US SIF
The Forum for Sustainable and Responsible Investment

September 18, 2014

Mary Jo White
Chair

Keith Higgins
Director, Corporation Finance Division
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Disclosure Effectiveness Review

Dear Chair White and Mr. Higgins:

US SIF: The Forum for Sustainable and Responsible Investment welcomes the opportunity to comment on the ongoing review of disclosure undertaken by your agency following the Commission-issued staff report to Congress on its disclosure rules for US public companies. The report, mandated by the Jumpstart Our Business Startups (JOBS) Act, offered an overview of Regulation S-K, which provides requirements for public company disclosure and the staff's preliminary conclusions and recommendations about disclosure reform. We welcome the chance to build on those preliminary recommendations as the Division of Corporation Finance reviews the disclosure requirements in Regulation S-K and Regulation S-X, which provides requirements for financial statements.

US SIF is the US membership association of investment firms and financial professionals engaged in sustainable, responsible and impact investing ("SRI"). Our members include more than 300 investment management and advisory firms, mutual fund companies, research firms, financial planners and advisors, broker-dealers, community investing institutions, non-profit associations, pension funds, foundations and other asset owners. For more information, see www.ussif.org.

This letter offers comments on several issues highlighted in the Disclosure Effectiveness Review, however, our primary concern is that this process does not result in a weakening or a rollback of corporate disclosure. We believe there needs to be more robust and effective disclosure, not less disclosure.

One of the key priorities for US SIF and its members is **enhanced reporting of corporate environmental, social and governance (ESG) information**. There is increasing demand from investors for corporate sustainability reporting, and many organizations and investment firms strongly support such disclosure. For example, US SIF, along with other US and global standard setting organizations, has supported ESG disclosure and reporting underscoring that ESG issues can pose material financial risks and opportunities to companies. The deep and expanding interest of mainstream investors in seeking ESG information to help them manage risk and protect shareholder value is demonstrated by the growth of the Principles for Responsible Investment (PRI) where assets under management by PRI investor signatories now stand at more than $45 trillion, up from $4 trillion in 2006.

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Additionally, endorsers of CDP, formerly the Carbon Disclosure Project, are urging companies to disclose greenhouse gas goals and plans to reduce emissions. The CDP's investor initiatives – backed in 2014 by more than 767 institutional investors representing an excess of $92 trillion in assets – gives investors access to information that supports long-term objective analysis. When investment firms such as Morgan Stanley, State Street, Goldman Sachs, Bank of New York Mellon and Alliance Bernstein publicly declare the importance of ESG issues in making investment decisions, we believe there is a compelling case to be made for such disclosure. Unfortunately, investor efforts to comprehensively incorporate ESG information into investment decisions have been hindered by a lack of comprehensive, comparable and reliable data. The primarily voluntary nature of corporate sustainability reporting means that the information available to investors remains inconsistent and incomplete.

In 2009, US SIF and its members requested that the SEC mandate corporate environmental, social and governance disclosure and that the Commission make ESG or "sustainability" reporting a top priority (*please see attached*). US SIF and our members have met with SEC Commissioners and staff on numerous occasions and have stressed the importance of ESG disclosure, among other issues.

We appreciate the opportunity to weigh in on - and help improve - the effectiveness of the disclosure system—an important issue for both investors and the public.

Objective of the Disclosure Effectiveness Review (hereinafter, "the Review")

The Report on Review of Disclosure Requirements in Regulation S-K submitted by the Corporation Finance staff stated that "*The goal is to comprehensively review the requirements and make recommendations on how to update them to facilitate timely, material disclosure by companies and shareholders' access to that information*."[1] We agree that a comprehensive approach that includes "reviewing and updating requirements on a wholesale basis, taking into account the appropriateness of substantive requirements as a whole as well as presentation and delivery issues" is preferable to a targeted approach.[2]

However, we offer the following five broad comments regarding the objective of this Review:

- <u>Engagement with Investors</u>: We urge the Commission to undertake a balanced Review and proactively seek input and participation from investors. It is our general impression that the process appears more focused on issuers than investors. The Commission should strive to hear directly from investors, including investors engaged in sustainable, responsible and impact investment.

