PRI Principles for Responsible Investment

Secretary

Securities and Exchange Commission

100 F Street,

NE, Washington, DC

20549-1090

BUSINESS AND FINANCIAL DISCLOSURE REQUIREMENTS IN REGULATION S-K

INTRODUCTION TO THE PRI

The United Nations-supported Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment.

Responsible investment is an approach to investment that explicitly acknowledges the relevance to the investor of environmental, social and corporate governance (ESG) factors, driven by recognition in the financial community that evaluation of ESG factors is fundamental to assessing portfolio value and investment performance. Since 2006, over 1500 investors globally with USD$60 trillion in assets under management have signed the Principles, committing to including ESG factors in investment decision making, voting and engagement. The US is the PRI's largest market with 273 signatories and USD$33 trillion assets under management.

We set out below the response by the PRI Executive to the Securities and Exchange Commission (the "Commission") Concept Release No. 33-10064; 34-77599; File No. S7-06-16 (the "Concept Release"). We respond to questions throughout the Concept Release.

OVERARCHING RESPONSE

US securities laws were intended to ensure that investors have the information needed to understand a registrant's business and financial condition, and so make informed investment and voting decisions. ESG factors are increasingly recognized as an important part of investment decision making. Considering these factors is part of an investor's fiduciary duty.

Despite the growth in the number of investors considering ESG issues, current corporate disclosure is not meeting their needs. **PRI calls on the Commission to update Regulation S-K to ensure high quality, substance over-form disclosure of ESG factors.**

We further recommend that **the Commission adopt the term "ESG factors" to provide conceptual clarity around ESG disclosures to investors, and to differentiate these from voluntary reporting.**

In order to disclose ESG factors to investors, **PRI recommends that Corporate Disclosures;**

- **Include ESG factors in the annual report, with clear links between ESG factors and the company's business model.**
- **Assure ESG factors, consistent with financial data. We suggest a phased introduction.**

- **Report using common performance metrics to allow for comparability, in particular, comparability by industry, portfolio and across time-series. The Commission should codify industry and sector specific KPIs for ESG factors within Regulation S-K.**
- **Disclose additional company-specific ESG risks and opportunities.**

We encourage the Commission to read this submission alongside PRI, UNEP FI and The Generation Foundation's US roadmap (attached), which provides a pathway to full integration of ESG factors into investment decision making.

The PRI has experience in ESG regulation, guidance and implementation in a number of investment markets, and offers its expertise to support the Commission's consultation on business and financial disclosure requirements in Regulation S-K.

For further details contact policy@unpri.org.

BACKGROUND

Fiduciary duties require investors to take into account material environmental, social and governance factors ("ESG") into their investment decision-making processes.

This was clarified by the Department of Labor in its October 2015 Interpretive Bulletin to ERISA fiduciaries, which stated that ESG factors were part of the primary analysis of a prudent investment decision. Though directed at ERISA fiduciaries, we note that a significant proportion of US investors are influenced by or subject to fiduciary standards mapped out in ERISA and applicable guidance.

Credible, decision-relevant and comparable ESG information about investee companies is therefore necessary for investors to operate within the requirements of their fiduciary duties[1].

Current corporate reporting practice is failing to meet this need[2]. Despite this, the PRI finds increased demand for ESG information[3], with investors supplementing information from Commission filings with data obtained from third party data providers. Investor demand for ESG information is also indicated by the increase in voluntary reporting of ESG factors and other sustainability related disclosures by corporations.

The terms "non-financial", "ESG", "corporate social responsibility (CSR)" and "sustainability" reporting are often used interchangeably, including in the Concept Release, to refer to such reports. Although this information is in part due to increase in investor interest, it is often written for a broader stakeholder audience, not presented in the necessary context and reported with information unconnected with the core operations of the business. Different voluntary frameworks are used which adopt varying calculation methodologies and apply differing standards of materiality.

For this reason, we propose that the Commission adopt the terminology "ESG factors" to avoid confusion between these forms of reporting.

---

[1] See PRI, UNEP FI: Fiduciary Duty in the 21st Century:
www.unepfi.org/fileadmin/documents/fiduciary_duty_21st_century.pdf
See FSB Task Force, Phase 1 report, page 4: seven fundamental principles for effective disclosure:
https://www.fsb-tcfd.org/wp-content/uploads/2016/03/Phase_I_Report_v15.pdf
[2] See PRI/Accenture/UN Global Compact: The Investor Study
[3] See PRI: How Asset Owners Can Drive Responsible Investment: https://www.unpri.org/download_report/6385

Given the demand for this information from the investor community and the costs that issuers and investors are willing to incur in both producing and analyzing it, there is great value in the Commission assisting registrants in coordinating their disclosures around common performance metrics.

