THE PREDISTRIBUTION INITIATIVE

June 14, 2021

Gary Gensler, Chairman
Allison Herren Lee, Commissioner
Ms. Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

By webform: https://www.sec.gov/cgi-bin/ruling-comments

Re: Public Input Welcomed on Climate Change Disclosures, Acting Chair Allison Herren Lee, March 15, 2021.

Dear Chairman Gensler, Commissioner Lee, and Ms. Countryman,

The Predistribution Initiative applauds the SEC for identifying the urgent need for mandatory climate and environmental, social, and governance (ESG) disclosures and appreciates the opportunity to comment. The Commission should move quickly to propose, adopt, implement, and enforce detailed disclosure requirements for all public issuers and private companies, while also considering disclosure requirements for investors, as well.

Our organization is comprised of a team with over 90 years of combined experience in finance, economics, and corporate law, approximately 46 years of which have included a focus on ESG and sustainable investing. Members of our team have developed ESG Management Systems for private equity investment firms, co-founded the Impact Management Project, serve on working groups and committees of standard setting bodies such as the Sustainability Accounting Standards Board (SASB) Standards Advisory Group, structured deals with ESG considerations, worked at Bear Stearns during the Global Financial Crisis, among other experiences that shape our feedback. We are generally supportive of the recommendations made in the Public Citizen / Americans for Financial Reform comment letter. In addition, our own experiences have led us to the understanding of several critical points:

1) Should the SEC mandate E, S, and G disclosures?

   ESG is not and should not be a political issue. E, S, and G considerations impact the health of the financial system and investors' portfolios. Thus, these issues fall squarely within the SEC's mandate to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation. There is an abundance of evidence showing that climate change can pose physical and transition risks which manifest as widespread financial losses to companies, investors, and markets overall. There is also emerging evidence, thanks to initiatives such as the Taskforce on

Nature-related Financial Disclosures (TNFD), that biodiversity loss and other risks to nature can pose systematic risks to investors' portfolios.

As we describe in our recent working paper, "ESG 2.0: Investor Risks Beyond the Enterprise Level," there is also strong evidence that investors and companies engage in activities that result in inequality, and these activities create negative impacts for the real economy.[1] These negative impacts boomerang back to investors' portfolios in the forms of higher risk and lower return. We encourage you to read our paper, which details how over-leveraging companies and pursuing other investment strategies can ultimately shift risk to workers and communities in the forms of lower quality jobs and the deterioration of quality and affordable goods and services. We also outline how these market trends and resulting inequality contribute to secular stagnation, reduced economic growth, monetary policy stretched to its limits, non-financial corporate debt levels (both private and public) that are historically high, and market instability.

Given climate and nature-related issues are existential threats to humanity and by default the financial system, we understand the widespread support of measuring and managing activities that involve climate change. However, invoking the SEC's remit, inequality is also a real and present danger to the health of markets. It will therefore be critical for the SEC to simultaneously prioritize inequality issues.

Investor concern is mounting regarding ESG issues, as documented in the comment letters submitted by our peers, including from, for instance, Paul Rissman, Public Citizen, and Americans for Financial Reform. The abundance of evidence cited in these submissions points to investors viewing these issues to be material in nature, but not having access to meaningful, comparable, and standardized data. And, as others point out in their comment letters, not requiring disclosures on ESG issues is a missed opportunity to prevent another financial crisis.

2) Who should disclose? (this section includes a response to SEC question #14, although it is not designed to be solely a response to #14, as it covers additional topics)

Disclosures must consider risks stemming from both public and private companies, as well as investors.

The case for mandating disclosure by both public and private companies is strong. Public markets have been shrinking, while private markets have become more dominant. As of 2019, the asset value of private equity grew twice as fast as global public equities since 2002, and the

[1] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3820316

number of private equity-backed firms was approximately double that of public equities.[2] Alternatives, including private equity and private credit, are accounting for increasing portions of investors' asset allocation strategies. It would be irresponsible and ineffective for the SEC to bypass an opportunity to mandate reporting from what is now a dominant segment of the market.