- <u>Use of appropriate language</u>: We urge the Commission staff to be mindful and use caution to ensure that language used—or representations made—around the Review process do not diminish investor confidence in the process. Initial comments by staff to review *"…the costs and burdens on companies while continuing to provide material information and eliminate duplicative disclosures*"[3] and references to "*disclosure overload*" could lead to speculation that current disclosures are ineffective and that the review is focused solely on cutting back or

[1] "Disclosure Effectiveness," US Securities and Exchange Commission, accessed August 27, 2014, https://www.sec.gov/spotlight/disclosure-effectiveness.shtml.

[2] Securities and Exchange Commission, *Report on Review of Disclosure Requirements on Regulation S-K* (2013), 95-96.

[3] Keith Higgins, "Disclosure Effectiveness" (Speech, American Bar Association Business Law Section Spring Meeting, April 11, 2014), Securities and Exchange Commission, http://www.sec.gov/News/Speech/Detail/Speech/1370541479332#.U_43gfldWBI.

eliminating disclosure requirements to the benefit of issuers. Investors hope that the Review instead is focused primarily on stronger disclosure and the needs of investors.

- Inclusion of ESG and other risk-related issues: We recommend that the Review result in clear recommendations that take into account the broad-based needs of investors around environmental, social and governance issues and other risk-related topics. There are significant gaps in current disclosure practices, including a general lack of ESG reporting. Additional disclosures are needed, not fewer.

- No weakening of existing disclosures: US SIF strongly cautions against weakening any existing disclosures. While there may be opportunities to eliminate duplication and streamline reporting and modernize technology to improve the way information is presented and delivered, we hope that the Review is focused on the needs of investors for better, more uniform disclosure.

- No distraction from completing Dodd-Frank rules: The staff reported that a comprehensive review of disclosure effectiveness would likely be a long-term project involving significant staff resources across the Commission. We hope that this endeavor can be undertaken without detracting from the ongoing rulemaking duties of the agency, particularly the long-delayed implementation of rules required under Dodd-Frank concerning Section 953(b) on pay ratio disclosure and Section 1504 on disclosure of payments by resource extraction issuers.

- Consideration of the context of disclosures: There is a great deal of financial information for which reporting is required, and in our experience, investors use this information to assemble a picture of the value of the enterprise issuing the security. Rarely are single bits of information used in isolation. Yet when it comes to ESG information, judgments as to the materiality or relevance of such information is often judged exactly that way: in isolation. We urge the Commission to be open to the possibility that the quality of management, one of the key indicators of value, is best judged by assembling a full picture of how the corporation manages risks and opportunities, including environmental and social ones.

In the Report, the Commission identified several specific areas of Regulation S-K that could benefit from review. The following are areas of particular interest to US SIF:

1. **Risk-related requirements**

If the Commission is conducting a review of risk-related disclosures, we encourage that the review be conducted in order to *improve* the disclosures and to identify whether different risk-related disclosures should be required.

ESG Disclosure - In 2009, US SIF and its members provided comments to the SEC requesting mandatory corporate environmental, social and governance disclosure and making ESG or "sustainability" reporting a top priority (please see attached). In this letter we proposed two components for such disclosure. The first requested that the SEC require issuers to report annually on a comprehensive, uniform set of sustainability indicators comprised of both universally applicable and industry-specific components. The second asked that the SEC issue interpretative guidance to clarify that companies are required to disclose short- and long-term sustainability risks in the Management Discussion and Analysis (MD&A) section of the 10-K. Since then, US SIF and its members have met with SEC Commissioners and staff on numerous occasions and have stressed the importance of ESG disclosure, among other issues.

