The SEC and the Regulation S-K Concept Release

What Financial Executives Need to Know

Webinar for Financial Executives International
June 9, 2016

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Overview of the SEC Concept Release and its Significance

Elisse Walter
Enactment of Securities and Exchange Acts resulted in two, overlapping, duplicative disclosure regimes lasting ~30 years

1969 Wheat Report recommended coordination between these requirements

1977 Regulation S-K was adopted following Sommers Report recommendation to simplify and integrate disclosure system

- S-K originated with only two sections: description of business and description of properties
- 1978 – Items 103, 401-403 moved to S-K
- 1980 – Items 201, 301-303 and 601 moved to S-K

1982 – Regulation S-K expanded and reorganized as repository of “uniform non-financial statement” disclosure requirements

1996 – Task Force on Disclosure Simplification resulted in elimination of 45 rules and six forms; three other recommended changes not implemented
Background – SEC’s Disclosure Effectiveness Project

- Originated with SEC staff bulletin in 2013; mandated by the Jumpstart Our Business Startups (JOBS) Act
- JOBS offers overview of Regulation S-K (Regulation S-X also under review)
- Overarching goal – comprehensively review requirements and make recommendations on how to best facilitate timely, material disclosure
- Initially focused on 10-K, 10-Q and 8-K; subsequent phases will include governance information included in proxy statements
- Public comments on the SEC’s Disclosure Effectiveness Project were solicited in December, 2013; Concept Release responds to those comments
The Release is wide-ranging, covering a variety of topics both narrow and broad.

- 94 pages, discussing nature of, and different approaches to public company disclosure requirements
- Majority of the Release addresses particular Regulation S-K business and financial item requirements
- Raises general considerations re scaled disclosure frameworks and the format, structure of method of delivery of information to investors
- Includes an 4-page section on sustainability and public policy disclosures

Comments due July 21, 2016
Regulation S-K Concept Release
General topics covered in the Release

- **Disclosure Framework**
  - Basis for disclosure requirements
  - Nature of disclosure requirements

- **Information for Investment and Voting Decisions**
  - Core company business information
  - Company performance, financial information, future prospects
  - Risk and Risk Management
  - Securities of the registrant
  - Industry guides
  - Disclosure of information relating to public policy and sustainability matters
  - Exhibits
  - Scaled requirements

- **Presentation and Delivery of Important Information**
  - Cross-referencing
  - Incorporation by reference
  - Hyperlinks
  - Company websites
  - Specific formatting requirements
  - Layered disclosure
  - Structured disclosures
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Polling Question 1

In your view, disclosure reform most needs to address:

a. Cost burden from voluminous filings
b. Requirements that are duplicative and relate to immaterial matters
c. Liability and the need for additional safe harbors
d. Establishment of a standard for the disclosure of sustainability-related information in SEC filings
e. Technology
f. Other
Significance of the Sustainability Section of the Concept Release

Tom Riesenbreg
What sustainability issues are important to investment decisions?

What would a sustainability disclosure framework look like? Could it be flexible enough to address evolving issues?

Would line-item disclosure requirements be consistent with the Commission’s rule-making authority? Would they yield immaterial information?

Does information on ESG factors reported outside Commission filings address investor needs?
Why is This Important?
SEC hasn’t examined disclosure of sustainability issues in detail since the mid-1970s

- 1971 – NRDC v. SEC. centered on expanded civil rights and environmental disclosure
  - SEC concluded expanded social disclosure not required.
- 1974 Supreme Court directed SEC to determine “extent of ethical investor’ interest in expanded environmental and civil rights disclosure”
  - SEC determines an “insignificant percentage” of American shareholders was interested in these disclosures - 0.0005% of the market
- 1976 – Commission adopted specific disclosure requirements mandating disclosure of any material estimated capex for environmental control facilities
- 1980 – SEC recognized identification of what information is material to investors an ongoing task; Item 303 moved to Regulation S-K
- 1982 – SEC expanded and reorganized Reg. S-K as repository for the uniform non-financial statement disclosure requirements
- 2010 – Interpretive Guidance on Climate Change related risk
Investor Interest in Sustainability-related Information

PRI Signatory Assets Under Management

- Number of Bloomberg ESG Data Customers
- PRI Signatory AUM (in US$ Trillions)

