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COMMENT

PRINCIPLES PLUS SASB STANDARDS

by Thomas L. Riesenberg

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Prof. Jill E. Fisch has authored an excellent piece about sustainability disclosure. Her proposal to mandate a new Sustainability Disclosure and Analysis section of SEC filings is an interesting idea for improving the disclosures that investors currently receive regarding such important matters as climate change, human capital, and a range of other issues. She also proposes that company management certify as to the accuracy of these disclosures, another step toward improved disclosure.

But it is likely the case that without significant tweaks, her suggestion would not improve the consistency and comparability of disclosures. This is because her proposal is principles-based, that is, issuers would decide for themselves the three most significant sustainability issues and then decide what to disclose about these issues.

Thus, for example, Company X, in the hotel industry, might disclose information about water use efficiency. Company Y, a competitor, might disclose data relating to employee retention. Company Z might address climate change. And even when two companies in the same industry disclose information on the same issue or topic, they might use different metrics in doing so.

This type of information would not result in comparability and consistency in disclosures. As Professor Fisch discusses, companies currently disclose considerable information about ESG matters, typically in documents known as corporate social responsibility reports. But numerous surveys and studies have shown, and outreach by the Sustainability Accounting Standards Board (SASB) has confirmed, that investors are dissatisfied with these disclosures because they are generally inconsistent and noncomparable between companies. SASB's researchers have found that most ESG disclosures consist of boilerplate disclosures—generic statements that are not specifically tailored to the individual company, the risks it faces, and the opportunities it might have. SASB found that vague, non-specific information was used more than 50 percent of the time when companies addressed a SASB topic in 2017.[1] Professor Fisch also acknowledges this problem; she describes "a lack of standardization that makes it difficult for investors to compare information across issuers."

Investors and corporate issuers both have expressed dissatisfaction with the current state. For example, a recent McKinsey study found that 85% of investors either agreed or strongly agreed that "more standardization of sustainability reporting" would help them allocate capital more effectively, and 68% of corporate executives either agreed or strongly agreed that standardization would enhance their company's ability to create value or mitigate risk.[2]

The lack of comparable, decision-useful information has also been shown to have negative long-term societal and economic impacts. For example, a company's investments in employee training, or health, or direct compensation can lead to lower dividends or reduction in short-term profitability, so companies might avoid making such expenditures. This is unfortunate, since those types of costs can create long-term value for shareholders and broader societal benefits. As Professor Fisch notes, ESG disclosures in the United States lag behind those made in Europe and elsewhere, largely because such disclosures are mandated in many non-U.S. countries. This means that the economic benefits accruing from more comprehensive and better disclosure also lag in the United States.

Professor Fisch concedes that a principles-based approach will likely lead to unsatisfactory results. She states: "Because each issuer's board determines the most significant sustainability issues independent, there is likely to be substantial variation among the issues addressed."

Why, then, does she opt for this approach? She believes that there is no adequate alternative, stating: "the applicability of any specific issue varies by issuer and industry" and that "the issues that arguably warrant disclosure and their importance continue to evolve." Thus, "designing a line-item series of disclosures to address sustainability is likely unworkable, and a principles-based approach appears more appropriate." Further, Professor Fisch believes that the problem will correct itself over time because of the SEC review process and reviews by industry participants: "This

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1. SASB, *The State of Disclosure: An Analysis of the Effectiveness of Sustainability Disclosure in SEC Filings* (2018), https://www.sasb.org/wp-content/uploads/2019/08/StateofDisclosure-Report-web112717-1.pdf?__hstc=105637852.135a89045bd6ea85f68591478e99eb09.1553809423920.1570492048390.1570494269935.17&__hssc=105637852.1.1570494269935.

