July 21, 2016

Office of the Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

To the Office of the Secretary, SEC re: **File Number S7-06-16**:

We are an international association of sustainability professionals known as the *Sustainability Context Group*, or SCG. We consist of corporate managers, practitioners, consultants, academics, accountants and NGO advisors dedicated to the improvement of sustainability measurement and reporting practices in business and society. We are particularly committed to the development and use of "context-based" tools, methods and metrics, by which the sustainability performance of organizations can be revealed in more meaningful and rigorous ways than most of what passes for mainstream practice today.

We are writing at this time to provide comments in response to specific sections of the *Concept Release* you issued on April 22, 2016 re: **Business and Financial Disclosure Required by Regulation S-K**. We appreciate your consideration and would be happy to address any questions you might have about our views on the subject as set forth in the pages below. More information about the "context-based" approach we subscribe to and our association itself can be found here: www.sustycontext.org.

Sincerely,

Bill Baue, Reporting 3.0, Co-founder of SCG
David Baxter, Independent Sustainability Consultant
Heather Burns, Connecticut Sustainable Business Council
Charles Cho, ESSEC Business School
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Comments Submitted by the Sustainability Context Group
To the Securities and Exchange Commission
re: April 22, 2016 Concept Release
File Number S7-06-16

July 21, 2016

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 210, 229, 230, 232, 239, 240 and 249

[Release No. 33-10064; 34-77599; File No. S7-06-16]

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Business and Financial Disclosure Required by Regulation S-K

IV. Information for Investment and Voting Decisions

F. Disclosure of Information Relating to Public Policy and Sustainability Matters

3. Request for Comment

216. Are there specific sustainability or public policy issues [that] are important to informed voting and investment decisions? If so, what are they? If we were to adopt specific disclosure requirements involving sustainability or public policy issues, how could our rules elicit meaningful disclosure on such issues? How could we create a disclosure framework that would be flexible enough to address such issues as they evolve over time? Alternatively, what additional Commission or staff guidance, if any, would be necessary to elicit meaningful disclosure on such issues?

The needs and interests of investors include consideration of registrants' non-financial performance as well as their financial performance. This is especially the case now, as the vast majority of shareholder value or market capitalizations (>80 percent) cannot be attributed to the book values of listed firms alone (see representative study by Ocean Tomo, LLC on this issue here: http://www.oceantomo.com/2015/03/04/2015-intangible-asset-market-value-study/). Thus, the need to require non-financial reporting in addition to financial reporting is fundamental and long overdue. Having access to that information not only serves the interests of investors, but helps ensure the operating integrity of our capital markets – and the social and environmental systems upon which they are founded – as well. From our perspective, this is the public policy issue in play here.

Of particular importance is the role that corporate reputations play in the determination of stock prices and market values, especially as a consequence of their Corporate Social Responsibility (CSR) and sustainability performance. This swings both ways: companies with strong (i.e., positive) CSR/sustainability performances and reputations can expect to be rewarded in the form of higher stock prices and market values, just as companies with weak (i.e., negative) performances and reputations can expect their stock prices and market values to decline.

Perhaps the strongest evidence of the causal connections between CSR/sustainability performance, reputations and market capitalizations (caps) can be found in the research performed by Reputation Dividend in the UK, whose quantitative analyses of the phenomenon are striking. In 2015, for example, researchers there found that close to 17 percent of the total market caps of the S&P 500, or approximately $3.329 trillion, were attributable to the reputations of the firms listed. Roughly $356 billion of that amount, in turn, was attributable to CSR/sustainability performance alone. That equates to roughly 2 percent of the total market caps of the S&P 500 in 2014.

But that's just an average. The market caps of individual firms can be much higher or lower. Apple Computer, for example, in 2014 experienced a 4 percent boost in its market value as a result of its CSR/sustainability reputation or roughly $26 billion. In the UK at the close of 2015, Unilever, a recognized leader in CSR/sustainability performance, experienced an even higher boost of 5 percent, valued at $6.52 billion, while Marks & Spencer's (another CSR/sustainability leader) enjoyed a 6.2 percent bump.