REQUEST FOR COMMENT 6, 7 AND 9:

6. Should we revise our principles-based rules to use a consistent disclosure threshold? If so, should a materiality standard be used or should a different standard, such as an "objectives-oriented" approach or any other approach, be used? If materiality should be used, should the current definition be retained? Should we consider a different definition of materiality for disclosure purposes? If so, how should it be defined?

7. Should we limit prescriptive disclosure requirements and emphasize a principles-based approach? If so, how? How can we most effectively balance the benefits of a principles-based approach while preserving the benefits of prescriptive requirements?

9. Do registrants find it difficult to apply principles-based requirements? Why? If they are uncertain about whether information is to be disclosed, do registrants err on the side of including or omitting the disclosure? If registrants include disclosure beyond what is required, does the additional information obfuscate the information that is important to investors? Does it instead provide useful information to investors?

The existing materiality standard used by the Commission is familiar to the investment community and ought to be maintained. The Commission should continue to use a mix of principles-based and prescriptive or rules-based disclosures.

We note that within individual industries there will generally be a set of KPIs and disclosure elements which represent uncontested matters of investor interest. As such, there should be an increasing focus on intra-industry KPIs to encourage comparability between registrant disclosures.

REQUEST FOR COMMENT 27:

27. Should we revise Item 101(a)(1) to require disclosure of a registrant's business strategy? Would investors find such a disclosure important or useful? If so, should this requirement be included in a registrant's MD&A? Should we define "business strategy"? If so, how?

Business strategy is central to a corporation's financial prospects. Given this, investors should have an understanding of a registrant's business strategy to enable an investor to interpret the information set out in filings with the Commission and assess the sustainability, in financial terms (including ESG factors), of the registrant's business model.

An assessment of the business strategy is important to be able to read in the context of the other forward-looking statements made by registrants in filings with the Commission such as at 303(a)(3)(ii) (*known trends and uncertainties*) in the MD&A. It is important for an investor to interpret management's understanding of its business in the context of the known trends and uncertainties relevant to its business-model. This is consistent with the European Union's *Non-Financial Reporting Directive*.

REQUEST FOR COMMENT 50 AND 51:

50. Is disclosure about the material effects that compliance with provisions regulating the discharge of

materials into the environment, or otherwise relating to the protection of the environment, may have upon a registrant's capital expenditures, earnings and competitive position important to investors? If so, should we require registrants to present this disclosure in a specific format? Would this disclosure be more appropriate in MD&A or the business section?

51. Should we require specific disclosure about the material effects that other regulations may have on a registrant's capital expenditures, earnings and competitive position? If so, are there specific laws and regulations that our rules should cover?

Disclosure of the material effects of compliance with environmental laws and their impact on a registrant's competitive position as required by item 101(c)(1)(xii) is of huge importance to investors. The relevance of this disclosure is not symmetrical across all industries – with extractive and carbon intensive industries having much greater exposure to these disclosures. However, it is vital that management have assessed this information and thoughtfully disclose against it to its investors. Across a range of industries, this information will increase in commercial importance given trends towards enhanced regulatory approach to environmental protection[4].

REQUEST FOR COMMENT 88, 103 AND 104:

88. What requirements in Item 303 are important to investors? How could Item 303 be improved?

103. Should we revise Item 303 to include a principles-based requirement for all registrants to disclose performance metrics and other key variables important to their business? Why or why not?

104. Should we require disclosure of any commentary, analysis, performance indicators or business drivers related to a registrant's key indicators? If so, why? For example, would it be feasible to adopt prescriptive requirements for discussion of specific performance metrics that are applicable to an entire industry and are easily comparable between registrants?

Management's discussion and analysis (MD&A) disclosures are designed to support investors to determine whether the company's past performance is indicative of future performance. Management should therefore demonstrate that they have considered the regulatory environment in which the company operates, the market for its products, their life-cycle and the resilience of its business model. ESG factors can, and do, influence all of the above.

To enhance the quality and usability of disclosures, the Commission should provide clarity that ESG factors should be considered, and require reporting of common performance metrics to allow for comparability, in particular, comparability by industry, portfolio and across time-series.

