Does Using the Term “Materiality” in Your CSR Report Create Risk?

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Director of Legal Policy and Outreach

Moderator:
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Education Manager
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Housekeeping Matters for Today’s Webinar

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Douglas Park, JD, PhD
Director of Legal Policy and Outreach

- Leads the development and articulation of SASB’s positions on legal and regulatory matters
- Engages with lawyers, corporate governance professionals, accountants, sustainability professionals, and others on these issues
- Chair of American Bar Association’s Corporate Social Responsibility Disclosure and Reporting Committee, and Member of Sustainability and Governance Subcommittee
- Formerly an Assistant Professor of Management at School of Business and Management, Hong Kong University of Science and Technology, and Lecturer at Stanford University
Agenda

- What companies are doing now may be risky
- The risks of using different definitions of materiality
- SASB’s approach to materiality aligns with securities law
- How to use the term “materiality”
SASB and Materiality

SASB identifies sustainability topics likely to constitute material information

SASB develops and disseminates sustainability accounting standards that help public corporations disclose material, decision-useful information to investors.

- The U.S. Supreme Court’s definition of materiality guides the standards setting process
- Develops industry-specific standards for 10 sectors and 80+ industries
- Uses a rigorous process that includes evidence-based research and broad, balanced stakeholder participation
A Market-Driven Response
SASB addresses needs of both investors and issuers

<table>
<thead>
<tr>
<th>Issuers</th>
<th>Investors</th>
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<tbody>
<tr>
<td>▪ A minimum set of disclosure topics that are likely to constitute material information for companies in an industry, and a model for disclosing those factors in a decision-useful way for investors</td>
<td>▪ Comparable data for benchmarking and evaluating performance</td>
</tr>
<tr>
<td>▪ A method to understand, manage, and improve performance on ESG-related value drivers</td>
<td>▪ Standardized, decision-useful information in a trusted channel (i.e., 10-K)</td>
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<td>▪ A way to satisfy the disclosure requirements of Regulation S-K, especially MD&amp;A</td>
<td>▪ Tools and resources to analyze and understand sustainability risk at the portfolio level</td>
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SASB INDUSTRY WORKING GROUPS REFLECT BROAD-BASED INTEREST AND CONSENSUS

>2,800 MEMBERS  $23.4T ASSETS UNDER MANAGEMENT  $11T MARKET CAP
SASB Standards Support Disclosure in the MD&A

The standards rest on existing regulation

**Regulation S-K requires companies to:**

- Disclose *material information* as appropriate in SEC filings such as the Form 10-K and 20-F.

- Disclose management’s view on known trends and uncertainties that are reasonably likely to have a material impact on results of operations and financial condition.

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**Form 10-K (MD&A)**

**United States Securities and Exchange Commission**

**Washington, D.C. 20549**

**FORM 10-K**

- **Disclosure**
  - **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
  - For the fiscal year ended December 26, 2015

**INTEL CORPORATION**

- **Address of principal executive offices**
  - 3300 Nobel Drive, Santa Clara, California 95051

- **Representative in charge of registration**
  - Jason Hartman, Vice President/Secretary

- **Common stock, $0.01 par value, listed on NASDAQ Global Select Market**

*Indicates information required to be disclosed in this Form 10-K.*

**Company Information**

- **Date of the report**
  - 6/30/2015

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## Different Concepts of Materiality

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<thead>
<tr>
<th>Subject</th>
<th>SASB</th>
<th>GRI</th>
<th>IIRC</th>
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</thead>
<tbody>
<tr>
<td>Definition of materiality</td>
<td>Non-financial</td>
<td>Non-financial</td>
<td>Both financial and non-financial</td>
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<tr>
<td>U.S. Supreme Court</td>
<td>Proprietary</td>
<td></td>
<td>Proprietary</td>
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<tr>
<td>Target audience</td>
<td>Investors</td>
<td>All stakeholders</td>
<td>Investors</td>
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<tr>
<td>Target disclosure</td>
<td>Mandatory filing</td>
<td>Voluntary report</td>
<td>Voluntary report</td>
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<tr>
<td>Decisions affected</td>
<td>Investment decisions</td>
<td>Broad range</td>
<td>Investment decisions</td>
</tr>
</tbody>
</table>
What Companies Are Doing Now

