



Columbia Center on Sustainable Investment

A JOINT CENTER OF COLUMBIA LAW SCHOOL
AND THE EARTH INSTITUTE, COLUMBIA UNIVERSITY

December 10, 2019

The Honorable Jay Clayton, Chair
Commissioner Robert J. Jackson, Jr.
Commissioner Hester M. Peirce
Commissioner Elad L. Roisman
Commissioner Allison H. Lee

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

Re: Disclosure of Payments by Resource Extraction Issuers - Section 13(q)

Dear Chair Clayton and Commissioners:

We are writing to share our comments regarding the drafting of the proposed Rule 13(q) to implement Section 1504 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Our comments expand on the October 30, 2015 submission by the Columbia Center for Sustainable Investment (CCSI).¹ These comments, which outlined seven points regarding the usefulness of data made public as a result of Section 13(q) were subsequently addressed by SEC Division of Corporation Finance staff in the notes to the Final Rule for Disclosure of Payments by Resource Extraction Issuers (Release No. 34-78167) made effective on September 26, 2016.²

The following is intended as a response to the points raised in the notes to the 2016 final rules. Our hope is that further elaboration on the materiality of these disclosures will be useful as you draft a new proposed rule for the implementation of Section 13(q) that protects investors and promotes efficient capital markets by making public valuable factual information useful in securities analysis.

Since the beginning of the first Section 13(q) rulemaking comment period in late 2010, investors with more than \$10 trillion in assets under management have written repeatedly to the SEC Chair and Commissioners in support of strong rules for the

¹ Letter to Mary Jo White, Chairman, U.S. Securities and Exchange Commission. Columbia Center on Sustainable Investment, Jeffrey Sachs and Paul Bugala. October 30, 2015. <https://www.sec.gov/comments/df-title-xv/resource-extraction-issuers/resourceextractionissuers-93.pdf>.

² U.S. Securities and Exchange Commission. Disclosure of Payments by Resource Extraction Issuers Final Rule. Effective September 26, 2016. Pages 169 to 173. <https://www.sec.gov/rules/final/2016/34-78167.pdf>.

implementation of the law. Among the general benefits and considerations, they referenced “investors’ substantial interest in oil, gas and mining industry payment transparency.”³ They also underscored that the SEC’s August 2012 implementing rule “...would protect investors and promote efficient capital markets by providing investors with valuable factual information on risk profiles and company performance.”⁴ They have also noted, “The disclosures required by Section 13(q) help address the need of detailed information regarding the financial relationship between extractives companies and the governments where they operate.”⁵ More specifically, investor comments have consistently emphasized the value of disclosures that are disaggregated at the project level and company specific in a manner consistent with the complementary and already implemented European Union (EU) and Canadian laws.

On February 16, 2016, Calvert Research Management, Inc. (a subsidiary of Eaton-Vance), submitted a summary of investor comments regarding Section 13(q) to that date.⁶ Investors have made subsequent supportive comments during the 2016 rulemaking process⁷ and following the February 14, 2017 joint resolution of disapproval enacted pursuant to the Congressional Review Act.⁸

Presiding SEC commissioners and a former chair validated the perspectives shared by these investors when the SEC issued its final implementation rules for Section 1504 in August 2012. For example, Commissioner Luis Aguilar stated plainly, “[t]he final rule we consider today is in the interest of investors.”⁹ Additionally, Chairman Elisse Walter

³ Letter to Mary Jo White, Chairman, U.S. Securities and Exchange Commission. Group of institutional investors. August 14, 2013. <https://www.sec.gov/comments/df-title-xv/resource-extraction-issuers/resourceextractionissuers-3.pdf>.

⁴ Letter to Mary Jo White, Chairman, U.S. Securities and Exchange Commission. Group of institutional investors. April 28, 2014. <http://www.sec.gov/comments/df-title-xv/resource-extraction-issuers/resourceextractionissuers-36.pdf>.

⁵ Letter to Jay Clayton, Chairman. U.S. Securities and Exchange Commission. Steve Waygood, Chief Responsible Investment Officer, Aviva Investors. February 12, 2018. <https://www.sec.gov/comments/df-title-xv/resource-extraction-issuers/cll6-3130136-161939.pdf>.