REQUEST FOR COMMENT 145, 152 AND 169:

145. How could we improve risk factor disclosure? For example, should we revise our rules to require that each risk factor be accompanied by a specific discussion of how the registrant is addressing the risk?

152. Should we require registrants to identify and disclose in order their ten most significant risk factors without limiting the total number of risk factors disclosed? If so, should other risk factors be included in a separate section of the filing or in an exhibit to distinguish them from the most significant risks? Alternatively,

[4] See http://www.unepfi.org/fileadmin/documents/PRI-FrenchEnergyTransitionLaw.pdf

should we require registrants to provide a risk factors summary in addition to the complete disclosure? Would a summary help investors better understand a registrant's risks by highlighting certain information? Are there challenges associated with requiring a summary of the most significant risks?

169. Should we require registrants to describe their risk management processes? If so, what level of detail would be appropriate? If a registrant has no formal risk management approach or process, should we require it to describe how it monitors and evaluates risk?

Registrants should avoid disclosure of boiler-plate risk factors in filings with the Commission. Registrants should be guided to prioritize their risk factors to enable investors to assess management's view of the key risks and vulnerabilities specific to its business and sector. A deliberative, specific and responsive approach is vital as it reflects the changing nature of the business environment in which the registrant operates.

For instance, liquidity may not have been a major risk factor for stable corporations in 2006 but would have been in 2008 during the financial crisis – a responsive and prioritized set of risk factors would acknowledge these critical changes in the business environment in registrant filings in real time.

Likewise, the Paris Agreement, agreed by representatives of 177 countries in December 2015, limits global average temperature well below 2 degrees Celsius above pre-industrial levels. In that context, a registrant should indicate how it is addressing its climate risk factors and describe its risk management processes.

REQUEST FOR COMMENT 216:

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

The Commission's disclosure framework provides for extensive disclosure in relation to ESG information, such as material contracts and availability of raw materials.

We note that the Commission's reporting framework has been subject to progressive expansion, reflecting the evolution in practices for the evaluation of corporate performance. The Concept Release notes that capital and liquidity reporting were added to the 10-K in 1980, disclosures against market risk based derivatives instruments were added in 1997 and off-balance sheet transactions were added in 2003. This information is considered core to understanding the registrant's business model, its vulnerabilities and prospects. Yet until recently was not subject to disclosure.

We consider that these expansions to the S-K reporting framework provide examples as to how the fundamental elements of assessing corporate performance and making informed investment and voting decisions changes over time. These changes respond to market developments, technological advances, analytic frameworks, exposed areas of corporate vulnerability and investor expectations.

As noted in our overarching response, disclosure of ESG information is directly relevant to the stated goals of US securities laws: providing investors with the information needed to understand a registrant's business and financial condition and make informed investment and voting decisions.

The existing structure of the S-K and the history of the Commission's reporting framework indicated that ESG information is not just a concern of "limited segments of the investing public", but is relevant to investors seeking to contextualize financial information on registrant companies. In this context, it is important to distinguish the disclosure of ESG information from "policy-driven" disclosure.

"Policy-driven" disclosures are intended to achieve a particular public policy requirement, which can overlap, but is not always the same as the disclosure of ESG information that is required by investors.

ESG information is requested so that an investor can form a rounded assessment of the operational performance and financial prospects of a registrant and to enable focused engagement by investors with the boards of registrant companies. The audience for these disclosures is typically different (general public, regulators) and they may not meet the SEC's materiality definition. We recommend that the Commission adopt consistent terminology – "ESG factors" – to avoid confusion.

The Commission provides for a common materiality standard for its disclosures and a mixture of principles-based and rules-based disclosures. This reflects the diversity of registrant companies disclosing within the framework, the asymmetry of relevance of particular types of information between registrants, and the tension between flexibility and comparability within any disclosure regime.

The PRI would like to clarify further that ESG information is not less relevant or less useful to an investor in assessing the financial prospects and operational performance of a registrant than the disclosures produced by conventional accounting practice. Such information is vital to contextualize and interrogate a registrant's financial performance.

Given this, the PRI calls on the Commission to update Regulation S-K to require companies to:

- **Include ESG data in the annual report, with clear links between ESG factors and the company's business model .**
- **Assure ESG data consistent with material financial data. We suggest a phased introduction.**

Material financial and ESG information are part of the same product and consequently should be delivered in the same wrapper and be subject to the same standards of rigor.

