AICPA National Conference: "Maintaining High-Quality, Reliable Financial Reporting: A Shared and Weighty Responsibility,"* Dec. 9, 2015, *available at* http://www.sec.gov/news/speech/keynote-2015-aicpa-white.html; U.S. Securities and Exchange Commission, *Non-GAAP Financial Measures*, Oct. 17, 2017, *available at* https://www.sec.gov/divisions/corpfin/guidance/nongaapinterp.htm.

[55] Gellasch Joint Report, *supra* note 2, at 17.

[56] *See* BlackRock, *Viewpoint, Exploring ESG: A Practitioners Perspective* (June 2016), *available at* http://www.blackrock.com/corporate/en-fi/literature/whitepaper/viewpoint-exploring-esg-a-practitioners-perspective-june-2016.pdf.

changes to require companies to disclose such information, assuming appropriate safe harbors are also provided.[57]

BlackRock is not alone among substantial asset owners and asset managers advocating for better ESG disclosure in required securities filings. As discussed in Section Four, below, the Human Capital Management Coalition, a group of 25 institutional investors representing $2.8 trillion in assets, has submitted a rulemaking petition to the Commission urging the adoption of standards that would require listed companies to disclose information on human capital management policies, practices, and performance.[58] In July 2017, 390 investors representing more than $22 trillion in assets wrote to G20 heads of state, calling on governments to "evolve the financial frameworks required to improve the availability, reliability and comparability of climate-related information."[59]

Bloomberg, another global company that sells capital markets data, has reached conclusions similar to those of BlackRock about the quality of ESG data. Since 2009, Bloomberg has incorporated ESG data into the data that it sells to dealers, brokers, and investors around the world.[60] Even so, its CEO Michael Bloomberg has said this:

> [F]or the most part, the sustainability information that is disclosed by corporations today is not useful for investors or other decision-makers. . . .To help address this issue, I became chair of the Sustainability Accounting Standards Board (SASB) in 2014, and last year [2015], I agreed to build on that work by chairing the new Task Force on Climate-Related Financial Disclosures (TCFD)....The market cannot accurately value companies, and investors cannot efficiently allocate capital, without comparable, reliable and useful data on increasingly relevant climate-related issues....[61]

The Task Force on Climate-Related Financial Disclosure (TCFD) was constituted by the Financial Stability Board, under the auspices of the G20.[62] It has now released its final recommendations for a framework of climate-relevant financial disclosure, focusing on four aspects of a company's operations in respect of climate change: Governance, Strategy, Risk Management, and Metrics & Targets.[63] Among what the TCFD calls its "key recommendations" is that climate-related financial disclosures should be included in required financial filings, thus that this type of reporting should be mandatory.[64]

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[57] *Id.* at 1.

[58] http://uawtrust.org/hcmc.

[59] https://www.ceres.org/news-center/press-releases/over-200-global-investors-urge-g7-stand-paris-agreement-and-drive-its.

[60] *See* Bloomberg, *Impact Report Update 2015* 2, (2015), *available at* http://www.bbhub.io/sustainability/sites/6/2016/04/16_0404_Impact_report.pdf.

[61] *Id.*

[62] The Task Force, chaired by Michael R. Bloomberg, was established by the FSB in December 2015 pursuant to a request from Bank of England Governor Mark Carney "to develop a set of voluntary disclosure recommendations for use by companies in providing information to investors, lenders and insurance underwriters about their climate-related financial risks." *See* https://www.fsb-tcfd.org/news/#.

[63] *See* Recommendations of the Task Force on Climate-related Financial Disclosures, June 2017, at iii, *available at* https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-TCFD-Report-062817.pdf [hereinafter "Task Force Report"].

[64] *Id.*

Notwithstanding the problems with the quality of voluntarily produced ESG information in the markets, the substantial growth in voluntary sustainability disclosure globally is important for a number of reasons. First, companies are responding to investors who are increasingly aware of the relevance of ESG data to a full evaluation of company strategies, risks, and opportunities. This investor awareness shows the materiality of this information, particularly to shareholders with a long-term orientation. Second, to produce sustainability reports companies have developed internal procedures to collect and evaluate the kinds of information that an SEC framework would likely require, thus showing that costs to companies should not be an impediment. While not all companies have embarked on sustainability reporting, therefore adoption will include some additional costs to some companies, the SEC is well-positioned to provide "on-ramps" or differentiated requirements for smaller companies, as it has done historically. Third, and perhaps most important, twenty-five years of development of voluntary sustainability disclosure has not led to the production of consistent, comparable, highly-reliable ESG information in the market, notwithstanding the voluntary, multi-stakeholder development of a framework for disclosure (GRI) that is being used by 75% of the world's largest companies. SEC leadership providing a mandate for ESG disclosure in the world's largest, and arguably most important, capital market can significantly contribute to solving this problem.

5. ***Commission rulemaking will reduce the current burden on public companies and provide a level playing field for the many American companies engaging in voluntary ESG disclosure***

In addition to benefiting investors, rulemaking regarding ESG disclosure would benefit America's public companies by providing clarity to them about what, when and how to disclose material sustainability information. Today companies are burdened with meeting a range of investor expectations for sustainability information without clear standards about how to do so. A number of promising frameworks have been promulgated over the previous decade or decades, many of which have been mentioned in this petition: GRI, SASB, CDP, and now TCFD being the most prominent. And yet, because there isn't clear guidance and an authoritative standard in the U. S. for all public reporting companies to use, different companies are using different frameworks and multiple mechanisms to disclose sustainability information. Thus, investors are still dissatisfied with the comparability of sustainability information, even between companies in the same industry.[65]

That ESG disclosure requirements could actually reduce burdens on America's public companies was well-stated in the CFA Institute's Comment Letter to the Concept Release:

> Many issuers already provide lengthy sustainability or ESG reports to their investors, so many issuers will not face a new and burdensome cost by collecting, verifying and disclosing ESG information. Costs may be saved if instead of producing large sustainability reports that cover a broad range of sustainability information, issuers can instead focus on only collecting, verifying and disclosing information concerning the factors that are material to them and their investors.[66]

[65] *See* PwC, *Sustainability Disclosures: Is your company meeting investor expectations?* (July 2015), *cited in* Jean Rogers, SASB Comment Letter to the SEC's April, 2016 Concept Release, July 1, 2016, at 7 fn.20 (79% of investors polled said they were dissatisfied with the comparability of sustainability information between companies).

[66] CFA Institute Comment Letter to the Concept Release, October 6, 2016, at 19. The CFA Institute is a global, not-for-profit professional association of over 137,000 investment analysts, advisers, portfolio managers, and other

Such rulemaking would also act to create a level playing field between companies. Today, sustainability information is being provided by some but not all companies, in formats that differ, using different mechanisms for disclosure (sustainability reports, company websites, SEC filings), and different timing. As recognized in an analysis of sustainability reporting by PwC in 2016, this has created a situation where information is not comparable between companies in the same industry and sector; where "an increasing volume of information is being provided without linkage to a company's core strategy," and where there are no clear standards all companies within the same industry are using.[67] Such standards could well encompass a mix of required elements, based on industry and sector; information about firms' governance of sustainability issues across industries; and principles-based elements to act as a materiality back-stop. By providing clarity to issuers on what sustainability disclosure is required, the SEC would create comparability between firms in the same industry, thus promoting a level playing field between companies. Comparability will allow actual sustainability leaders to be recognized as such, with attendant financial benefits such as increased investment and a lower cost of capital.[68]

**6. *Various ESG-related Petitions and Stakeholder Engagements with the SEC Suggest, in Aggregate, that it is Time for the SEC to Act to Bring Coherence to this Area***

In recent years, there have been a number of significant petitions and other investor proposals seeking expanded disclosure of ESG information. These initiatives give evidence of the views of investors and capital markets professionals that more needs to be done to meet investors' needs for consistent, comparable, and high-quality ESG data. Moreover, stakeholders have used additional opportunities created by the SEC to support for broader ESG disclosure. A sampling of such petitions, investor proposals, and stakeholder engagements includes:

Climate Risk Disclosure: In 2007 and 2009, Ceres filed petitions to the SEC calling for better guidance to companies on how to disclose risks and opportunities from climate change. In 2010, the SEC responded by issuing such guidance.[69] Analysis indicates that the guidance has not been successful in producing consistent, comparable, high-quality information concerning climate change risks and opportunities, however.[70] The Framework and Technical Guidance published

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investment professionals in more than 157 countries. On the question of the SEC requiring sustainability disclosure, the CFA Institute concluded that "[i]t is imperative that the SEC develop disclosure requirements that require companies to disclose material sustainability information while allowing issuers the flexibility to disclose that which is germane to their industry/sector . . . " Thus the Institute supported differentiated sustainability disclosure according to industry and sector, along with a general requirement for companies to disclose the corporate governance arrangements for sustainability issues. *Id.*

[67] PwC, *Point of View: Sustainability reporting and disclosure: What does the future look like? (July 2016)*, at 1, *available at*. https://www.pwc.com/us/en/cfodirect/publications/point-of-view/sustainability-reporting-disclosure-transparency-future.html.

[68] *See, e.g.*, Clark et al., *supra* note 29 (summarizing empirical literature through 2015, and finding that 90% of studies show lowered cost of capital for firms with sound sustainability practices; 88% of studies show that better E,S, or G practices (the latter specific to sustainability) result in better operational performance; and 80% of studies show stock market out-performance for firms with good sustainability practices.

[69] Commission Guidance Regarding Disclosure Related to Climate Change, Release No. 33-9106; 34-61469; FR-82, Feb. 8, 2010, U.S. SECURITIES AND EXCHANGE COMMISSION, *available at* https://www.sec.gov/rules/interp/2010/33-9106.pdf.

[70] *See, e.g.*, Robert Repetto, *It's Time the SEC Enforced Its Climate Disclosure Rules*, INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT (IISD)(Mar. 23, 2016), *available at* https://www.iisd.org/blog/it-s-time-sec-enforced-its-climate-disclosure-rules.

by the FSB's Task Force on Climate-Related Financial Disclosure (TCFD), mentioned above, would be an industry-developed (operating companies, investors, insurance companies, and accounting) platform for the SEC to use as a starting point in promulgating its own Framework for comprehensive ESG disclosure.

ESG Disclosure: On July 21, 2009, the U.S. Social Investment Forum (USSIF) requested that the SEC promulgate a new, annual requirement for ESG disclosure, modeled on the framework of the Global Reporting Initiative (GRI). GRI sets out a general framework for disclosure of information applicable to all companies, and then industry-specific requirements relevant to the social, environmental, and governance concerns applicable to each specific industry. The USSIF petition also asked the SEC to issue interpretive guidance to clarify that companies are required to disclose short and long-term sustainability risks in the Management Discussion and Analysis section of their 10-K.

Gender pay ratios: On February 1, 2016, Pax Ellevate Management LLC, investment adviser to the Pax Ellevate Global Women's Index Fund submitted a petition to the Commission requesting that it require public companies to disclose gender pay ratios on an annual basis. Petitioners stated that "[w]e believe that pay equity is a useful and material indicator of well-managed, well-governed companies, and conversely, that companies exhibiting significant gender pay disparities may bear disproportionate risk, and that investors therefore may benefit from having such information."[71]

Human Capital Management: On July 6, 2017, the Human Capital Management Coalition, a group of institutional investors with $2.8 trillion in assets, submitted a petition to the Commission requesting that it "adopt new rules, or amend existing rules, to require issuers to disclose information about their human capital management policies, practices and performance."[72] The Coalition seeks this expanded disclosure so that "(1) investors can adequately assess a company's business, risks and prospects; (2) investors can more "efficiently direct capital to its highest value use, thus lowering the cost of capital for well-managed companies; (3) companies can stop responding to a myriad of voluntary questionnaires seeking this information; and (4) investors can pursue long-term investing strategies in order "to stabilize and improve our markets and to effect the efficient allocation of capital."

Human Rights: The human rights policies, practices, and impacts of filers are material to many investors.[73] The SEC has already provided for some human rights disclosure regarding conflict minerals under 17 CFR §240.13p-1, in response to the Dodd-Frank Act, and in certain guidance on disclosure relating to climate change[74] and cyber-security information.[75] General guidance on disclosure of human rights policies, practices, and impacts is lacking, however.

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[71] *See* Pax Ellevate Petition, February 1, 2016, *available at* https://www.sec.gov/rules/petitions/2016/petn4-696.pdf.
[72] *See* Human Capital Management Coalition Petition, July 6, 2017, available *at* https://www.sec.gov/rules/petitions/2017/petn4-711.pdf.
[73] *See, e.g.*, CYNTHIA WILLIAMS ET AL., "KNOWING AND SHOWING" USING U.S. SECURITIES LAWS TO COMPEL HUMAN RIGHTS DISCLOSURE (Oct. 2013) at 16, *available at* http://icar.ngo/wp-content/uploads/2013/10/ICAR-Knowing-and-Showing-Report4.pdf.
[74] Securities & Exchange Comm'n, Commission Guidance Regarding Disclosure Related to Climate Change (Jan. 27, 2010), Release Nos. 33-9106; 34-61469; FR-82, http://www.sec.gov/rules/interp/2010/33-9106.pdf [hereinafter Climate Change Guidance (2010)].
[75] Securities & Exchange Comm'n, Division of Corporate Finance, CF Disclosure Guidance: Topic No. 2 Cybersecurity (2011), http://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic2.htm [hereinafter Cyber-

In responding to the 2016 Concept Release, a number of stakeholders provided comments on the value of increased disclosure about a number of human rights issues. These comments highlighted the need for better information about the impacts of companies on the human rights of affected communities, but also discussed human rights impacts related to the environment, climate change, human capital, and workforce issues. Over 10,000 commenters raised issues within these different substantive areas.[76] Additionally, in relation to Conflict Minerals rule, when Acting Chairman Piwowar announced the SEC's reconsideration of the rule's implementation in January 2017, the Commission received over 11,500 comments in support of the rule—demonstrating strong stakeholder interest in its continued use.[77]

Political Spending Disclosure: On August 3, 2011, the Committee on Disclosure of Corporate Political Spending (ten academics at leading law schools whose teaching and research focus on corporate and securities law), petitioned the Commission to develop rules to require public companies to "disclose to shareholders the use of corporate resources for political activities."[78] Recognizing that the U.S. Supreme Court in *Citizens United v. FEC*, 130 S. Ct. 876 (2010), noted shareholder mechanisms to hold management to account for its use of corporate funds to support political candidates, the petitioners argued that for that mechanism to work, "shareholders must have information about the company's political speech."[79] To date, this petition has garnered more than 1.2 million comments of support, the most in the agency's history.[80]

Tax Disclosure: In its April 2016 Concept Release the SEC asked about what, if anything, should be changed, updated, included or removed regarding tax disclosure. The Comment Letter submitted by the Financial Accountability and Corporate Transparency (FACT) Coalition emphasized that the role played by international tax strategies and rates on the operations and earnings of many U.S. corporations is important and growing. The letter highlighted the risks to investors created by these at best uncertain and often legally problematic strategies. Given the scope of fines and risks arising from tax jurisdictions around the world, investors need more information to be able to evaluate the scope of tax risks tht the company is running. Moreover, the new tax law in the U.S. moves the U.S. to a territorial tax system, which will open up further uncertainties and risks related to how and where revenues are booked.

The IRS recently finalized a rule to require country-by-country reporting of revenues, profits, taxes paid and certain operations by larger multinational corporations. The European Union has also established new country-by-country reporting requirements for larger firms doing business in any of the member nations. Increasingly, tax authorities have access to this material information, as do company managers, yet investors do not. The growing use of offshore tax

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Security Guidance].

[76] Gellasch Joint Report, *supra* note 2, at 10.

[77] *Comments on the Statement on the Commission's Conflict Minerals Rule*, U.S. SECURITIES AND EXCHANGE COMMISSION, *available at* https://www.sec.gov/comments/statement-013117/statement013117.htm (last visited Jan. 25, 2018).

[78] *See* Committee on Disclosure of Corporate Political Spending Petition, August 3, 2011, *available at* https://www.sec.gov/rules/petitions/2011/petn4-637.pdf.

[79] *Id.* at 7.

[80] *See* Comments on Petition to Require Public Companies to Disclose to Shareholders the Use of Corporate Resources for Political Activities, *available at* https://www.sec.gov/rules/petitions/2017/petn4-711.pdf (viewed November 20, 2017),

strategies, the international response to rein in aggressive tax avoidance, and the potential tax liability for corporations engaged in these practices makes this information material for investors.

These petitions, in conjunction with the large numbers of comments in support of expanded sustainability disclosure in response to the SEC's Concept Release, clearly show that investors and capital market professionals think the time has come for the SEC to act to develop a mandatory rule for clearer, consistent, comparable, high-quality ESG disclosure by all companies subject to SEC public-reporting requirements.

**Conclusion**

We respectfully request the Commission to promptly initiate rulemaking to develop mandatory rules for public companies to disclose high-quality, comparable, decision-useful environmental, social, and governance information. If the Commission or Staff have any questions, or if we can be of assistance in any way, please contact either **Osler Chair in Business Law Cynthia A. Williams**, Osgoode Hall Law School, who can be reached at (416) 736-5545, or by electronic mail at cwilliams@osgoode.yorku.ca; or **Saul A. Fox Distinguished Professor of Business Law Jill E. Fisch**, University of Pennsylvania Law School, who can be reached at (215) 746-3454, or by electronic mail at jfisch@law.upenn.edu.

Sincerely,

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The Fund for Constitutional Government

Green Century Capital Management

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October 8, 2018

# CalPERS President Loses Her Board Seat

## *Priya Mathur, an advocate for CalPERS ESG programs, will be replaced by California police officer Jason Perez.*

The president of the California Public Employees' Retirement System (CalPERS) board has been unseated by a Southern California police officer who ran an election campaign questioning the environmental, social, and governance (ESG) investment policies of the nation's largest retirement plan.

Priya Mathur, who became the CalPERS board president in January and has been a member of the $360 billion system's governing board for 15 years, was defeated by Jason Perez, a police officer in the Southern California community of Corona. Perez received 9,208 votes to Mathur's 7,008, show CalPERS election results.

Perez will take his board seat in January. The 13-member CalPERS board also serves as members of the system's powerful investment committee, which sets investment policy.

Perez, along with other members of the Corona Police Officers Association, the union representing police officers in the city of 150,000, have attended CalPERS meetings the last two years, and have been frequent critics of CalPERS's ESG efforts. Instead, they have urged the CalPERS board to focus on making money from any legal source.

Perez criticized California State Treasurer John Chiang, a CalPERS board member, at a meeting in March 2018 over his plan to divest the retirement system from holding the stock of assault rifle retailers and wholesalers. Perez said the divestment wasn't consistent with the board's fiduciary duty to maximize investment returns.

The board voted 9-3 against Chiang's proposal.

It's unclear how much effect Perez's election will ultimately have on CalPERS's investments. Most of the board's 13 members, including Chiang and state controller Betty Yee, have expressed support for continuing the system's ESG focus. The election of Perez, however, will likely give another new CalPERS board member, Margaret Brown, an ally. Brown, who took office in January, has often been a lone dissenting voice in questioning CalPERS's investments.

Perez's election comes at a critical time for CalPERS. The pension system is only 71% funded and many of the member agencies that are part of the system, including the City of Corona, are facing massive increases in their payments to the retirement system.

In addition, CalPERS CEO Marcie Frost is embroiled in a controversy going back to her hiring in 2016 over whether she padded her educational background. A CalPERS press release announcing her hiring stated that she was enrolled in a public policy dual-degree bachelor and master's program at Evergreen State College in Olympia, Washington. Evergreen has no such program. Frost, who has a high school education, stated the press release account of her educational background was a mistake. She stated that she has been fully honest about her educational background at all times.

Mathur has been one of Frost's biggest supporters, including issuing a press release with other board members in support of the CEO. Chiang has called for an independent investigation of the issue. It's unclear where Perez lines up on the issue. He did not address it in his statement in the CalPERS voter guidebook.

Mathur, a financial analyst for BART, a regional rail system in the San Francisco Bay Area, has been a big proponent of CalPERS ESG investment programs. She has used her CalPERS board position to travel the world, speaking at conferences and seminars on ESG. She is a member of the advisory board of the United Nations-backed Principles for Responsible Investment.