Regarding the questions of how, if the SEC were to adopt specific disclosure requirements involving sustainability or public policy issues, its rules could elicit meaningful disclosure on such issues; and how it could create a disclosure framework that would be flexible enough to address such issues as they evolve over time, we have a specific solution to offer here. In the field of CSR/sustainability management, a flexible methodology for measuring and reporting performance known as *Context-Based Sustainability* makes it possible to assess performance in consistent ways despite the differences that will exist between organizations and their changing circumstances over time. The measurement and reporting principle behind this approach is known as *Sustainability Context*, which has been long advocated by the world's leading international standard for sustainability reporting (the Global Reporting Initiative, or GRI) for the past sixteen years. GRI defines the Sustainability Context principle as follows (taken from GRI's G4 Sustainability Reporting Guidelines found here: https://www.globalreporting.org/standards/g4/Pages/default.aspx):

> Information on performance should be placed in context. The underlying question of sustainability reporting is how an organization contributes, or aims to contribute in the future, to the improvement or deterioration of economic, environmental and social conditions, developments, and trends at the local, regional or global level. Reporting only on trends in individual performance (or the efficiency of the organization) fails to respond to this underlying question. Reports should therefore seek to present performance in relation to broader

> concepts of sustainability. This involves discussing the performance of the organization in the context of the limits and demands placed on environmental or social resources at the sector, local, regional, or global level.

Like financial reporting, the use of Context-Based Sustainability (CBS) begins with the completion of materiality analyses to determine (a) who an organization's stakeholders are, and (b) what its non-financial impacts are or ought to be of a sort that can affect (their) stakeholders' well-being. This is very much akin to setting financial goals or standards of performance, against which actual performance can be assessed. Indeed, the process is almost identical except for (a) instead of focusing only on shareholders, non-financial impacts are assessed relative to the interests of other stakeholders as well, and (b) instead of assessing impacts on economic capitals only, non-financial assessments evaluate impacts on other capitals as well (i.e., natural, human, social, constructed and intellectual capitals).

This multiple-capitals-based approach to assessing performance is now rapidly gaining steam and is explicitly called for in three other highly relevant international standards for measuring and reporting the non-financial performance of listed firms: the Sustainability Accounting Standards Board (SASB), the International Integrated Reporting Council (IIRC) standard for Integrated Reporting (<IR>), and the Global Initiative for Sustainability Ratings (GISR). The SEC, too, should embrace this approach in its own rules.

We also wish to call the SEC's attention to what many are now referring to as "systemic risk." Such risks can be found in the social, environmental and economic systems in which organizations operate and to which they themselves may be contributing (either positively or negatively). Climate change, for example, both affects and is affected by an organization's operations. Other sources of systemic risk include global financial volatility and deepening income and wealth inequality. And while all investors should be concerned with systemic risk, institutional investors in particular have a fiduciary responsibility to the long-term well-being of their beneficiaries, the fulfillment of which arguably requires access to information about much more than just the financial performance of their holdings.

In a report entitled, *Portfolios and Systemic Framework Integration: Theory and Practice* (http://static1.squarespace.com/static/55774504e4b079af9a837d5d/t/5648c79de4b0e7b6bff354f6/1447610269762/TIIP_Portfolios+and+Systemic+Framework+Integration_Exposure+Draft.pdf), Steve Lydenberg of *The Investment Integration Project* (http://www.investmentintegrationproject.com) explains systemic risk as follows:

> … the strength or weakness of environmental, societal and financial systemic frameworks [or systems] substantially impacts the ability of investors to generate returns. Without the smooth function of these systems, returns to all portfolios suffer. Conversely, portfolio managers through their collective investment decisions can disrupt these same systems either negatively or positively—creating instability or enhancing their investment potential. As we enter the heart of the 21st century, investment portfolios and the systemic

> frameworks that support them will be increasingly interdependent and interrelated.

