Investor Environmental Health Network

HEALTHY PEOPLE...HEALTHY BUSINESS

February 11, 2015

Mary Jo White
Chair

Keith Higgins
Director
Division of Corporation Finance

Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Re: Disclosure Effectiveness Review

Dear Chair White and Director Higgins,

Thank you for your work on the disclosure effectiveness review, considering the business and financial disclosures of public companies in Forms 10-K, 10-Q, and 8-K. The Investor Environmental Health Network (IEHN) is a collaborative partnership of investment managers focused on financial risks and opportunities, as well as public health risks, associated with corporate use of environmentally toxic materials and their safer substitutes. IEHN members manage approximately $40 billion in assets.

We previously wrote to the SEC about the need for additional SEC policymaking and enforcement in this area in 2009.[1] Since then, although we have seen substantial progress in dialogues with companies, in our experience disclosure practice in SEC filings has not improved.

The following pages contain our comments for the disclosure effectiveness review.
Thank you for the opportunity to comment.

Sincerely,

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[1] Our previous correspondence can be seen at http://iehn.org/documents/IEHN_Emerging_Risks_to_SEC.pdf

COMMENTS OF
INVESTOR ENVRONMENTAL HEALTH NETWORK
ON SECURITIES AND EXCHANGE COMMISSION
DISCLOSURE EFFECTIVENESS REVIEW

1. Disclosure of Emerging Science on Risks.

Although existing disclosure requirements of Reg S-K encompass the disclosure of material trends, events, and uncertainties, when it comes to substantial emerging scientific information on hazards of materials used in products and services, the current regulation does not, by and large, lead to disclosure of toxicity trends and uncertainties that would be of concern and interest to shareholders.

Such information is relevant to assessing risk exposures, as well as whether companies are proactively adopting safer chemicals policies to reduce the regulatory risks associated with potential government bans or restrictions on products. In the absence of such a proactive stance, some companies have encountered a full-blown "toxic lockout" from markets. This emerging information also portends changes in demands as both consumers and institutional purchasers move to products without various chemicals of concern.

For instance, a substantial body of emerging scientific literature demonstrates the risk of certain nanotechnology materials. Where several peer-reviewed articles or credible government compilations of public health data demonstrate a potential catastrophic public health outcome from the use of a material, the accumulated information should suffice to trigger disclosure requirements. Yet the record is replete with10K reports that failed to disclose such trends. (See our prior report, Bridging the Credibility Gap: Eight Corporate Accounting Loopholes that Regulators Must Close.) We have long recommended that additional guidelines be provided by the SEC .[2]

Nanotechnology applications include toothpaste, cosmetics, food processing, and food packaging. As a food additive, nanoparticles could deliver flavor, nutrition, medicines and supplements to existing food products.

However, such materials also bring with them special health risks, which the scientific community is studying as these products emerge. Nano-particles [particles smaller than 1,000 nanometers (nm)] are often more chemically reactive than their larger-scale counterparts. Specifically, as particle size decreases so dramatically, materials can penetrate the body far more aggressively. Laboratory studies indicate that some nanoparticles – be they inhaled or ingested from food and water – can pass through the intestinal walls or lungs and reach the bloodstream. Some inhaled nano-materials can access the brain, as they can pass the blood-brain barrier via the olfactory nerve.[3]

One example of special concern is a material known as Carbon Nanotubes (CNTs). These materials are very useful because they make materials that are light and strong. However they also top the list of potential mass tort catalysts because certain forms – specifically long, thin CNTs – possess the same physical characteristics as the most hazardous types of asbestos known as amphiboles. The physical similarities between CNTs and amphibole asbestos have lead some

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[2] We previously described ongoing disclosure challenges, including those raised here, in our 2009 report: *Bridging the Credibility Gap*: *Eight Corporate Liability Accounting Loopholes that Regulators Must Close.* http://iehn.org/documents/EightLoopholes.pdf

[3] G. Oberdörster, E. Oberdörster, and J. Oberdörster, Nanotoxicology: An Emerging Discipline From Studies of Ultrafine Particles. *Environmental Health Perspectives* 113, no. 7 (2005): 823-839.

researchers to suggest that long, thin CNTs may be capable of inducing mesothelioma. Although mesothelioma cases are very unusual in the general public, they are not uncommon in populations who are exposed to the amphibole forms of asbestos.4

While all of the effects of nanoparticles are impossible to predict, these known toxicity risks mean that liability potential is significant. Indeed, some experts assert that nanotechnology's liability potential matches that of asbestos. The Expert Forecast on Emerging Chemical Risks, a body of 49 experts across Europe, places nanoparticles at the top of the list of substances from which workers need protection.[5] The world's second largest reinsurer, Swiss Re, deems nanotechnology risk on a par with asbestos risk, noting the ease of tracing toxins directly to a manufacturer – by contrast to more diffuse pollutants.[6] Similarly, Lloyd's of London deems the emerging risk of nanotechnology as grounds for close attention, risk evaluation, and disclosure.