On March 8, she rang the opening bell at the London Stock Exchange in recognition of International Women's Day, a fact that Perez used against her in a statement in a voter booklet sent by CalPERS to eligible voters. He said in the statement, "Mathur is out of touch, believing her role is to fly around the world, ringing the bell of the London Stock Exchange, and hobnobbing with United Nations officials."

He also said in the statement that Mathur had put CalPERS members' retirement security at risk, "due in part to environmental, social, and governance investing priorities, regardless of the investment risk."

While CalPERS has been considered a leader in ESG investing in the US, the system has largely advocated for ESG principles through its corporate governance program, challenging companies to have more diverse corporate boards and to be more mindful of sustainability risks in their business practices.

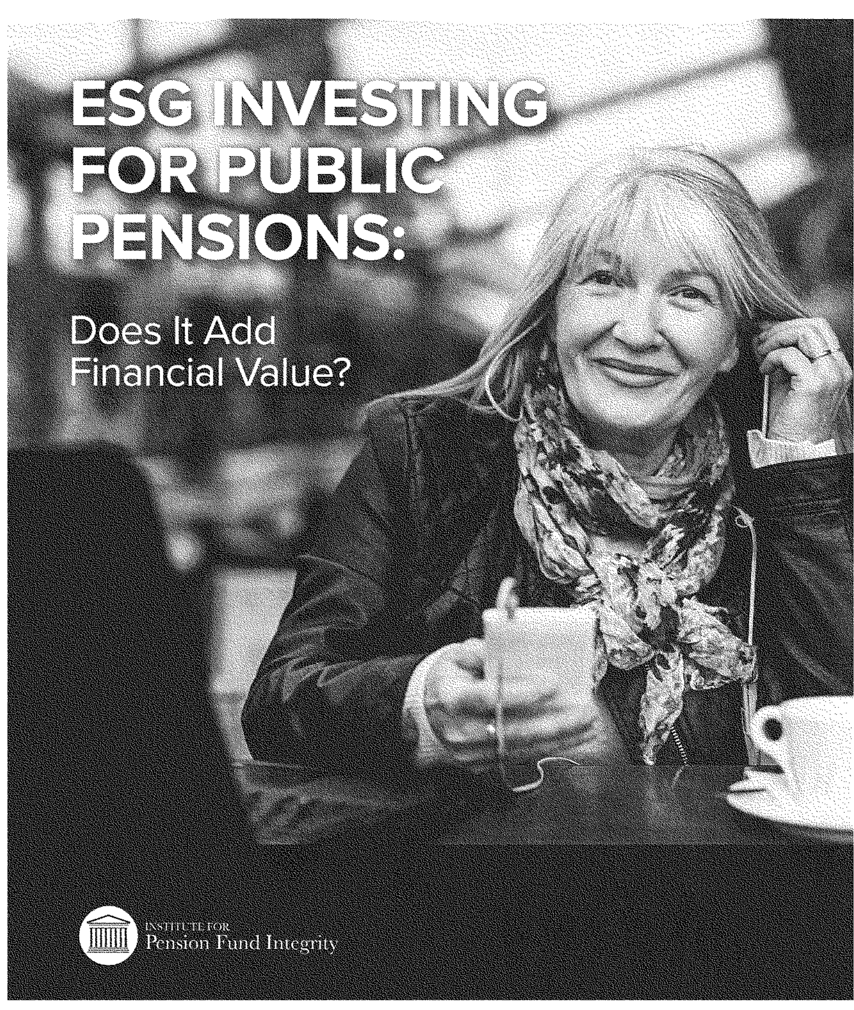
It is also requiring its external money managers to assess ESG risk in its investment decisions. But when it comes to actual ESG investments, CalPERS is not always in the forefront, particularly compared to some European counterparts. Its largest asset class, for example, its $177.7 billion global equity program, has only several billion dollars invested in strategies with an ESG focus.

Mathur, in her statement in the CalPERS voter booklet, emphasized some of her ESG investing focus, including increasing long-term shareholder value by engaging corporate boards over diversity and climate change. She also cited her board role in CalPERS's engagement with gun retailers, which she said led to Dick's Sporting Goods and Walmart decision to cease selling assault-style weapons and accessories.

Mathur's election to president of the CalPERS board in January was a comeback for her. In 2014, she was vice president of the CalPERS board when she was stripped of her title and other leadership positions for violating state campaign financial reporting requirements. The board acted against Mathur after the California Fair Political Practices Commission fined her $4,000 for failing to file campaign finance reports in 2012 and 2013 while running for a CalPERS seat. Mathur apologized publicly at the time but did not explain why she never filed the required financial reports.

And in 2010, she was fined $7,000 for failing to file on time her legally required statement of economic interest, listing her financial holdings for 2007 and 2008. Mathur ended up submitting the documents, but the 2007 report was 21 months late and the 2008 report was nine months late.

Tags: CalPERS, Jason Perez, John Chiang, pension, Priya Mathur
By Randy Diamond


ESG INVESTING FOR PUBLIC PENSIONS:
Does It Add Financial Value?
INSTITUTE FOR
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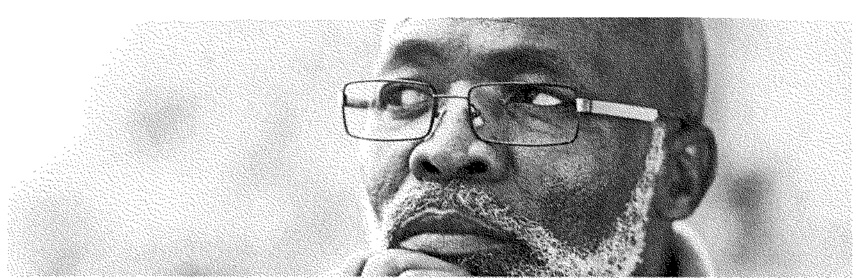

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## EXECUTIVE SUMMARY

- Environmental, Social, and Governance (ESG) investing is growing in popularity in both the private and public sectors.
- The Institute for Pension Fund Integrity (IPFI), which focuses on fighting for fiduciary responsibility in public pension funds, believes that it is important to investigate the merits and potential scope of ESG investment, particularly when it comes to our nation's public pension systems.
- IPFI firmly believes that the primary duty of a fiduciary is to ensure the financial stability of the funds with which they are entrusted. Fiduciaries should not be motivated by politics, ideology, or any other extrinsic force.
- On the surface, this may suggest that IPFI is against the idea of ESG investing. On the contrary, in its purest form, ESG investment can serve to add value and reduce risk in an investment portfolio. And while ESG is not always applicable, there are certainly cases in which ESG investment would be prudent.
- ESG investment measures have become increasingly politicized through institutional investors and pension funds' growing reliance on proxy advisory firms. These advisory firms have introduced political agendas for corporate governance decision-making, leaving corporations and pension funds to operate at the whims of advisory firms with serious conflicts of interest that disregard investor value.
- In short, our position on the matter is simple: ESG investments should be made when they add value to a fund. When such investments will not improve the financial performance of the fund, or the decision to invest in them is based on political motives, they should be forgone.

## WHAT IS ESG INVESTING?

ESG investing refers to investing funds according to environmental, social, and governance factors. Environmental factors include a firm's carbon footprint, its total water consumption, and its contributions to deforestation. Social factors include a firm's working conditions, its impact on local communities, and its contribution to local and global conflict. The third category, governance, includes corruption and overall corporate behavior. The theory behind ESG investing is that firms who act positively towards the environment, update their policies to reflect today's societal expectations, and have strong governance practices, are more likely to produce stronger returns. Therefore, together these three categories of factors guide investors in their decision making while they choose which organizations to invest in and which to stay away from.

The ideas behind ESG investment have been around for several decades. In the 1970s, many pension funds sold off South African assets after dozens of state, counties, and cities had taken a stance against the country's government. ESG investing involves investing an organization's funds into endeavors deemed more "socially responsible," because it is expected that the organization will be more profitable, and therefore have stronger stocks. Often, ESG investing takes the form of investors prioritizing organizations and firms with stronger ESG scores than investing in companies that produce controversial goods and services, such as tobacco and fossil fuels.

As ESG investing has grown over the past few decades, many have sought to develop guidelines to ensure that it is done properly to produce strong returns for the beneficiaries. For example, in 2006, the United Nations Secretary General Kofi Annan charged a group of investment professionals with developing guidelines for organizations who wanted to engage in more socially aware investment strategies. The result was the Principles for Responsible Investment (PRI). Since that time, PRI has become the globally acknowledged lead proponent of responsible investments. PRI is an independent organization that is not beholden to any political agenda, and that "encourages investors to use responsible investment to enhance returns and better manage risks."[1]

As a part of its work, PRI has identified several strategies by which organizations and individuals can integrate ESG factors into their investment strategies:

1. Fundamental Strategies: Adjusting traditional financial forecasts by a firm's impact on the relevant ESG factors

2. Quantitative Strategies: Developing models which can be used to integrate ESG factors alongside more traditional ones

3. Smart Beta Strategies: Using ESG factors as a weight when creating a portfolio to improve its overall risk

4. Passive Strategies: Using indexing based on ESG to adjust the weights on investments in a portfolio[2]

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1 https://www.unpri.org/about-the-pri
2 https://www.unpri.org/listed-equity/esg-integration-techniques-for-equity-investing/11.article

These strategies cover a broad range of ways in which investors can use ESG to enhance their portfolios. This idea is appealing because it suggests that they can use their investments to not only increase their capital, but also make a positive impact on the world.

Because of the increase in ESG investing, 80% of companies in the S&P 500 are now producing annual corporate responsibility reports, and within the financial industry, developing a wide range of tools for investors to ensure that their ESG investments yield high returns.[3] Further, with many investors looking for ways to incorporate ESG into their portfolios, several firms have taken the lead with providing guidance on the matter.

In order to help investors capitalize on the strong prospects of ESG, several organizations have established themselves as guides who can provide insight into the best way to integrate ESG investments into a portfolio. One such organization is Morningstar, which provides Sustainability Ratings for companies by comparing them to other firms in their industry "peer group." Morningstar defines a "Portfolio Sustainability Score" as the firm's Portfolio ESG Score" less its "Portfolio Controversy Deduction." The Portfolio ESG Score for a firm is the weighted sum of the ESG scores of every item in its investment portfolio. Once all of the scores are calculated within a peer group, these scores are then made to fit a normal distribution with mean 50 in order to compare firms across the group. A firm's normalized ESG score is thus defined as their placement on the distribution of scores.

A firm's Portfolio Controversy Deduction is developed in a similar fashion. First, a controversy score is based on a firm's relative contribution to negative impacts on environmental/social factors. Its overall score is the weighted sum of the controversy scores of each of its investments. Based on the distribution of these scores, each firm is then assigned a controversy deduction based on its relative performance. Together, the ESG score and controversy deduction create a firm's overall sustainability score.[4]

A key aspect of Morningstar's rating system is that it only allows for comparisons across industry peer groups. This is due to the relative nature of the scoring system in which firms are assigned their rating based on where they fall in the distribution of scores within their peer group. In this type of system, firms' scores can only be compared to similar firms. For example, a small technology firm would be incomparable to a large energy firm. Therefore, the ratings would not provide strong guidance if an investor was looking to take funds out of one firm and put them into another if that other firm is in a different peer group.[5] This is important as investors weigh the overall impact of their investments and estimate returns.

Understanding this aspect of the ratings system is key to its proper use and providing additional assurance that the ratings will not be used for political purposes. If the manager of an investment fund had a political agenda that involved selectively investing in only certain endeavors, he could abuse the relative rating system to justify his actions. Thus, while on the surface he may appear to be investing according to ESG criteria, he would actually be using the umbrella of ESG to hide his true political motivations.

Further, though ESG ratings can be useful when used properly, they should not be the sole metric used to make investment decisions. The Vice Fund (formerly known as the Barrier Fund) is a mutual fund that invests a significant amount of its funds into firms that profit off human 'vices' (i.e. tobacco, alcohol, weapons, and gambling). While such a fund would be politically unappealing to many investors, it consistently yields strong returns. Over the past five years, the fund has had a return of 10.52% and has an alpha and Sharpe Ratio of 2 and 1.008 respectively, making it a relatively high-performing, low-risk investment.[6] According to Morningstar, however, unsurprisingly the Vice Fund has a low sustainability score.[7] Yet even with this low score, it is still a well-performing asset, showing that while ESG is a useful tool for guiding investments, it is not the only metric that should be considered when designing a portfolio. Considering how underfunded public pensions are, this is a serious consideration that needs to be further examined.

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3 https://www.dol.gov/asp/evaluation/completed-studies/ESG-Investment-Tools-Review-of-the-Current-Field.pdf

4 https://www.morningstar.com/content/dam/marketing/shared/Company/Trends/Sustainability/Detail/Documents/Morningstar-Sustainability-Rating-Methodology-0916.pdf

5 https://www.forbes.com/sites/investor/2018/06/14/what-you-need-to-know-about-fund-sustainability-ratings/#43441d486032

6 https://money.usnews.com/funds/mutual-funds/large-blend/usa-mutuals-vice-fund/vicex

7 https://www.morningstar.com/funds/xnas/vicex/quote.html

## WHAT DOES THE RESEARCH SAY?

The research on the impact of ESG investing is still developing and seems to suggest a differing applicability between the public and private sectors. On the one hand, the research into ESG in the private sector has yielded some very promising results. For example, one study published in the Journal of Applied Corporate Finance found that companies that have integrated ESG metrics into their investment strategies have, on average, seen higher returns and lower risks.[8] Another study from The Quarterly Review of Economics and Finance suggests that for firms located in the United States and the Asia-Pacific region, investing in firms with high ESG scores yields returns at the same level as investing in firms with low scores.[9] However, while ESG investing appears to have a useful tool for the private sector, the research regarding public sector ESG investment is much more mixed.

In 2016, the Center for Retirement Research (CRR) at Boston College conducted a study that looked at the effects that ESG investment has had on the nation's public pension plans. In the study, the authors explain how every additional restriction that is placed on pension fund investment lowers the system's ability to diversify its portfolio sufficiently. Thus, when they compared the performance of funds in states with and without ESG restrictions, the results showed that the rate of return on the plans engaged in ESG investing tended to be lower by almost 40 basis points.[10] They found that the average net returns on mid-to-large sized equities were 60-70 basis points lower in ESG mutual funds when compared to Vanguard mutual funds.[11]

While these results are enlightening in and of themselves, it is important to try and understand why public pension systems may have such different experiences with ESG investments. The CRR article and several other studies examined the discrepancy closer and did just that. These studies have cited several reasons as to why public pension plans may not be well suited for ESG investing.

Principal-Agent Problem: The Principal-Agent problem is an age-old idea from political economics. The premise is that a problem arises when the party in charge of making decisions (the "agent") does not have the proper incentives to focus solely on the goals of the owner of the endeavor (the "principal"). Instead, the agent often seeks to fulfill their own goals which may be misaligned with those of the principal.[12] This problem is particularly relevant to public pensions as the individuals who will ultimately pay the costs for low returns (i.e. pensioners and taxpayers) are not the ones empowered to make decisions regarding the fund's management.[13]

Political Heterogeneity of Beneficiaries: Even if some of the beneficiaries are willing to accept lower returns for the sake of some political agenda, the heterogeneity of plan participants practically assures that not everyone will feel this way.[14]

Lack of Data: There is currently a lack of resources and data to guide pension fund managers in ESG investment and to ensure they are making financially responsible decisions.[15]

Thus, while there are times when ESG investing may be prudent for public pensions, it is not yet a universally applicable investment strategy.

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8 https://onlinelibrary.wiley.com/doi/pdf/10.1111/jacf.12169
9 https://www.sciencedirect.com/science/article/pii/S1062976915000770
10 http://crr.bc.edu/wp-content/uploads/2016/11/slp_53-1.pdf
11 Ibid.
12 https://www.investopedia.com/terms/p/principal-agent-problem.asp
13 https://www.oecd.org/finance/private-pensions/35802785.pdf
14 Ibid.
15 https://www.forbes.com/sites/tedknutson/2018/05/22/esg-investing-roadblocks-by-retirement-plans-should-be-removed-urges-congressional-report/#57865dc4517a

# ILLUSTRATING THE ISSUES WITH ESG

As stated previously, ESG has the potential to be used as a valuable tool for investors to increase returns and lower risk. Its promising performance in the private sector all but assures that it will continue to play a large role in the investment world. However, ESG presents specific problems to the public sector that makes its utility and value proposition much less clear. What follows are case studies and examples of how the problems outlined above can be seen in the actions of pension managers in the real world.

## Case Study – New York City

In 2003[16], the United States Securities and Exchange Commission (SEC) enacted a rule that required institutional investors to develop and disclose information pertaining to their proxy-voting decisions and the reasoning behind those decisions. Firms could also exercise the option to rely on the guidance of proxy advisory firms to make voting decisions, releasing the institutional investor from responsibility regarding the voting decision.

These sorts of actions are especially important to pensioners and those involved in pooled investment plans. Any time public officials with jurisdiction over pensioners' money use their leadership positions to influence corporate decisions that adhere to their own political ideologies, they violate their fiduciary duty. Further, by weaponizing the massive holdings of public pension systems, politicians are putting the beneficiaries of those plans at risk through corporate policies that focus on politics and not profit.

One of the major violators of this principle is New York City Comptroller Scott Stringer. In 2017, Comptroller Stringer boasted about the 'backing from independent proxy advisory firms'[17] that he received in relation to a pharmaceutical company and their executive compensation. Citing proxy advisory firms as 'independent' was the first false narrative presented by the comptroller in his announcement, but it is not the last time the comptroller's office has shared his preference for the power of proxy advisory firms. In 2018, Stringer's office stated[18] that "proxy access is now a market standard for long-term investors." In a press release, Stringer's office showed a graphic with ESG language where he referred to the progressive causes his office had championed. The issue with these initiatives, like climate risk reporting and industry specific targeting, is their lack of value added to the corporations that are forced to enact them. According to ACCA Global, only 19% of investors[19] found the inclusion of ESG-measures 'very important' on yearly financial reports, showing that while these measures may look good for re-election campaigns, they carry minimal weight in the minds of investors caring about concrete financials of a corporation.

Relying on third party advising presents risk as proxy advisory firms are not independent entities. The advisory firm Institutional Shareholder Server (ISS), one of the two firms holding 97%[20] of the combined market share in the industry, sells its services to corporations that are "trying to get in its corporate good-governance graces" as the Wall Street Journal editorial board recently assessed.[21] This conflict of interest presents great risk to the companies and pension funds affected by proxy voting decisions. Proxy recommendations could guide corporate decisions in less than profitable directions under the guise of ESG proposals.

## Case Study – California

In 2000, the board of the California Public Employee Retirement System (CalPERS) voted to divest its investments from tobacco companies. This vote resulted in the plan selling off over $670 million in tobacco stocks. CalPERS defended its decision by arguing that tobacco is an unhealthy product that contributes to major health issues and lower life expectancies and that, as a government agency, it could not take part in the funding of such a product.

16 https://www.sec.gov/news/press/2003-12.htm
17 https://comptroller.nyc.gov/newsroom/comptroller-stringer-and-major-pension-funds-with-backing-from-independent-proxy-advisors-vote-no-campaign-at-epipen-maker-mylan-gains-momentum/
18 https://comptroller.nyc.gov/newsroom/comptroller-stringer-nyc-funds-after-three-years-of-advocacy-proxy-access-now-close-to-a-market-standard/
19 https://www.accaglobal.com/content/dam/acca/global/PDF-technical/financial-reporting/reassessing-value.pdf
20 https://corpgov.law.harvard.edu/2018/05/23/congress-increases-pressure-on-proxy-advisory-firms/
21 https://www.wsj.com/articles/cracking-the-proxy-racket-1537227532

While this line of argument may seem commendable, it is not the type of decision that a fiduciary should make in regard to its fund. The primary goal of the CalPERS board, and every other fiduciary, is to ensure the strong and stable performance of its fund. Tobacco stocks were, and still are, high-performing investments. It is estimated that the annualized return on tobacco-related securities is around 18.6%, compared to a broad market return of 7.4%. Further, a review of the CalPERS divestment concluded the act ended up costing the plan in excess of $3 billion.[22] And though CalPERS staff encouraged the board to end its divestment strategy, in 2016 it voted to continue this politically motivated distortion of ESG investment.