It is vitally important, therefore, that the non-financial sustainability performances of organizations be measured and reported in the broader context of the social, environmental and economic systems in which they occur, so that investors can understand the degree to which their investments may be exposed to, if not at least partly responsible for, systemic risk. Context-based reporting is indispensable for characterizing and measuring such risk, since it is precisely an organization's performance (and sustainability) in the broader context of social, environmental and economic systems that it is designed to address.

* * * *

[More information about Reputation Dividend and its 2015 U.S. Report (re: 2014 performance) can be found here: http://www.reputationdividend.com/recent-studies/]

[Two articles by one of us [McElroy (2015 and 2016)] in which the connections between the CSR/sustainability performance of listed companies and their market values can be found here:

> *At Last, A Business Case for CSR That Even Milton Friedman Could Love: The Sustainability Effect!* (2015):
>
> http://www.sustainablebrands.com/news_and_views/new_metrics/mark_mcelroy/last_business_case_csr_even_milton_friedman_could_love_susta
>
> *New Evidence Bolsters Claims of Connectivity Between CSR and Market Caps* (2016):
>
> http://www.sustainablebrands.com/news_and_views/new_metrics/mark_mcelroy/new_evidence_bolters_claims_connectivity_between_csr_market_]

217. Would line-item requirements for disclosure about sustainability or public policy issues cause registrants to disclose information that is not material to investors? Would these disclosures obscure information that is important to an understanding of a registrant's business and financial condition? Why or why not?

This question highlights the importance of performing materiality analyses as an integral part of measuring and reporting non-financial performance. If properly performed, there should be no immaterial information included in such reports. In general, we take the position that disclosure of an organization's non-financial (i.e., social and environmental) performance should be confined to only those impacts for which corresponding duties or obligations to act or not act in specific ways exist. Just as an organization owes a duty of economic performance to its shareholders, so will it typically owe duties of other kinds (social and environmental ones) to other stakeholders. It is its performance relative to these other duties and obligations that should be reported in non-financial disclosures, if only because of the effects it can have on shareholder value.

The position we take here effectively rules out the possibility of including disclosures of actions companies have taken to engage in voluntary social causes, philanthropy or other discretionary activities and instead focuses on performance relative to normative duties and obligations. Indeed, it is the latter form of performance that should matter most to shareholders, since the failure to act in obligatory ways (legal, moral or otherwise) is what can put shareholder value at risk. This is why under the *Context-Based Sustainability* methodology cited above we give top priority to identifying the types of social and environmental (non-financial) impacts an organization is or ought to be having in ways that can affect stakeholder well-being, and that a firm is duty-bound to have or not have as the case may be.

By performing materiality determinations in this way, only non-financial impacts that can affect shareholder value are included in reports. And since CSR/sustainability performance as defined in these terms also contributes to the market value of a firm (see 216 above), shareholders and non-shareholders alike stand to gain from this approach: shareholders gain insight as to how a registrant's non-financial performance is affecting stock price and market value; and stakeholders of other types gain insight as whether or not the same company's social and environmental impacts are sustainable.

218. Some registrants already provide information about ESG matters in sustainability or corporate social responsibility reports or on their Web sites. [700] Corporate sustainability reports may also be available in databases aggregating such reports. [701] Why do some registrants choose to provide sustainability information outside of their Commission filings? Is the information provided on company Web sites sufficient to address investor needs? What are the advantages and disadvantages of registrants providing such disclosure on their Web sites? How important to investors is integrated reporting, [702] as opposed to separate financial and sustainability reporting? If we permitted registrants to use information on their Web sites to satisfy any ESG disclosure requirement, how would this affect the comparability and consistency of the disclosure?