In order to develop meaningful disclosures that accurately represent our economy and capture most companies, it will be critical for *at least* private companies with investments from SEC-registered advisers to disclose comparable data to public companies (we would advocate for a larger segment of the market to report – particularly those with institutional capital - depending on the scope of the SEC's remit). We recognize that many private companies are smaller, resulting in a concern of reporting resources and related expenses. However, in an age of big data and technological advancements, there should be no excuse for why companies do not have basic E, S, and G data appropriately documented and organized through data management services. Companies should not just be managing data to report to investors, but to efficiently and effectively manage their organizations. The SEC could develop a template of required disclosures that could easily be captured by stronger data management services. Reporting requirements could be tiered or scaled according to several thresholds of firm size (to be determined through further consultation).

In addition, as we highlight in point #1 above, particularly in private markets, investors engage in activities that can put pressure on portfolio companies to cut costs related to quality jobs, the quality and affordability of goods and services, or the conservation of natural resources, such as biodiversity. Alongside the establishment of mandatory ESG disclosures for public issuers and privately held companies, the SEC should begin to investigate what mandatory disclosures for investors could look like. The goal would be to avoid and mitigate risks that certain investor activities pose to the financial system. Examples could include the over-leveraging of companies and uses of funds from debt proceeds over a certain leverage ratio (e.g. dividend recapitalizations occurring for a company with over 6x debt-to-EBITDA ratios could be disclosed publicly), compensation practices of fund managers (e.g. compensation ratio between fund manager executives and the average portfolio company worker), and tax practices of fund managers (e.g. domiciling of funds in tax havens, "carry waivers," and "fee waivers").

While there have been numerous initiatives by policy makers to develop regulation around these practices, the issues and implications of proposed policy are not well-understood. Mandating disclosure around these activities would allow for improved transparency that would better inform multistakeholder discussions with investors, issuers, civil society, academics, and policy makers and regulators to co-create solutions.

[2] https://www.mckinsey.com/~/media/mckinsey/industries/private equity and principal investors/our insights/private markets come of age/private-markets-come-of-age-mckinsey-global-private-markets-review-2019-vf.ashx

3) What should be disclosed? (includes responses to SEC questions #4, #5, and #15, in addition to other feedback beyond these questions)

   It is becoming widely accepted by investors that ESG issues can pose risks to portfolio companies' financial performance ("outside-in" risks). However, many investors are also beginning to recognize that companies can engage in activities that result in ESG risks to the financial system ("inside-out" risks), even if these activities are not risks to the portfolio company's financial performance. For instance, paying low wages and not offering paid sick leave historically has contributed to strong corporate financial performance. However, when 40% of Americans cannot afford a $400 emergency expense, and when most Americans cannot afford to miss a day of work when sick, the economy is left with little resilience when there are even minor economic shocks.[3] COVID-19 was greater than a minor economic shock, and the real economy's lack of resilience threatened financial markets, as seen in the market losses of March 2020. This required government intervention in the form of low interest rates, QE, and unprecedented commitments to purchase corporate bonds.

   Such government intervention is not without cost, including to investors. Markets now face future uncertainty about the strength of the US dollar, inflation, and the volatility of interest rates. Government intervention has led to such a high build-up of debt – both government and corporate – that it will be difficult to raise interest rates anytime soon without concern of a taper tantrum. And yet, low interest rates are not good for investors' portfolios and incentivize further migration up the risk curve for yield – perpetuating cycles of instability.

   As such, it is critically important that the resilience of the real economy, and particularly matters related investment structures and inequality, are addressed in disclosures. This means not only issues that are financially material to particular portfolio companies, but also to the health of the financial system. Investors' portfolios are largely influenced by systematic factors. In their book, *Moving Beyond Modern Portfolio Theory: Investing that Matters*, co-authors Jon Lukomnik and Jim Hawley reference studies explaining that 75-94% of investors' returns are affected by systematic risk.[4] Thus, our disclosure regime, which focuses only on idiosyncratic risks to particular issuers, is outdated.