⁶ Letter to Mary Jo White, Chairman, U.S. Securities and Exchange Commission. Calvert Investment Management, Inc. February 16, 2016. <https://www.sec.gov/comments/s7-25-15/s72515-39.pdf>.

⁷ These comments include the following.

Letter to Mary Jo White, Chairman. U.S. Securities and Exchange Commission. Erik Jan van Bergen, Chief Investment Officer, ACTIAM NV, et al. March 8, 2016. <https://www.sec.gov/comments/s7-25-15/s72515-52.pdf>.

Letter to Mary Jo White, Chairman. U.S. Securities and Exchange Commission. US SIF: The Forum for Sustainable and Responsible Investment. March 8, 2016. <https://www.sec.gov/comments/s7-25-15/s72515-54.pdf>.

⁸ These comments include the following.

Letter to Jay Clayton, Chairman. U.S. Securities and Exchange Commission. Steve Waygood, Chief Responsible Investment Officer, Aviva Investors. February 12, 2018. <https://www.sec.gov/comments/df-title-xv/resource-extraction-issuers/cll6-3130136-161939.pdf>. Anne Sheehan, Director of Corporate Governance, California State Teachers' Retirement System. Letter to Jay Clayton, Chairman. U.S. Securities and Exchange Commission. February 1, 2018. <https://www.sec.gov/comments/df-title-xv/resource-extraction-issuers/cll6-3079757-161907.pdf>.

⁹ U.S. Securities and Exchange Commission. Aguilar, Commissioner Luis A. “Facilitating Transparency of Resource Revenue Payments to Protect Investors.” SEC Open Meeting.

pointed out how investors could use this payment information in securities analysis and referenced the capability of these disclosures to contribute to market stability and more predictable investment conditions.¹⁰

Investors themselves have identified specific use cases for the data that would result from Section 13(q), as in a March 8, 2016 submission made by investors representing more than \$3.1 trillion in assets under management including Aviva Investors, BMO Global Asset Management, BNP Paribas Investment Partners, and Legal & General Investment Management.¹¹ That submission to the Commission included the following endorsement of the arguments set forth in the CCSI letter on October 30, 2015.

Finally, as the SEC evaluates the investor benefits of the proposed rule we recommend for your consideration the submission made by Jeffrey Sachs and the Columbia Center for Sustainable Investment (CCSI), which includes several clear demonstrations of the usefulness of the current Section 13(q) proposed rule in investment analysis for differing asset classes and methodologies.

In the notes to its 2016 final rules for Section 13(q), the SEC provided specific responses to each of the seven points outlined in the CCSI submission. What follows are both general and specific responses to the SEC's comments regarding the CCSI letter's arguments as set out in Release No. 34-78167. Following that is a further elaboration on the letter's points regarding government take and political risk assessment, which provides a further illustration of the usefulness of Section 13(q) disclosures in routine securities analysis.

Summaries of CCSI's arguments regarding the usefulness of Section 13(q) payment data in securities analysis and the SEC responses follow. They have been abbreviated here, but can be read in full in Release No. 34-78167, pages 169 to 173 (81 Fed. Reg. 49359, 49404).

Argument 1: Project level payment reporting helps deploy sound risk-diversification strategies where a key component of projects' costs (i.e. taxes, royalties or other payments) become known.

SEC Response: "We note, however, that additional information, beyond the disclosure required by Section 13(q), is needed to estimate returns and variation of returns of a project or portfolio of projects in a given country."

Argument 2: Help adjust assumptions on major costs to the project, like taxes and other payments. With the benefit of project level income tax reporting, using the actual tax rate rather than the "company-wide income tax data" can have an impact on valuations.

SEC Response: "While the benefit of having accurate tax information when valuing a project or a company is indisputable, it is unlikely, as we indicated [above], that an

Washington, D.C. August 22, 2012.

<http://www.sec.gov/News/PublicStmnt/Detail/PublicStmnt/1370542580723>.

¹⁰ U.S. Securities and Exchange Commission. "Statement at SEC Open Meeting." Commissioner Elisse B. Walter Washington, D.C. August 22, 2012.