The fact is that most of what passes for mainstream practice in measuring and reporting sustainability performance is not about sustainability at all, be it inside Commission filings or not. This is because most such reporting does not adhere to the *Sustainability Context* principle explained above. The *Context-Based Sustainability* approach, by contrast, reports performance relative to contextually relevant social and ecological limits and thresholds instead of ignoring them. The sustainability of a company's water use, for example, can only be assessed relative to a quantification of how much water is available in a place of business. It is not enough to simply say this year's use of water was less than last year's. Indeed, both years' rates of use might be unsustainable; who can say in the absence of contextually relevant information?

As for the question of why some registrants choose to provide sustainability information outside of their Commission filings, we believe the answer is that they do so because they can (i.e., without risk of penalty from the SEC). In other words, as long as it is commonly believed that there is no causal connection between the non-financial performance of listed companies and their stock prices and market values, such performance will be deemed immaterial and therefore irrelevant to the kind of information that should be included in a company's S-K filings.

As we have already explained above, however, evidence now shows that there are measurable and verifiable causal connections between companies' CSR/sustainability performances and their market values. Indeed, more than 80 percent of companies' market capitalizations have nothing to do with their book values, with much of the associated intangible values being attributable to their CSR/sustainability performances instead. The CSR/sustainability performances of listed firms, therefore, *is demonstrably material* to their financial performance and should always be disclosed in their annual S-K filings. Whether or not they also disclose such information elsewhere is entirely up to them, but whether or not they disclose it in their S-K filings should not be.

And then, of course, registrants must also take steps to ensure that what's being disclosed in their filings is in fact information about sustainability performance per se, and not just a recitation of their marginal social and environmental impacts this year versus last year. In the field of sustainability management, we refer to such marginal reporting as *incrementalism* and it stands in sharp contrast to *Context-Based Sustainability*. Whereas the former masquerades as sustainability reporting, the latter actually delivers it.

To permit or encourage incrementalist reporting, and not require context-based reporting instead, only undermines the credibility and value of sustainability reporting to investors, not to mention the integrity of the capital markets. It is for that reason that we urge the SEC in the strongest possible terms to actively embrace the *Sustainability Context* principle and require that *Context-Based Sustainability*, an open-source method, be utilized for non-financial, sustainability reporting by registrants in their S-K filings.

With respect to integrated reporting, we feel that the historical separation of financial from non-financial performance disclosures is arbitrary and misguided and that the performance of organizations in all of their dimensions are material to investors as explained above. As addressed below, it is also the case that an international standard for integrated reporting now exists (the International Integrated Reporting Council's Integrated Reporting *Framework*), which provides the theoretical and practical basis for operationalizing this concept (i.e., multiple capital accounting). We and many others are strong proponents of multiple capital accounting and believe that it offers precisely the basis and mechanism needed to make integrated reporting possible. We urge the SEC to embrace and promulgate the concept as well.

219. In an effort to coordinate ESG disclosures, several organizations have published or are working on sustainability reporting frameworks. [703] Currently, some registrants use these frameworks and provide voluntary ESG disclosures. [704] If we propose line-item disclosure requirements on sustainability or public policy issues, which, if any, of these frameworks should we consider in developing any additional disclosure requirements?

As explained above, meaningful sustainability reporting must be context-based and should also ideally be expressed in terms of impacts on multiple capitals. With respect to the established measurement and reporting standards or frameworks extant, there is only one such system that meets both requirements: the Global Initiative for Sustainability Ratings (GISR). The GISR standard, however, was designed for use by rating agencies, not organizations or registrants themselves. It is also still early in its own development, and so it remains to be seen how, for example, its call for context-based, multiple capital ratings should be performed.

For its part, the Global Reporting Initiative (GRI) is context-based, but (a) fails to provide sufficient guidance for how to abide by the *Sustainability Context* principle it promotes, and (b) does not call for reporting relative to impacts on vital capitals. As a result of these shortcomings, most “GRI compliant” reports do not disclose sustainability performance at all, and are, instead, in the terms used just above, purely incrementalist in content. To refer to such reports – and incrementalist reporting in general – as sustainability reporting is to do a disservice to investors and to anyone else who is interested in understanding the actual sustainability performance of a company.