Data from 2006 to 2015 showing the growth in PRI signatory assets under management and the number of Bloomberg ESG data customers.
Boilerplate disclosure:
“Climate change and water availability may negatively affect our business and financial results… Clean water is a limited resource in many parts of the world and climate change may increase water scarcity and cause a deterioration of water quality in areas where we maintain brewing operations. The competition for water among domestic, agricultural and manufacturing users is increasing in some of our brewing communities…. The above risk, if realized, could result in a material adverse effect on our business and financial results.”
[Form 10-K filed 12-Feb-15]

Quantitative disclosure:
“Overall this year, Diageo has delivered improved performance across all water and other environmental target areas versus the prior year, and progressed towards meeting 2015 goals. We reduced absolute water use by 9% or 2,268,000 cubic metres while water efficiency improved by 2.4% compared to the prior year. In water-stressed locations, we have reduced water wasted by 12%, an important contribution towards our target of a 50% reduction versus the company’s 2007 baseline.”
[Form 20-F filed 12-Aug-14]
Investor Interest in Sustainability-related Information

SHAREHOLDER PROPOSALS
Percent of total proposals filed that are related to social and environmental issues

- 2011: 40%
- 2012: 40%
- 2013: 45%
- 2014: 55%
- 2015: 63%
- 2016: 67%

GLOBAL INSTITUTIONAL INVESTORS

- 89% Will request sustainability information directly from the company
- 67% More likely to consider ESG information if common standards used
- 50% “Very likely” to sponsor or co-sponsor a shareholder proposal

Sources: EY, 2011-2014, As You Sow, 2015
Peer to Peer Comparison on Material Factors is Needed

- Investors “are especially eager to measure a company’s non-financial performance against that of its sector peers and to link a company’s non-financial information to its expected performance.”
- Little support for line-item disclosures, with “comparatively low ranking of prescriptive accounting standards with fixed criteria, that would seek to apply a level of uniformity across all sectors.”
Investors Need A Market Standard to Evaluate Disclosure in Context

“The lack of common standards to assess the materiality of environmental or social issues may be affecting investors’ ability to consider these issues as they want. Two-thirds of investors responding to our survey say that they would be more likely to consider this type of information when making investment decisions if common standards were used.”
The Pain Point for Investors

They’re challenged to understand how sustainability performance impacts returns.

Focusing specifically on U.S.-listed companies, how satisfied are you with the information currently being provided by these companies on the following topics?

- How risks and opportunities are identified and quantified in financial terms
- Comparability of sustainability reporting between companies in the same industry
- Relevance and implications of sustainability risks issues
- How the company identifies social and environmental impacts in its supply chain
- Key performance indicators related to each identified material issue
- Sustainability strategy that is linked to business strategy
- Internal governance of sustainability issues
- Process used to identify material sustainability issues

Source: PwC
*Sustainability Goes Mainstream, May 2014*
The Investor View of ESG Disclosure Effectiveness – Lessons Learned from our Standards Setting Process

Jean Rogers
The SASB Mission
Improved sustainability disclosure enhances market efficiency

SASB’s mission is to develop and disseminate sustainability accounting standards that help companies disclose material, decision-useful information to investors in a cost-effective way.

That mission is accomplished through a rigorous, transparent process that includes evidence-based research and broad, balanced stakeholder participation.

Facts about SASB

- Independent 501(c)(3) non-profit
- Develops standards for 79 industries in 10 sectors for use in mandatory filings such as the Form 10-K and 20-F
Cost-Effective Disclosures

SASB provides a cost-effective way to report on material sustainability factors.

SASB standards have a median of 5 topics and 13 metrics (80% quantitative) per industry.
Materiality in Practice as a Basis for Standards Setting

SASB standards include issues with demonstrated evidence of impacts on the financial condition and operating performance of a company.

### Disclosure Topics Examples
- Drug safety and side effects
- License to Operate
- Energy-efficient chemicals production
- Operational safety of gas pipelines
- Stranded coal assets

### Types of Financial Drivers
- **Demand for Core Products and Services**
- **Market Share and Long-Term Growth**
- **Operational Efficiency/Cost Structure**
- **Governance, Volatility and Risk Factors**
- **Tangible and Intangible Assets and Liabilities**

### Financial Impact
- **REVENUE**
- **COST**
- **COST OF CAPITAL**
- **ASSETS & LIABILITIES**
Integration Into Mainstream Investment Decisions
SASB standards and related information support a variety of investment strategies

MACRO TRENDS
- Which industries are facing the greatest sustainability headwinds?
- How do sustainability issues impact core industry drivers, such as consumer preference or regulatory change?