2. McKinsey & Company, *More Than Values: The Value-Based Sustainability Reporting That Investors Want* (Aug. 2019). Likewise, a 2016 PwC survey on ESG found that only 29 percent of investors polled were confident in the quality of ESG information they were receiving and only eight percent of investors thought that existing ESG disclosures allow for comparison across companies and peers. PricewaterhouseCoopers, *Older and Wiser: Is Responsible Investment Coming of Age?* (2016), https://www.pwc.com/gx/en/sustainability/publications/assets/pe-survey-report.pdf. Numerous other reports and studies have discussed the general topic of the growing interest in better ESG disclosure. *See, e.g.*, Deloitte, *Heads Up: Sustainability Disclosure Goes Mainstream* (Sept. 24, 2019).

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review process is likely to generate common disclosure policies among issuers, particularly for those in the same or related industries," and "issuers will learn from and be able to emulate the disclosures made by their peers."

There is a much better answer to this problem. It is an answer addressed in some detail in a comment letter that SASB submitted to SEC in connection with its August 2019 proposed Regulation S-K amendment that would require issuers to include in their Form 10-Ks a "description of the registrant's human capital resources, including in such description any human capital measures or objectives that management focuses on in managing the business (such as, depending on the nature of the registrant's business and workforce, measures or objectives that address the attraction, development, and retention of personnel)." Rather than complying with specific human capital line item disclosure requirements, the issuer would make its own determination of material human capital issues that require disclosure—that is, the same sort of principles-based approach as that urged by Professor Fisch.

SASB's position is that a principles-based approach can work if it is coupled with a requirement that issuers use a common disclosure framework. Such frameworks have been developed by nonprofit organizations, in particular SASB and the Global Reporting Initiative (GRI). Professor Fisch mentions the existence of both organizations but does not link them to the success of her proposal.

SASB is an independent nonprofit organization established in 2011 to set standards for companies to use when disclosing ESG information to investors. SASB standards relate 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.

SASB takes an industry-specific approach to sustainability accounting, establishing standardized performance metrics for sustainability factors most relevant to companies in a given industry, driven by the concept of financial materiality. Generally speaking, financially material information is that which is important to a person making an investment or voting decision and which impacts the financial condition or operating performance of the company.

SASB published sustainability accounting standards for 77 industries in November 2018. Because not all matters of potential interest to investors are financially material, the average SASB standard contains six industry-specific topics and 14 associated performance metrics. A company that opts to use the SASB standards then decides whether the disclosure items contained in the SASB standards are in fact material for its particular business and, hence, warrant disclosure.

There are two aspects of SASB's work that merit emphasis. First, SASB is the only comprehensive, industry-specific set of ESG standards based on financial materiality. As Professor Fisch notes, SASB is focused on materiality as that term is understood by investors, that is, information that is important to an investor in making his or her investment or voting decision. There are some other private-sector standard setters that use this approach but do so only for a narrow range of issues, such as climate change. A broader set of standards has been developed by GRI, which has widespread global use but uses a broader definition of materiality and seeks to serve a set of interested parties beyond investors.[3]

Second, the industry-specific approach has been widely affirmed. With respect to SEC's human capital management disclosure proposal, SEC's Investor Advisor Committee recommended that "any [human capital disclosure] requirements should be crafted so as to reflect the varied circumstances of different businesses, and to eschew simple 'one-size-fits-all' approaches that obscure more than they add."[4] Similarly, in discussing human capital disclosures at the March 2019 Investor Advisory Committee meeting, Chairman Clayton stated: "Each industry, and even each company within a specific industry, has its own human capital circumstances. For example, I would expect that the material human capital information for a manufacturing company will be different from that of a biotech startup, and different from that of a large healthcare provider."[5] SASB's industry-specific standards correspond precisely to this aspect of human capital disclosures.