Additionally, there have been several recent important developments related to ESG disclosure:

- In March, Ceres, a non-profit organization, published the **Investor Listing Standards Proposal: Recommendations for Stock Exchange Requirements on Corporate Sustainability Reporting**. Prior to this release, three exchanges, including NASDAQ OMX, urged members of Ceres' Investor Network on Climate Risk to reach agreement and provide clarity on a unified sustainability disclosure standard that could be adopted by all stock exchanges. This proposal, the result of multi-year dialogues between institutional investors and stock exchanges around the world, includes a set of investor recommendations focused on corporate sustainability disclosure. Investors proposed three items of disclosure for all exchanges to consider:

    1. A "materiality" assessment disclosed in annual financial filings for management to discuss its approach to determining the company's material ESG issues;
    2. Specific ESG disclosure on a "comply and explain" basis for about **10 key ESG topics**, in the format and location of a company's choosing;[4]
    3. A hyperlink in annual financial filings to an ESG Disclosure Index (a table or spreadsheet), based on the Global Reporting Initiative Content Index or its equivalent, indicating where existing information can be found.

- On April 15, the European Parliament adopted the Non-Financial Reporting Directive which requires corporate reporting for certain large companies and groups. Companies concerned will need to disclose information on policies, risks and outcomes regarding environmental matters, social and employee-related aspects, respect for human rights, anti-corruption and bribery issues, and diversity in their board of directors. In particular, large public-interest entities with more than 500 employees will be required to disclose certain non-financial information in their management report. This includes listed companies as well as some unlisted companies, such as banks, insurance companies, and other companies. The Directive includes approximately 6,000 large companies and groups across the European Union.

- On March 5, 2014, the Toronto Stock Exchange and the Chartered Professional Accountants of Canada issued a new publication that provides guidance on environmental and social disclosure, A Primer for Environmental & Social Disclosure. The primer discusses principles for environmental and social business conduct, mandatory disclosure requirements, developments in key performance indicators and other global initiatives to advance ESG disclosure.

- In December 2013, KPMG, the United Nations Environment Programme (UNEP), Global Reporting Initiative (GRI) and the Centre for Corporate Governance in Africa at the University of Stellenbosch Business School produced the third edition of *Carrots and Sticks: Sustainability reporting policies worldwide – today's best practice, tomorrow's trends* covering 45 countries

[4] The Proposal recommends that every company should disclose information on the following 10 ESG categories, using a "company or explain" approach for each category: 1. Governance and Ethical Oversight, 2. Environmental Impact, 3. Governmental Relations and Political Involvement, 4. Climate Change, 5. Diversity, 6. Employee Relations, 7. Human Rights, 8. Product and Service Impact and Integrity, 9. Supply Chain and Contracting, and 10. Communities and Community Relations. See Investor Listing Standards Proposal, Ceres (2014).

and regions and 180 sustainability reporting policies and initiatives. The report highlighted some of the major developmental trends in sustainability reporting, including the following:

- ✓ a continued and growing interest in regulation;
- ✓ an increase in the number of countries becoming involved in the sustainability reporting policy arena, including developing countries;
- ✓ a growing reference to existing sustainability and reporting frameworks and the continued emergence of new frameworks;
- ✓ sustainability reporting becoming a listing requirement on several stock exchanges in non-OECD countries; and
- ✓ request from the United Nations to governments to stimulate sustainability reporting by developing best practices and smart regulations, among other developments.

One of the key findings of the *Carrots and Sticks* Report was that the gradual integration of organizational performance data is on the rise, with attempts to combine corporate governance, financial and sustainability reporting, and that it is likely that more governments will issue sustainability reporting policies. The Report found that corporate reports will increasingly focus on sustainability issues that are material for stakeholders and investors. By doing so, these reports provide the most accurate and relevant view of organizations' sustainability performance and impacts.

Climate Change

Four years after the SEC issued guidance on climate change disclosure through release Nos. 33-9106, 34-61469 and FR-82 Commission Guidance Regarding Disclosure Related to Climate Change, we are concerned that the guidance has had little effect. According to a recent article, roughly half of the 3,000 biggest publicly traded companies in the US did not report on climate change disclosure in their annual filings. The article states that the guidance was not a game changer: while the number of companies mentioning climate risks in their 10-Ks has increased, according to Ceres, the disclosures have actually become less specific in recent years.[5] Additionally, there appears to be a stark difference between what companies are reporting to CDP and what they are reporting in SEC filings, according to reports from CDP and Ceres.

