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100 F Street, NE
Washington, DC 20549

RE: Comments on Business and Financial Disclosure Requirements of Regulation S-K Concept Release, File Number S7-06-16

Ms. Kim:

ELM SUSTAINABILITY PARTNERS LLC ("ELM") is pleased to submit the following comments on Section IV.F. *Disclosure of Information Relating to Public Policy and Sustainability Matters* of the referenced Concept Release (pages 205 – 215).

We appreciate that the Commission is exploring linkages between sustainability and corporate financial performance. ELM, through more than 30 years in environmental, health, safety and sustainability (EHSS) management practice, has studied this matter and taken several approaches at quantifying economic value of EHSS activities/matters. Although we realize that exceptions exist to our views and experiences, our comments are based on our first hand knowledge and from working with clients.

General Comments

There is little doubt that sustainability matters are of increasing interest to consumers and certain investor groups/investment philosophies. In our opinion, however, sustainability remains something of a niche investment criterion and not typically important to the *broad investment community* (debt or equities) or their investment and voting decisions. It has been our experience that, as stated by one commenter referenced in the Release, sustainability issues "are not typically material to an understanding of the company's financial performance." As was noted in the Release, "disclosure to serve the needs of limited segments of the investing public, even if otherwise desirable, may be inappropriate."

Literature is widely available alleging a correlation between a "strong [environmental, social or governance] ESG record" and excellence in operations and management. Commenters to the Release will likely reference the studies. ELM began monitoring these developments in the early 1990s and is familiar with many of the analyses conducted. Common themes across them relevant to the questions posed in the Release include:

- The scope and definition of ESG activities vary greatly, as does the definition of sustainability itself. Studies, articles and reports too numerous to cite offer many views of the constituents of sustainability and ESG. The myriad sustainability indices/indicators for the investment community bears this out through the different factors/matters evaluated[1]. The current situation marginalizes sustainability and produces different algorithm results thereby diluting any real successes that may be achieved as well as impeding comparability. This variability means a suitable foundation for financial valuation, materiality determinations and subsequent reporting does not currently exist.

- A linkage between ESG activities and operational or managerial results is not definitive, nor is there necessarily a causal relationship. One study claimed that implementing an environmental management system (EMS) reduced a company's cost of capital by 1%[2]. A New York University Stern School of Business study using January 2016 data from 7480 companies representing 95 industrial classifications determined that the cost of capital for those companies ranges from 3.92% to 11.82%, averaging 6.29%[3]. Accordingly, a reduction of 1% is very significant and it is highly improbable that such a large impact would result from EMS implementation.

- Most studies attempting to quantify the capital market impact of sustainability matters focus on equities. The equities market has long centered on short term quarter-by-quarter, or at most year-over-year, performance. As the implicit nature of sustainability is long term, ELM suggested in the past that bonds may be a more appropriate mechanism for sustainability valuation than stocks[4]. This seems to have been rather prescient: a MorganStanley*Voice* article in Forbes published June 6, 2016 reported that:

  > *Total green bond deal volume in the global markets for 2015 hit a new record of $39.5 billion by November, issued in 161 deals. That breaks the previous record in 2014 of almost $36.6 billion in 118 transactions.*[5]

  Investment grade bond transactions for 2015 totaled $1.51 trillion, with the three largest single deals of the year valued at $21 billion, $17.5 billion and $16.7 billion[6]. While the record-setting level of green bond deals is impressive, it made up a mere 2.6% of the 2015 total activity, further demonstrating the niche nature of sustainability investments.

- Inability to isolate sustainability matters from other equities market influences and business changes. Relevant studies we are familiar with contain "disclaimers" stating that the authors were unable to effectively isolate ESG impacts from broader market influences. This obscures the actual impact, if any, that ESG-related matters or events may have had on the studied

[1] One client recently stated that by their count, there are over 250 sustainability indices intended for investors. Another client stated that she completes more than 100 sustainability questionnaires from investors and rating firms each year and no two are alike.
[2] Feldman, Stanley J., Soyka, Peter A., and Paul Ameer. "*Does Improving a Firm's Environmental Management System and Environmental Performance Result in a Higher Stock Price*?" Journal of Investing, Vol. 6, Number 4: Winter 1997. pp. 87-97. Tellingly, the study did not actually prove the linkage that it claimed exists.
[3] http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/wacc.htm
[4] http://www.elmsustainability.com/an-inconvenient-reality-for-environmentalsustainability-professionals/
[5] http://www.forbes.com/sites/morganstanley/2016/06/06/green-bonds-take-root/#2da5c11d34ae
[6] http://marketrealist.com/2016/01/2015-saw-biggest-ever-bond-deal-whats-next/

equities[7].