PORTFOLIO ALLOCATION
- How can I measure and diversify concentrated sustainability risk?
- What is sustainability’s impact on portfolio performance?

COMPANY BENCHMARKING
- Which companies are leaders?
- Which are laggards?

SECURITY VALUATION
- How should I adjust my discounted-cash-flow analysis or valuation metrics for sustainability risks and impacts?
Investors are Demanding, and Receiving, ESG information

Current state of disclosure is a burden for both issuers and investors

Investors currently obtain ESG information from the following corporate communication channels:

- Questionnaires
- Sustainability Reports
- Shareholder Resolutions
- Forms 10-K and 20-F
Companies Face Reporting Fatigue

ESG Questionnaires create a burden for companies without meeting investor needs

- Large-cap companies receive hundreds of information requests each year, leading to “questionnaire fatigue” and information asymmetry.

- On a recent Institute of Management Accountant (IMA) webinar survey of 100 members, 7.5% of respondents reported completing more than 250 ESG surveys per year.

- At GE, responding to over 650 ESG questionnaires involved more than 75 people at GE and took several months, “with virtually no value to (GE’s) customers or shareholders and even less impact on the environment.”

A market standard eliminates the possibility of selective disclosure.
Polling Question 2

How many ESG information requests or questionnaires does your company receive per year?

a. Less than 250
b. More than 250
c. I don't know
A True and Fair Representation of Performance?

Voluntary sustainability reports are not decision-useful for investors

A 2013 study of GRI A and A+ reports in the Accounting, Auditing & Accountability Journal found that “90 per cent of the significant negative corporate (social or environmental) events were not reported.”
Ideal Corporate Disclosure on Sustainability Information includes Material Info in Mandatory Filings and Relevant Info in CSR Reports

Different purposes, different audiences

Relevant Information
All environmental, social, and governance topics of interest

Stakeholders
Alignment is key
(e.g., consistent use of the description “material”)

Material Information
Sustainability factors likely to effect the financial condition or operating performance of a company

Investors
Investors look to Mandatory Public Filings for Material Information

SASB standards enable effective disclosure without additional regulation or reporting mechanisms

“Material information” is defined by the U.S. 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.

Current State of Disclosure in the 10-K on SASB topics
Reporting lacks consistency, comparability, industry-specificity

75% of SASB disclosure topics are already being disclosed in the 10-K—but not effectively
Complete, Reliable Data Sets are Essential for Investor Use
SASB standards enable peer-to-peer comparisons and industry benchmarking.

SASB Metrics

Illustrative

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<td>Scope 1 GHG Emissions</td>
<td>Nitrogen Oxide Emissions</td>
<td>Sulfur Oxide Emissions</td>
<td>VOC Emissions</td>
<td>Total Energy Consumed</td>
<td>Electricity Used</td>
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<td>17.1</td>
<td>2.0</td>
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<td>8.1</td>
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<td>Globex</td>
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<td>8.1</td>
<td>2.2</td>
<td>7.3</td>
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<td>Northeast Chemicals</td>
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<td>52,893.1</td>
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<td>Bio Life Inc</td>
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<td>3.8</td>
<td>1.6</td>
<td>0.1</td>
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<td>2,438.9</td>
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<td>8,250.6</td>
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<td>Average</td>
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<td>1.9</td>
<td>3.2</td>
<td>25,761.8</td>
<td>3,624.3</td>
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<td>Median</td>
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<td>7.9</td>
<td>2.1</td>
<td>7.3</td>
<td>44,583.4</td>
<td>3,122.2</td>
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Peer comparison
Complete data set
Consistent units
Benchmarking
**An industry view is important to investors**