The SEC climate guidance, which focused exclusively on current conceptions of materiality, has arguably not been followed. There is a more significant gap, however, between investor needs and actual mandated climate disclosure. CDP, an independent not-for-profit organization working to drive greenhouse gas emissions reduction and sustainable water use by business and cities, has an investor initiative which is now backed by more than 767 institutional investors representing an excess of $92 trillion in assets.[6] In 2010 when the SEC issued its climate guidance, CDP was backed by 534 institutional investors with a combined $64 trillion in assets under management.[7] This stunning growth suggests that investors need more than basic MD&A climate risk disclosure. The CDP survey also includes actual emissions reporting, policies, procedures, management systems, relevant lobbying activities, etc. We

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[5] Tom Randall, "Is Climate a Material Risk? Here's What Companies Are Really Reporting," *Bloomberg*, June 30, 2014, http://www.bloomberg.com/news/print/2014-06-30/is-climate-a-material-risk-here-s-what-companies-are-really-reporting.html.

[6] "CDP Investor Initiatives," CDP, accessed August 25, 2014, https://www.cdp.net/en-us/whatwedo/pages/investors.aspx.

[7] "CDP Drives Forward Carbon Management Globally," *CDP*, February 17, 2010, https://www.cdp.net/en-US/News/CDP%20News%20Article%20Pages/CDP-drives-carbon-management-globally.aspx.

would urge the Commission to review the CDP surveys, which now cover water, forests and supply chains, in addition to climate, to identify additional line item disclosure requirements in this area.

We are also concerned that the requirement to disclose environmental liabilities of at least $100,000 under Reg. S-K Item 103 regarding environmental liabilities has been historically ignored by companies. In 1998, for example, a study by the EPA Office of Enforcement and Compliance Assurance ("OECA") found that 74 percent of publicly-traded companies had failed to adequately disclose the existence of environmental legal proceedings in their 10-K registration requirements.[8]

The rule, as written, only covers "potential" sanctions, "*unless the registrant reasonably believes that such proceeding will result in no monetary sanctions, or in monetary sanctions, exclusive of interest and costs, of less than $100,000 …*" An issuer can generally assert that it has a reasonable belief that any ultimate fine will be less than $100,000. Even if the issuer turns out to be incorrect, and a large fine is paid, however, the rule no longer applies as it only covers "potential" sanctions. In this case, nothing gets disclosed even if that reasonable belief turned out to be wrong. We believe that this runs counter to the original intent of the rule and can be easily fixed by either removing the clause beginning with "unless" or simply requiring the reporting of actual sanctions of $100,000 or more. This information is material to many investors' decisions as it may signal significant fines in the future or a generally lax culture of compliance at an issuer.

Corporate Political Spending and Lobbying Disclosure

Additionally, as part of necessary ESG disclosure, US SIF and its members have urged the Commission to proceed with rulemaking requiring disclosure of political spending information from public companies. Reflecting the intense investor interest in enhanced political spending disclosure, the rulemaking petition filed at the Commission on political spending disclosure by 10 prominent securities law professors has attracted a record level of support for an SEC rulemaking petition. Nearly one million comment letters have been submitted – the vast majority in support of increased disclosure. These comments, from individuals and institutions, including pension funds, State Treasurers, and other major investors, represent a diverse collection of voices united in their support for greater corporate political transparency. Disclosure of corporate political expenditures exposes whether a company is acting in a manner consistent with its business plan and public values. It can reveal legal, regulatory and business risks not otherwise apparent to investors.

Information about corporate political spending is a clear gap that investors are looking to their regulator to address. Requests by shareholders provide important insight into this demand. A 2014 report by Glass Lewis found that in 2013 resolutions relating to political spending of a company were the most common shareholder proposal put forth during the proxy season for the third consecutive year. Additionally, analysis of recent annual meetings shows that from 2011 to 2014, corporate political activity was the most popular topic for shareholder proposals.[9] From 2010 to 2014, investors filed 449 shareholder proposals calling for increased disclosure of company political spending or lobbying expenditures. Of the 285 proposals that came to a vote, the average vote in favor was 28 percent (30

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[8] The Rose Foundation for Communities and the Environment, *The Gap in GAAP: An Examination of Environmental Accounting Loopholes* (2003) at page 7. The authors state that the EPA study was conducted by Abt Associates Inc., Cambridge, Massachusetts, under Contract #68-W98-005, WA 1-07 and WA-2-07 but never formally released to the public. The EPA study was discussed by Nicholas Franco, in his paper "Corporate Environmental Disclosure: Opportunities to Harness Market Forces to Improve Corporate Environmental Performance" presented at the U.S. Environmental Protection Agency Conference on Environmental Law, Keystone, CO March 8-11, 2001.