The following are our suggestions for disclosure criteria and possible guidelines to companies on how to address the issue of emerging scientific literature within the context of Reg S-K reporting.

1. **Describe any trends in scientific studies (peer-reviewed literature or government sponsored literature reviews or public health risk reports) that indicate potential for substantial health or environmental risks associated with the preparer's products or activities.** An example from nanotechnology manufacture and use would be to disclose evidence that "carbon nanotubes" affect lungs through materials structurally similar to asbestos.

2. **Describe measures the company is taking (or unable to take) to prevent, reduce, or mitigate the risks of potential long-term effects on reputation, demand, liability or regulation.** Such measures could include seeking insurance, promoting exposure controls, funding research, testing or modifying the materials, etc. Investors should know, for instance, that Continental Western Insurance Group announced in 2008 that it would not cover nanotechnology-related risks, citing nanotube dangers specifically. [7]

3. **Qualitatively describe the scope of potential exposure.** While precise quantification of risk may be impossible for nascent technology, where the science triggers these risk makers, investors should also know the extent of a company's potential exposure – e.g., how many people may be exposed and what portion of the company's activities involve use of the material in question.

2. Benchmarking Liabilities: The Example of Asbestos

Clearer guidance and enforcement is needed to ensure that companies estimating liabilities understand the necessity of considering and benchmarking the liability resulting from

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[4] http://www.jdsupra.com/legalnews/nanotechnology-and-asbestos-informing-i-72106/ "Nanotechnology and Asbestos: Informing Industry's Approach to Carbon Nanotubes, Nanoscale Titanium Dioxide, and Nanosilver." Catherine Morris, December 1, 2012

[5] Nanotechnology is a major concern for European health experts, Nanowerk, March 27, 2009 http://www.nanowerk.com/news/newsid=9846.php

[6] George W. Pearson, "The Cost of Uncertainty: Nanotechnology Could be Risky Business," RMI Newsletter (Volume 7. No 1) http://www.asse.org/assets/1/7/GeorgePearsonArticle.pdf

[7] http://www.vorys.com/media/publication/104_Nanotechnology%20Excluded%20from%20Insurance.pdf

comparable cases at other companies. Historical comparisons can accurately indicate the number of cases that could eventually be filed, and the cost per case. Investors, consumers, and companies alike suffer from underestimation.

Present practice conceals the best estimate of liability, prolonging the inevitable acknowledgement of financial failure and subsequent filing for bankruptcy. The history of accounting in asbestos cases illustrates this trend. In the filings and literature on asbestos cases, companies and their lawyers consistently strove to underestimate both the number of cases that would eventually be filed and the cost per case. When a company that fails to benchmark liabilities finally faces the inevitable, it raises its estimates, and declares bankruptcy. Investors are harmed. Two examples illustrate the need for such change.

When Dow Chemical acquired Union Carbide in 2001, Dow reported no asbestos liabilities. Two years later, however, Dow reported $2.2 billion in asbestos liability resulting from the acquisition. The latter figure resulted from benchmarking liability to comparable lawsuit outcomes at other companies. *In the interim*, Dow claimed in its 2002 10-K that it lacked "sufficient comparable loss history from which to assess either the number or value of future asbestos-related claims."

Kaiser Aluminum (a subsidiary of Maxxam Corporation) ignored predictable costs when it reported its asbestos liabilities in the mid-1990s. The resulting imprecision and later elevation of that estimate resulted in a Moody's downgrade and eventual bankruptcy for Kaiser. In 1995, Kaiser estimated on its 10-K that future cash payments resulting from asbestos litigation to be $13 to $20 million for each of the years 1996 through 2000, with an approximate aggregate sum of $78 million for the subsequent period through 2008. *Had Kaiser benchmarked its forecast to the asbestos cases against the Johns-Manville Trust, it would have arrived at a total potential loss of $2.5 billion, disclosing potential liability greater than 15 times the amount accrued.* After subsequent increases to the estimate, Moody's Investor Services lowered Kaiser's ratings on senior and unsecured debt in 2000 – citing uncertain liability estimates as a cause. By 2002, Kaiser and 24 subsidiaries filed for bankruptcy.