The International Integrated Reporting Council’s (IIRC’s) Integrated Reporting <IR> *Framework,* while unlike GRI is an integrated reporting system, suffers from the opposite problem: it stresses the importance of reporting in terms of impacts on multiple vital capitals but does not require that such reporting be context-based. Indeed, the <IR> *Framework* is not intended to be a sustainability reporting solution at all, so perhaps this is not surprising. Rather, it purports to be a system for describing the manner in which organizations create value. And so although we laud the IIRC for its advocacy of reporting performance in terms of impacts on vital capitals, the kind of performances we versus they are talking about are entirely different. To report on the manner in which value is created is not to report on sustainability performance at all, or at least not necessarily so.

Last is the Sustainability Accounting Standards Board (SASB), which for the past several years has been grooming itself for adoption by the SEC. And although SASB has, in fact, adopted a multiple capitals framework to some degree, its commitment to it is incomplete and, more to the point, is not at all accompanied by the use of context-based principles. Indeed, one has to wonder where the “sustainability” is in the SASB standards, since even the most dogmatic application of their content cannot result in the disclosure of sustainability performance – incrementalist and even immaterial disclosures, yes, but not sustainability reports. Indeed, to adopt SASB would arguably set the sustainability reporting trend back by at least a generation, since it would very likely take that long to discover the damage done and take whatever steps are necessary to resolve it.

While none of the three frameworks discussed above may be perfect by our standards, they each have made very positive contributions to the field, the value of which should not be overlooked, much less discarded in the search for a more perfect solution. The Global Reporting Initiative, for example, first introduced the Sustainability Context principle more than fifteen years ago, without which there can be no meaningful measurement and reporting of sustainability reporting at all. The IIRC’s <IR> *Framework*, in turn, formally ushered in the concept of multiple capital accounting and thereby made it clear that just as financial reporting pertains to impacts on economic capital, non-financial reporting should, too, be thought of in terms of impacts on capitals (of other kinds). And finally the GISR ratings standard, for its part, stitches the two together (Sustainability Context and multiple capital accounting) with third-party ratings in mind, but clearly in a way that also has implications for organizational reporting. Performance assessments on both fronts should ideally be grounded in the same general perspective on what performance means (financial and non-financial) and how best to measure, report and rate it.

In light of the important and very positive contributions the three frameworks above have already made to non-financial measurement and reporting, we urge the SEC to: (1) recognize and embrace the specific progress made to date as we have explained it, (2) identify shortfalls in terms context-based disclosures, and (3) include explicit language in the final rule that says, in effect, that the SEC believes that all material sustainability disclosures should (or must) be expressed in context-based terms and that nothing less will do. Guidance or criteria for how to do so should also be provided.

220. Are there sustainability or public policy issues for which line-item disclosure requirements would be consistent with the Commission's rulemaking authority and our mission to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation, as described in Section III.A.1 of this release? If so, how could we address the evolving nature of such issues and keep our disclosure requirements current?

Yes, we think the severity of certain social and environmental issues at particular points in time might warrant such prescriptive reporting. Impacts on the climate system, water, product safety, etc. arguably call for it. For the most part, though, relevant areas of social and environmental impact should be determined by individual organizations as a result of their own materiality analyses. Indeed, no two organizations are alike and it is a basic principle of the Context-Based Sustainability method that organizations should be free to identify their own material areas of impact within their own contexts. The process we follow for making materiality determinations for non-financial performance should be no different than the one we use for financial performance.

That said, we also believe very strongly that such self-determined, organization-specific scopes of reporting should be specified by organizations in accordance with the same overarching principles and that such principles should be defined and enforced by the SEC. These would include principles for how to perform non-financial, sustainability materiality analyses and also how to measure and report sustainability performance in context-based ways. All of this, in turn, would spill over into the assurance and auditing arena, whose practitioners and methodologies would, as well, need to be consistent with and supportive of the same principles.