Inconsistency and confusion may result

- Using different definitions of materiality for different purposes
  - CSR/sustainability reports – Proprietary definitions
  - SEC filings – Supreme Court definition
- Calling information in sustainability/CSR report “material”
- Some are saying that information in the sustainability/CSR report is not material under the securities law definition
- Performing two different materiality assessments that reach different conclusions
What Companies Are Doing May Create Unnecessary Risk
Legal issues and other risks arise

Different issues and considerations for different audiences

Lawyers are paying more attention to CSR/sustainability reports

**STAKEHOLDERS**

- Voluntary reports
- About social responsibility, marketing, and stakeholder relations
- Some of the information is “puffery” – vague, optimistic statements

**INVESTORS**

- Mandatory reports
  - What is material under the securities law definition of materiality?
  - What does the company have a duty to disclose?
- Voluntary: Bloomberg ESG Valuation Tool, MSCI ESG Impact Monitor, FTSE4Good, CDP
Calling Information in the CSR/Sustainability Report “Material”
Calling Information in the CSR/Sustainability Report “Material”

Materiality Matrix

- Influence on Stakeholders
- Importance to Business

- Environment
- Social
- Economic

GHG Emissions & Climate Change
Employee Health & Safety
Energy Availability, Reliability & Power Quality
Calling Information in the CSR/Sustainability Report “Material”

Materiality matrix
Identifying important sustainability issues
Calling Information in the CSR/Sustainability Report “Material”

MATERIALITY MATRIX

- GHG Emissions
- Sustainable Agriculture
- Healthful Products
- Packaging
- Food Safety
- Innovation

High priority issues are in the upper right-hand corner of the matrix

Stakeholder Concern
Potential Impact
Calling Information in the CSR/Sustainability Report “Material”

MATERIALITY ASSESSMENT RESULTS

- governance
- economic
- product content
- product innovation and quality
- factory working conditions
- workplace practices
- environment
- philanthropy
- diversity and inclusion
Calling Information in the CSR/Sustainability Report “Material”

Material issues

- Low carbon solutions
- Products and services for development
- Our carbon footprint
- Supply chain
- Environmental impacts of products
- Mobiles, masts and health
- Safety
- Responsible commercial approach
- Electronic waste
- Accessible products and assisted living
- Earning customer trust
- Tax
- Responsible commercial approach
- Ethical business practices
- Network deployment and maintenance
- Our people
- Public policy
- Other environmental issues

Importance to stakeholders

Influence on business success
Calling Information in the CSR/Sustainability Report “Material”
The foundation of our strategic approach is our Citizenship & Sustainability Materiality Assessment. Through our first non-financial materiality assessment conducted in late 2014 into 2015, and incorporating internal and external stakeholders like our associates, suppliers, and external advocacy groups, Energy, Travel & Waste came up as a material issue for us to focus our efforts.
For the purposes of this report, we consider *material information* to be that which is of greatest interest to, and which has the potential to affect the perception of, those stakeholders who wish to make informed decisions and judgments about the company’s commitment to environmental, social and economic progress. This definition predates, but
The Risks of Using Different Definitions of Materiality
Specific to US publicly listed companies

- Risk of liability
  - Misperceptions about materiality and liability
    - Company cannot be liable for CSR/sustainability report if it uses a proprietary definition of materiality
    - Company cannot be liable for disclosures of sustainability information that are not required in SEC filings
    - Shareholders cannot challenge company's description of information as material under the securities law definition
  - Conflicting characterizations of sustainability information by the company increases the risk of shareholder scrutiny
The Risks of Using Different Definitions of Materiality
Specific to US publicly listed companies

- **Liability for securities fraud: Section 10(b) of Exchange Act and Rule 10b-5**
  - Reporting on an issue must be complete and accurate – even for disclosures that are not required, but are voluntarily made
  - Shareholders sue the company, alleging
    - A material misrepresentation and/or
    - A material omission

- **Example of sustainability report in securities fraud suit**
  - Oil company’s environmental preparedness and its ability to respond to an environmental disaster (In re BP p.l.c. Sec. Litig., 852 F. Supp. 2d 767, 796 (S.D. Tex. 2012)).
The Risks of Using Different Definitions of Materiality

Depends on the jurisdiction

- **Risk of contradiction**
  - The company says one thing about a topic in sustainability report, and something different in its 10-K or other filings and reports

- **Risk of inappropriate communication**
  - The company communicates sustainability factors to stakeholders and investors in a way that does not match the type and purpose of the information
The Risks of Using Different Definitions of Materiality

Apply to all companies

- **Risk of investor overload**
  - The company reports large amounts of immaterial information, thereby overloading investors with unhelpful information.
  - Using a proprietary definition of materiality could mean that the CSR/sustainability report is not useful to an investor.