This is a prime example of the principal-agent problem of ESG investing for public pensions. The individuals on the CalPERS board had desired outcomes other than just the strong financial performance of the CalPERS fund. While surely the board members were concerned about achieving a high rate of return, they were also concerned about appearing as a "responsible" government entity by taking measures to improve public health. Thus, on a political level, it made more sense for them to divest from tobacco stocks, as they would benefit more from the political rewards of divestment than from the strong performance of their fund. ESG investing has the potential to exacerbate the principal-agent problem in public pensions as fund managers begin to have incentives to use their power to achieve their personal political goals.

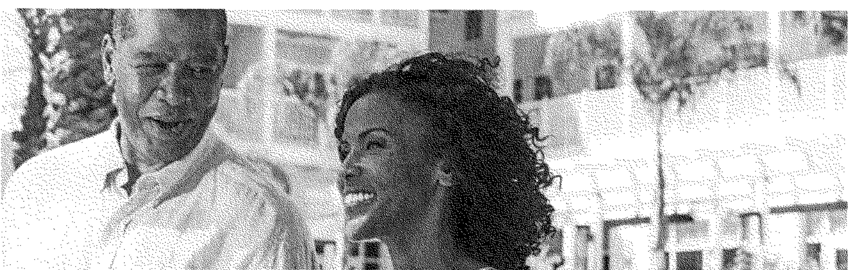
### Case Study – New Jersey

The New Jersey State Investment Council is currently developing a formal ESG policy to guide the investment of state funds, including its over $75 billion in pension investments. Even though the process is not yet complete, this has not stopped the fund's managers from incorporating social and environmental issues into their investment strategy. New Jersey has made this decision even though it could mean a loss of $300 million a year in returns.[23]

Although many states are struggling with their pension systems, New Jersey is among the worst. Of the seven state pension plans, only two of them (the smallest two) are fully funded. Combined, the plans' unfunded liabilities total over $40 billion with a funded ratio of just around 55%.[24] Clearly the state is not in a strong enough position to be taking risks with its investments. Further, the Director of the Division of Investment Chris McDonough recently revealed that the state has yet to predict the potential impact ESG investment will have on investment returns. This revelation is problematic because it suggests that the state is undergoing its ESG strategy without a clear understanding of the possible implications.[25]

New Jersey's story is emblematic of the larger problem of a lack of data on ESG investing in public pensions and the possible dangers of going in blind. New Jersey appears to be getting ahead of itself when it comes to ESG, making investment decisions before developing a formal policy or forecasting a realistic effect on returns. The state is still in the process of looking for a corporate governance officer to oversee the state's expansion of ESG.[26] Experimenting with pension funds before the data is out is irresponsible as the funds represent the financial security of New Jersey's former teachers, police officers, and thousands of other public servants.

22 https://www.calpers.ca.gov/docs/board-agendas/201612/invest/item05b-00.pdf
23 https://www.northjersey.com/story/news/new-jersey/2018/07/09/new-jersey-pension-investments-guided-social-environmental-values/680349002/
24 https://www.state.nj.us/treasury/pensions/documents/financial/gasb/statutory-summary-chart-2017.pdf
25 Ibid.
26 http://www.pionline.com/article/20180719/ONLINE/180719836/nj-looking-to-hire-corporate-governance-officer-for-esg



**Case Study – Illinois**

In recent years, there has been a growing movement that calls on organizations to divest from the state of Israel. This movement has had some success in convincing various universities and financial institutions to withdraw their financial support from Israel over various issues. In reaction to this movement, another divestment movement has arisen that calls for divestment from institutions that engaged in Israeli divestment.

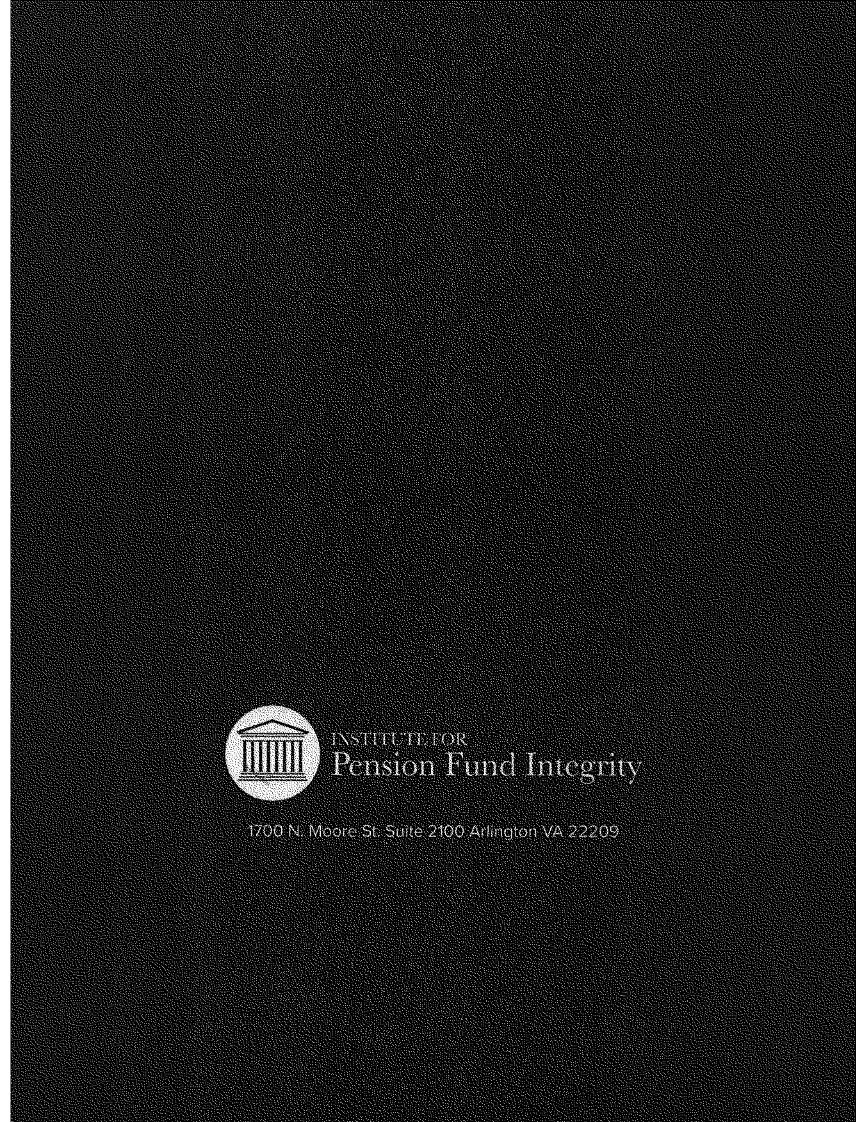
An example of such divestment occurred in the state of Illinois in 2015. That year Illinois passed a bill requiring the state's pension systems to divest from companies who engage in boycotts of Israel.[27] This law made Illinois the first state to take such action over the incredibly complicated issue. At its time of passage, many critics said that the law was politicizing the state's pension funds and setting dangerous precedent that would allow for future acts of divestment based off a political ideology.

There is perhaps no issue more complicated and divisive than the situation between Israel and Palestine. A 2014 study by the Brookings Institution showed the American public is deeply divided over many of the issues surrounding the Israeli-Palestinian conflict.[28] Thus, it is all but certain there are members of the Illinois pension systems who lie on both sides of this issue and do not want their funds being used to make this political statement. These states would be better off focusing on achieving a high rate of return (as per their fiduciary responsibility) rather than using funds for a political agenda.

## CONCLUSION

ESG investment is an important tool for diversifying portfolios and impacting corporate governance. But at the end of the day, public pension fiduciaries need to focus on the financial returns of their investments. Considering that public pensions in the U.S. have unfunded liabilities of at least $4 trillion, the emphasis on ensuring strong returns is more important than ever.[29] While ESG investing can have benefits when considered as a part of a robust investment strategy, ultimately, if the investment does not add alpha then the fiduciary should opt for something else.

27 http://www.ilga.gov/legislation/BillStatus.asp?DocNum=1761&GAID=13&DocTypeID=SB&SessionID=88&GA=99
28 https://www.brookings.edu/research/american-public-attitudes-toward-the-israeli-palestinian-conflict/
29 https://www.wsj.com/articles/the-pension-hole-for-u-s-cities-and-states-is-the-size-of-japans-economy-1532972501?ns=prod/accounts-wsj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*MarketWatch*

# Opinion: ESG — or socially responsible — funds may soothe your conscience but could weaken your portfolio

By Alicia H. Munnell
Published: June 29, 2019 9:56 a.m. ET

Despite the hype, new study concludes ESG funds hurt returns

*MarketWatch photo illustration/iStockphoto, Everett Collection*
*Feel-good investing isn't always great for your bottom line.*

I have always been opposed to socially responsible investing — that is, investing with the aim of making a political statement — in the public pension environment.

It's an easy case to make for a number of reasons. First, while such efforts often have powerful emotional appeal, they have no impact on the targeted companies, especially since vice funds VICEX, -0.03% stand ready to buy stocks diverted from standard portfolios. Second, public plans are particularly ill equipped to integrate another criterion in their investment decision-making. Third, the people advocating for divestiture — today's politicians — are not the ones who will bear the burden of lower returns; that would be tomorrow's retires and taxpayers.

Until recently social investing wasn't a real issue for private plans because guidance from the Department of Labor clearly stated that plan trustees or other investing fiduciaries may not accept higher risk or lower returns in order to promote social, environmental, or other public policy causes.

In 2015, however, the agency clarified that fiduciaries may incorporate environmental, social, and governance (ESG) factors into the investment decision. The argument was that these factors may have a direct impact on the economic value of a plan's investment, and, as such, should be integrated into risk and return calculations, alongside financial indicators. In 2018, the agency clarified that ESG factors should only be considered as a tiebreaker or if they represent material risks or opportunities.

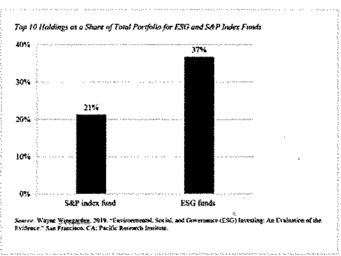
Since 2015, ESG investing has become very popular. At one level, ESG investing makes sense. Consumers may value products that are produced in an ESG compliant manner, and workers may prefer companies that operate consistent with ESG principles. If so, then good ESG behavior will also produce higher returns. And indeed, stories abound about the financial success of ESG investing.

A recent study from the Pacific Research Institute, however, moves from the anecdotal to the systematic and concludes that ESG investing produces poor outcomes. (I don't know the author or the institute, but the study came from a reputable guy and the methodology seems sensible.)

The study looks at 30 ESG funds that have either existed for more than 10 years or have outperformed the S&P 500 SPX, +0.45% over some short-term time frame. These funds tend to fall into three categories: 1) "broad-based index" funds that exclude one or more of the following industries: gambling, alcohol, tobacco, fire arms or fossil fuel; 2) "waste and clean tech" funds that invest in alternative technology and clean waste management — that is, they pursue the environmental component of ESG; and 3) "social goals" funds that use explicit social goals, such as strong women leadership, to select companies.

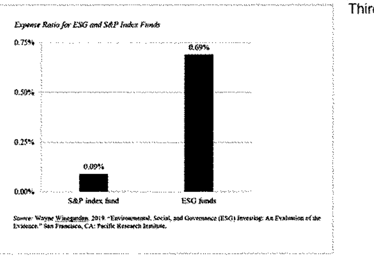
The results show that all three types of ESG funds do not perform as well as an S&P index fund.

First, ESG funds are more concentrated in a few companies than an S&P index fund (see figure below). The higher is the share of the top 10 investments, the smaller the benefits of diversification and the greater the risk.



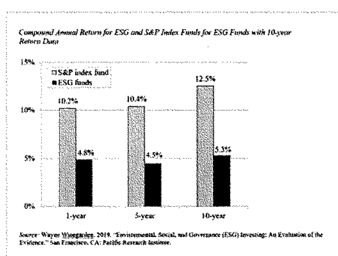
Source: Wayne Winegarden. 2019. "Environmental, Social, and Governance (ESG) Investing: An Evaluation of the Evidence." San Francisco, CA: Pacific Research Institute.

Second, ESG funds have higher expense ratios than an S&P index fund. A 60-basis- point higher expense will reduce accumulations by 15% over a 25-year span.



Source: Wayne Winegarden. 2019. "Environmental, Social, and Governance (ESG) Investing: An Evaluation of the Evidence." San Francisco, CA: Pacific Research Institute.

Third, focusing on a subset of the ESG funds (18 of the 30) that have been in existence for 10 years, the results show that the ESG funds have been unable to match the S&P index fund in 1-year, 5-year or 10-year performance (see below).



Source: Wayne Winegarden. 2019. "Environmental, Social, and Governance (ESG) Investing: An Evaluation of the Evidence." San Francisco, CA: Pacific Research Institute.

With more risk, higher fees, and lower returns, investors should think seriously before getting into the ESG game.

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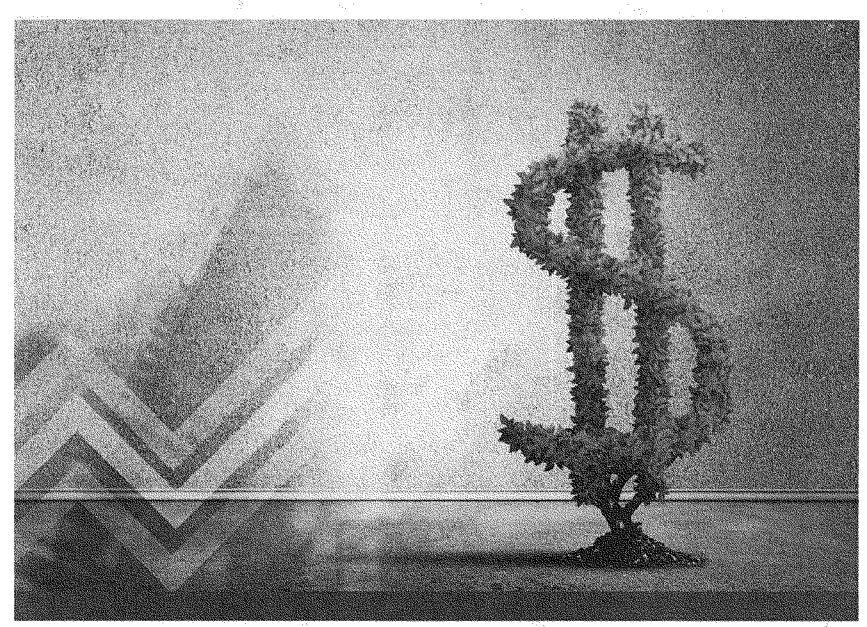
## Alicia H. Munnell

Alicia H. Munnell is the director of the Center for Retirement Research at Boston College.

# ENVIRONMENTAL, SOCIAL, AND GOVERNANCE (ESG) INVESTING: An Evaluation of the Evidence

Wayne Winegarden



Environmental, Social, and Governance (ESG) Investing: An Evaluation of the Evidence
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May 2019

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# Executive Summary

Environmental, social, and governance (ESG) criteria are used as a guideline for both corporate management and investing (an investment strategy known as ESG investing). ESG programs often make sense, but, as documented by many studies, these programs can also be detrimental to a firm's financial performance. Consequently, investors need an individualized and objective view to effectively evaluate the merits of ESG related shareholder proposals, or when considering an ESG investment strategy.

Starting with the former, there are concerns that the two major proxy advisory firms – ISS and Glass Lewis, which control 97 percent of the proxy advisory market – have a conflict of interest that biases their recommendations in favor of ESG shareholder proposals regardless of the resolution's merits. When coupled with these firms' inadequate transparency and lack of individualized analysis, there is growing evidence that the proxy advisory firms are biasing votes toward supporting value-reducing ESG proposals.

With respect to ESG as an investment strategy, there is a growing trend of investors using a company's impact on the environment, social issues, and/or how it treats its employees as criteria for making investment decisions. How ESG funds apply these criteria will vary significantly. Some ESG funds are, for all intents and purposes, broad-based index funds that simply exclude certain industries (e.g. gun or tobacco manufacturers). Other ESG funds will actively invest their money into companies that are pursuing specific ESG goals such as alternative clean energy.

Several reports have documented that some ESG funds are outperforming their benchmarks. In response to these reports, this analysis evaluated the performance of 30 ESG funds that have either existed for more than 10-years or have outperformed the S&P 500 over a short-term timeframe. The findings showed that, over the long-term, it is difficult for ESG funds to outperform the broader market indices.

Of the 18 ESG funds examined that had a full 10-year track record, a $10,000 ESG portfolio (equally divided across the funds including the impact from management fees) would be 43.9 percent smaller after 10-years compared to a $10,000 investment into an S&P 500 index fund. Further, only 1 of the 18 funds was able to exceed the earnings of an S&P 500 benchmark investment over a 5-year investment horizon, and only 2 of the 18 funds were able to beat the S&P 500 benchmark over a 10-year investment horizon.

Two other material differences were the higher expense ratios and higher risks associated with ESG funds. With respect to higher expenses, the average expense ratio was 0.69 percent for the 30 ESG funds examined compared to the expenses associated with a broad-based S&P 500 index fund of 0.09 percent. It is common wisdom that a critical consideration for investors, particularly for small investors, is to ensure that a fund's expenses are as low as possible.

The higher risks ESG funds create can be measured by the higher share of funds they allocate toward their top 10 holdings on average (37 percent) compared to a broad-based S&P 500 index fund (21 percent). The higher exposure to the top ten holdings means that the ESG funds' performance are driven by the returns of relatively fewer stocks, significantly reducing any diversification benefits.

Judged against past performance, ESG funds have not yet shown the ability to match the returns from simply investing in a broad-based index fund. Explicitly recognizing this tradeoff is essential to enable investors to better pursue their financial goals in the manner that reflects their values and the costs they are willing to bear.

## Introduction

Environmental, social, and governance (ESG) investing is an investment strategy that incorporates non-financial criteria as well as the investments' expected financial returns into investment decisions. These non-financial criteria typically include a company's impact on the environment and its impact on pressing social issues, such as gun violence. The criteria also include how a company treats its employees, vendors, and other business partners. The flip side of ESG investing is the ESG programs that companies will often implement, such as implementing policies that ensure women are appointed to the corporate board or policies that govern the company's business practices. These goals are above the legal requirements a company must meet.

Investors are allocating an increasing share of dollars toward ESG compliant assets. According to the US SIF Foundation, assets that were denoted as socially responsible products "grew from $8.7 trillion at the start of 2016 to $12.0 trillion at the start of 2018, a 38 percent increase. This represents 26 percent—or 1 in 4 dollars—of the total US assets under professional management."[1] Further, there are growing reports that using ESG criteria as an investment consideration will not necessarily come at the expense of financial returns. Several recent financial news reports have documented the ability of some ESG funds to outperform their benchmarks. For example, a *Morningstar* analysis found

> that 41 of the 56 Morningstar's ESG indexes outperformed their non-ESG equivalents (73%) since inception. ESG screens largely added value in Europe and Asia, thanks to stocks like Vodafone, Allianz, Taiwan Semiconductor, and Sony. The picture in the U.S. market was more ambiguous. Stellar performers in recent years, such as Apple, Amazon.com, and Facebook, are not as strong from an ESG perspective, though better-scoring companies, such as Intel and Medtronic, lifted the returns of some U.S.-focused indexes.[2]

An analysis of its own ESG index funds performed by Morningstar found "that Morningstar ESG indexes tend to select companies that are less volatile and possess stronger competitive advantages and healthier balance sheets than their non-ESG equivalents."[3] Similarly, reports also state that companies with better ESG ratings are more likely to outperform their competitors. For instance, a story in the *Financial Times* noted that,

> Companies with better environmental, social and governance standards typically record stronger financial performance and beat their benchmarks, according to research from Axioma.
>
> The risk and portfolio analytics provider said the majority of portfolios weighted in favor of companies with better ESG scores outperformed their benchmarks by between 81 and 243 basis points in the four years to March 2018.[4]

Scratch the surface on these claims, however, and a more complex reality emerges. For example, according to *InvestmentNews*, "the Morningstar ratings assess funds on environmental, social and governance factors, even if the funds don't label themselves as ESG investments."[5] While funds may appreciate the label, it is very different to be labeled an ESG fund as an afterthought than to intentionally devise an ESG fund as an explicit strategy. More importantly, there are several concerns regarding the ESG performance claims that raise significant questions regarding their long-term applicability.