<http://www.sec.gov/News/PublicStmnt/Detail/PublicStmnt/1370542577444>.

¹¹ Letter to Mary Jo White, Chairman. U.S. Securities and Exchange Commission. Erik Jan van Bergen, Chief Investment Officer, ACTIAM NV, et al. March 8, 2016.

<https://www.sec.gov/comments/s7-25-15/s72515-52.pdf>.

investor or analyst will have accurate information for other components (e.g. revenues, total costs and cost of capital) necessary to value a project.”

Argument 3: Help assess the exposure to commodity price downturns by using industry cost curves to forecast commodity prices.

SEC Response: “As noted [above], such benefit assumes that all other relevant costs (e.g. production costs and capital expenditures), besides the one reported under Section 13(q), are known to investors, which may not be the case.”

Argument 4: Studies have shown that companies that disclose earnings and tax payments outperform peers. In addition, more transparent companies lower their cost of capital over time.

SEC Response: “The studies, however, do not provide that resource extraction transparency in particular leads to lower cost of capital; rather, the studies conclude more generally that earnings transparency and the strength of the country’s securities regulations can have a major impact on cost of capital.”

Argument 5: Project level payment reporting can help lower political risk.

SEC Response: Such a benefit, however, depends not only on resource extraction payment disclosure, but also on other types of disclosure and the quality of the governance of the host country.

Argument 6: Better understand the risks of fiscal regulatory change

SEC Response: Not addressed.

Argument 7: Help solve the principal – agent problem

SEC Response: Not addressed.

The SEC's response to several of these arguments was that additional information, beyond the disclosure required by Section 13(q), were needed to achieve the benefits or utility identified by several of the arguments. For example, the response to Arguments 1, 2, 3 and 5 in the notes to the final 2016 rulemaking said that investors and analysts would need a variety of additional elements, including, revenues, total costs, production costs, capital expenditures and cost of capital, which may not be readily available, to achieve the claimed benefit or insight.

While this line of reasoning has some validity through the lens of economic analysis, it overlooks the realities of applied securities analysis in fiercely competitive markets where consistent, reliable and detailed project-level payment data already are quite valuable to energy and materials analysts. The provision of incremental, material financial data due to security market regulatory changes or increased oversight has been a regular occurrence over time. These additional data are often valuable simply to validate the claims of company management or prompt new questions surrounding the risks and opportunities of a documented activity. From a securities analyst's perspective, the large dataset of disclosures already required by complementary laws producing public, project-level disclosures in Canada and the European Union are a powerful tool for the analysis of material considerations in the oil and mining industries, including those outlined in Argument 5 (Political Risk) and Argument 6 (Fiscal Regime Change).

The value of these data to securities analysts is so clear to the market that an incomplete version is already available on Bloomberg terminals. The field ES122 - Taxes

Paid to Governments (TAXES_PAID_TO_GOVERNMENTS) lists the total amount of taxes paid directly to governments by companies across all industries including the energy and materials sectors. Like the statutory requirements of Section 13(q) and its companion laws in the EU and Canada, the data provided in the Bloomberg field includes all taxes, royalties, and duties paid, not just those taxes paid on income. For companies in Bloomberg's Energy and Metals and Mining categories, these data might be disclosed as part of the Extractive Industries Transparency Initiative (EITI) and in company corporate responsibility reports. Since these data represent actual annual cash outflows, and not accrual-based estimates -- and are often significant as a percentage of total cash flow from operations -- their value in making future cash flow forecasts is clear.

The availability of this data from a Bloomberg terminal is a strong indication of its value to securities analysts alongside the many other data points that contribute to their decision-making. Further, while EITI reports and corporate responsibility disclosures have value, they are not the global, consistent and reliable source of payment data that the reports under Section 13(q) would be alongside the already successful payment reporting that has been taking place for several years pursuant to complementary EU and Canadian laws.

Beyond the general point regarding the usefulness of any one data point in securities analysis, the discussion in the 2016 rule also discounted the specific value of several of the arguments endorsed by investors including: "Better understand the risks of fiscal regulatory change" and "Project level payment reporting can help lower political risk". We believe that further consideration of these points reveal why these conclusions should be reconsidered.