3. Encouraging SEC Staff to reference externally developed, investor endorsed Key Performance Indicators.

Regulation S–K promotes the use of key performance indicators in disclosure reports. SEC staff should be encouraged to familiarize itself with, utilize and reference the leading key performance indicators developed or endorsed by investors on issues relevant to ESG disclosure.

On the issues on which the Investor Environmental Health Network engages companies, there are numerous examples of disclosure benchmark documents developed by trade associations, NGO company partnerships, investor organizations and accounting organizations. For instance, with regard to the issue of hydraulic fracturing and its environmental impacts, numerous benchmark documents have been published. In 2011, to clearly articulate investors' reporting expectations, the Investor Environmental Health Network ("IEHN") and the Interfaith Center on Corporate Responsibility ("ICCR") published *Extracting the Facts: An Investor Guide to Disclosing Risks from Hydraulic Fracturing Operations*.[8] An eighteen-month investor dialogue with energy companies, convened by Boston Common Asset Management and Apache Corporation, and supported by members of ICCR and Ceres, provided a venue for extended conversations concerning risks, management practices, and disclosures associated with hydraulic

[8] http://iehn.org/documents/frackguidance.pdf

fracturing operations and a forum for industry experts to review draft practices and indicators.

The dialogue became the foundation for *Extracting the Facts*. The report identifies 12 core management goals, best management practices, and key performance indicators on which investors require disclosure to adequately assess risk management practices. *Extracting the Facts* was intended to promote a "race to the top," encouraging companies to be more transparent and strive for and report on best practices. The guidelines focus on encouraging companies to implement best management practices or to explain why such practices cannot be carried out. Furthermore, they emphasize the importance of going beyond compliance with existing regulations since the current regulatory framework, primarily at the state level, varies in stringency and, as evident from local bans and moratoria, may not be trusted by local communities.

Extracting the Facts has been widely referenced and utilized by investors. Investors on three continents (Australia, Europe, and North America) managing more than $1.3 trillion in assets have expressed support for the guidelines. The guidelines have also been used as the basis for internal risk evaluations conducted by JPMorgan Chase, reportedly the largest energy lender in the United States, and by Standard Chartered and Credit Agricole.[9] The guidelines have also drawn support from companies and nongovernmental advocacy organizations. Referring to an investor disclosure scorecard report based on *Extracting the Facts*, BHP Billiton has stated "The investor scorecard report issued last year gave a clear signal of where investors are seeking broader disclosure. We used that to help improve our public reporting this year."[10]

Out of the various benchmark documents, effective disclosure practices may emerge. The relevant question for regulation S-K reforms relates to whether and how the Securities and Exchange Commission will encourage the uptake of these benchmarks into the SEC filings. Taking the example of hydraulic fracturing, the SEC staff has corresponded with numerous companies on shortcomings of their individual 10-K disclosures. The subject areas found to be inadequate in the SEC's correspondence included companies' approaches to the disclosure of the toxicity of fracturing fluids, controls related to water supply and water quality risks, the companies' penalty records and discussions of liability.

These same subject areas are among the topics covered by external benchmarks intended to provide key performance indicators. A modest step toward improving corporate disclosures in this area would be for Corporation Finance sector Staff to become familiar enough with those external standards to provide references to them in comment letters to companies, as potential models to follow to resolve noted shortcomings in a company's current disclosures. For instance if there were insufficient disclosure of how the company is managing toxicity issues related to hydraulic fracturing, the staff might mention the investor-endorsed disclosure criteria provided in *Extracting the Facts*.

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[9] See page 53 at http://www.jpmorganchase.com/corporate/Corporate-Responsibility/document/JPMC_Full__CR_Report_2013.pdf. See also, http://iehn.org/documents/CPFIShaleGasGuidanceNoteApril2013.pdf.

[10] http://www.mysanantonio.com/opinion/editorials/article/Disclosure-about-fracking-risks-best-policy-5974299.php