June 14, 2021

Via webform

Re: Public Input on Climate Change and ESG Disclosures

Dear Chairman Gensler:

This letter is submitted on behalf of the Fiduciary Duty and Policy Working Group ("Working Group") of the Intentional Endowments Network ("IEN") to support enhanced corporate reporting on climate change and ESG.

The IEN is a non-profit, peer-learning network of more than 185 academic financial institutions, investment managers and related advisors devoted to advancing intentionally designed endowments – those that seek to generate competitive long-term financial performance through sustainable investment practices that are aligned with mission goals of the academic or other institutions to which they are attached. The Working Group consists of investment fiduciaries, attorneys, advisors and educators. It is tasked with developing resources for higher education trustees on application of fiduciary duties to sustainable investment practices.

Summary – Reporting should be Aligned with Fiduciary Duties

We appreciate the opportunity to comment on Acting Chair Lee's Request for Public Input on Climate Change Disclosures. We believe that the SEC's fundamental mission (to protect investors; ensure fair, orderly, and efficient markets; and facilitate capital formation) requires that corporate reporting be updated in order to be fit for achieving its mission goals within our 21st century context.

Most importantly, we think current SEC disclosure standards fail to protect the interests of the ultimate beneficiaries of the collective investment funds that manage their long-term savings. Due to misalignment of reporting standards with the fiduciary obligations imposed upon the managers of those collective funds, it is difficult for investor fiduciaries to meet the full intent of legal obligations to their fund beneficiaries.

Corporate directors are also placed in a similar dilemma because company reporting infrastructure has been developed to capture information that is misaligned with director fiduciary duties to serve long-term company and shareholder interests. This has been a systematic diver of inefficient capital allocation in the markets and will become more problematic as other countries adopt sustainability reporting standards.

As active members of the institutional investment community, we are keenly aware of the need for improved disclosure standards that are aligned with investor fiduciary duties. In order to meet investor needs, ensure efficient allocation of capital in the markets and facilitate sustainable companies, we think that reporting standards should be:

- **Mandatory** for all reporting issuers, while recognizing differences in the resources available at companies of varying size;
- **Comprehensive**, requiring both universally applicable and industry-specific information, so that investors can gain an holistic understanding of company strategic priorities, assess the quality of management and evaluate the suitability of company management incentives, performance metrics and risk management;
- **Comparable**, to facilitate comparisons across industries and companies;
- **Consistent** with the best practices of current frameworks and, to the extent practicable, with developing international standards;
- **Flexible** enough to facilitate regular updating in response to developing issues and advancing knowledge; and
- **Reliable** and suitable for independent reassurance.

We note that the SEC has received extensive data from other commenters which demonstrates that climate change and other environmental, social and governance ("ESG") issues are material pecuniary factors for 21st century investor fiduciaries. We are also aware that increasing amounts of investor assets are flowing into mainstream sustainable investment funds that include climate change and other ESG factors as material investment considerations. We believe these trends highlight the importance of improved reporting standards, for both companies and investors.

However, given that our Working Group has expertise on the fiduciary duties of institutional investors with long-term investment horizons, we will focus the rest of our comments regarding the need for improved corporate reporting on application of the fiduciary duties of investors and corporate directors. We believe it is clear that enhanced disclosure of material climate change and ESG considerations is required in order for investor and corporate fiduciaries to fulfill the full range of their legal duties to fund participants, companies and the shareholders that provide long-term capital to companies. Improved corporate reporting on climate change and material ESG issues is essential for protection of the workers and savers whose long-term funds are being managed by investor fiduciaries, which is a central SEC mission goal.

We have included links to additional information throughout this letter and incorporate those resources herein. Our comments relate primarily to the following topics identified in Acting Chair Lee's request:

- Topic #1 - investors' need for more consistent, comparable and reliable information;
- Topic #8 - company disclosure of related internal governance and oversight practices;
- Topic #13 - how to elicit meaningful discussion of company views; and
- Topic #15 - incorporating climate issues into a broader ESG disclosure framework.

Investors Need Enhanced Reporting to Fulfill the Full Range of their Fiduciary Duties

The focus of the IEN Fiduciary Duty and Policy Working Group has been on educating trustees about their full range of fiduciary duties within the context of our current knowledge base and circumstances in the 21st century. Unfortunately, popular understanding of fiduciary duties is often restricted to simplistic and out-of-date application of a constrained subset of the full scope of fiduciary duty principles with use of outdated assumptions. A more comprehensive legal analysis of fiduciary duty principles which applies current knowledge to 21st century circumstances was authored by one of the Working Group members and is published in the University of Colorado Law Review. We incorporate that analysis as part of our comments.

Fiduciary advice is also regularly discussed in terms that recognize only the minimum behaviors required to avoid liability, rather than to fulfill the purposes and intent of the legal principles intended to guide governance of assets held in trust by agents for the benefit of third party beneficiaries. The Working Group believes that regulatory reporting standards should be structured to inform and incentivize achievement of the full intent of investor fiduciary duties as applied in the current economic, social and natural environment, rather than facilitate only minimalist compliance.