First, similar to investment management in general, over the long-term, it is difficult for ESG funds to outperform the broader market indices. In fact, while some funds have outperformed a passive S&P 500 index fund over select short-term periods, ESG funds rarely do so over the long-term.

Second, ESG funds dramatically differ from one another. Some ESG funds are, for all intents and purposes, broad index funds that exclude only a select list of industries. For example, the only restriction on the American Century NT Emerging Markets Institutional fund (ACLKX, an ESG fund) is to not invest in tobacco companies. While there is an opportunity cost from this restriction (e.g. the strong dividends paid by stable companies can be valuable during periods of economic weakness), it is unlikely that this restriction is stringent enough to materially impact a fund's performance. In fact, often the ESG funds that provide competitive financial performance are the same funds whose holdings are similar to a typical investor fund. As the restrictions grow, the underperformance of the ESG funds often increase.

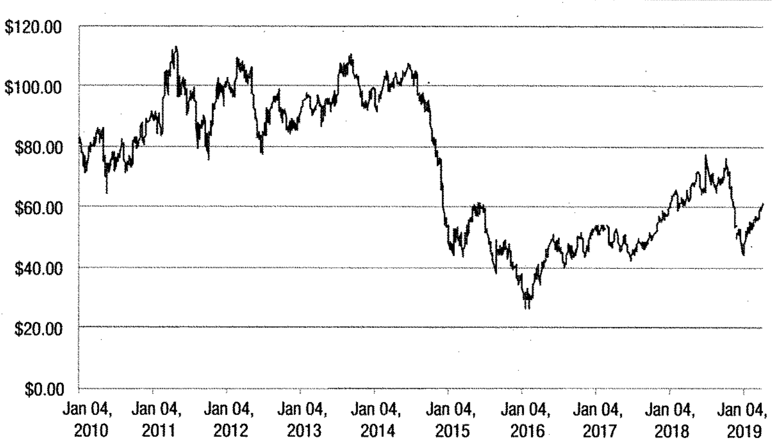
Third, short-term performance metrics often reflect unique factors that are not indicative of the long-term investment value. For example, back in 2016 American Century Sustainable Equity Fund (AFDIX) transformed into an ESG fund. As part of adhering to its new ESG criteria, AFDIX divested its holdings of ExxonMobil and increased its holdings of Conoco Philips because ExxonMobil "lagged its peers on environmental initiatives" but ConocoPhillips "had an action plan to lower its greenhouse gas emissions, among other things".[6] Since its transition, AFDIX has also posted a 16.7 percent annualized return and ConocoPhillips has outperformed ExxonMobil.

> "While funds may appreciate the label, it is very different to be labeled an ESG fund as an afterthought than to intentionally devise an ESG fund as an explicit strategy.

While these facts give the impression that the ESG criteria have enabled financial outperformance there is a missing factor – oil prices. As Figure 1 illustrates, oil prices had just bottomed out around $26 per barrel in 2016, and experienced a steady rise to nearly $80 per barrel by the end of 2018. ExxonMobil (market capitalization over $330 billion) and ConocoPhillips (market capitalization under $77 billion) are very different types of oil companies. ConocoPhillips is an independent oil and gas exploration and production company, compared to ExxonMobil, which is the largest integrated oil major. Due to these different corporate structures, their respective performance should vary significantly, particularly during periods of wild oil price swings; and, this was the case in 2016.

Starting at the end of 2014 until the beginning of 2016 oil prices crashed from historically high prices. ConocoPhillips' stock price crashed much further than ExxonMobil's during the oil price crash. It would not be surprising, consequently, to see its stock rise faster than ExxonMobil's during the ensuing recovery, which is what happened. The example of ExxonMobil and ConocoPhillips exemplifies the importance of evaluating whether other factors are driving the performance results.

**Figure 1**
**Spot Oil Prices**
**January 4, 2010 through April 1, 2019**




*Source: Energy Information Administration*

Due to the combination of these impacts, the assertion that ESG considerations enhance financial performance should be viewed with care. It should be noted that whether or not an ESG strategy outperforms holding a broad-based index of stocks (such as an S&P 500 index fund), individual investors who care about social and environmental issues may prioritize these concerns over purely financial returns. ESG funds serve an important purpose for these investors. It is important, however, to accurately document the alternative trade-offs that investors are making when choosing ESG investment options.

Similarly, the inability of ESG funds to outperform the S&P 500 over the long-term does not mean that corporate ESG programs add no value. In many instances consumers value products to be produced in an ESG compliant manner, and will value these products higher than products that are produced in a non-compliant manner. Similarly, workers may prefer organizations that are ESG compliant over employment alternatives that are not. In these instances, ESG is consistent with the firms' financial responsibilities, and companies should be pursuing these ESG programs. Given the proliferation of responsibility programs throughout Corporate America, clearly, most companies value these programs to some extent. But, simply because some ESG programs have value does not mean that all programs have value. Suggested ESG programs raised via proxy votes (the proposals brought to a vote at corporate shareholder meetings) are an excellent example of the latter. Many of these proposals are neither desired by customers nor employees. As a consequence, these programs are linked to financial under-performance and warrant caution.

The remainder of this study evaluates the financial returns of a sample of ESG funds that were documented as a top/strong performing fund to substantiate these claims. This evaluation demonstrates that, generally speaking, the top performing ESG funds lag the returns of an S&P 500 index fund over short-, medium-

and long-term time horizons. Further, at the corporate level, the link between ESG proxy votes and lower company returns will be discussed. As a consequence, the general proclivity of institutional funds (via the advice they receive from their proxy advisory firms) to support ESG proxies is detrimental to future financial returns, and the general support of proxy advisory firms for these policies is unwarranted.

## Evaluating ESG Fund Performance

In an April 2018 Field Bulletin, the Department of Labor "reiterated its longstanding view that, because every investment necessarily causes a plan to forego other investment opportunities, plan fiduciaries are not permitted to sacrifice investment return or take on additional investment risk as a means of using plan investments to promote collateral social policy goals."[7] While the memo was written for pension plan fiduciaries, this concern is well founded with respect to the long-standing ESG funds.

In an apparent contradiction of these concerns, several reports have documented the strong performance of ESG funds over the past year. In 2017, Think Advisor (an investment advisory firm) documented the 10-best performing ESG funds as ranked by Morningstar that all outperformed the S&P 500 over the past year.[8] However, this short-term outperformance was atypical for ESG funds. Further, over the longer-term ESG funds have underperformed the returns of the S&P 500 index. Additionally, the performance measures fail to consider the higher risks ESG funds impose on investors, or the ESG funds' higher management cost.

To illustrate these points, this analysis evaluated the performance of 30 ESG funds that have been documented as either having existed for more than 10-years or having outperformed the S&P 500 over a short-term timeframe.[9] Table A1 in the Appendix list these funds and summarizes their ESG strategy. Table A1 categorizes the ESG funds into 3 different sub-categories based on their ESG strategy.

The first sub-category of ESG funds are denoted as "broad-based index" funds because the ESG strategy prohibits investments in specific industries that typically include one or more of the following industries: gambling, alcohol, tobacco, gun manufacturers, or fossil fuel companies. Other than these relatively minor restrictions, these funds operate similarly to any other broad-based, actively managed, index fund.

> "It should be noted that whether or not an ESG strategy outperforms holding a broad-based index of stocks (such as an S&P 500 index fund), individual investors who care about social and environmental issues may prioritize these concerns over purely financial returns.

The second sub-category of ESG funds, "waste and clean tech" takes a more pro-active approach to fulfilling the ESG mission statement. As Table A1 illustrates, these funds invest in alternative technology companies and clean waste management companies. The ESG funds in this sub-category differ substantially from those funds in the first category. These funds employ an investment strategy that explicitly pursues an ESG goal – in this case environmental goals.

The third sub-category of ESG funds, "social goals", is similar to the second - only instead of actively investing in clean tech companies, these ESG funds use explicit social criteria to select the companies in

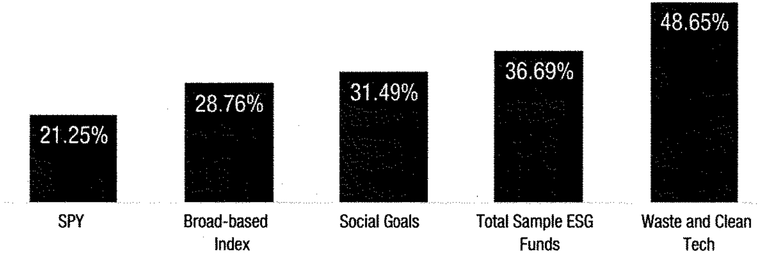
their portfolio. For example, the WIL fund invests in companies that demonstrate strong women leadership (either as CEOs or ample board membership). The SDG fund invests in companies pursuing the United Nations Sustainable Development Goals.

> "A concentration of investments into a single industry enables outsized returns should the selected industry outperform the market, but exposes the funds to outsized losses should the selected industry experience outsized losses.

Over the long-term, the returns from the broad-based index funds should be closer to the returns of a broad index fund than the pro-active ESG categories because the ESG prohibitions place marginal restrictions on the funds' options, which can be seen in Table A2. Table A2 lists the top 10 holdings of the SPY (an S&P 500 index fund) as well as the holdings of the 30 ESG funds evaluated. The holdings of the broad-based index ESG funds vary depending upon whether the fund focuses on large-caps, mid-caps, or small caps. While the top 10 holdings of the large-cap ESG funds (those that are directly comparable to the SPY) varies from the SPY, the holdings are similar. This directly results from the reality that the prohibition on investing in tobacco companies or investing in fossil fuel companies would only impact, possibly, one of the top ten holdings of the SPY.

Table A2 also demonstrates that the investments of the pro-active ESG funds, particularly the waste and clean-tech funds, are concentrated in the selected industries. A concentration of investments into a single industry enables outsized returns should the selected industry outperform the market, but exposes the funds to outsized losses should the selected industry experience outsized losses. For example, Tesla and First Solar are one of the top ten holdings for many of the funds in the waste management and cleantech sub-category. As a result, if Tesla is able to meet its current aggressive sales goals, these funds will likely perform extremely well in the short-term, but if Tesla were to go bankrupt, these funds will likely significantly underperform the S&P 500. These higher risks associated with all of the ESG funds, but particularly the pro-active ESG funds, are summarized in Figure 2.

**Figure 2**
**Top 10 Holdings Share of Total Portfolio**
**SPY Compared to Average of ESG Funds and ESG Fund Sub-Categories**



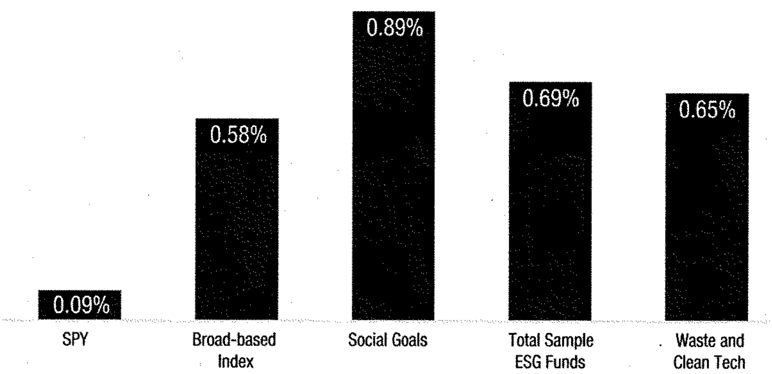

*Source: ETF.com and Yahoo! Finance*

Figure 2 presents the top ten holdings' share of the total portfolios of an S&P 500 index fund (SPY) compared to the average share of the funds that comprise the three ESG sub-categories, as well as the average share for the total sample of ESG funds. The higher the share of the top ten investments, the more a fund's performance will be influenced by the performance of these holdings, and the smaller the fund's benefits from diversification will be.

The top ten holdings of the SPY comprise 21.25 percent of the total portfolio. Compared to this amount, all of the ESG funds face significantly more exposure to the performance of its top ten holdings. For the total sample of ESG funds examined, the top 10 holdings comprised 36.69 percent of the total portfolio. The waste and clean tech ESG funds have an even larger exposure to the performance of their top ten holdings as these stocks represent nearly one-half of their total portfolios. In one fund, the EVX, the top ten holdings represent 64.03 percent of the entire portfolio. Concentration at these levels imposes a very large amount of risk on the investors in these ESG funds should these holdings underperform.

In addition to the important issue of risk, ESG funds also tend to have higher expense ratios, see Figure 3. Figure 3 illustrates that the expense ratio for the SPY is very low – 0.09 percent. In comparison, the costs for the ESG funds are significantly higher. The average expense ratio associated with the social goals sub-category (0.89 percent) is the highest, which makes sense since executing on the specific "social" strategies will typically require significantly more work on the part of management compared to the broad-based funds, for instance, which only need to apply the appropriate investment screen.

**Figure 3**
**Expense Ratio: SPY Compared to Average of ESG Funds and ESG Fund Sub-Categories**




*Source: ETF.com and Yahoo! Finance*

The expense ratios matter because these costs directly offset the investment returns. Over time, even if alternative investments earn the exact same investment returns, higher expense costs will lead to significantly lower overall investment returns. These considerations are illustrated in Table 1. Table 1

projects out the cumulative impact from the alternative expense ratios over a 25-year investment horizon assuming a similar 10 percent annual return for all investment alternatives. Therefore, the performance difference between the SPY and the three ESG sub-categories is completely driven by the alternative average expense ratios of each group. And, as Table 1 illustrates, the ultimate impact on the value of an investor's portfolio is large.

## Table 1
## Hypothetical Investment Returns Accounting for Alternative Expense Ratios: SPY Compared to Average of ESG Funds and ESG Fund Sub-Categories

| | SPY | BROAD-BASED INDEX | SOCIAL GOALS | WASTE AND CLEAN TECH |
|---|---|---|---|---|
| **Annual Return** | **10.0%** | **10.0%** | **10.0%** | **10.0%** |
| **Initial Investment** | **$10,000** | **$10,000** | **$10,000** | **$10,000** |
| Year 1 | $10,991 | $10,942 | $10,911 | $10,935 |
| 2 | $12,080 | $11,973 | $11,906 | $11,956 |
| 3 | $13,277 | $13,101 | $12,991 | $13,074 |
| 4 | $14,593 | $14,335 | $14,175 | $14,296 |
| 5 | $16,039 | $15,685 | $15,467 | $15,632 |
| 6 | $17,629 | $17,162 | $16,876 | $17,092 |
| 7 | $19,376 | $18,779 | $18,414 | $18,690 |
| 8 | $21,296 | $20,548 | $20,093 | $20,436 |
| 9 | $23,406 | $22,484 | $21,924 | $22,346 |
| 10 | $25,726 | $24,602 | $23,922 | $24,435 |
| 11 | $28,275 | $26,919 | $26,102 | $26,718 |
| 12 | $31,078 | $29,455 | $28,481 | $29,215 |
| 13 | $34,157 | $32,230 | $31,077 | $31,945 |
| 14 | $37,542 | $35,266 | $33,909 | $34,931 |
| 15 | $41,263 | $38,588 | $36,999 | $38,195 |
| 16 | $45,352 | $42,223 | $40,371 | $41,765 |
| 17 | $49,846 | $46,200 | $44,051 | $45,668 |
| 18 | $54,786 | $50,552 | $48,065 | $49,936 |
| 19 | $60,215 | $55,314 | $52,446 | $54,603 |
| 20 | $66,183 | $60,525 | $57,226 | $59,706 |
| 21 | $72,741 | $66,226 | $62,441 | $65,285 |
| 22 | $79,950 | $72,465 | $68,132 | $71,387 |
| 23 | $87,873 | $79,291 | $74,341 | $78,058 |
| 24 | $96,581 | $86,760 | $81,116 | $85,353 |
| 25 | $106,152 | $94,933 | $88,509 | $93,329 |
| **% Returns Relative to SPY** | **-** | **-10.6%** | **-16.6%** | **-12.1%** |
| **$ Returns Relative to SPY** | **-** | **-$11,219** | **-$17,644** | **-$12,823** |

Table 1 illustrates that over 25 years, an initial investment into the SPY of $10,000 would become $106,152. Relative to this return, the average broad-based index ESG fund would become $94,933, or 10.6 percent lower than the SPY; the average social goals ESG fund would become $88,509, or 16.6 percent lower; and, the average waste and clean tech ESG fund would become $93,329, or 12.1 percent lower. Of course, these investment discrepancies have assumed the exact same annual investment return of 10.0 percent annually. Therefore, these lower realized returns from the ESG funds are due to the higher costs associated with running these funds.

Considering the risks inherent in the ESG funds' investment concentration, as well as the higher management fees, the ESG funds are at a significant disadvantage relative to a broad index fund based on the S&P 500 even before the alternative returns of these investments are considered. On top of these disadvantages, overall, ESG funds have not performed as well as the S&P 500.

Of the 30 funds considered, only 18 of these funds had a track record for at least 10-years. Since the basis of this evaluation is to include long-term considerations, only these 18 funds are compared in the series of charts below. The Appendix Table A4 presents the financial returns (including the impact from the expense ratios) for all 30 funds. Evaluating the performance of the 18 ESG funds with a full 10-year track record over a 1-year, 5-year, and 10-year performance illustrates that, in addition to the previous disadvantages, the majority of these funds are unable to replicate the performance of a benchmark S&P 500 index fund. Further, while 5 of the 18 funds were able to beat the benchmark over the past 12 months through April 2019, only one and two funds beat the S&P 500 benchmark over a 5-year and 10-year investment horizon, respectively. Figures 4 through 6 present these trends.