In this context, we note that ESG factors have proved a key ingredient in driving operational performance and financial prospects. A range of studies indicate that corporations with better ESG practices have a lower cost of capital – equity and debt – experience lower stock price volatility[5], show better valuations over the long-term and experience other business-upsides such as improved customer loyalty and lower employee turnover.

There is a significant case for such information, where it is material, to be incorporated within the S-K reporting framework. This will provide investors with information that a registrant's management considers material to an assessment of its overall business and financial circumstances. Incorporating this information within the S-K will help to ensure the continuing relevance and usefulness of the S-K reporting framework to investors.

[5] For example: http://www.arabesque.com/index.php?tt_down=51e2de00a30f88872897824d3e211b11

REQUEST FOR COMMENT 208, 211, 217, 219, 220 AND 223:

208. Should we include additional industry-specific disclosure requirements in Regulation S-K by codifying all or portions of the Industry Guides? What are the advantages and disadvantages of including industry-specific disclosure requirements in Regulation S-K versus retaining the Industry Guides?

211. The Industry Guides originally were intended to assist registrants, their counsel and accountants in the preparation of disclosure by publishing staff policies and practices related to staff review of registrant filings. Does the public release of the staff's comment letters and increased availability of tools that aggregate information about disclosure included in Commission filings and comment letters reduce the need for the Industry Guides as guidance for registrants?

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

219. In an effort to coordinate ESG disclosures, several organizations have published or are working on sustainability reporting frameworks. Currently, some registrants use these frameworks and provide voluntary ESG disclosures. If we propose line-item disclosure requirements on sustainability or public policy issues, which, if any, of these frameworks should we consider in developing any additional disclosure requirements?

220. Are there sustainability or public policy issues for which line-item disclosure requirements would be consistent with the Commission's rulemaking authority and our mission to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation, as described in Section III.A.1 of this release? If so, how could we address the evolving nature of such issues and keep our disclosure requirements current?

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

In order to provide ESG information, and its ESG component, the PRI calls on the Commission to require companies to:

- **Report using common performance metrics to allow for comparability, in particular, comparability by industry, portfolio and across time-series. The Commission should codify industry and sector specific KPIs for ESG factors within Regulation S-K.**
- **Disclose additional company-specific ESG risks and opportunities.**

Disclosure requirements have to find a balance between comparability and flexibility. The materiality of ESG factors varies with sector, business model and operating practices. The metrics, discussion and analysis that are key to the assessment of a financial institution are not those that are core to the assessment of an oil and gas firm.

The Concept Release notes that industry specific reporting requirements have been a tool used by the Commission to maximize disclosure quality and generate comparable disclosures by registrants within a particular industry. It makes the process for preparing the 10-K more efficient for registrants. A refined set of industry-specific disclosures is more likely to be of use to the investment community.

We note that the Commission expects to take an incremental approach to adopting additional reporting elements. However, the trends in reporting ESG information are not new and ought not to be considered “in the nature of an experiment”. The volume of such reporting and investor demand for it indicates that it has become a core feature of information required by investors in assessing corporate performance.

The Commission has encouraged comparability in MD&A disclosures[6]. Registrants look for legitimation by industry peers in disclosure practices and will be strongly influenced by Staff Comment Letters relevant to their industry[7].

REQUEST FOR COMMENT 218:

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

The terms “non-financial”, “ESG” and “corporate social responsibility (CSR)” are often used interchangeably. Such reporting has in part been driven by increasing recognition that ESG factors are relevant to investors. However, historically, CSR has addressed a wide stakeholder audience, and has included information that may not be of relevance to a ‘reasonable’ investor. **We propose that the Commission adopt the terminology “ESG information” to avoid confusion between these forms of reporting.**

It is a growing practice for corporations to produce corporate social responsibility reports, and they do so for a variety of reasons[8]. Some of these disclosures duplicate information provided in Commission filings[9]. We do not seek to discourage the production of corporate social responsibility reports by corporations. For many investors, the impact of business operations on stakeholders are core to the analysis of the corporation. Often, however, these reflect corporations’ broad responsibilities to society beyond their shareholders.

Corporations should acknowledge and respond to the variety of stakeholders on whom they depend and to whom they should account – employees, suppliers, customers and the communities in which their products are produced, sold and disposed of. However, the Commission’s reporting framework is directed towards a registrant’s investors, for specific purposes and subject to a common materiality standard.

Housing a Corporate Social Responsibility report on a corporation’s website is not a substitute for timely and assured filing with the Commission disclosing material ESG factors for which the board can be held accountable.