- Inconsistent time boundary for quantifying ESG impact on equities. Some studies analyzed stock prices for one or two days after an ESG related event. Others attempt to reflect a longer-term view of sustainability. But the longer the analysis horizon, the more difficult it becomes to isolate the ESG impact. This becomes more complex, if not impossible, given the long-term nature of sustainability.

In conclusion, more than 25 years of efforts to empirically demonstrate the relationship of sustainability to capital formation or broad investor interest have not done so conclusively. A small percentage of registrants may be able to claim individual success resulting from new product development, entry into new markets or issuance of green bonds. While there are investors and funds using ESG information as an investment criterion, it is unclear to what extent this information is weighted in their decisions, and which of the multitude of sustainability definitions and indicators are used.

Responses to Questions 216 - 223

ELM has shortened some of the questions posed in the Release and deleted the footnotes for ease of reading.

Question 216: 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?

> **Response:** Any disclosure must be based on a generally consistent and formal definition of sustainability in order to facilitate comparability across investors' options and support meaningful investor use. Assuming the Commission determines that the current materiality threshold is not appropriate for sustainability issues, ELM believes that the Commission or official financial accounting standards bodies would need to formally issue guidance on a specific materiality threshold for sustainability reporting as a critical first step in eliciting meaningful sustainability disclosures by registrants[8].
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> No one can predict how the issue will evolve over time. If the Commission chooses to require sustainability disclosure, it should be considered a starting point. As with any other matter, the Commission could then respond to future needs through rulemakings and interpretive guidance. Official financial accounting standards bodies may also issue relevant standards and guidance in response to future developments.

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[7] The best examples that in our view come the closest in realistically isolating sustainability in equities valuation are (a) the April 17, 2015 letter from Ceres to the SEC on climate disclosure as being material to investors, discussing the matter in terms of asset risk, materiality of future pricing/demand scenarios and long-term capital expenditure plans/assumptions for oil and gas companies; and (b) a recent study from Harvard Business School *Corporate Sustainability: First Evidence on Materiality* http://hbswk.hbs.edu/item/corporate-sustainability-first-evidence-on-materiality

[8] An excellent and concise analysis of the importance of defining materiality for sustainability was provided by Todd Cort, PhD, a faculty member at the Yale School of Management and Yale School of Forestry and Environmental Studies in a September 15, 2015 article at http://www.environmentalleader.com/2015/09/15/vanishing-materiality-in-sustainability-reporting/

Moreover, we suggest that the Commission consider the potential risk of retroactive liability discussed further under Question 221, which could become a disincentive to registrants providing robust and meaningful disclosure.

Question 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?

Response: As stated in the General Comments above, it is our opinion that the vast majority of sustainability matters do not rise to the level of materiality (as that is currently defined). Should disclosure of sustainability issues be summarily required, non-material matters would almost certainly be included in the disclosure. At the same time, such disclosures would not typically obscure information concerning a registrant's business and financial condition *if the required disclosure is narrative only* – similar to the discussion of risk factors in a 10-K[9] or the conflict minerals disclosure in Form SD[10]. A narrative, non-financial disclosure could provide additional business, product, operational or managerial context that some investors may find valuable in their investment decisions[11]. But this context is unlikely to be financially material. Conversely, should *financial disclosure* be required for non-material sustainability issues, ELM believes that would create confusion and misinterpretation by investors, possibly obscuring other (material) financial information.

Question 218: Some registrants already provide information about ESG matters in sustainability or corporate social responsibility reports or on their websites. Corporate sustainability reports may also be available in databases aggregating such reports. Why do some registrants choose to provide sustainability information outside of their Commission filings?

Response: Registrants enjoy flexibility and reduced risk in report content/language that is provided outside of regulatory filings. Reporting outside of filings allows registrants more leeway in describing issues and results, a critical concern given that sustainability matters are highly diverse and many times intangible. This became evident with Form SD and the Conflict Minerals Report (CMR) disclosures required under Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. As one of the leading advisory and auditing firms in the conflict minerals space, ELM works and talks with hundreds of registrants about their Form SD and CMR filings. The prevalent approach registrants have taken in the three years of conflict minerals reporting is to limit disclosure to what Form SD Instructions and the Final Release require[12].

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[9] Of course, should any risk factor discussed in the narrative also be material, the associated financials would be disclosed concurrently.

[10] There are certain parallels between the Form SD disclosure requirements and potential sustainability disclosures. We discuss this in our response to Question 218.