With regard to the use of Section 13(q) data in understanding fiscal regulatory change one needs only consider how often the fiscal terms of oil and gas contracts change over their existence. The valuation of a typical oil and gas exploration and production company has its most obvious sensitivities to energy prices and finding and development costs. However, research indicates that changes in the host country take rates or total remittances to foreign governments can also have a material effect on a security's value. This is particularly interesting, because annual fluctuations in remittances are common.

The production entitlements, income taxes, royalties, bonuses, license fees, and other expenses that make up government remittances are set and managed through varying agreements based on the country of operation. These might include production sharing agreements, concessions, joint ventures or service agreements. The only constant in these arrangements is change. Whether due to political instability, the challenges in other host country industries or changes in energy prices, fiscal regime changes occur frequently. The Figure 1 illustrates the annual change in investor value around the world in 2018, due to petroleum fiscal regime disruptions through the year. Increases in government share imply a corresponding decrease in investor share.

Figure 1
 Petroleum Fiscal Regime Disruptions 2018 versus 2017



Source: WoodMac

The value of this data to securities analysts is indicated by its availability from the energy and mining research and consulting group Wood Mackenzie. Wood Mackenzie markets a product called its Fiscal Service to oil and gas exploration and production companies, investors and governments. This service offers petroleum fiscal regime summaries for over 150 countries, the tracking of 750 economic metrics per fiscal system and a global fiscal terms database with each country's exploration terms and fiscal changes over time. An essential part of this service is the ability to "compare and benchmark global fiscal systems", as well as "Assess fiscal systems' response to changes in the economic environment".¹²

Investors with sufficient resources are able to access Wood Mackenzie's Fiscal Service and those with holdings in EU or Canadian registered oil and mining companies can access payment reports that aid in benchmarking regimes, yet investors in US-listed companies still do not have access to the same data. This highlights one of the key disadvantages of the lack of publicly available data under Section 13(q) pointed out by investors repeatedly during the course of the rulemaking process. The SEC must take into account its responsibility to promote capital formation and protect investors as it develops rules to implement Section 13(q). Slow implementation of this mandate has created a hindrance to investors that can be addressed only by the prompt issuance of a rule that mandates disclosure consistent with the existing EU and Canadian laws.

Another area where the 2016 final rule analysis found fault was in the usefulness of Section 13(q) data in decreasing political risk. The response in the SEC's analysis indicates that, as is the case for other factors, additional information is necessary to achieve the benefit or utility indicated in the CCSI letter. We believe that this perspective also reflects a view of the usefulness of this data indicative of an economist's point of

¹² Wood Mackenzie Web site. "Products and Services: Fiscal Service". Accessed December 7, 2019. <https://www.woodmac.com/research/products/upstream/fiscal-service/>.

view, but not that of a practicing securities analyst. In fact, in the area of sovereign debt analysis, positive market signals regarding the decrease in political risk deriving from increased transparency of extractives payments abound. In addition, much evidence suggests that EITI implementation and compliance have become leading indicators of substantive efforts to reduce political risk and enhance stability in the eyes of the main credit rating agencies.

As noted in the October 2015 CCSI letter, in October 2013, the credit rating agency, Moody's, referenced the approval of Senegal's EITI candidacy as a "credit positive."¹³ In its note on the development, Moody's noted the following:

*[Senegal's EITI candidacy] is credit positive because it reinforces Senegal's commitment to improve transparency and governance, strengthens the predictability of the operating environment in the extractive sector, and promotes exploitation of the country's resources, all of which will support the country's future growth prospects and the government's creditworthiness. Adopting EITI standards will provide a more predictable operating environment in the natural resources sector.*¹⁴

More recently, in May 2018, the International Monetary Fund (IMF) conditioned a three-year Extended Fund Facility loan to Equatorial Guinea of \$280 million on factors including the country's implementation of EITI¹⁵. As of December 2019, Equatorial Guinea has not begun EITI implementation and the IMF has yet to approve the credit facility.