Performance is evaluated within the context of industry value drivers

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<tr>
<th>Industry</th>
<th>Disclosure Topic</th>
<th>Value Driver Impacted</th>
<th>Selected Metrics</th>
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<tbody>
<tr>
<td>Automobiles</td>
<td>Fuel Economy &amp; Use-phase Emissions</td>
<td>- Revenue</td>
<td>• Sales-weighted average passenger fleet fuel economy, consumption, or emissions, by region</td>
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<tr>
<td>Auto Parts</td>
<td>Product Safety</td>
<td>- Reputation - Liabilities</td>
<td>• Number of recalls and total units recalled</td>
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</table>
| Oil & Gas – Exploration & Production | Reserves Valuation & Capital Expenditures           | - Assets - CAPEX - Cost of Capital | • Sensitivity of hydrocarbon reserve levels to future price projection scenarios that account for a price on carbon emissions.  
• Estimated carbon dioxide emissions embedded in proved hydrocarbon reserves |
| Restaurants                  | Food Safety                                           | - Revenue - Reputation | • Number of recalls, total amount of food product recalls  
• Number of confirmed foodborne illness outbreaks, percentage resulting in CDC investigation. |
| Agricultural Products        | Climate Change Impacts on Crop Yields                 | - Revenue - Cost of Capital | • Average crop yield and five-year standard deviation per major crop type by major operating region  
• Identification of principal crops and discussion of risks and opportunities presented by climate change |
| Pharmaceuticals              | Counterfeit Drugs                                     | - Revenue - OPEX - Reputation | • Description of methods and technologies used to maintain traceability of products throughout the supply chain and prevent counterfeiting.  
• Description of process for alerting end customers and business partners of potential or known risks associated with counterfeit products. |
| Biotechnology                | Affordability & Fair Pricing                          | - Revenue - Reputation | • Ratio of weighted average rate of net price increases (for all products) to the annual increase in the U.S. Consumer Price Index. |
| Real Estate                  | Energy Management                                     | - OPEX - Assets       | • Like-for-like change in energy consumption of portfolio area with data coverage, by property subsector.  
• Percentage of eligible portfolio that (1) has obtained an energy rating and (2) is certified to ENERGY STAR®, by property subsector. |
Climate Risk: Ubiquitous but Differentiated

Line item disclosures are a challenge due to unique industry impacts

**CLIMATE RISK**

Impacts 72 of 79 industries

- *Event readiness* in Health Care Delivery
- *Carbon intensity of reserves* in Oil & Gas – Exploration & Production
- *Emissions from refining* in Oil & Gas – Refining & Marketing
- *Vulnerability of real estate* in Insurance
- *Impact on crop yields* in Agricultural Products
- *Financed emissions* in Commercial Banks

Percentage of U.S. equity market impacted: 93%

Market cap of companies affected: $33.8T
## Types of Climate Risk Across Industries

SASB has mapped climate risk for all industries of the economy

<table>
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<tr>
<th>Sector &amp; Industries</th>
<th>Physical Effects</th>
<th>Transition To A Low-Carbon, Resilient Economy</th>
<th>Climate Regulation</th>
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<td>Security and Commodity Exchanges</td>
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<td><strong>Non-Renewable Resources</strong></td>
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<td><strong>Consumption</strong></td>
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<td>Household &amp; Personal Products</td>
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Corporate Concerns about Sustainability Disclosure

Tom Riesenberg
Issuer Concerns

Controls  Attestation  Liability

Costs
Polling Question 3

Would you elect to have third-party assurance of sustainability-related disclosures included in SEC filings?

a. Yes
b. No
c. I don't know
Public Policy and Sustainability Disclosure Section Significance
Provides opportunity for the Commission to address key challenges

- Investor demand for material sustainability information
- Corporate cost burden of questionnaires and shareholder resolutions
- Biased disclosure (i.e. “cherry picking”) in voluntary sustainability reports
- Proliferation of boilerplate information on material factors in mandatory filings
- Inability to distinguish immaterial from material information; unreliable data
- Selective disclosure, information asymmetry of material information through questionnaires
- The need for investors to purchase ESG information from commercial services
- Inability of regulators to enforce disclosure against a market standard
Polling Question 4

Would a market standard for the disclosure of material sustainability-related information:

a. Streamline responses to investor inquiry regarding issues and related cost reduction
b. Improve understanding and management of these issues
c. Level the playing field
d. All of the above
e. None of the above
SEC Possible Actions and Timing

Elisse Walter
Possible Outcomes

Rule making

No action

Comment period could be extended

Substantive changes unlikely during current administration.
Make Your Voices Heard

• SEC Concept Release open for comment through July 21, 2016.
• Submit comments here: https://www.sec.gov/cgi-bin/ruling-comments
• SASB’s comment letter will be submitted before month-end. Please refer to our website for a copy: www.sasb.org
Polling Question 5

Does your organization plan to submit a comment letter to the SEC on this Concept Release?

a. Yes
b. No
c. I don't know
Accounting for a Sustainable Future