And SASB is receiving extraordinary acceptance. As of this writing, approximately 250 public companies are using the standards. And this is likely to increase rapidly over coming months and years. One reason is that investors are increasingly demanding more ESG information. A particularly significant event occurred in January 2020. In his widely-read annual letter to CEOs,[6] the chairman and CEO of BlackRock, Larry Fink, said that investors and others need a "clearer picture" of a wide range of sustainability-related matters and that "while no framework is perfect, BlackRock believes that the Sustainability Accounting Standards Board (SASB) provides a clear set of standards for reporting sustainability information across a wide range of issues, from labor practices to data privacy to business ethics." He said that BlackRock, the world's largest asset manager, wants companies it invests in on behalf of clients to publish disclosure in line with SASB's industry-specific guidelines before the end of 2020. BlackRock will use these disclosures to evaluate how well its investees are managing and overseeing ESG risks and planning for the future. "In the absence of robust disclosures, investors, including

3. GRI developed the first corporate sustainability reporting framework and its standards are used by the majority of companies reporting sustainability information. GRI's approach and that of SASB are complementary. As explained in an article authored by the heads of both organizations, "[t]he GRI standards are designed to provide information to a wide variety of stakeholders and consequently, include a very broad array of topics. SASB's are designed to provide information to investors and consequently, focus on the subset of sustainability issues that are financially material." Tim Mohin & Jean Rogers, *How to Approach Corporate Sustainability Reporting in 2017*, Greenbiz (Mar. 16, 2017), https://www.greenbiz.com/article/how-approach-corporate-sustainability-reporting-2017.
4. SEC Investor Advisory Committee, *Recommendation From the Investor-as-Owner Subcommittee on Human Capital Management Disclosure* 3, (Mar. 19, 2019), https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac032819-investor-as-owner-subcommittee-recommendation.pdf.
5. Jay Clayton, *Remarks for Telephone Call With SEC Investor Advisory Committee Members* (Feb. 6, 2019).
6. Larry Fink, Blackrock Dear CEO Letter 2020, *A Fundamental Reshaping of Finance*, https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

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BlackRock, will increasingly conclude that companies are not adequately managing risk." In those cases, BlackRock will seek to hold directors accountable. "Given the groundwork we have already laid engaging on disclosure, and the growing investment risks surrounding sustainability, we will be increasingly disposed to vote against management and board directors when companies are not making sufficient progress on sustainability-related disclosures and the business practices and plans underlying them."[7]

SASB's view, expressed in its comment letter on the human capital proposal, is that SEC should either strongly encourage or require companies to use a recognized framework for disclosure. This would improve Professor Fisch's proposal in at least three ways. First, corporate executives' discretion in what and how to disclose would be limited. This is because SASB's guidelines provide that a company using the SASB framework should use all the metrics applicable to that company's industry or, alternatively, to explain why it is omitting certain metrics.[8] This approach ensures makes it less likely companies might pick and choose disclosure items depending on what might make them look good.

Second, this approach would lead to more disclosure. Professor Fisch proposes that companies be required to disclose three topics. SASB standards typically include 10 to 15 metrics.

Third, it seems likely that companies would actually prefer this sort of approach. With a principles-based approach, it can be difficult for corporations and their disclosure counsel to decide what they should disclose, that is, what is most material. Having a set of standards that they can rely upon facilitates decisionmaking.

Having the SEC rely on a private set of standards would hardly be unprecedented. As SASB's comment letter discussed in some detail,[9] a close analogy is the action taken by the Commission in 2003 when it adopted an internal control reporting rule as required by Section 404 of the Sarbanes-Oxley Act. In the Adopting Release, the Commission stated that commenters supported the establishment of "specific evaluative criteria" for internal control reports "in order to improve comparability among the standards used by companies to conduct their annual internal control evaluations." The Commission determined not to "establish" specific criteria, but instead to refer issuers to the work of Committee of Sponsoring Organizations as an acceptable approach framework.[10]

There are other precedents as well. SEC took a similar approach in its conflict-minerals rule adopted pursuant to Section 1502 of the Dodd-Frank Act. The rule requires that an issuer's due diligence with respect to conflict mineral determinations "follow a nationally or internationally recognized due diligence framework" so as to "enhance the quality" and "promote comparability" of conflict mineral reports.[11]