221. What, if any, challenges would registrants face in preparing and providing this information? What would be the additional costs of complying with sustainability or public policy line-item disclosure requirements, including the administrative and compliance costs

of preparing and disseminating disclosures, beyond the costs associated with current levels of disclosure? Please quantify costs and expected changes in costs where possible.

Because of the manner in which context-based materiality determinations have the effect of screening out discretionary philanthropic, social or environmental impacts from reporting, we believe the cost to take such an approach is actually less than what most companies are spending in the production of elaborate annual sustainability reports. We also believe that reporting of the kind we are describing (Context-Based Sustainability) can add value on a day-to-day management basis, since unlike sustainability reports, Context-Based Sustainability reports can also be used as management information systems for helping managers and directors better understand how their organizations are performing on a day-to-day, month-to-month or quarter-to-quarter basis. This, in turn, can help to reduce operating costs.

222. If we propose line-item disclosure requirements that require disclosure about sustainability or public policy issues, should we scale the disclosure requirements for SRCs or some other category of registrant? Similarly, should we exempt SRCs or some other category of issuer from any such requirements?

See our response to No. 220 above. Our response is substantially the same here.

223. In 2010, the Commission published an interpretive release to assist registrants in applying existing disclosure requirements to climate change matters. As part of the Disclosure Effectiveness Initiative, we received a number of comment letters suggesting that current climate change-related disclosures are insufficient. Are existing disclosure requirements adequate to elicit the information that would permit investors to evaluate material climate change risk? Why or why not? If not, what additional disclosure requirements or guidance would be appropriate to elicit that information?

Existing disclosure requirements pertaining to climate change risk are in fact not adequate precisely because they do not require that such disclosures be context-based. To be context-based, such disclosures would minimally have to consist of a measure of an organization's own greenhouse gas emissions and whether or not its emissions are trending downwards at a rate that is consistent with what the climate science says is required in order to reverse climate change and restore greenhouse gas concentrations in the atmosphere to safe levels. All registrants should be required to disclose their greenhouse gas emissions in such context- and science-based ways, otherwise there is no meaningful way to evaluate their emissions performance and whether or not it is helping or hurting their shareholders' value.

Here it is also important to point out that there is a difference between assessing climate change risks *to* a registrant and climate change risks *caused* by a registrant. In the first case, the risk is to the registrant, in the second case it is to the climate system itself. In other words, a dysfunctional climate can impose risks and costs on organizations that can be assessed, prepared for and disclosed to shareholders. Separately, organizations can cause and exacerbate climate change by continuing to emit (or fail to reduce) their own greenhouse gases. Shareholders are arguably entitled to receive disclosures of both kinds, and not just the first one.

Indeed, if the question being asked is, *Are we sustainable in terms of our greenhouse gas emissions?*, then disclosures consisting only of assessments of risk posed by climate change to the organization don't even begin to provide an answer. Rather, they beg the question. Certainly it is the case that organizations and their shareholders want and deserve to know how, if at all, climate change is affecting their business, but that is not the kind of question sustainability disclosures are supposed to be addressing. The fundamental question a sustainability report should address is, *Are the organization's operations sustainable?*

Here it might be helpful to call the SEC's attention to a relatively new, context-based greenhouse gas initiative that several of us in this group (the Sustainability Context Group) are involved in known as the Science-Based Targets (SBT) initiative. The SBT initiative is a joint effort of the World Resources Institute, the World Wildlife Fund, the UN Global Compact and CDP, the purpose of which is to urge companies to begin setting targets for greenhouse gas emissions reductions that are science- and context-based (see here for more information about the SBT: http://sciencebasedtargets.org).

If it were up to us, we would have the SEC modify its rules for disclosing climate change risks so as to require that all registrants participate in the SBT program on a mandatory basis. But that, of course, would only be the tip of the iceberg. Sustainability reporting more broadly applied would also be required and not just for greenhouse gas emissions, but for all material social and environmental areas of impact of relevance to individual organizations and the well-being of their stakeholders.