A February 2016 report released by the United Nations Principals for Responsible Investment and the EITI Secretariat titled "Using the Extractive Industries Transparency Initiative (EITI) to enhance credit ratings assessments" points out several other benefits of detailed, public extractives payment data in the credit analysis done by investors in all sectors. In particular, the report notes, "As the EITI moves toward project-by-project reporting, data disclosed become even more granular, enabling CRAs (Credit Risk Analysts) to examine specific projects that are likely to have a major impact on the government fiscal position."¹⁶

These are only a few of the many examples that indicate that the availability of oil and mining payment disclosures to securities analysts can have positive effects on the investment environment of countries and their sovereign debt. The SEC indicates a very similar understanding in the analysis of 2016 final rule, as it notes, "To the extent that the final rules increase transparency and thus reduce corruption, they would increase

¹³ Moody's Investors Service, Inc. "Issuer Comment: Senegal's EITI Candidacy Status Approved, a Credit Positive". October 25, 2013. http://www.alacrastore.com/moodys-credit-research/Senegal-s-EITI-Candidacy-Status-Approved- a-Credit-Positive-PBC_159679#sthash.1OG03a9s.dpuf.

¹⁴ Ibid.

¹⁵ Equatorial Guinea: Letter of Intent, Memorandum of Economic and Financial Policies, and Technical Memorandum of Understanding. The Government of Equatorial Guinea and the International Monetary Fund. May 11, 2018. <https://www.imf.org/external/np/loi/2018/gnq/051118.pdf>.

¹⁶ United Nations Principals for Responsible Investment and the EITI Secretariat. Using the Extractive Industries Transparency Initiative (EITI) to enhance credit ratings assessments. February 2016. <https://www.unpri.org/download?ac=202>.

efficiency and capital formation."¹⁷ It should also be noted that the credit ratings of countries also are a significant factor in the analysis of securities beyond sovereign debt.

However, these benefits are presently limited to countries in which EITI implementation is politically feasible and/or where payment data is available through Section 13(q)'s complementary laws in the EU and Canada. Unfortunately, the limits of EITI's reach, its relatively slow and sometimes uneven reporting, and the not yet global implementation of mandatory extractives payment reporting deprive investors of important data and indicators of investment stability and creditworthiness in many countries where improvements in governance are likely to be material considerations. The public availability of consistent, global oil and mining payment data would remove the need for analysts and regulators to rely on cumbersome tests of political risk and accountability such as EITI membership and let a country's payment disclosures speak for themselves.

In summary, we commend the SEC on its thoroughness in the development of the previous versions of the rules for the implementation of Section 13(q). We are particularly grateful for the detailed response to the arguments set forth in the October 30, 2015 CCSI letter. As such, we have taken this opportunity to respond briefly to the points raised in the SEC's 2016 discussion, in hopes of further assisting SEC in this process by demonstrating the important investor interests served by a robust rule consistent with the rules already in place in other jurisdictions. We would like to reemphasize that the investor comments indicate strongly that an effective implementing rule would mandate disclosures that are disaggregated at the project level and company specific in a manner consistent with the complementary and already implemented EU and Canadian laws.

We are quite eager to expand on these and related points with the SEC as it contemplates the development of a new draft version of the Section 13(q) implementation rules. We welcome the opportunity to be in touch in this regard at your convenience.

Sincerely,



Perrine Toledano
Head: Extractive Industries, Columbia Center on Sustainable Investment



Nicolas Maennling
Senior Economics and Policy Research, Columbia Center on Sustainable Investment

¹⁷ U.S. Securities and Exchange Commission. Disclosure of Payments by Resource Extraction Issuers Final Rule. Effective September 26, 2016. Page 166.
<https://www.sec.gov/rules/final/2016/34-78167.pdf>.



Paul Bugala
Independent Investment Analyst

CC:

Mr. Brent J. Fields, Secretary of the Commission, Office of the Secretary

Ms. Elizabeth Murphy, Associate Director, Division of Corporation Finance

Ms. Tamara Brightwell, Senior Special Counsel to the Director, Division of Corporation Finance

Mr. Elliot Staffin, Special Counsel, Division of Corporation Finance

Mr. Vladimir Ivanov, Financial Economist, Division of Corporation Finance