[9] Information provided by Heidi Welsh of the Sustainable Investment Institute (Si2), August 27, 2014.

percent for election spending disclosure and 25 percent for lobbying disclosure). During that same time, 123 disclosure proposals were withdrawn because the companies reached an agreement with the filer to provide more information about the political activities. The average vote supporting disclosure for 2014 was 26.9 percent.[10] These figures demonstrate clear and ongoing demand from investors for this information. We infer from the voting results and the negotiated policy changes that there is strong agreement with the observation made in the initial rulemaking petition, which was submitted by a group of prominent law professors specializing in the areas of corporate and securities law, that: "*Absent disclosure, shareholders are unable to hold directors and executives accountable when they spend corporate funds on politics in a way that departs from shareholder interests*."[11]

Undisclosed corporate political spending can encourage behavior that poses legal, reputational and operational risks to companies and systemic risks to the economy. The Supreme Court has stated that complete real-time disclosure of public company political spending allows shareholders to "…*determine whether their corporation's political speech advances the corporation's interest in making profits*..."[12]

Corporations use treasury funds to make a variety of political expenditures, including direct contributions to state-level political candidates, political parties, judicial races, ballot initiatives, and a range of tax exempt entities such as trade associations and 527 organizations that engage in political activity. Corporations may also contribute funds to finance political advertising on public policy issues or to advocate for or against the election of particular candidates. These activities are subject to a variety of state and federal laws. But because there are no current rules that require that companies disclose this spending to their shareholders, it is essentially impossible for an investor to obtain a full picture of any individual company's political spending unless the company chooses to disclose. Without an SEC rule requiring full disclosure for all public companies, shareholders have no uniform means to monitor these activities, or assess the risks of corporate political spending. Voluntary disclosure has led to a patchwork of information that makes it impossible for investors to manage, and potentially mitigate, the full range of risks presented by corporate political spending. From an issuer's perspective, a disclosure mandate would level the playing field by relieving concern that disclosing activities could disadvantage the issuer's standing or competitiveness.

2. Requirements relating to a registrant's business and operations

Requirements for description of business and description of properties disclosure should be reviewed for continuing relevance in light of changes that have occurred in the way that businesses operate. While we support disclosing material facts about properties and any trends or uncertainties in connection with that property, we would caution against only disclosing material properties and eliminating requirements to list locations, capacity and ownership.

In order to properly evaluate the scope of a company's risks and opportunities, investors need a complete understanding of the scope of its operations and assets. For example, we have noted a trend among certain multinationals to dramatically limit the number of subsidiaries disclosed in the 10-K, presumably to deflect investor attention from subsidiaries maintained in known tax havens. According to one academic paper, "From 2009 to 2010, 98 percent of Google's and 99 percent of Oracle's subsidiaries disappeared from the Exhibit 21s filed with their SEC Form 10Ks. However, a March 2012

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[10] Ibid.

[11] "Committee on Disclosure of Corporate Political Spending – Petition for Rulemaking," August 3, 2011, 8 at http://www.sec.gov/rules/petitions/2011/petn4-637.pdf.