   While it is still important to measure and manage idiosyncratic risk, the SEC, in its mandate to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation, must also recognize that it is currently missing information about critical aspects of financial risk to investors. Moreover, the SEC must not only consider the risks that ESG issues pose to issuers

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[3] https://www.federalreserve.gov/publications/2019-economic-well-being-of-us-households-in-2018-dealing-with-unexpected-expenses.htm

[4] Lukomnik, Jon and James Hawley. *Moving beyond Modern Portfolio Theory: Investing That Matters*. Abingdon, Oxon ; New York, NY: Routledge, 2021.

and investors, but also the risks that issuers and investors pose to the health of systems upon which our financial system depends. The Predistribution Initiative would be pleased to engage in follow-on discussions about what these disclosures could look like and how they could be practically reported in a cost-effective manner.

Separately, in response to your question marked #4, the SEC should mandate a single set of disclosures for all companies, and then additional disclosures as relevant by the disclosing entity's activities or sector. In particular, we have found that certain S and G issues are material to all companies and investors (e.g. matters relating to workforce structure and human resource practices), whereas certain E issues (e.g. biodiversity loss) are often more material by sector, but also sometimes by activities (e.g. greenfield development is an activity with significant environmental impacts, but it may not happen every year). We would recommend that companies and investors complete a brief questionnaire about their activities and sector on an annual basis to determine (e.g. automatically generate via webform) the appropriate annual disclosures.

Every disclosing entity should be required to disclose details on some form of an ESG management system, which should comprise of policies, procedures, responsible parties, resources, and performance management practices. Targets with action plans and timelines, and performance against targets, should also be disclosed. In terms of E and S disclosures, disclosing entities over a certain size (to be determined through further consultation) should be required to disclose against generally accepted science-based targets in order for the information to be meaningful and decision-useful. As Donella Meadows once noted, "[S]ustainability indicators should be related to carrying capacity or to threshold of danger… Tons of nutrient per year released into waterways means nothing to people. Amount released relative to the amount the waterways can absorb without becoming toxic or clogged begins to carry a message."[5]

Regarding the proposal of "comply or explain," we believe this could be an appropriate option to offer during a transition period as the initial disclosure framework is developed and adopted. This transition could allow for a one year grace period following the establishment of disclosure requirements, for instance.

Finally, there has been increased concern in the investor community about misalignment between entities' stated ESG priorities and their lobbying and political activities. As Commissioner Lee noted in her remarks on March 15, 2021, political spending disclosure is necessary for investors to adequately test management's claims.[6] In fact, SASB's Conceptual Framework is quite explicit in defining Leadership and Governance to include political influence as a potential area of liability, stating, "This dimension involves the management of issues that

[5] https://donellameadows.org/wp-content/userfiles/IndicatorsInformation.pdf
[6] https://www.sec.gov/news/speech/lee-climate-change

are inherent to the business model or common practice in the industry and that are in potential conflict with the interest of broader stakeholder groups (e.g., government, community, customers, and employees), and therefore create a potential liability or, worse, a limitation or removal of a license to operate. This includes regulatory compliance, and regulatory and political influence. It also includes risk management, safety management, supply-chain and materials sourcing, conflicts of interest, anticompetitive behavior, and corruption and bribery."[7]

While much has been discussed publicly about disclosure by issuers, in line with our other comments in this letter, we also urge the SEC to mandate disclosure for investors, to the extent practicable. For instance, the private equity industry manages approximately 200 lobbyists and has made nearly $600 million in campaign contributions over the past decade.[8] The influence that the private equity industry has over policy and regulation inhibits the ability of policy makers and regulators, including the SEC, to independently govern capital markets. This influence has also been found to protect tax avoidance schemes, which further limits the resources available for policy makers and regulators to govern.