**Figure 4**
**1-year Annual Returns SPY Compared to ESG Funds With 10-Year Return Data**

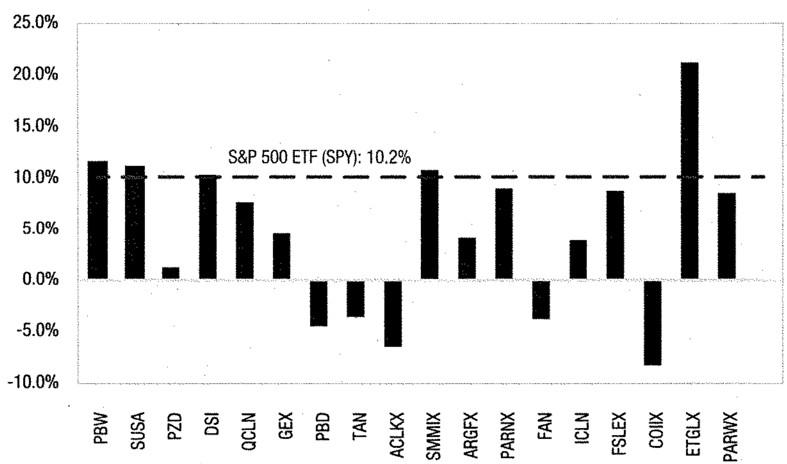


**Figure 5**
**5-year Compound Annual Growth Rate:**
**SPY Compared to ESG Funds With 10-Year Return Data**

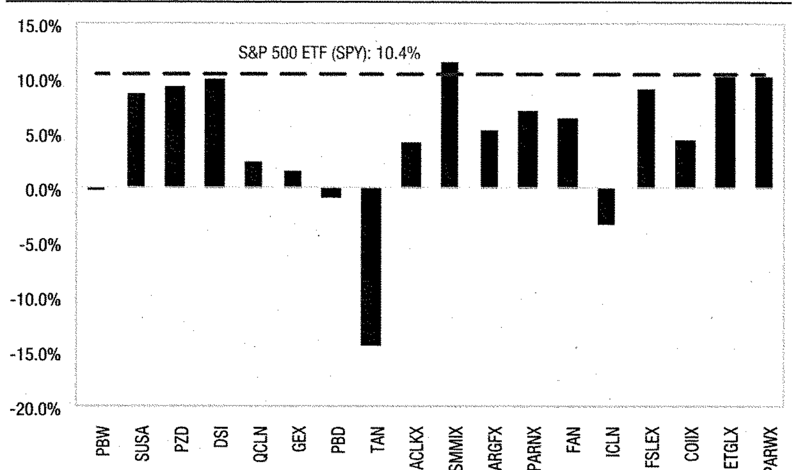
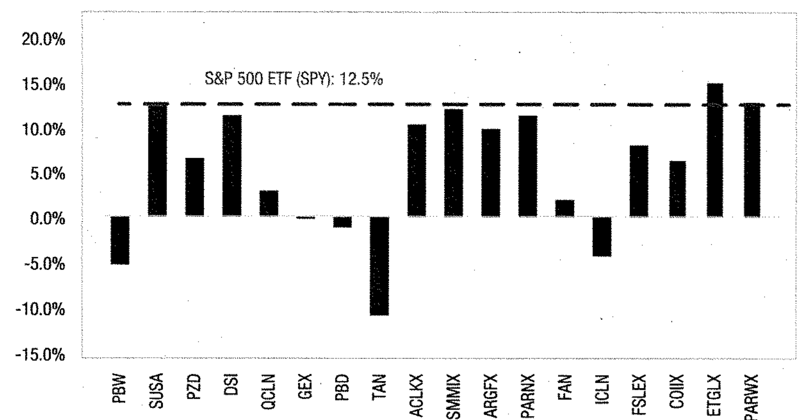
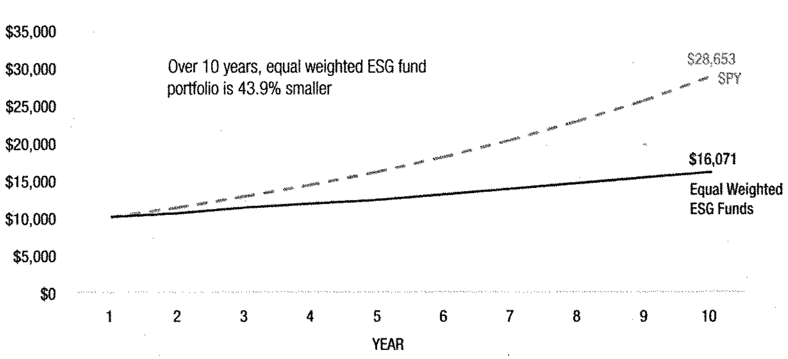



**Figure 6**
**10-year Compound Annual Growth Rate:**
**SPY Compared to ESG Funds With 10-Year Return Data**



As a final measure of how the ESG funds performance compares to the SPY, Figure 7 compares the 10-year growth rate of a $10,000 investment into the SPY to the 10-year growth rate of a $10,000 investment equally divided across the 18 ESG funds with a 10-year track record. As Figure 7 demonstrates, including the impact from management fees, a $10,000 investment into the SPY would yield an extra $12,581 compared to the ESG investment – starting with the same initial investment, the ESG portfolio would be 43.9 percent smaller after 10-years.

**Figure 7**
**Historical Performance: SPY Compared to Equal Weighted ESG Fund Portfolio Management Expenses Included**




There is one more caveat concerning the 10-year returns reviewed. Over the past 10-years, there has not been a sustained bear market for stocks. The last sustained bear market occurred between 2007 and 2009. Without a full understanding of the impact of a bear market on the long-term returns of ESG funds, questions regarding the funds' long-term performance will remain.

## The Impact from ESG Programs on Corporate Performance

The relative underperformance of ESG funds relative to a broad-based index fund speaks to ESG as an active investment strategy. It does not address the value of ESG programs from a corporate management perspective.

Undoubtedly, some ESG programs make sense. For a specific publicly-owned company, consumers may demand that the products are produced in a manner consistent with ESG criteria. In this case, the company is providing its customers with the products they desire in the manner they want it produced, and adhering to these ESG criteria is a win-win proposition. Similarly, adhering to other ESG criteria could

improve worker morale, and consequently, improve overall efficiency and profitability. These ESG criteria are worth pursuing as well. From an individual investor's perspective, these ESG programs will improve corporate performance and paying attention to these considerations will help investors earn competitive financial returns.

While ESG programs can be financially viable, these programs can also be financially harmful and there are many studies that have concluded that ESG programs are often detrimental to a firm's financial performance or, at best, simply a distraction. This point, as represented by ESG shareholder proposals, was emphasized by a report by the Center for Capital Markets Competitiveness which noted that

> Shareholder proposals increasingly deal with social or political matters that most shareholders deem immaterial to their decision making. The Manhattan Institute's Proxy Monitor Report found that in 2017, fully 56% of shareholder proposals at Fortune 250 companies dealt with social or policy concerns. Despite the prevalence of such proposals, shareholders have overwhelmingly rejected them when put to a vote. To highlight just one example, from 2006 to 2016, Fortune 250 companies received 445 proposals dealing with political spending disclosures – a perennial favorite topic of activists. Only 1 of these proposals during that time frame received majority backing, and in most years, proponents failed to garner the support of more than 20% of voting shareholders. Proposals dealing with other social or political matters have similarly received very low support when put to a vote.
>
> Main Street investors have also demonstrated an aversion to bringing social and policy issues into corporate governance. A striking survey released earlier this year by the Spectrem Group found that 88% of public pension plan beneficiaries want plan assets to be used for maximizing returns and not political agendas, even if they agree with whatever cause the overseers of the plan may be advocating. The survey also found that beneficiaries largely believe pension funds should have to explain and justify their votes on proxy matters such as shareholder proposals, or abstain from voting if it cannot.[10]

A 2002 study by Tracie Woidtke in the *Journal of Financial Economics* directly examined the impact from activist public pension funds on the market values of a sample of Fortune 500 companies.[11] Professor Woidtke's results illustrate that increased shareholder activism by public pension funds is negatively correlated with stock returns. Particularly noteworthy, the firms who received proposals from public pension funds that were demonstrably advancing social agendas were valued 14 percent lower than similar companies that did not receive such proposals.

These results illustrate that investors will also often view ESG programs as detrimental to corporate performance. This makes the inclination to view these programs positively problematic, particularly the bias illustrated by proxy advisory firms due to their influence over the voting behavior of institutional investors. Two proxy advisory firms, ISS and Glass Lewis, control 97 percent of the proxy advisory market – effectively, the proxy advisory market is controlled by a duopoly. A 2018 Manhattan Institute study found "a positive association between ISS recommendations and shareholder voting and a negative relationship between share value and public pension funds' social-issue shareholder-proposal activism (which is much more likely to be supported by proxy advisory firms than by the median shareholder)."[12]

These negative associations emerge because the two major proxy advisory firms establish their position on ESG without adequate transparency, without considering how the programs can impact different investors (the advisory firms generally employ a one-sized fits all approach to deciding issues), and their internal ESG advisory programs demonstrate a conflict of interests/bias. As a result, institutional investors (particularly public pension funds) may be violating their fiduciary responsibilities when they adopt the ESG voting positions suggested by these proxy advisory firms.

## Conclusion

As the old investment adage goes, "past performance is not indicative of future results". Past performance is not irrelevant, however. Judged against its past performance, ESG funds have not yet shown the ability to match the returns from simply investing in a broad-based index fund. By intention, ESG funds limit their investment options, creating higher investment risks. ESG funds also charge investors higher expense ratios and typically earn lower investment returns. Based on this historical performance, ESG funds provide investors with financially inferior results.

Some investors may prioritize other non-financial goals in addition to their investment returns, and for these investors, the lower financial returns may not be relevant. For other investors, particularly institutional funds such as public pension funds that have fiduciary responsibilities to their investors, the lower financial returns are material. The historical data do not recommend that these investors should invest in ESG funds.

Explicitly recognizing the tradeoffs between ESG goals and financial returns is essential to empower investors. With this knowledge, investors are better positioned to pursue their financial goals in the manner that reflects their values and the costs they are willing to bear.

# Appendix

## Table A1
## ESG Fund Name and Strategy

| FUND NAME | FUND SYMBOL | ESG STRATEGY |
|---|---|---|
| SPDR S&P 500 ETF | SPY | N/A |
| **Broad-based Index** | | |
| iShares MSCI KLD 400 Social ETF | DSI | DSI tracks a market-cap-weighted index of 400 companies deemed to have positive environmental, social and governance characteristics by MSCI. |
| ClearBridge Large Cap Growth ESG ETF | LRGE | LRGE is an actively managed fund that seeks long-term capital appreciation. The fund focuses on global large-cap stocks with positive ESG attributes. |
| iShares MSCI U.S.A. ESG Select ETF | SUSA | SUSA tracks an index of 250 companies with high environmental, social and governance (ESG) factor scores as calculated by MSCI. |
| iShares MSCI ACWI Low Carbon Target ETF | CRBN | CRBN tracks an index of stocks from global firms selected for a bias toward lower carbon emissions, but with tight constraints to the broad, marketlike ACWI index. |
| iShares ESG MSCI U.S.A. ETF | ESGU | ESGU tracks an index composed of US companies that have been selected and weighted for positive environmental, social, and governance characteristics. |
| SPDR MSCI ACWI Low Carbon Target ETF | LOWC | LOWC tracks an index of stocks from global firms selected for a bias toward lower carbon emissions but with tight constraints to the parent broad and marketlike ACWI index. |
| American Century NT Emerging Markets Fund G Class | ACLKX | The fund invests at least 80% of its net assets in equity securities of companies located in emerging market countries. The fund cannot invest in tobacco stocks. |
| Invesco Summit Fund Class P | SMMIX | The fund invests primarily in equity securities of issuers of all market capitalizations. It does not invest in companies whose primary business involves alcohol, tobacco or gambling. |
| Ariel Fund Investor Class | ARGFX | The fund invests in mid-cap value stocks. It does not invest in companies whose primary source of revenue comes from tobacco and handgun manufacturing. |
| American Century Sustainable Equity Fund Investor Class | AFDIX | AFDIX generally invests in large-cap stocks taking into account ESG factors when making investment decisions. |
| Parnassus Fund | PARNX | Large growth fund that avoids investing in fossil fuel companies. Accounts for all ESG factors when making investment decisions. |
| **Waste and Clean Tech** | | |
| VanEck Vectors Environmental Services ETF | EVX | EVX tracks a tiered equal-weighted index of companies that stand to benefit from increased demand for waste management. |
| Invesco Cleantech ETF | PZD | PZD tracks a tiered equal-weighted index of companies in the cleantech industry selected for their outperformance potential. |
| VanEck Vectors Global Alternative Energy ETF | GEX | GEX tracks a market-cap-weighted index of companies that derive at least 50% of their revenues from alternative energy. |
| Invesco Global Clean Energy ETF | PBD | PBD tracks an index of companies that focus on cleaner energy weighted equally in tiers. |

| | | |
|---|---|---|
| Invesco WilderHill Clean Energy ETF | PBW | PBW tracks a modified equal-weighted index of companies involved in cleaner energy sources or energy conservation. |
| First Trust NASDAQ Clean Edge Green Energy Index Fund | QCLN | QCLN tracks a market-cap-weighted index of US-listed firms involved in clean energy. |
| Invesco Solar ETF | TAN | TAN tracks an index of solar energy companies selected based on the relative importance of solar power to the company's business model. |
| First Trust Global Wind Energy ETF | FAN | FAN tracks an index of companies involved in the wind energy industry weighted according to float-adjusted market cap with strict limits on individual holdings. |
| iShares Global Clean Energy ETF | ICLN | ICLN tracks a market-cap-weighted index of 30 of the most liquid companies involved in businesses related to clean energy. |
| Global X YieldCo & Renewable Energy Income ETF | YLCO | YLCO tracks a market-cap-weighted index of global holding companies for renewable energy projects and other renewable energy companies. |
| Fidelity Select Envir and Alt Energy Portfolio | FSLEX | FSLEX invests in companies engaged in alternative energy and clean environment products and services. |
| **Social Goals** | | |
| iShares MSCI Global Impact ETF | SDG | SDG tracks an index composed of companies whose revenues are driven by products and services that address at least one of the United Nations Sustainable Development Goals. |
| Global X Conscious Companies ETF | KRMA | KRMA tracks an equal-weighted index composed of U.S.-listed companies that exhibit environmental, social, and corporate governance (ESG) characteristics. |
| Barclays Women in Leadership ETN | WIL | WIL tracks an index of US stocks issued by firms with women as CEOs or board members. The index picks a maximum of 10 such stocks from each sector. Stocks are market cap weighted. |
| Eventide Healthcare & Life Sciences Fund CLASS I SHARES | ETIHX | Seeks out companies (particularly healthcare) with ethical governance, that promote family and community and practice environmental stewardship. Avoids companies that promote addictive behaviors such as gambling, pornography, tobacco, alcohol, and weapons proliferation. |
| Calvert International Opportunities Fund Class I | COIIX | The fund invests primarily in common and preferred stocks of non-U.S. small-cap to mid-cap companies. Investment decisions guided by the Calvert Principles for Responsible Investment. |
| Calvert Emerging Markets Equity Fund Class I | CVMIX | Invests primarily in emerging markets in companies that contribute toward addressing one or more global sustainability challenges including development, poverty, health, environment, climate change, and rights. |
| Eventide Gilead Class N | ETGLX | Seeks out companies with ethical governance that promote ESG principles. Avoids companies that promote addictive behaviors and products such as gambling, pornography, tobacco, alcohol, and weapons. |
| Parnassus Endeavor Fund Investor Shares | PARWX | The fund invests in companies that provide good workplaces for their employees, and avoids companies engaged in any part of the fossil fuel business. |

## Table A2
## Top 10 Holdings

| FUND SYMBOL | TOP 10 HOLDINGS | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **SPY** | **Microsoft Corp.** | **Apple Inc.** | **Amazon.com, Inc.** | **Facebook Inc. A** | **Berkshire Hathaway Inc. B** | **Johnson & Johnson** | **Alphabet Inc. Class C** | **Alphabet Inc. A** | **ExxonMobil Mobil Corp.** | **JPMorgan Chase & Co.** |
| **Broad-based Index** | | | | | | | | | | |
| DSI | Microsoft Corp. | Facebook, Inc. Class A | Alphabet Inc. Class C | Alphabet Inc. Class A | Visa Inc. Class A | Procter & Gamble | Intel Corporation | Cisco Systems, Inc. | Verizon Communications | Home Depot, Inc. |
| LRGE | Amazon.com, Inc. 6.48% | Facebook, Inc. Class A 4.99% | Microsoft Corporation 4.73% | Visa Inc. Class A 4.17% | Apple Inc. 3.99% | W.W. Grainger, Inc. 3.24% | Alphabet Inc. Class C 3.23% | United Health Group Inc.orp. orated 3.05% | Walt Disney Company 2.82% | Comcast Corporation Class A 2.73% |
| SUSA | Microsoft Corp. | Ecolab Inc. | Apple Inc. | 3M Company | Accenture Plc Class A | Alphabet Inc. Class A | BlackRock, Inc. | Salesforce.com Inc. | Northern Trust Corporation | Agilent Technologies, Inc. |
| CRBN | Apple Inc. | Microsoft Corp. | Amazon.com Inc. | Facebook Inc. A | Alphabet Inc. A | Johnson & Johnson | Alphabet Inc. Class C | JPMorgan Chase & Co. | Tencent Holdings Ltd. | Visa Inc. Class A |
| ESGU | Microsoft Corporation | Apple Inc. | Amazon.com, Inc. | Alphabet Inc. Class C | Facebook, Inc. Class A | Alphabet Inc. Class A | Johnson & Johnson | JPMorgan Chase & Co. | ExxonMobil Mobil Corporation | Visa Inc. Class A |
| LOWC | Apple Inc. | Microsoft Corporation | Amazon.com, Inc. | Facebook, Inc. Class A | Alphabet Inc. Class A | Johnson & Johnson | JPMorgan Chase & Co.. | Alphabet Inc. Class C | Visa Inc. Class A | Nestle S.A. |
| ACLKX | Tencent Holdings Ltd. | Taiwan Semiconductor Manufacturing Co. Ltd. | Alibaba Group Holding Ltd. ADR | Samsung Electronics Co. Ltd. | NOVATEK PJSC GDR | China Construction Bank Corp. H | HDFC Bank Ltd. | Naspers Ltd. Class N | CNOOC Ltd. | Industrial And Commercial Bank Of China Ltd. H |
| SMMIX | Amazon.com Inc. | Alphabet Inc. Class C | Visa Inc. Class A | Facebook Inc. A | UnitedHealth Group Inc. | Salesforce.com Inc. | Microsoft Corp. | Mastercard Inc. A | Lowe's Companies Inc. | Alibaba Group Holding Ltd. ADR |
| ARGFX | KKR & Co. Inc. | Zebra Technologies Corp. | MSG Networks Inc. Class A | Lazard Ltd. Shs A | Tegna Inc. | Kennametal Inc. | Nielsen Holdings PLC | JM Smucker Co. | Viacom Inc. B | Northern Trust Corp. |

| FUND SYMBOL | TOP 10 HOLDINGS | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| AFDIX | Microsoft Corp. | Bank of America Corp. | Apple Inc. | Exelon Corp. | Amazon.com Inc. | Procter & Gamble Co. | JPMorgan Chase & Co. | Cisco Systems Inc. | Visa Inc. Class A | Prologis Inc. |
| PARNX | Alliance Data Systems Corp. | Thomson Reuters Corp. | Signature Bank | Motorola Solutions Inc. | Mondelez International Inc. Class A | Hologic Inc. | Cadence Design Systems Inc. | Alphabet Inc. A | Linde PLC | Novartis AG ADR |
| **Waste and Clean Tech** | | | | | | | | | | |
| EVX | Waste Connections, Inc. | Waste Management, Inc. | STERIS Plc | Republic Services, Inc. | Stericycle, Inc. | ABM Industries Inc. | Donaldson Company, Inc. | Covanta Holding Corporation | Advanced Disposal Services | Clean Harbors, Inc. |
| PZD | BorgWarner Inc. | Roper Technologies, Inc. | Autodesk, Inc. | Intertek Group plc | ANSYS, Inc. | Kingspan Group Plc | Vestas Wind Systems A/S | Sensata Technologies | Xylem Inc. | Schneider Electric SE |
| GEX | Vestas Wind Systems A/S | AMETEK, Inc. | Microchip Technology Inc. | Eaton Corp. Plc | Tesla Inc. | Cree, Inc. | NIBE Industrier AB Class B | First Solar, Inc. | Siemens Gamesa Renewables | VERBUND AG Class A |
| PBD | Tesla Inc. | Signify NV | Cree, Inc. | NIBE Industrier AB Class B | Kingspan Group Plc | Acuity Brands, Inc. | Universal Display Corp. | GS Yuasa Corp. oration | Landis+Gyr Group AG | Hannon Armstrong |
| PBW | SunPower Corporation | JinkoSolar Holding Co., Ltd. | Daqo New Energy Corp. | Tesla Inc. | First Solar, Inc. | Hexcel Corp. oration | Enphase Energy, Inc. | Canadian Solar Inc. | Ormat Technologies, Inc. | Albemarle Corp. |
| QCLN | ON Semiconductor Corporation | Albemarle Corp. | Tesla Inc. | Universal Display Corp. | Hexcel Corporation | Cree, Inc. | Brookfield Renewable Partners | First Solar, Inc. | Littelfuse, Inc. | Acuity Brands, Inc. |
| TAN | First Solar, Inc. | Xinyi Solar Holdings Ltd.. | SolarEdge Technologies | Sunrun Inc. | Canadian Solar Inc. | Scatec Solar ASA | Enphase Energy, Inc. | JinkoSolar Holding Co., Ltd. | Hannon Armstrong Sustainability | TerraForm Power, Inc. |
| FAN | Siemens Gamesa Renewable Energy, S.A. | Orsted | Vestas Wind Systems A/S | China Longyuan Power Group Corp. Ltd. Class H | Northland Power Inc. | Pattern Energy Group, Inc. Class A | Renewables Infrastructure Group Limited GBP Red.Shs | Nordex SE | Boralex Inc. Class A | Xinjiang Goldwind Science & Technology Co., Ltd. Class H |
| ICLN | Siemens Gamesa Renewable Energy, S.A. | Vestas Wind Systems A/S | Companhia Energetica de Minas Gerais SA Sponsored ADR Pfd | Meridian Energy Limited | Contact Energy Limited | First Solar, Inc. | Pattern Energy Group, Inc. Class A | China Everbright International Limited | VERBUND AG Class A | Covanta Holding Corp. |