There have also been occasions when the Commission has actually required companies to use a private-sector set of standards. The most prominent of such instance is, of course, with respect to the FASB, whose standards must be followed by U.S. public companies.[12] Another less well-known example is SEC's adoption in 1999 of revised disclosure requirements for foreign private issuers to conform to the disclosure requirements endorsed by a nongovernmental body, the International Organization of Securities Commissions (of which SEC is a member).[13] Additionally, in 2018, SEC adopted amendments to modernize the property disclosure requirements for mining registrants; in doing so, the Commission relied upon a set of standards called the Committee for Reserves International Reporting Standards.[14] Further, use of a private-sector set of standards is common throughout the government. For example, in 1996, the U.S. Congress passed the National Technology Transfer and Advancement Act, which stated in part that "all federal agencies and departments shall use standards that are developed or adopted by voluntary consensus standards bodies, using such technical standards as a means to carry out policy objectives determined by the agencies and departments."[15]

This is a rapidly developing area, with new proposals and ideas emerging almost daily from legislators, regulators, NGOs, trade groups, and others—although much more of this is happening in Europe than in the United States. In my view, securities law professors have not spent as much time addressing the topic as is warranted. Professor Fisch's article is a thoughtful contribution to the literature in this area.

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7. It should be noted in this regard that in a 2017 letter to public company directors William McNabb, then Chairman and CEO of Vanguard, the world's second largest asset manager with $5.6 trillion under management, also referred to SASB's work. He said: "Our participation in the Investor Advisory Group to the Sustainability Accounting Standards Board (SASB) reflects our belief that materiality-driven, sector-specific disclosures will better illuminate risks in a way that aids market efficiency and price discovery."
8. SASB, Standards Application Guidance Version 2018-10 (2018), https://www.sasb.org/wp-content/uploads/2018/11/SASB-Standards-Application-Guidance-2018-10.pdf:

 > An entity that omits one or more disclosure topics and/or accounting metrics should disclose the omission(s), as well as the rationale for the omission(s). For example, if a disclosure topic does not apply to an entity's business model, the entity should disclose that the topic and its associated metrics were omitted on the lack of applicability. If an entity believes it necessary to modify a metric, the entity shall disclose the fact that the metric was changed, as well as the rational for that change.

9. Other stakeholders have expressed support for this position. For example, the CFA Institute surveyed its members and found that "[s]ome 63% believe securities regulators should either develop ESG disclosure standards or support an independent standard setter to develop such standards." Mohini Singh, *Embracing the Inevitable: ESG Disclosures*, Market Integrity Institute CFA Institute (July 23, 2019), https://blogs.cfainstitute.org/marketintegrity/2019/07/23/embracing-the-inevitable-esg-disclosures/. CFA members stated, among other things that "[t]he Sustainability Accounting Standards Board standards should be strongly considered by regulators as forming the basis of a standard." *Id.*
10. Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, Exchange Act Release Nos. 33-8238, 34-47986, IC-26068, File Nos. S7-40-02, S7-06-03 (June 5, 2003), https://www.sec.gov/rules/final/33-8238.htm.
11. Conflict Minerals, Exchange Act Release No. 34-67716 (Aug. 22, 2012) at 207.
12. *See generally* Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter, Exchange Act Release Nos. 33-822, 34-47743, IC-26028, FR-70 (Apr. 25, 2003).
13. *See* International Disclosure Standards, Exchange Act Release Nos. 33-7745, 34-41936; International Series Release No. 1205 (Sept. 28, 1999).
14. *See* Exchange Act Release Nos. 33-10570, 34-84509 (Oct. 31, 2018).
15. Pub. L. No. 104-113, Mar. 7, 1996, 110 Stat. 775 §12(d)(1) (1996).