[6] 2003 MD&A Interpretive Release
[7] It is important for driving comparability and disclosure quality that Staff Comment Letter remain public and are prepared with a view to encouraging comparability.
[8] Following corporate crisis or scandal, brand value enhancement, to secure employee loyalty, to better communicate with suppliers and other stakeholders, to develop corporate purpose as part of the brand.
[9] For example, disclosure of climate risk to the CDP Investor programme may duplicate climate risk disclosure via 10-K filings.

REQUEST FOR COMMENT 221:

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

Registrants can be subject to additional requests for ESG information from their investors and other organizations. The production and analysis of disclosures both have significant costs associated with them, particularly where the information produced has a low signal to noise ratio, is immaterial to an assessment of the business or generic in nature. There are significant efficiency-gains from developing a refined set of industry specific KPIs for the reporting of ESG information.

This may improve the quality of the information produced and create efficiencies in both its production and analysis. A core of industry-specific KPIs can then be supplemented by additional disclosures that management considers material and relevant to the business. This approach represents "smart disclosure" and may produce several efficiencies in both the production and evaluation of information set out in registrant filings.

REQUEST FOR COMMENT 53, 257 AND 258:

53. Foreign regulations, including foreign tax rates and treaties, may have a material impact on a registrant's operations. Should we specifically require registrants to describe foreign regulations that affect their business? If so, what specific information and level of detail should we require? How would any additional information inform investment and voting decisions? Would there be challenges for registrants to provide such disclosure?

257 Should we revise Item 601(b)(21) to eliminate the exclusions and require registrants to disclose all subsidiaries? What would be the benefits and challenges associated with this alternative?

258. Should we expand the exhibit requirement to include additional disclosure about the registrant's subsidiaries? What additional information would be important to investors and why?

An aggressive corporate approach to tax planning is a concern to investors as it can create earnings risk and lead to governance problems, damage reputation and brand value and cause macroeconomic and societal distortions. Aggressive tax planning is a key systemic risk that could have a serious effect on the profitability and sustainability of a company, as well as broader impacts on portfolio returns. The current lack of corporate disclosure does not allow for appropriate assessment of risks by investors[10].

Better disclosure on companies' tax practices should allow investors to understand how corporate boards identify tax related risks and respond to government and other stakeholders' expectations. It should also allow investors to identify a potential aggressive approach to tax planning. At a minimum, this requires companies to disclose meaningful information on the following areas:

- Their overarching **tax policy** and principles, **governance** and oversight frameworks, and **management systems** for tax-related risks.

[10] In 2013 the PRI convened a group of global investors to explore the issue of corporate tax planning and produce a guide on how to engage with investee companies on this topic. More information can be found here: https://www.unpri.org/download_report/8531.

- What drives the **gap between effective tax rate shown on income statement and the weighted average statutory rate based on the firm's geographic sales mix**.
- Explanation of the difference between the **foreign effective tax rate and the average statutory rate of the countries** where companies do business, particularly the key tax strategies employed and the risks of those strategies, including regulatory risks; currently, this figure is not explained within the tax footnote.
- An overview of what is driving **unrecognised tax benefit (UTB)** changes; UTBs display the tax positions being taken by companies that management believes are less than 50% likely to be upheld by a tax authority.
- Disclosure on **intracompany debt**, including the countries where the debt is held, the amount of intracompany debt, and the average interest rate paid by other subsidiaries on that debt.
- The most financially **material tax incentives** across jurisdictions; information on expiries of all incentives, investment requirements and commentary regarding the likelihood that such incentives will not be renewed should be provided.

In addition, investors need to understand an organization or corporate structure, the business nature of existing subsidiaries, as well as the overall approach to the use of secrecy jurisdictions. While increased disclosure will require more efforts and resources from companies, the information would provide more insight on corporate tax practices and would be valuable for investors. Therefore, it is recommended that the Commission ensures that its disclosure requirements are aligned with evolving international standards on country by country reporting (e.g. the OECD- Base Erosion and Profit Shifting project and relevant template for Country by Country reports). This would entail asking companies for:

- Additional information on revenues, taxes paid, FTE employees, net income and assets across all countries
- List of all the constituent entities included in each aggregation per tax jurisdiction.

CONTACT DETAILS

This submission was prepared by Will Martindale, Head of Policy, PRI and Brian Tomlinson, Associate Director, PRI and UNEP FI.

For further details email: policy@unpri.org.

The PRI's US Network Manager is Carol Jeppesen: carol.jeppesen@unpri.org.