| FUND SYMBOL | TOP 10 HOLDINGS | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| YLCO | ENGIE Brasil Energia S.A. | Vestas Wind Systems A/S | EDP-Energias de Portugal SA | Enel Americas S.A. | Orsted | AGL Energy Limited | Meridian Energy Limited | Enel Chile SA | Brookfield Renewable Partners LP | Algonquin Power & Utilities Corp. |
| FSLEX | 3M Co. | Honeywell International Inc. | Danaher Corp. | Eaton Corp. PLC | Ingersoll-Rand PLC | TE Connectivity Ltd. | Cummins Inc. | Parker Hannifin Corp. | Innospec Inc. | Comfort Systems USA Inc. |
| **Social Goals** | | | | | | | | | | |
| SDG | Umicore | Johnson Matthey Plc | Procter & Gamble Company | AbbVie, Inc. | East Japan Railway Company | Tesla Inc. | Vestas Wind Systems A/S | Gilead Sciences, Inc. | Central Japan Railway Company | SUEZ SA |
| KRMA | Estee Lauder Companies Inc. Class A | Best Buy Co., Inc. | Apple Inc. | KLA-Tencor Corp.oration | Keysight Technologies Inc. | Intuit Inc. | Air Products and Chemicals, Inc. | Lowe's Companies, Inc. | Danaher Corp. oration | VMware, Inc. Class A |
| WIL | NA | | | | | | | | | |
| ETIHX | Sarepta Therapeutics Inc. | Sage Therapeutics Inc. | Ascendis Pharma A/S ADR | Zogenix Inc. | argenx SE ADR | Blueprint Medicines Corp. | Immunomedics Inc. | Vertex Pharmaceuticals Inc. | Biohaven Pharmaceutical Holding Co. Ltd. | KalVista Pharmaceuticals Inc. |
| COIIX | Sika Ag Reg Common Stock Chf.01 | SpareBank 1 SR Bank ASA | Melrose Industries PLC | IMCD NV | CAE Inc. | Cembra Money Bank AG | WH Smith PLC | Halma PLC | Rubis SCA | Smith (DS) PLC |
| CVMIX | Tencent Holdings Ltd. | Samsung Electronics Co. Ltd. | Alibaba Group Holding Ltd. ADR | Taiwan Semiconductor Manufacturing Co. Ltd. ADR | AIA Group Ltd. | Techtronic Industries Co. Ltd. | KB Financial Group Inc. | Bank Rakyat Indonesia (Persero) Tbk Class B | NARI Technology Co. Ltd. | Itau Unibanco Holding SA Participating Preferred |
| ETGLX | SendGrid Inc. | Ascendis Pharma A/S ADR | Splunk Inc. | Palo Alto Networks Inc. | The Trade Desk Inc. A | Sarepta Therapeutics Inc. | Sage Therapeutics Inc. | Lowe's Companies Inc. | Wayfair Inc. Class A | XPO Logistics Inc. |
| PARWX | Mattel Inc. | Micron Technology Inc. | Applied Materials Inc. | Cummins Inc. | Hanesbrands Inc. | Gilead Sciences Inc. | Lam Research Corp. | American Express Co. | Alliance Data Systems Corp. | NVIDIA Corp. |

**Table A3**
**Top 10 Holdings Share of Total Assets, Expense Ratio, and Net Assets**

| FUND SYMBOL | SHARE OF TOP 10 HOLDINGS | EXPENSE RATIO | NET ASSETS (BILLIONS) |
|---|---|---|---|
| SPY | 21.25% | 0.09% | $264.06 |
| **Broad-based Index** | **28.76%** | **0.58%** | **$8.96** |
| DSI | 27.23% | 0.25% | $1.34 |
| LRGE | 39.43% | 0.60% | $0.12 |
| SUSA | 29.02% | 0.25% | $0.94 |
| CRBN | 10.91% | 0.20% | $0.12 |
| ESGU | 20.64% | 0.15% | $0.18 |
| LOWC | 11.02% | 0.20% | $0.06 |
| ACLKX | 30.17% | 1.19% | $0.45 |
| SMMIX | 40.88% | 0.90% | $2.30 |
| ARGFX | 36.28% | 1.01% | $2.23 |
| AFDIX | 30.27% | 0.79% | $0.28 |
| PARNX | 40.56% | 0.84% | $0.94 |
| **Waste and Clean Tech** | **48.65%** | **0.65%** | **$1.34** |
| EVX | 64.03% | 0.56% | $0.03 |
| PZD | 30.46% | 0.67% | $0.17 |
| GEX | 66.81% | 0.63% | $0.09 |
| PBD | 17.63% | 0.75% | $0.05 |
| PBW | 32.00% | 0.70% | $0.12 |
| QCLN | 56.10% | 0.60% | $0.10 |
| TAN | 58.36% | 0.70% | $0.30 |
| FAN | 54.24% | 0.60% | $0.07 |
| ICLN | 51.98% | 0.47% | $0.21 |
| YLCO | 53.88% | 0.65% | $0.02 |
| FSLEX | 49.66% | 0.87% | $0.19 |
| **Social Goals** | **31.49%** | **0.89%** | **$9.76** |
| SDG | 36.89% | 0.49% | $0.05 |
| KRMA | 7.17% | 0.43% | $0.06 |
| WIL | N/A | 0.45% | $0.04 |
| ETIHX | 38.70% | 1.31% | $0.97 |
| COIIX | 15.44% | 1.10% | $0.32 |
| CVMIX | 39.66% | 0.99% | $1.72 |
| ETGLX | 32.25% | 1.40% | $2.38 |
| PARWX | 50.32% | 0.92% | $4.23 |
| **Total Sample ESG Funds** | **36.69%** | **0.69%** | **$29.02** |

**Table A4**
**1-year, 5-year and 10-year Average Annual Returns**

| | 1-YEAR GROWTH | 5-YEAR CAGR | 10-YEAR CAGR |
|---|---|---|---|
| SPY | 10.1% | 10.3% | 12.4% |
| PBW | 11.8% | -0.1% | -5.4% |
| SUSA | 11.3% | 8.7% | 12.3% |
| PZD | 1.3% | 9.2% | 6.5% |
| DSI | 10.3% | 9.9% | 11.4% |
| QCLN | 7.7% | 2.4% | 2.8% |
| GEX | 4.6% | 1.4% | -0.2% |
| PBD | -4.4% | -1.1% | -1.4% |
| TAN | -3.6% | -14.5% | -11.0% |
| ACLKX | -6.5% | 4.2% | 10.2% |
| SMMIX | 10.7% | 11.3% | 12.0% |
| ARGFX | 4.2% | 5.2% | 9.8% |
| PARNX | 9.1% | 7.1% | 11.2% |
| FAN | -3.8% | 6.3% | 1.9% |
| ICLN | 3.9% | -3.4% | -4.4% |
| FSLEX | 8.9% | 9.0% | 7.9% |
| COIIX | -8.3% | 4.4% | 6.3% |
| ETGLX | 21.1% | 10.1% | 14.8% |
| PARWX | 8.6% | 10.1% | 12.7% |
| EVX | N/A | 11.0% | N/A |
| LRGE | 16.7% | N/A | N/A |
| CRBN | 4.6% | 6.3% | N/A |
| ESGU | 11.3% | N/A | N/A |
| LOWC | 4.1% | 6.5% | N/A |
| AFDIX | 9.6% | N/A | N/A |
| YLCO | 15.2% | -0.4% | N/A |
| SDG | 4.2% | N/A | N/A |
| KRMA | 12.5% | N/A | N/A |
| WIL | 6.2% | 5.7% | N/A |
| ETIHX | 24.1% | 13.5% | N/A |
| CVMIX | -3.0% | 5.2% | N/A |

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# About the Author

Wayne Winegarden

Wayne H. Winegarden, Ph.D. is a Senior Fellow in Business and Economics at the Pacific Research Institute and director of PRI's Center for Medical Economics and Innovation. He is also the Principal of Capitol Economic Advisors.

Dr. Winegarden has 25 years of business, economic, and policy experience with an expertise in applying quantitative and macroeconomic analyses to create greater insights on corporate strategy, public policy, and strategic planning. He advises clients on the economic, business, and investment implications from changes in broader macroeconomic trends and government policies. Clients have included Fortune 500 companies, financial organizations, small businesses, state legislative leaders, political candidates and trade associations.

Dr. Winegarden's columns have been published in the *Wall Street Journal, Chicago Tribune, Investor's Business Daily,* Forbes.com, and Townhall.com. He was previously economics faculty at Marymount University, has testified before the U.S. Congress, has been interviewed and quoted in such media as CNN and Bloomberg Radio, and is asked to present his research findings at policy conferences and meetings. Previously, Dr. Winegarden worked as a business economist in Hong Kong and New York City; and a policy economist for policy and trade associations in Washington D.C. Dr. Winegarden received his Ph.D. in Economics from George Mason University.

# About PRI

The Pacific Research Institute (PRI) champions freedom, opportunity, and personal responsibility by advancing free-market policy solutions. It provides practical solutions for the policy issues that impact the daily lives of all Americans, and demonstrates why the free market is more effective than the government at providing the important results we all seek: good schools, quality health care, a clean environment, and a robust economy.

Founded in 1979 and based in San Francisco, PRI is a non-profit, non-partisan organization supported by private contributions. Its activities include publications, public events, media commentary, community leadership, legislative testimony, and academic outreach.

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### Center for Education

PRI works to restore to all parents the basic right to choose the best educational opportunities for their children. Through research and grassroots outreach, PRI promotes parental choice in education, high academic standards, teacher quality, charter schools, and school-finance reform.

### Center for the Environment

PRI reveals the dramatic and long-term trend toward a cleaner, healthier environment. It also examines and promotes the essential ingredients for abundant resources and environmental quality: property rights, markets, local action, and private initiative.

### Center for Health Care

PRI demonstrates why a single-payer Canadian model would be detrimental to the health care of all Americans. It proposes market-based reforms that would improve affordability, access, quality, and consumer choice.

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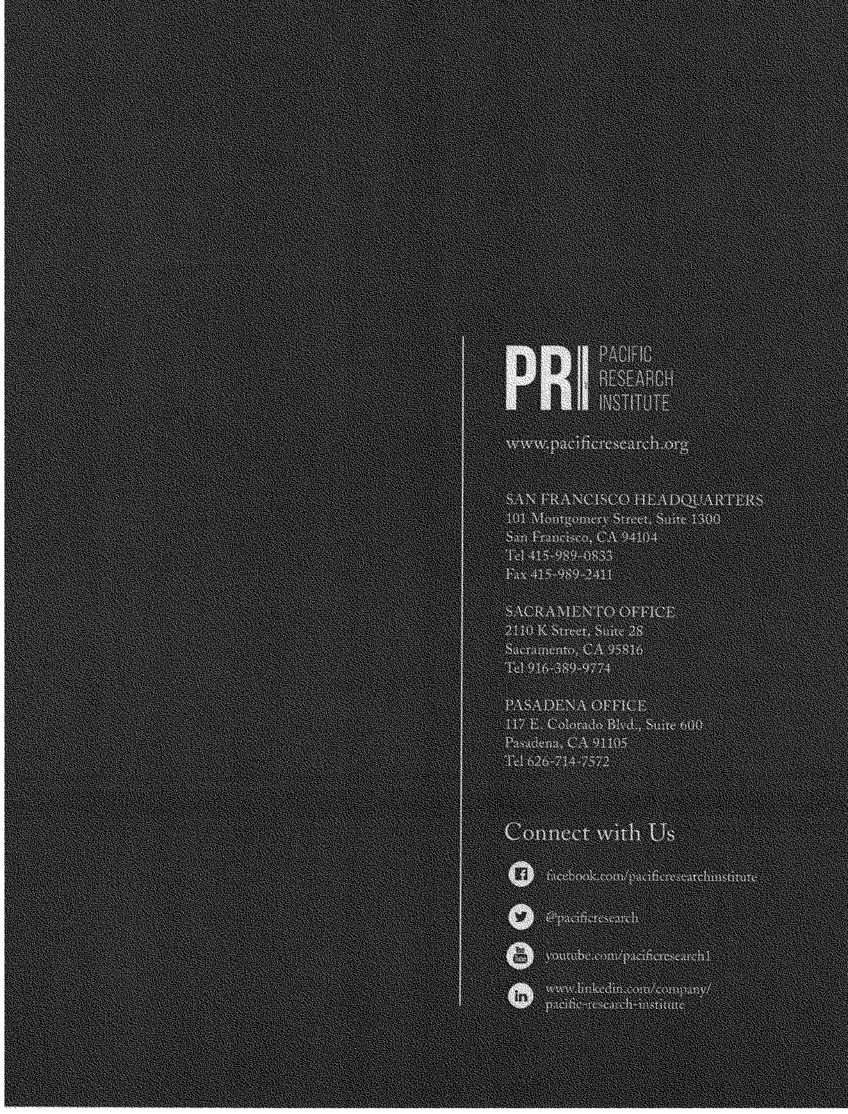
The Center for California Reform seeks to reinvigorate California's entrepreneurial self-reliant traditions. It champions solutions in education, business, and the environment that work to advance prosperity and opportunity for all the state's residents.

### Center for Medical Economics and Innovation

The Center for Medical Economics and Innovation aims to educate policymakers, regulators, health care professionals, the media, and the public on the critical role that new technologies play in improving health and accelerating economic growth.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https://www.wsj.com/articles/calpers-dilemma-save-the-world-or-make-money-11560684601

MARKETS

# Calpers' Dilemma: Save the World or Make Money?

California's public pension system wrestles with new doubts about divestments based on social concerns

*By Heather Gillers*
Updated June 16, 2019 4:22 pm ET

The California Public Employees' Retirement System was one of the first public-pension systems to tie its investments to social activism. Now it is having second thoughts.

In the last two years, its directors have opposed proposals to sell stocks in private prisons, gun retailers and companies tied to Turkey because of the potential for lost revenue and skepticism about whether divestment forces social change. One of these directors is now urging the system, also known as Calpers, to end its ban on stocks tied to tobacco, a policy in place since 2000.

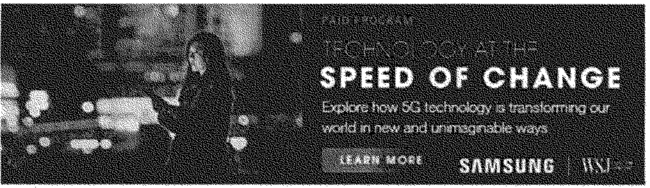
"I do see a change," said that director, California police sergeant Jason Perez, in an interview. "I think our default is to not divest."

Calpers isn't the only system wrestling with these new doubts. Rising funding deficits are prompting public officials and unions across the U.S. to reconsider the financial implications of investment decisions that reflect certain social concerns. The total shortfall for public-pension funds across the U.S. is $4.2 trillion, according to the Federal Reserve.

New York state's Democratic comptroller and unions representing civil service workers oppose a bill in the Legislature to ban fossil fuel investments by the state pension fund. In New Jersey, Gov. Phil Murphy, a Democrat, vetoed legislation last year that would have forced divestment of state pension dollars from companies that avoid cleaning up Superfund sites by declaring bankruptcy.

There is some evidence that divesting from certain holdings can be costly for systems that oversee retirement savings for millions of public workers. A November 2016 study by the Boston College Center for Retirement Research found average annual returns in states with divestment requirements were 0.40 percentage point lower than plans in states without such requirements.

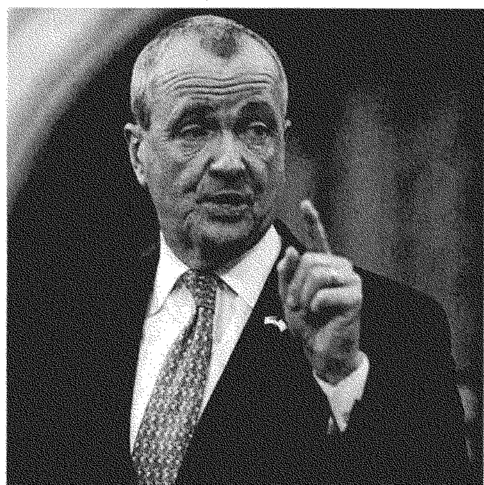
Divestment mandates "detract from what a retirement fund is for, which is to provide retirement income for public-sector workers," said Anqi Chen, one of the study's authors.




Public-pension funds once gave little thought to the money they might lose from social activism. Many sold investments in South Africa in the 1980s to protest apartheid. Others banned investments in tobacco products in the 1990s and early 2000s.

In the aftermath of the Sept. 11, 2001, terrorist attacks, more than 20 states passed laws that could compel their pension funds to divest from Sudan, Iran or other governments considered by the U.S. to be sponsors of terrorist activity.

Calpers was an early adopter of divestment, selling investments in companies tied to South Africa in 1986 and ditching tobacco stocks in 2000. At the time, Calpers had more than enough assets on hand to pay for future obligations, according to the fund.



New Jersey Gov. Phil Murphy vetoed legislation last year that would have forced divestment of state pension dollars from companies that avoid cleaning up Superfund sites by declaring bankruptcy. PHOTO: THE RECORD/ASSOCIATED PRESS

Doubts about the strategy rose as Calpers' funding situation worsened in the decade after the 2008 financial crisis. A key sign came in December 2016 as retirement-system officials recommended the board drop its tobacco ban, citing the potential money lost. Staying out of the investments for 16 years had cost the fund more than $3.5 billion, a fund consultant calculated.

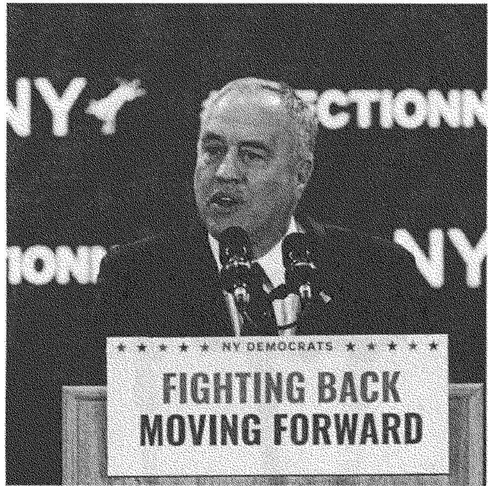
After a debate, the board not only kept the ban but expanded it to cover investments made by external managers. Three directors dissented from that decision.

Calpers had $366 billion in assets as of Thursday. The fund was $139 billion short of what it needs to fulfill its liability as of June 30, 2017, the latest figure available.

Anti-divestment sentiment gained more momentum in 2017 as new Calpers Chief Executive Marcie Frost cautioned against new divestments during a tour of newspaper editorial boards in California. In 2018 the Calpers board resisted calls to sell more gun-company shares following a deadly high-school shooting in Parkland, Fla.

"Divestment limits our investment options," Ms. Frost said. "With a targeted return of 7%, we need access to all potential investments across all asset classes. Divesting does the exact opposite—it shrinks the investment universe."

The board now plans a comprehensive review, scheduled for 2021, of all of Calpers' existing divestment policies, which include bans on investments in companies that mine thermal coal, manufacturers that make guns illegal in California and businesses operating in Sudan and Iran. Directors have stated a preference for "engagement," meaning direct communication with portfolio companies.




New York State Comptroller Thomas DiNapoli is opposing a bill that would ban fossil fuel investments from the state pension fund. PHOTO: MARY ALTAFFER/ASSOCIATED PRESS

Leading the internal opposition to divestment is Mr. Perez, a Corona, Calif., police sergeant who decided to run in the 2018 Calpers board election because of frustrations with the pressures pension costs were putting on his department. He handily unseated the board president after promising to keep politics out of pensions.

"It's not that I'm pro-tobacco or pro-firearms or pro-private prisons or pro-fossil fuels," Mr. Perez said. "I'm anti limiting our pool."

This year, the Calpers board opposed two more divestment bills in the California Legislature—one involving private prison companies and a second for companies tied to Turkey in protest of that country's lack of recognition for the Armenian genocide. In both cases it voted down motions to take a neutral position on the legislation.