Therefore, we highly recommend that mandatory disclosures include requirements for companies and investors to disclose their political influence activities, focusing on the disclosures that most effectively support investors' ability to test claims and establish accountability. In practice, this means disclosure of all direct and indirect political spending designed to influence elections, ballot measures and legislation, as outlined in the CPA-Zicklin Model Code of Conduct for Corporate Political Spending.[9] In addition, it is critical that disclosures include the content of companies' lobbying positions and not just their spending.[10]

Recognizing the importance of this issue, the Big Four accounting firms included a metric for lobbying alignment in their effort to align on a coherent, universal set of ESG metrics, described in Measuring Stakeholder Capitalism.[11] Drawing on GRI standard #415, they included an extended metric under Principles of Governance, which requires, "Alignment of strategy and policies to lobbying: The significant issues that are the focus of the company's participation in public policy development and lobbying; the company's strategy relevant to these areas of focus; and any differences between its lobbying positions and its purpose, stated policies, goals or other public positions." In our view, this requirement would provide much of the critical information investors' need to advance and protect their interests; however, to do so, it would have to be elevated beyond its current status as an optional, "extended" metric.

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[7] https://www.sasb.org/standards/conceptual-framework/
[8] https://www.opensecrets.org/industries/totals.php?cycle=2020&ind=F2600; https://www.nytimes.com/2021/06/12/business/private-equity-taxes.html
[9] https://politicalaccountability.net/hifi/files/CPA-Wharton-Zicklin---model-code-of-conduct-for-corporate-political-spending---10-13-20-.pdf
[10] https://hbr.org/2016/10/research-whos-lobbying-congress-on-climate-change
[11] http://www3.weforum.org/docs/WEF_IBC_Measuring_Stakeholder_Capitalism_Report_2020.pdf

4) Where should disclosures appear and how should integrity of disclosures be maintained? (responses to SEC questions #10, #11, #13)

   Disclosures should appear at least in annual SEC filings. Disclosures must be consistent, standardized, comparable, clear and transparent, decision-useful, and where possible, machine-readable across comparable entities. As such, we are not in favor of disclosures solely appearing in qualitative sections of financial reports, such as MD&A. There should be a standardized format requesting quantitative data where possible, but also allowing for qualitative data in sections such as MD&A.

   We believe that issuers and investors above a certain size (to be determined through further consultation) should be required to have their disclosures externally audited. We do not have recommendations on who appropriate auditors would be at this time. Regardless of company size, all disclosures should be subject to review by the Chief Financial Officer (CFO) and Audit Committee, and subject to attestation by the CFO.

   We agree with the proposal that the SEC consider whether management's annual report on internal control over financial reporting and related requirements should be updated to ensure sufficient analysis of controls around climate reporting, but also ESG reporting. We recommend that a task force develop and maintain basic certification requirements for CEOs, CFOs, and Board Directors relating to climate disclosures.

5) How should disclosures be formed? (responses to SEC questions #5, #6, and #9)

   There are a number of voluntary disclosure regimes from which the SEC could learn, including SASB, Global Reporting Initiative (GRI), Taskforce on Climate-related Financial Disclosures (TCFD), Climate Standards Disclosure Board (CSDB), the Impact Management Project (IMP), among others, including emerging frameworks such as the TNFD and Taskforce on Inequality-related Financial Disclosures (TIFD).[12] We believe that each of these frameworks were or are being developed for specific purposes, many of which are not entirely aligned with the SEC's mandate, but which can still offer a strong foundation for a SEC-mandated disclosure framework. We believe that each framework has its pros and cons and recommend that the SEC develop a task force to evaluate each framework and adopt the most appropriate disclosures from each. The task force could have a continuous mandate to liaise with voluntary disclosure frameworks and maintain updates to the SEC's framework accordingly.

   We also recommend that this task force work closely with other standard setters that are responsible for mandatory disclosures in other jurisdictions to ensure alignment between global

[12] The Predistribution Initiative is a founding partner of TIFD, and more information may be found at www.thetifd.org

mandates. This will support investors in maintaining access to consistent and comparable data and support the seamless functioning of markets.

We realize that many of our recommendations require further discussion, and we would be pleased to follow-up if it is of interest to you. The Predistribution Initiative recognizes that there are no simple and easy answers, and that solutions are best developed when co-created together with industry, diverse stakeholders, and policy makers and regulators.

Thank you for taking the time to consider our responses. We look forward to future engagement on these complex issues.

Kind regards,

Delilah R. Rothenberg,

Co-Founder & Executive Director

Predistribution Initiative