- **Risk of management misalignment**
  - More difficult for management to prioritize sustainability issues.
A Shared Definition of Materiality
SASB is guided by the Supreme Court definition in prioritizing disclosure topics

“Material information” is defined by the Supreme Court as presenting 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.


- Objective standard pegged to the reasonable investor—not to other stakeholders
- Fact-intensive, company-specific analysis
- “Interesting or desirable” information is not sufficient
- Focus is on financial impact
- Materiality determinations require making judgments
  - Courts and SEC have rejected bright-line rules
  - Five percent threshold does not substitute for full analysis of all relevant considerations, both quantitative and qualitative
- HBS study on evidence of materiality
Rigorous, Transparent Process

SASB’s industry-specific standards are rooted in evidence and shaped by consensus.

Evidence of Interest

- Issue frequency in five data-driven tests:
  - Financial disclosure
  - Legal drivers
  - Industry norms
  - Stakeholder concerns
  - Innovation opportunity

Evidence of Financial Impact

- Issue impact on three business value drivers:
  - Revenue and costs
  - Assets and liabilities
  - Risk profile (cost of capital)
SASB’s Five Factor Test

Factors that indicate evidence of interest

5 FACTORS

1. **FINANCIAL IMPACTS & RISK**
   
   This factor relates to the likelihood that the topic will have a direct impact on near-, medium-, or long-term financial performance. The remaining factors may inform the assessment of actual or potential financial impacts.

2. **LEGAL, REGULATORY, & POLICY DRIVERS**
   
   Existing, evolving, or emerging regulation may influence company actions and affect financial performance by forcing the internalization of certain costs and/or by creating upside opportunity associated with sustainability-related externalities.

3. **INDUSTRY NORMS & COMPETITIVE DRIVERS**
   
   Peer actions on an industry issue may create pressure for high standards of performance related to the management of sustainability topics in order to remain competitive. This can result in a positive or negative impact on financial performance.

4. **STAKEHOLDER CONCERNS & SOCIAL TRENDS**
   
   Stakeholders may raise concerns that could influence long-term financial or operating performance or create acute short-term financial impacts through changes in customer demand, influence on new regulations, and disruptions to business viability.

5. **OPPORTUNITIES FOR INNOVATION**
   
   New products and business models can drive market expansion or have the potential for a disruptive change that provides competitive advantages.

Most “materiality” assessments of CSR/sustainability issues emphasize Stakeholder Concerns.
One General Counsel’s Solution
The pen is mightier than the sword

BEFORE:

Company Sustainability Report

“MATERIAL”

AFTER:

Company Sustainability Report

“SIGNIFICANT”
How to Use the Term “Materiality”
Appropriate language for different audiences and reporting channels

- Use “material” to describe **only** sustainability information that meets securities law definition

- Describe information in your sustainability/CSR report as “relevant,” “interesting,” or “significant,” but not “material” unless you use the Supreme Court definition

- Have legal counsel review your sustainability report and other communications against what is disclosed in SEC filings

- Disclose sustainability information that is reasonably likely to materially affect financial condition or results of operations in SEC filings, using SASB’s five factor test and standards as a guide
Key Takeaways

- Companies who use different definitions of materiality create risks for themselves.
- Legal counsel should weigh the benefits and risks of how and where the company communicates CSR and sustainability information.
- SASB’s approach to materiality avoids the problem of using different definitions of materiality and squares with the SEC’s disclosure requirements.
Professional Development
Delve deeper into materiality as it pertains to sustainability

Fundamentals of Sustainability Accounting Credential
Connecting sustainability to the US securities law definition of materiality

- The context for materiality and sustainability
- How to identify the sustainability factors that impact financial performance

Level I (now)

Level II (2016)
- How to analyze sustainability information that may be material
- How to interpret sustainability information for strategic decision-making or investment analysis

FSA.sasb.org/prep for curriculum, free resources, and registration
Coming Soon

Select sustainability accounting topics relevant to your business
Assess current disclosure and management of those topics
Embed indicators into your financial management and reporting processes
Support integration with internal controls to achieve data quality objectives
Present information to Disclosure Committee for review

• Implementation Guide publishing in July
• Contact Harrison Thomas at Harrison.Thomas@sasb.org for information about supportive programming launching later this year
We’ll answer as many questions as we can – others to be answered afterwards

Housekeeping Reminders

- Please complete the short, 5-question survey at the end of the webinar
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