Many California lawmakers are now wary of pushing Calpers to sell investments based on principle, said Democratic state Assemblyman Freddie Rodriguez, head of the Public Employment and Retirement Committee.

"I could give it a little more consideration if we were a fully funded system," Mr. Rodriguez said. "I think the word is getting out year after year that these bills are not going to have a lot of luck."

California Assemblyman Rob Bonta, a Democrat and the sponsor of the private prisons bill, hopes to find enough allies to get the divestment measure approved by January. "I believe we should be investing in things that represent our values," he said.

Write to Heather Gillers at heather.gillers@wsj.com

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**Questions for the Record**

**Chair Carolyn B. Maloney (NY-12)**

**Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets hearing entitled: "Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social, and Governance Disclosures"**

**July 10, 2019**

Answers by Mindy S. Lubber, CEO and President, Ceres

**Question #1: Some people claim that SEC rules on ESG disclosures aren't necessary because companies would *already* be disclosing information on ESG issues if those issues were "material" to investors. But if the SEC doesn't mandate ESG disclosure, is it really possible for investors who believe ESG disclosures are material to force companies to make these disclosures? Aren't there serious limitations to the enforcement mechanism for "material" disclosures?**

1. In answer to the first question, if the SEC does not mandate ESG disclosures, it is not possible for investors to receive adequate disclosures of material ESG issues from companies. Ceres has recently studied this issue, analyzing how well the 476 largest companies of the Forbes Global 2000 disclose and perform on five indicators valued by investors: disclosure standards, board oversight of ESG, materiality assessment, stakeholder engagement, and external assurance.[1] The report found that companies are beginning to provide decision-useful ESG disclosures, but the maturity of their disclosure systems and the rigor of these disclosures are still evolving. Specifically:

- Only 15 percent of companies in the report provided strong disclosure of the role of the board in overseeing sustainability, including evidence of formal board mandates for sustainability and disclosure of how relevant environmental and social issues are discussed at the board level.

- Only 23 percent provided detailed disclosure of materiality practices, including evidence of how the results are then used to inform strategic decision-making.

[1] *See* Ceres, *Disclose What Matters: Bridging the Gap Between Investor Needs and Company Disclosures on Sustainability* (August 15, 2018), *available at* https://www.ceres.org/resources/reports/disclose-what-matters-bridging-gap-between-investor-needs-and-company-disclosures?report=view.



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- Some 58 percent provided no evidence of formal assurance of sustainability disclosures. Less than 10 percent provided third party verified disclosures with some recommendations for improvements.

The case of climate change-related disclosures provides a good illustration of the challenges investors face absent mandatory disclosure. For more than two decades, investors have sought improved climate disclosures through voluntary reporting mechanisms, while also working to improve the quality of these disclosures in financial filings.

While this has produced significant improvements in voluntary reporting from some companies, as well as improvements in the quality of climate disclosures in financial filings from some companies, most climate disclosures in SEC filings remain inadequate. The main reasons for this are the lack of specificity from the SEC about how companies should assess and disclose material climate risks, and the lack of attention to the issue—specifically, staff comment letters that address climate risks—from Division of Corporation Finance staff. SEC rulemaking is required for investors to receive comparable, consistent and robust disclosures of material climate risks.

The SEC's 2010 interpretive guidance on climate-related disclosure was a helpful first step to address this problem, and it led to a jump in the percentage of S&P 500 companies that reported climate risks in SEC filings, from 45 percent in 2009 to 56 percent in 2010. In 2010 and 2011, SEC staff issued 49 comment letters to companies in cases where their disclosure was inadequate.[2]

But implementation of the guidance has been highly subject to the priorities of the SEC Chair and the Head of the SEC's Division of Corporation Finance. Today the SEC is doing very little to ensure companies disclose material climate risks and opportunities. A search for SEC comment letters asking issuers to improve their climate-related disclosure in Commission filings reveals only one such letter from January 2017 to the present, to the company FLEX LNG Ltd.[3] In July 2016, 45 investors representing $1.1 trillion in assets under management issued a letter, noting that in regard to climate change, "existing SEC rules have not, as applied by the Commission to date, produced sufficient information for investors to evaluate material risks, which we believe are becoming increasingly significant to companies in multiple sectors."

A 2014 Ceres report[4] examined climate disclosure in 10-K filings by S&P 500 companies from 2009 to 2013. If climate disclosures were identified in a 10-K filing, it was scored in a range from

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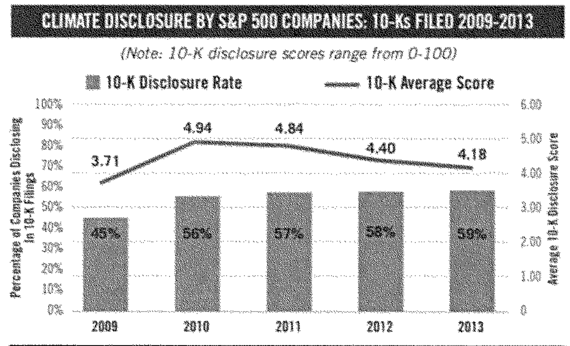
[2] https://www.ceres.org/resources/reports/cool-response-sec-corporate-climate-change-reporting.

[3] https://searchwww.sec.gov/EDGARFSClient/jsp/EDGAR_MainAccess.jsp?search_text=%22climate%20change%22&sort=Date&formType=FormUPLOAD&isAdv=true&stemming=true&numResults=10&numResults=10. Search performed on September 26, 2019.

[4] https://www.ceres.org/resources/reports/cool-response-sec-corporate-climate-change-reporting.

0 to 100, with the best disclosure over the study period being assigned a score of 100. All other disclosures were calibrated against this standard, and no disclosure received a score of 0. The average disclosure score for 10-Ks filed in 2013 was less than 5 out of 100 points for companies that disclosed climate issues:




Other articles have discussed the low quality of climate-related disclosure in SEC filings.[5] A detailed analysis of the quality of disclosure from 2009 to 2014 also provided discussion of roadblocks to improved disclosure that may help legislators craft the most effective legislation to require climate disclosure in SEC filings.[6]

To address this deficiency in SEC filings and in securities filings worldwide, some of the largest financial firms, corporations and investors worldwide have worked together for the last four years, as members of the Financial Stability Board's (FSB) Task Force on Climate-related Financial Disclosures (TCFD), to create globally applicable guidelines for climate-related financial disclosures.[7] The TCFD was created because G20 nations asked the Financial Stability Board to study how to improve climate risk disclosure in financial filings worldwide.

The TCFD has been an important factor in elevating this issue on the agendas of companies and governments in the last four years. The TCFD's 2018 and 2019 status reports on progress by companies are helpful resources to lawmakers for understanding the deficiencies in current disclosure.[8]

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[5] https://www.law.georgetown.edu/environmental-law-review/blog/leaving-investors-in-the-dark-the-secs-growing-silence-on-guidance-related-to-the-business-and-legal-developments-on-climate-change/; https://thehill.com/opinion/energy-environment/459258-investors-need-to-know-about-climate-risks.

[6] Alan R. Palmiter, William T. Wilson, III Presidential Chair For Business Law, Professor Of Law, Wake Forest University - School of Law, *Climate Change Disclosure: A Failed SEC Mandate*, Aug. 5, 2015 (revised Mar. 15, 2017), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2639181.

[7] https://www.fsb-tcfd.org/publications/.

[8] https://www.fsb-tcfd.org/publications/.

The TCFD 2019 Status Report discusses the requirement in most G20 countries to disclose material climate risks in financial filings, and the state of this disclosure:

> The Task Force recommends that preparers of climate-related financial disclosures provide such disclosures in their mainstream (i.e., public) annual financial filings. In most G20 jurisdictions, companies with public debt or equity have a legal obligation to disclose material information in their financial filings—including material climate-related information. The Task Force believes climate-related issues are or could be material for many companies, and its recommendations should be useful to companies in complying more effectively with existing disclosure obligations.[9]
>
> . . . As described in its 2017 report, the Task Force recommended that preparers of climate-related financial disclosures provide such disclosures in their annual financial filings. However, the Task Force also recognized that reporting practices would evolve over time, with more climate-related information moving into financial filings. To better understand whether more companies are including climate-related information in their financial filings, the Task Force asked survey respondents that identified as preparers where they disclosed this information for fiscal years 2016, 2017, and 2018. *Sustainability reports continue to be the dominant location of climate- related financial disclosures; however, preparers increasingly include such information in their financial filings, annual reports, and integrated reports*, as shown in Figure 55.[10] (emphasis added)

The TCFD's 2019 status report also discusses efforts by governments and regulators to improve climate disclosure[11], including:

- Climate disclosure recommendations, reports or statements from the EU, IOSCO, International Association of Insurance Supervisors, the UK's Financial Conduct Authority (FCA), the Bank of England Prudential Regulation Authority (PRA), and the Network for Greening the Financial System (NGFS), a group of 36 central banks and supervisors and six observers from international organizations which "has stated that the TCFD recommendations could be a possible solution for a global standardized framework on climate-related reporting."

- Climate disclosure workshops or workstreams by governments in France, Japan, Canada, Belgium and Sweden.

In the U.S., financial regulators have recently taken important steps to begin analyzing and addressing climate risks to corporations, investors and the economy:

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[9] Task Force on Climate-related Financial Disclosures, *2019 Status Report* (June 2019) at 3.

[10] Id. at 54.

[11] Id. at 113-116.

- In March 2019, the Federal Reserve Bank of San Francisco released an Economic Letter discussing the role of the Fed with regards to climate change[12] and will hold its first conference on the economic effects of climate change in November.[13]

- The CFTC announced in July 2019 that it will form, this fall, a Climate-Related Market Risk Subcommittee "to identify and examine the risks that climate change poses to the stability of our financial system, and determine what future actions policymakers and market participants must consider to mitigate these risks."[14]

- In September 2019, the New York Department of Financial Services (DFS) became the first U.S. state banking regulator to join the Network for Greening the Financial System (NGFS), an international coalition of nearly fifty bank supervisors dedicated to mobilizing the financial industry to address climate change.[15] The DFS also joined the Sustainable Insurance Forum, an international network of insurance supervisors seeking to find collaborative ways to help the global insurance industry meet the challenges posed by climate change.[16]

The SEC's lack of recent action related to climate risks is particularly troubling in contrast to these initiatives by governments and financial regulators both in the U.S. and in other countries.

2. In answer to the second question, we believe there are serious limitations to the SEC's enforcement mechanism for "material" disclosures.

The July 2016 investor letter discussed above noted that staff at the SEC have issued very few comment letters about the inadequacy of current climate risk disclosures, and have not "pursued enforcement actions for failure to meet disclosure requirements, despite a very active financial risk and disclosure enforcement agenda in other areas." Ceres' reviews of climate-related comment letters have shown some companies disagreeing with staff comment letters focused on climate disclosure (and not taking action to improve their disclosures), leading staff to cease back and forth with companies, through the comment letter process, in order to improve the disclosure.

Several firms have analyzed SEC comment letters but found no letters focused on climate change. Deloitte's *A Roadmap to SEC Comment Letter Considerations, Including Industry*

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[12] https://www.frbsf.org/economic-research/publications/economic-letter/2019/march/climate-change-and-federal-reserve/.

[13] https://www.energycentral.com/c/cp/fed-hosting-its-first-ever-research-event-dedicated-climate-change.

[14] https://www.cftc.gov/PressRoom/PressReleases/7963-19.

[15] https://www.dfs.ny.gov/reports_and_publications/press_releases/pr1909242.

[16] Id.

*Insights* (2018) does not mention any comment letter related to climate change.[17] EY's *SEC Reporting Update: 2018 trends in SEC comment letters* (2018) also mentions no comment letters related to climate change.[18]

Of equal concern, the total number of SEC comment letters has declined for four years, from a high of 2,712 letters in 2014 to 1,036 letters in 2018.[19] Another analysis found that the number of SEC comment letters and response letters from companies has declined for nine consecutive years.[20]

**Question #2: There are already a number of private-sector standard-setters that address ESG disclosures, such as the Global Reporting Initiative (GRI), and the Sustainability Accounting Standards Board (SASB). The benefits of these private-sector standards have been substantial and have helped develop and refine reporting standards that are relied on by investors representing trillions of dollars of investments around the globe. Do you think the SEC could build on all of the work done by these private-sector standard-setters in standardizing basic metrics for ESG disclosure? What would be the benefit of having *SEC-mandated* ESG metrics?**

1. In answer to the first question, the SEC could and should build on all of the work done by private sector standard setters in standardizing basic metrics for ESG disclosure. Different voluntary standard setters, including but not limited to GRI, CDP, SASB and IIRC, make substantial contributions to the reporting landscape. Yet, as the 2018 Ceres report *Disclose What Matters* demonstrated, (i) companies are not fully reporting to any one standard and (ii) disclosure of "investor relevant" information remains inadequate. Additionally, while most large companies provide some level of ESG disclosure, smaller companies largely do not yet report on their ESG performance.

To address this, SEC staff should, as a start, build upon the work done by the existing ESG disclosure standard setters and mandate disclosure to a few basic metrics that investors have identified as "decision useful". This will have the effect of broadening the tent of companies providing ESG disclosures as well as allowing for more robust disclosures on metrics that are most decision useful.

The SEC should begin by recognizing the robust processes private sector standard setters have in place for ensuring the quality of ESG disclosure metrics, which has resulted in steady improvement of metrics, over several decades in some cases. For example, the GRI standards

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[17] https://www2.deloitte.com/us/en/pages/audit/articles/a-roadmap-to-sec-comment-letter-considerations-including-industry-insights.html.

[18] https://www.ey.com/publication/vwluassetsdld/secreportingupdate_04322-181us_commentstrends_24september2018/$file/secreportingupdate_04322-181us_commentstrends_24september2018.pdf.

[19] Deloitte's *Roadmap* at 6.

[20] Audit Analytics, *A Look at Top SEC Comment Letter Issues in 2018*, available at https://blog.auditanalytics.com/a-look-at-top-sec-comment-letter-issues-in-2018/.

have resulted from more than 15 years of a robust, global multi-stakeholder development process. GRI's website discusses the role of the Global Sustainability Standards Board (GSSB), an independent standard-setting body created by GRI, its use of a "Due Process Protocol" for developing the standards.[21] It ensures that the GRI Standards "move through a clearly communicated process from project identification, prioritization and commencement through to content development, including public exposure and consideration of feedback received, concluding in the final release."[22] This includes a robust process for reviewing existing standards and creating new ones.[23]

SASB also has a robust standards development process. SASB follows a multi-year cycle—expected to be every 3-4 years—for its standard-setting process.[24] Changes to the standards occur through Updates which are based upon Technical Agenda setting informed by evidence-based research, stakeholder consultation, ongoing stakeholder engagement, proposed Updates and public comment—which are subject to independent oversight and public transparency.

Specifically, SASB has received 1,596 global and sector-specific comments on its draft standards, which covered 133 of the 248 proposed changes and other components of the Exposure Drafts. Comments were made on 66 of the 77 SASB industry standards. SASB staff has reviewed and summarized these comments for consideration by the Standards Board, as well as to provide transparency and public insight into the extent and nature of the comments.[25]

While it is beyond the scope of this response to mention all relevant private sector ESG disclosure standards and the processes they have in place to ensure the quality of their standards, it is important to mention several leading climate disclosure standards. Answers to the CDP's annual climate change questionnaire provide, in many cases, detailed, decision-useful climate disclosures from corporations. CDP organizes a public consultation[26] once per year to provide feedback on its draft questionnaires. The Climate Disclosure Standards Board has provided public consultation processes[27] to make improvements to its frameworks for reporting climate change and natural capital information, which are aimed at reporting in mainstream financial reports worldwide, including annual reports, 10-K filings and integrated reports.[28]

Finally, it is worth noting that some standard setters have a mission for their standards to respond to the needs of all stakeholders, while others are aimed more at investors. Both types

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[21] https://www.globalreporting.org/standards/questions-and-feedback/developing-the-gri-standards/.

[22] Id.

[23] https://www.globalreporting.org/standards/work-program-and-standards-review/.

[24] https://www.sasb.org/standard-setting-process/.

[25] Id.

[26] https://www.cdp.net/en/companies/consultation; https://6fefcbb86e61af1b2fc4-c70d8ead6ced550b4d987d7c03fcdd1d.ssl.cf3.rackcdn.com/comfy/cms/files/files/000/002/746/original/CDP_2020_Questionnaire_Development_Consultation_Briefing_Document.pdf.

[27] https://www.cdsb.net/climate-change-reporting-framework/updates-framework.

[28] https://www.cdsb.net/what-we-do/reporting-frameworks/environmental-information-natural-capital.

of reporting are valuable to investors and aligned with the element of the SEC's mission aimed at protecting investors. Reporting that is responsive to the needs of all stakeholders is particularly relevant at present, given the critical sustainability risks facing economies and the need to ensure corporations are not imposing burdensome externalities on these economies.

This was acknowledged by the August 19, 2019 Business Roundtable *Statement on the Purpose of a Corporation*[29], signed by 181 CEOs, which aims to redefine the purpose of a corporation to promote "An Economy That Serves All Americans."[30] Previously, beginning in 1997, the Business Roundtable issued periodic statements that endorsed principles of shareholder primacy--that corporations exist principally to serve shareholders--which were superseded by the new statement's change in focus to a broad group of stakeholders.[31] The *Statement* says, in part:

> [W]e share a fundamental commitment to all of our stakeholders. We commit to:
>
> - Delivering value to our customers. We will further the tradition of American companies leading the way in meeting or exceeding customer expectations.
>
> - Investing in our employees. This starts with compensating them fairly and providing important benefits. It also includes supporting them through training and education that help develop new skills for a rapidly changing world. We foster diversity and inclusion, dignity and respect.
>
> - Dealing fairly and ethically with our suppliers. We are dedicated to serving as good partners to the other companies, large and small, that help us meet our missions.
>
> - Supporting the communities in which we work. We respect the people in our communities and protect the environment by embracing sustainable practices across our businesses.
>
> - Generating long-term value for shareholders, who provide the capital that allows companies to invest, grow and innovate. We are committed to transparency and effective engagement with shareholders.
>
> Each of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities and our country.

2. In answer to the second question, the benefits of having SEC-mandated ESG disclosure metrics include comparable, consistent and robust disclosure. This quality of disclosure cannot

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[29] https://opportunity.businessroundtable.org/ourcommitment/.

[30] https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.

[31] Id.

be achieved through voluntary reporting, as most companies pick and choose which metrics they decide to disclose, and many choose or create differing methodologies for calculating quantitative metrics.

Investors have advocated for SEC-mandated ESG disclosure metrics in petitions and letters to the SEC, among their other efforts. On October 1, 2018, 64 investors, associated organizations and securities law specialists representing more than $5 trillion in assets under management petitioned the SEC for ESG disclosure rulemaking.[32] The petition:

- Calls for the Commission to initiate notice and comment rulemaking to develop a comprehensive framework requiring issuers to disclose identified environmental, social, and governance (ESG) aspects of each public-reporting company's operations;
- Lays out the statutory authority for the SEC to require ESG disclosure;
- Discusses the clear materiality of ESG issues;
- Highlights large asset managers' existing calls for standardized ESG disclosure;
- Discusses the importance of such standardized ESG disclosure for companies and the competitive position of the U.S. capital markets; and
- Points to the existing rulemaking petitions, investor proposals, and stakeholder engagements on human capital management, climate, tax, human rights, gender pay ratios, and political spending, and highlights how these efforts suggest, in aggregate, that it is time for the SEC to bring coherence to this area.

In addition, investor responses to the SEC's 2016 *Concept Release – Business and Financial Disclosure Required By Regulation S-K* are particularly helpful.[33] Two examples of these responses illustrate the level of investor support for mandated metrics. A State Street Global Advisors letter to the Commission stated:

> Given our need as investors for information on companies' ESG practices, we request that the SEC consider requiring listed companies to enhance their ESG-related disclosures. We encourage the SEC to consider developing rules that would help companies:
>
> - Identify appropriate KPIs by industry and sub-sectors
> - Establish a common standard to measure the KPI
> - Introduce standardized reporting of KPIs on an annual basis[34]

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[32] Request for rulemaking on environmental, social, and governance (ESG) disclosure, Submitted by: Cynthia A. Williams, Osler Chair in Business Law, Osgoode Hall Law School; and Jill E. Fisch, Saul A. Fox Distinguished Professor of Business Law, University of Pennsylvania Law School (October 1, 2018), https://www.sec.gov/rules/petitions/2018/petn4-730.pdf.