[12] Citizens United v. FEC, 558 U.S.(2010) Opinion of the Court at page 55. See: http://www.supremecourt.gov/opinions/09pdf/08-205.pdf.

search of available public company registries revealed that at least 65 percent of the missing subsidiaries remained active as of the companies' 2010 filing dates."[13]

These material omissions prevent investors from accurately assessing corporate structure and tax strategy and the attendant contingent liabilities, as well as exposures to political risks in these countries. The need to assess "significance" may also create unnecessary legal expenses for issuers. We recommend that the Commission:

- require disclosure of <u>all subsidiaries</u>, rather than only "significant" subsidiaries. Several commentators have pointed to the SEC's four-part test of "significance" as the reason for the recent trend of "vanishing" or undisclosed subsidiaries.[14]
- require disclosure of additional information for each subsidiary, such as profits earned and numbers of employees in each in order to provide investors with sufficient information necessary to understand the structure of the company and its international strategy. A subsidiary in a known tax haven with zero employees and billions in profits, for example, would signal to investors the use of a particularly aggressive and potentially risky strategy to hide profits from regulators.

The SEC's current test of "significance" for subsidiary disclosure was undoubtedly intended to produce the most material information to investors. In our view, however, this test is used to hide material information. Removal of the "significance" test, combined with the addition of a few key points of information for each subsidiary, would dramatically improve disclosure to investors without imposing additional burdens on issuers.

3. Corporate governance disclosure requirements

As noted above on our discussion on risk-related requirements, corporate governance disclosures are material to investors. Requirements for corporate governance disclosure should be reviewed to confirm that the information is material to investors. Disclosure should be presented in a manner that provides investors with effective access to material information and avoids boilerplate language.

4. Executive Compensation Requirements

The Report notes that executive compensation disclosure is sometimes pointed to by companies and practitioners as an area of lengthy, technical disclosure. However, we believe that full implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act would supply shareholders with valuable and appropriate disclosures that provide context for the compensation structure of the overall company and how it aligns with executive compensation policies.

In December 2013, US SIF sent a letter to the SEC expressing our strong support for the proposed rule to implement Section 953(b) of the Dodd-Frank Act. We fully support the disclosure of a CEO-to-worker pay ratio because this data benefits investors as well as other important stakeholders (such as employees). We highlighted three broad points: disclosure of CEO-to-worker pay ratio is material to

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[13] Jeffrey D. Gramlich and Janie Whiteaker-Poe, "Disappearing subsidiaries: The cases of Google and Oracle," *Social Science Research Network,* March 6, 2013, http://ssrn.com/abstract=2229576.

[14] Jessica Holzer, "From Google to Fedex: The Incredible Vanishing Subsidiary," *Wall Street Journal*, May 22, 2013, http://online.wsj.com/news/articles/SB10001424127887323463704578497290099032374?mg=reno64-wsj. The author states that vanishing subsidiaries are not the result of asset sales or corporate restructurings. Rather, companies say they are taking advantage of SEC rules that demand disclosure only when subsidiary operations are "significant."

investors; investors need this data in order to incorporate compensation practices into financial analysis; and the Proposal allows flexibility in how the median compensation of non-principal executive officer ("non-PEO") employees is calculated and allows issuers to provide this information without undue difficulty or expense. Therefore, in our opinion, arguments that the Proposal would be overly burdensome, that the data is too complex to assemble and verify, or that companies are not capable of tracking employee compensation adequately to compute median compensation are simply not valid.[15]

Our members take their proxy voting responsibilities seriously and strongly support transparency by companies to inform their investment decisions as well as voting their shares. We believe that the information sought through this rule will assist investors to exercise both responsibilities.

5. Other General Requirements included in Item 10

We would recommend that Form 8-K be amended to require issuers to break out proxy voting results to eliminate shares controlled by management in order to allow investors to easily determine the actual level of support for proposals by independent shareholders.

Conclusion

Thank you for taking our views into consideration and for the opportunity to comment. If you have any questions regarding the contents of this letter, please contact me directly at lwoll@ussif.org or 202-872-5358.

Sincerely,

Lisa N. Woll

Lisa N. Woll
CEO
US SIF and US SIF Foundation

cc: Rick Fleming, Office of Investor Advocate, SEC

Attachments:
US SIF Comment Letter on ESG Disclosure (2009)
Strategic Plan Letter

[15] US SIF comment letter to the SEC on CEO pay, December 2, 2013, http://www.ussif.org/files/Public_Policy/Comment_Letters/Comment_to_SEC_on_Proposed_Pay_Ratio_Disclosure_Rule.pdf.