Our comments recognize that much has changed since the 20th century. We think it would be imprudent to not recognize how these developments affect the information that is needed by investor fiduciaries to best meet their legal obligations to fund participants. For example:

- Integrated analysis of climate change and ESG factors as part of the investment process has been broadly adopted by mainstream investors as material to management of risk exposures and investment performance.
- The markets have shifted from being primarily made up of retail investors who control their own investments to markets dominated by institutional investor fiduciaries that are managing long-term savings for large numbers of workers and families that are taxpayers and broadly representative of society in general; and who collectively are the ultimate risk holders and cost bearers of negative externalities created with their capital.
- Modern portfolio theory has come under criticism as incomplete, in that it ignores systematic risk, which determines 75 – 94 per cent of return, while focusing only on capturing small amounts of alpha. In addition, externalities, which are an accepted concept in standard economics, are simply not addressed by modern portfolio theory. Under post-modern portfolio theory, many large investors now recognize that it is possible (and financially rewarding) to manage exposure to systematic risks and reduce fund beneficiary pecuniary losses to negative externalities. ESG issues like climate change are typically a factor in these investment strategies.

In the context of these trends, comprehensive application of fiduciary duty principles necessarily requires analysis of company, industry and systematic ESG and climate change risks and opportunities. The following established aspects of fiduciary duty illustrate this dynamic.

Prudence is a Dynamic Standard that Evolves over Time

The standard of care under the fiduciary duty of prudence has evolved in response to changing knowledge and circumstances since the 20th century. Consideration of climate change and ESG/sustainability as material investment factors is now a mainstream institutional investor practice that has been found to be associated with improved performance. The duty of prudence cannot be fully implemented without increased reporting. IEN resources which address this dynamic include: fiduciary duty overview, state of the field, endowment practices and industry practice information.

The Duty of Obedience Contemplates Alignment of Investments with Mission Goals

Academic and other nonprofit investment institutions have a unique perspective that is often not adequately represented in comments from other investors. They have a fiduciary duty of obedience, which requires them to consider the mission goals of their sponsoring entity in development of investment beliefs and strategies. For example, college or university mission goals usually include preparation of new generations to address problems faced by society, promotion of the scientific method, dedication to the search for truth, etc. Obedience to serving these goals make consideration of climate change and other ESG factors a material component of investment processes for these investor fiduciaries. IEN offers a briefing on fiduciary duties with background on the duty of obedience.

Duty of Impartiality Requires Balancing of Short- and Long-Term Investment Horizons

For investors with inter-generational (even perpetual) financial obligations, use of a long-term investment horizon that considers ongoing portfolio and companies success is required by the duty of loyalty. This imposes an obligation on fiduciaries to consider the externalized effects of portfolio and company actions on resilience and sustainability of the societal, economic, governmental and environmental systems that are essential to generation of future wealth creation and risk mitigation; younger fund beneficiaries will be the ultimate universal holders of related risks and costs (as investors, taxpayers and members of society). The duty of impartiality requires that fiduciaries engage in a good faith balancing of any short-term investment performance benefits with the pecuniary impact of associated longer-term externalized effects of investment practices.

In addition, systematic risks and opportunities that cross company and industry boundaries, which may appear immaterial until they manifest, can increasingly influence beta (market) risk as they aggregate over time. Since the beta component of investment results can account for 75 percent or more of investor returns, it is of particular materiality to long-horizon investors. These dynamics are now understood as important to long-term investors and are beginning to be addressed through beta stewardship. However, effective implementation of related fiduciary duties requires enhanced corporate transparency. See post-modern portfolio theory analysis and resources on long-term investing and fiduciary duty, materiality of systematic issues and inter-generational equity.

Duty to Monitor Includes Ongoing Oversight of Compliance with All Fiduciary Duties

Fiduciary obligations include a duty to monitor how delegated agents are implementing fiduciary responsibilities. This includes oversight of investment management and proxy voting activities. It requires ongoing access to current information necessary for evaluating compliance with all the above aspects of fiduciary duty. See the US Supreme Court's opinion in the *Tibbles* case and a modern legal analysis of monitoring proxy voting for discussion of fiduciary monitoring duties.

Corporate Director Fiduciary Duties Encourage Evaluation of Climate Change and ESG Factors

Delaware corporate law now mandates (outside sale of the company) that directors act in good faith to generate long-term sustainable value for the benefit of the company and its long-term shareholders. For example, in a 2017 Delaware state corporate law case involving *ODN Holding Corporation*, the Delaware Chancery Court held that "the fiduciary relationship **requires that the directors act prudently, loyally, and in good faith to maximize the value of the corporation over the long-term for the benefit of the providers of presumptively permanent equity capital**, as warranted for an entity with a presumptively perpetual life. . . . The fact that some holders of shares might be market participants who are eager to sell and would prefer a higher near term market price likewise does not alter the **presumptively long-term fiduciary focus.**") [Emphasis added.]

This is consistent with the long-term horizon of investor fiduciaries and provides a consistent legal framework that brings materiality of climate change and ESG exposures into focus for both companies and investors – both of which have predominantly long-term horizons. It is inconceivable that corporate directors could comply with this long-horizon fiduciary duty without engaging in long-term strategic planning and risk management, which takes climate and other material ESG exposures into consideration. Disclosure obligations that link these symbiotic investor and corporate long-term fiduciary duties would align state and federal legal standards. This relationship is analyzed in detail in a recent Michigan Business & Entrepreneurial Law Review article.

Conclusion

The similarities of investor and corporate director fiduciary obligations around consideration of long-horizon risks and opportunities associated with climate change and other material ESG issues provides compelling support for SEC enhancement of corporate reporting standards. Alignment of these reporting and fiduciary obligations would not only promote fair and efficient markets, it would also improve the competitive position of American companies by focusing them on long-term strategic planning and risk management practices that have been shown to improve long-term corporate performance, create more jobs and increase GDP.

We hope this information will be helpful and would be happy to provide additional data upon request.

Respectfully submitted,

By: Keith Johnson, Working Group Chair
On behalf of the Fiduciary Duty and Policy Working Group
Intentional Endowments Network