[33] https://www.sec.gov/comments/s7-06-16/s70616.htm.

[34] Rakhi Kumar, Head Corporate Governance and Christopher McKnett, Head of ESG Investments, State Street Global Advisors, letter to SEC re: Concept Release – Business and Financial Disclosure Required By Regulation S-K (July 20, 2016), *available at* https://www.sec.gov/comments/s7-06-16/s70616.htm.

A CalPERS letter, in response to an SEC question[35] about line-item requirements to disclose sustainability or public policy issues, stated:

> There are some issues that are common to all firms (gender, diversity) and nearly all firms (impact of climate change). However, these issues manifest themselves differently in various sectors. Thus, we encourage line-item requirements for these cross-cutting issues, but with the caveat that the Industry Guides are updated to reflect the varying metrics the SEC is looking for per industry.
>
> Without mandatory reporting, as noted by Anne Simpson, Investment Director, Global Governance in her remarks to the Taskforce on Climate Related Risks, "Companies unwilling to report may harbor the most significant risks. Also, there is a concern by companies that they will face adverse reaction under litigation or reputation, if they disclose voluntarily ahead of other companies."
>
> As long as there is the mix of mandatory disclosure and industry specificity, we do not feel this would obscure understanding of financial condition.[36]

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[35] Securities And Exchange Commission, Concept Release No. 33-10064; 34-77599, Business And Financial Disclosure Required By Regulation S-K (April 13, 2016), question 217 (p. 213): "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?", *available at* https://www.sec.gov/rules/concept/2016/33-10064.pdf

[36] Douglas Hoffner, Interim Chief Executive Officer, California Public Employees' Retirement System, letter to SEC re: Concept Release – Business and Financial Disclosure Required By Regulation S-K (July 21, 2016) at 36, *available at* https://www.sec.gov/comments/s7-06-16/s70616.htm.

**Questions for the Record**

**Chair Carolyn B. Maloney (NY-12)**

**Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets hearing entitled: "Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social, and Governance Disclosures"**

**July 10, 2019**

Answers by Tim Mohin, Chief Executive, GRI

**Question #1:** In the Supreme Court's Citizens United decision, which opened the floodgates on unlimited political spending, the Court claimed that the government didn't need to restrict political spending by corporations because shareholders could police this political spending instead. The Court stated that any abuses could easily "be corrected by shareholders through the procedures of corporate democracy."

Of course, what the Court failed to note — or failed to understand — is that public companies don't have to disclose their political spending, which means that shareholders have no way of knowing what kind of political spending public companies are engaging in. In light of this, doesn't the political disclosure required by the Shareholder Protection Act just ensure that the mechanism that the Supreme Court thought existed when it decided Citizens United actually does exist? In other words, isn't this a modest step that even right-wing conservative scholars believe should be taken in order to allow shareholders to rightfully police political spending by public companies?

It is crucial that all stakeholders, including shareholders, have access to data to make informed decisions about a company or organization. Companies need to be accountable for their political spending, to show whether their political contributions are in line with their stated policies, goals, or other public positions (e.g., on climate change) and that they are not used to exert undue influence on the political process. The GRI Standards cover the issue of political spending (see GRI 415-1: "Total monetary value of financial and in-kind political contributions made directly and indirectly by the organization by country and recipient/beneficiary"[1]).

**Question #2:** As we've seen with the 2017 tax bill, companies often claim that they're paying much higher — or lower — taxes in foreign jurisdictions than they really are. The best way to force companies to own up to how much they're really paying in foreign taxes is to require companies to publicly disclose in their quarterly and annual SEC filings how much they pay in taxes in each foreign jurisdiction.

[1] https://www.globalreporting.org/standards/gri-standards-download-center/gri-415-public-policy-2016/

In addition to the public policy benefits of requiring country-by-country tax disclosures, would investors find this information valuable too? And why is this information important for investors — would it prevent companies from misleading investors about their true tax liabilities overseas?

There has been a growing call for increased corporate tax transparency from all stakeholders, including investors, governments, civil society organizations, media, and the public. Investors, in particular, see the existing lack of tax information as a source of potentially unrecognized risk.

Responding to such demand, GRI is launching a new reporting Standard on tax in December 2019[2]. This Standard includes disclosures on an organization's management approach, as well as country-by-country reporting of financial, economic and tax data. These disclosures will enable stakeholders to make more informed judgments about whether taxes paid align with where economic value is created and if an organization's practices are acceptable.

The investor community has been particularly engaged in the development process of the Standard. A 90-day public comment period on the draft saw more than 50% of respondent organizations come from the investment sector. These respondents directly manage assets worth in excess of $US 2.5 trillion globally, and inclusive of investments they represent, the total is an estimated $10 trillion [3].

Investors confirmed that at present they lack the disclosures necessary to assess the risks associated with corporate tax practices and inform their engagement and investment decisions. They expressed strong support for the principle of tax transparency and suggested that country-by-country reporting will better enable investors to assess and anticipate risks, including whether companies are seeking to generate profits by creating sustainable economic value through their core business activities or by pursuing tax avoidance strategies that may expose them to legal, financial, regulatory and reputational consequences[4].

Beyond value for investors, making tax data more widely accessible will help build stakeholder trust and benefit reporting organizations by reinforcing their community contribution as part of their sustainability impact, strategy, and performance.

**Question #3:** The Corporate Human Rights Risk Assessment, Prevention, and Mitigation Act would require public companies to both identify, and rank by severity, the human rights risks in their value chains. Why is it important for companies to not only identify, but also rank by severity, the human rights risks that they face? How would that help investors when they're making their investment decisions?

Companies have a responsibility to respect human rights, as established by the UN Guiding Principles on Business and Human Rights. This responsibility requires them to have in place policies and processes through which they can both know and show that they respect human rights in practice. This includes identifying and assessing any actual or potential adverse human rights impacts with which they may be involved, either through their own activities or as a result of their business relationships (Guiding Principle 18). Therefore, it is not only important for organizations to identify their human rights risks, it is their responsibility. Further, it is important to note that this responsibility applies to the

[2] https://www.globalreporting.org/standards/work-program-and-standards-review/disclosures-on-tax-and-payments-to-government/

[3] https://www.globalreporting.org/information/news-and-press-center/Pages/tax-transparency-investors.aspx

[4] https://www.globalreporting.org/standards/media/2215/gri-tax-standard-public-comments.xlsx

organization's activities and business relationships, not just to their value chains. Therefore, the Act should cover all of the companies' activities and business relationships.

With regard to ranking human rights risks by severity, the Guiding Principles state that "where it is necessary to prioritize actions to address actual and potential adverse human rights impacts, business enterprises should first seek to prevent and mitigate those that are most severe or where delayed response would make them irremediable," but they make clear that "business enterprises should address all their adverse human rights impacts" (Guiding Principle 24). Therefore, we believe that a literal ranking of human rights risks by severity is not needed and could be challenging for companies to draw up. The Act can simply require companies to identify their significant or most severe human rights risks.

**Question #4:** Publicly available disclosures about the human rights policies, practices, and impacts of public companies in the U.S. would allow investors and consumers to avoid inadvertently promoting or sanctioning human rights violations by purchasing raw materials, products, or shares from companies that engage in those practices. Without these disclosures about human rights practices, are investors essentially in the dark about which companies are the most exposed to egregious human rights violations?

Absolutely. Disclosures on human rights impacts are essential for any stakeholder, including investors who are increasingly pushing companies to improve their transparency. For example, in the U.S., investors filed 31 shareholder resolutions on human rights in 2018, most of them focused on supply chain standards, ethical recruitment, human trafficking, indigenous people, and weapons and the penal system[5].

GRI is currently updating the human rights-related Standards to align them more closely with the UN Guiding Principles on Business and Human Rights and the OECD Guidelines for Multinational Enterprises and Due Diligence Guidance for Responsible Business Conduct[6]. They will include disclosures on an organization's:

- policy commitment to respect human rights and how that is embedded throughout the organization;
- significant actual and potential negative human rights impacts with which it may be involved either through its own activities or as a result of its business relationships, including how these impacts have been identified and prioritized (based on their severity and likelihood – with the emphasis on severity);
- actions to prevent, mitigate and remediate the identified impacts.

These disclosures are being developed by a multi-stakeholder Technical Committee, including representatives from the Office of the United Nations High Commissioner for Human Rights (OHCHR) and the Organisation for Economic Co-operation and Development (OECD).

[5] https://www.ceres.org/news-center/blog/financial-filings-require-decision-useful-disclosure-human-rights

[6] https://www.globalreporting.org/standards/work-program-and-standards-review/review-of-human-rights-related-gri-standards/

**U.S. House Committee on Financial Services**
**Subcommittee on Investor Protection, Entrepreneurship and Capital Markets**

***Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social and Governance Disclosures***

July 16, 2019

Alyson Genovese – Director, North America Regional Hub – Global Reporting Initiative

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Thank you for the opportunity to answer clarifying questions to the record in the committee's hearing on "Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social and Governance Disclosures". These comments complement the testimony given by GRI's Chief Executive, Timothy J. Mohin, on 10 July 2019.

Please do not hesitate to reach out should further information be required.

**Question One: How do companies determine what ESG issues are material?**

Both financial and ESG disclosure rely on the concept of materiality to determine what must be disclosed. However, the application of this concept is different. In financial reporting, issuers must disclose information on the topics that could materially impact the finances of the organization. Topics that are material from an ESG perspective are often called "pre-financial" in that if they are not addressed they will likely have an impact on the company over the long-term. Companies that neglect to consider these issues often do so due to short-term considerations. Increasingly investors are seeking information about long-term risk disclosures through the application of the GRI Standards

The materiality methodology in the GRI Standards instructs issuers to "reflect the organization's significant economic, environmental and social impacts; or substantively influence the assessments and decisions of stakeholders." This includes impacts both within their organization and within their value chains. Companies determine their stakeholder group(s) to consider, shareholders and employees are understandably two of most important and frequent stakeholder groups cited by public companies.

Comparing this method to the concept of financial materiality, the major points of differentiation are inclusion of the "externalities" associated with an issuer's value chain and consultation with stakeholders. *However, like the concept of financial materiality, the GRI Standards deem it the responsibility of the organization itself to determine what topic is material enough to warrant disclosure and management.*

**Question Two: Do the GRI Standards include required disclosure on tax payments?**

Global discussion around tax transparency has gained momentum in recent years, with leading civil society groups, intergovernmental organizations, and investors calling for increased disclosure on corporate tax and payments to governments. Greater transparency can be one tool to help ensure public and stakeholder confidence that companies employ fair tax strategies and demonstrate their contributions to society in the regions where they operate. Research shows that greater transparency in tax is correlated with reductions in 'tax dodging' practices (such as base erosion and profit shifting) and this in turn leads to governments having more revenue to put towards development programs. Tax transparency is a key component of a global sustainable development agenda.

The draft standard was developed by a multi-stakeholder, expert Technical Committee appointed by the Global Sustainability Standards Board (GSSB), which is an independent board of directors that oversees the creation and management of the GRI Standards. GRI anticipates that this standard will be published for companies to use by Q1 2020. During the 90 day public comment period, 43% of the 85 submissions received – and 55% of the organizations represented – came from investment companies, who collectively manage assets worth in excess of 2.5 trillion US dollars globally. Investors are particularly interested in tax transparency as a way to reduce their exposure to risk stemming from the lack of information on tax practices.

It is important to note that the GRI Standard on Taxes and Payments to Governments will be a topic-specific Standard, i.e. that it will be applicable only to those companies for which the topic is determined as material. Organizations themselves determine their material topics in consultation with their relevant stakeholders, including but not limited to investors and employees.

**Question Three: How are the GRI Standards developed? Are businesses involved?**

Businesses are involved in all levels of GRI's governance structure.

While the Global Reporting Initiative manages the process and stewardship of the GRI Standards, the organization does not determine the content of the individual GRI Standards.

GRI Standards are created and managed by an independent board of directors that includes representatives from the business, investor, civil society, government and academic communities. The Global Sustainability Standards Board – or GSSB – has sole responsibility for setting the standards and represents a range of expertise and multi-stakeholder perspectives on sustainability disclosure. The GSSB operates under the GSSB Terms of Reference to oversee the development of the GRI Standards according to a formally defined Due Process Protocol. The GSSB works exclusively in the public

interest; all GSSB meetings are open to the public and available online. This process is overseen by the Due Process Oversight Committee (DPOC).

When the GSSB determines that a new topic should be considered for a new Standard, or an existing Standard should be reviewed for updating or removal, a Technical Committee is formed. The Technical Committee is made up of experts in the specific topic in question (e.g. Water, Taxes, Occupational Health & Safety) and diversity of experience. This approach enables us to produce universally-applicable and trusted reporting guidance. Representation from the following stakeholder groups must be considered: business, investors, civil society, labor, academia, governments and reporting practitioners.

**Questions for the Record**
**Chair Carolyn B. Maloney (NY-12)**
**Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets hearing entitled:**
**"Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social, and Governance Disclosures"**
**July 10, 2019**

To Mr. Degas A. Wright, CFA, Chief Executive Officer, Decatur Capital Management, Inc.:

**Question #1: The ESG Disclosure Simplification Act would direct the SEC to establish ESG metrics that public companies would be required to disclose. As an investor, what ESG metrics would you like to see the SEC establish? What are the most important ESG metrics to you and how does access to this information affect your ability to make the best investment decisions for your customers?**

As an investor, I would like to see the SEC adopt ESG metrics using a globally accepted sustainability reporting standard such as the Global Reporting Initiatives (GRI). I will use the GRI standards to identify the ten most important ESG metrics.

GRI 305 Emissions
GRI 303 Water and Effluents
GRI 402 Labor and Management Relations
GRI 405 Diversity and Equal Opportunity
GRI 406 Anti-Competitive Behavior
GRI 408 Child Labor
GRI 409 Forced or Compulsory Labor
GRI 412 Human Rights Assessment
GRI 414 Supplier Social Assessment
GRI 416 Customer Privacy

The inclusion of the above ESG metrics would allow investors to identify the impact of material events and trends on the long term firm performance. As these measures are applied across all listed firms, it would provide consistent information to investors. [1]

**Question #2: Would requiring companies to disclose the political spending that they *plan* to do in the upcoming year allow shareholders to better engage with public companies on the types of political spending that the shareholders find most objectionable — or the types of spending that the shareholders want to *encourage*?**

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The requirement for listed firms to disclose the political spending that they plan to do in the upcoming year would allow shareholders to measure the firm's anticipated political risk. The firm's political contributions are related to the firm's perceived political risk, therefore, the reporting of anticipated political contributions provides material information to shareholders. In addition, the disclosure of anticipated political contributions provides shareholders an opportunity to evaluate the beneficial impact of the contributions to reduce the firm's political risk.[2]

**Question #3: What is the *reputational* risk to a company and its investors when management decides to spend the company profits on political activity? Why is corporate political activity an important component of comprehensive ESG disclosure?**

The Center for Political Accountability, a nonpartisan public policy organization dedicated to transparent and responsible corporate political spending issued report for directors and executives on the reputational risk related to political spending. The report found that when a firm's political spending did not align with the firm's stated core values; the firm was exposed to negative media coverage and/or boycotts . Therefore, for dozens of U.S. companies, such political spending in recent years has led to unintended consequences, unwanted publicity and unanticipated risk. Therefore, corporate political activity is an important, material risk that should be disclosed to shareholders and investors.[3]

**Question #4: Why are public companies' current reporting on their tax liabilities is insufficient? Why do we need more granular information about how much companies pay in taxes in foreign countries?**

The current reporting of public companies on their tax liabilities is insufficient because the lack of country level detail does not allow investors to determine the extent, if present, of profit shifting. A study by the Principles of Responsible Investment (PRI), a United Nations supported organization, assessed the levels of corporate income tax disclosure at 50 large multinational companies in the healthcare and technology sectors. The study found insufficient explanation and data to test corporate commitments around avoiding profit shifting. Profit shifting is one of the primary methods to avoid the payment of taxes. Typically, corporations did not provide explanations regarding their operations in low tax jurisdictions where business operations were not apparent. The corporations' disclosures lacked any country level data on common economic activity indicators such as revenue, profits, employee numbers and taxes paid. The U.S. listed firms are required to report only foreign and domestic taxes.

Investors need more granular corporate tax information because the amount of corporate income tax a company pays is material to its profitability. Investors seek to understand the extent to which future cash flows are based on artificial tax structures. These artificial tax structures may be challenged in the future which will impact the firm's stock valuation.

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Furthermore, corporate tax avoidance activities, while perfectly legal, may suggest underlying regulatory or reputation risks

As an investor, it is important to know that the firm's tax practices of our portfolio companies can withstand stakeholder scrutiny and potential regulatory changes. As corporate tax regimes are reconsidered across countries to avoid revenue loss to tax avoidance, multinational companies will face increased pressure to defend their tax-related transactions and/or may see new forms of taxation applied. Also, if corporations disclose country by country tax rates, this will allow investors to determine the appropriate effective tax rate. Most corporations report their domestic effective tax rates in their quarterly reports which may not capture their global effective tax rate.

As investors, we have been unable to evaluate the full impact of tax avoidance risk given the lack of country by country tax reporting. By providing this detailed information, it will increase transparency and accountability. [4]

If there are any questions regarding my responses, please contact me for clarification.

[1] Global Reporting Initiative, GRI Standards 2018.

[2] Degas Wright, CFA. Decatur Capital Management, Inc. Written Statement to the U.S. House of Rep. Committee on Financial Services. Subcommittee on Investor Protection, Entrepreneurship, & Capital Markets. July 10, 2019.

[3] The Center for Political Accountability. "The Risks Companies Face When Their Political Spending and Core Value Conflict and How to Address Them." June 18, 2018.

[4] Wright

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**Question for the Record from Congressman Jim Himes for the Subcommittee on Investor Protection, Entrepreneurship and Capital Markets Hearing entitled "Building a Sustainable and Competitive Economy: An Examination of Proposals to Improve Environmental, Social and Governance Disclosures"**

***Wednesday, July 10, 2019 2:00 PM***

**Degas A. Wright, CFA, Chief Executive Officer, Decatur Capital Management, Inc.:**

**Mr. Wright, I have a bill, H.R. 1731, the Cybersecurity Disclosure Act, that requires that publicly traded companies to disclose if they have a cybersecurity expert on their board or indicate why cybersecurity expertise is not necessary due to other security steps taken by the company.**

**Mr. Wright, do you think that disclosure by the board of cyber expertise is a catalyst for causing the board to prioritize the cybersecurity by bringing it to the fore?**

The disclosure by the board of cyber expertise, specified in H.R. 1731, would prioritize cybersecurity, a material item for listed firms as identified by the Securities and Exchange Commission (SEC). The SEC published, Commission Statement and Guidance on Public Company Cybersecurity Disclosures [Release Nos. 33-10459; 34-82746] which specifies that:

*"A company must include a description of how the board administers its risk oversight function. To the extent cybersecurity risks are material to a company's business, we believe this discussion should include the nature of the board's role in overseeing the management of that risk.*

*In addition, we believe disclosures regarding a company's cybersecurity risk management program and how the board of directors engages with management on cybersecurity issues allow investors to assess how a board of directors is discharging its risk oversight responsibility in this increasingly important area."*

In addition, the cost of a cyber security breach, as identified by the SEC may cost a U.S. firm approximately, on average, $7.35 M, and this cost may not capture all of the related costs of such a breach.

We have found in our research that news on cyber security can be measured and this risk impacts the pricing of securities. We have found that those firms with positive cyber security media news compared to firms with negative cyber security news outperform one year later. Based on our research, we have found cyber security to be material item in making investment decisions.

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**Are there any changes that you would make to perfect H.R. 1731 to provide investors with useful information on a company's cybersecurity expertise?**

The one revision to H.R. 1731 is to expand the designated member to include employees of the reporting company that have expertise or experience in cybersecurity. The rationale is that the earlier SEC guidance, release No. 33-10459, clearly requires that the board of directors engage with the firm's management on cyber security issues:

If there are any questions regarding my response, please contact me for clarification.

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