[11] As previously mentioned, the extent to which sustainability information is currently weighted in investor decisionmaking is unclear, therefore the broad value of a narrative-only disclosure may be inherently questioned.

[12] There were exceptions to this approach. Registrants who chose to expand their conflict minerals disclosure did so due to reputational concerns, customer requirements, a desire to be overly inclusive in an abundance of caution in their filings and to address potential concerns about investor pressure. Interestingly, we are not aware of any

Registrants feel that there is a higher risk in governmental filings and therefore tend to approach that reporting in a more conservative and literal manner. They believe a regulatory filing is not an appropriate place to "tell a story"; that is reserved for reporting outside regulatory boundaries.

Question 219: In an effort to coordinate ESG disclosures, several organizations have published or are working on sustainability reporting frameworks. Currently, some registrants use these frameworks and provide voluntary ESG disclosures. 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?

Response: We have no opinion on any specific framework(s) the Commission should consider. However, characteristics the framework(s) should possess include:

- Reasonable in scope rather than aspirational or over-reaching
- Consistent with the Commission's view of materiality (either current or sustainability-specific)
- Developed through an open public process with significant industry involvement
- Confirmed as valid by the Commission and/or official financial accounting standards bodies
- Monitored by the Commission and/or official financial accounting standards bodies
- Independence from the regulated community to prevent impairment of objectivity

Importantly, the organization developing the framework should not have financial incentive to proliferate further standards. The issuance of ISO14001 (the environmental management system standard of the International Organization for Standardization[13]) in the mid-1990s catalyzed a "feeding frenzy" of consultants, advisors, corporate and practitioner certifications and further standards. While market forces rationalized much of the imbalance, proliferation of standards continues. In many cases, standards are of questionable value and the driving force is the organization's financial interest in simply issuing standards.

Question 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?

Response: As discussed above, registrants are already required to make materiality evaluations of their business and financials – regardless of the specific business or financial matter. Therefore, registrants should already be disclosing material issues. Unless the Commission chooses to define materiality differently for sustainability, it does not appear that line-item disclosure requirements for sustainability would be consistent with the Commission's rulemaking authority and mission.

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registrant who considered conflict minerals to be enough of a risk to warrant inclusion in the discussion of Risk Factors in their 10-K.

[13] www.iso.org

Question 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.

> **Response:** In our view, one challenge is the potential for significant retroactive liability from shareholder lawsuits should sustainability disclosure be required without additional/new guidance on its materiality. As noted in the Release, registrants are already required to make materiality evaluations of their business and financials – regardless of the specific business or financial matter. Therefore, registrants should already be disclosing sustainability issues if they rise to a level of materiality (as that is currently defined). If sustainability issues are classified as a distinct disclosure requirement, it is possible that shareholders, customers or the public could misinterpret a new financial disclosure of sustainability that was not reported in the past because the issue did not meet the current materiality threshold. Registrants could face shareholder actions if there is no clarity on how a new sustainability disclosure relates to the pre-existing materiality threshold.
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> Although unlikely, there is also a risk that some registrants may realize previous materiality evaluations inadvertently omitted certain sustainability matters that, after analysis triggered by a new disclosure mandate, may be material under the current definition. In the absence of a modified materiality threshold, the new revelations not only create possible shareholder challenges but also possible enforcement from the Commission.
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> We believe that these risks would impede robust sustainability disclosures, and suggest that the Commission consider this in the evaluation and analysis of sustainability materiality and disclosure.

Question 222: No comment.

Question 223: Are existing disclosure requirements adequate to elicit the information that would permit investors to evaluate material climate change risk?

> **Response:** As discussed above, registrants are already required to make materiality evaluations of their business and financials – regardless of the specific business or financial matter. Therefore, registrants should already be disclosing climate risk if it rises to a level of materiality (as that is currently defined). The April 15, 2015 Ceres letter to the Commission provides an excellent discussion of climate risk disclosure. We believe that in many cases, estimated financial consequences of climate risk are already included in existing financial reports without being called out specifically as "climate risk". For example, insurance companies already consider predictions of storm event frequency and severity in their claims/actuarial modeling. Whether losses are from storm events triggered by climate change is not specifically relevant (nor scientifically discernible). What is relevant and already reported is the materiality of the predicted and actual claims, associated reserves and premium revenue. This is simply part of their business.

ELM SUSTAINABILITY PARTNERS LLC appreciates the opportunity to comment on the Concept Release. We would be happy to discuss further any questions the Commission and/or Staff may have concerning our comments. If you have any questions, please contact me at 678-200-5220.

Sincerely,
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