



Ms. Vanessa Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE, Washington, DC 20549-1090

22nd October 2019

Dear Secretary Countryman,

Subject: Modernization of Regulation S-K Items 101, 103, and 105; Release Nos. 33-10668; 34-86614 (“Proposed Rule”)

Led by investors responsible for assets under management in excess of US\$34 trillion, the International Corporate Governance Network (ICGN) is a leading authority on global standards of corporate governance and investor stewardship. Our membership is based in more than 45 countries and includes companies, advisors and other stakeholders. ICGN’s mission is to promote high standards of professionalism in governance for investors and companies alike in their mutual pursuit of long-term value creation contributing to sustainable economies world-wide.

ICGN offers an important investor perspective on corporate governance to help inform public policy development and the encouragement of good practices by capital market participants. Our policy positions are guided by the ICGN Global Governance Principles and Global Stewardship Principles, both of which have been developed in consultation with ICGN Members and as part of a wider peer review.ⁱ

Today, we write to express caution that the Proposed Rule as written appears to be detrimental to the quality of corporate disclosures, rather than positively enhancing transparency. As investors and capital providers which rely on comprehensive and credible corporate reporting, we wrote the Commission on March 21, 2019 expressing our interest in a rulemaking on environmental, social, and governance (ESG) disclosures. (“March Letter”)ⁱⁱ as follows:

“ESG reporting should seek to reflect the complexities inherent in a contemporary business and the context of a company’s current and future strategic direction. It should support and enhance the information in the financial statements and help the reader to form an assessment of the company’s future prospects.”

Unfortunately, the Proposed Rule does not address any ESG topics except in additional wording on human capital in Item 101(c). At one level, it might appear that the Commission has expanded human capital disclosure requirements. However, the Commission elevated the materiality requirements while making the disclosure requirements principles based. We are concerned that this will likely result in less useful disclosures.

Further, given the Commission has not addressed these issues in 30 years, we are concerned that the failure to include additional ESG disclosures at this time would be a missed opportunity and in fact stall the progress towards high-quality ESG reporting which may take many years to come to fruition, unless the Proposed Rule is improved. In particular, we strongly support changes to climate risk reporting that would result in additional disclosures in the American market.



Climate change poses a level of risk which encompasses all markets, all sectors and all industries. These risks are foreseeable and measurable as we experience the effect on our warming planet in real time. Action taken now to mitigate the negative effects of carbon will directly impact the magnitude of risks in the future. It is therefore top of the agenda in shareholder engagements with companies. Board directors should be prepared to explain how they embed the effects of climate change in their business models and risk management systems to ensure they are properly identified, measured, monitored and managed.

In our March Letter, we also stated that:

“In the U.S., the lack of comprehensive, comparable, and reliable data hinders investor efforts to effectively incorporate ESG information into investment decisions. We encourage the Securities and Exchange Commission to require all listed companies to report annually on a comprehensive, uniform set of sustainability indicators comprised of both market-wide and industry-specific standards.ⁱⁱⁱ”

Investors are responsible for preserving and enhancing long-term value on behalf of their beneficiaries – anything that puts this value at risk such as climate change is material. The request for comment for the Proposed Rule uses the term “material” more than 350 times. When we use the term “material” in the context of disclosures, we are focused on what investors consider in making investment and voting decisions. In the Proposed Rule, the term has various meanings, and the Commission consistently modifies the term in each case which has the effect of reducing compliance by registrants impacting levels of transparency. In this latest Proposed Rule, the Commission has moved to further reduce disclosures with a more aggressive use of the term.

For example, there is no materiality limitation in the first item the Proposed Rule would amend, Item 101(a). The Proposed Rule adds materiality and consequently tells registrants that they should report less under 101(a). Interestingly, there is little reporting under 101(a), so little in fact that unlike with Item 105 where the Commission takes a survey to conclude that 15 pages of risk factor disclosure is enough for any investor, the Commission is totally silent regarding the level of disclosures and actual necessity to reduce such disclosure. In the last item addressed in a Proposed Rule, Item 105, the current disclosure standard is “most significant.” The Commission moves to change the term to “material.” Interestingly, the Commission then uses the Securities Act Rule 405 definition of material which being taken from the Securities Act focuses on the purchase of a security.

This is made more interesting with a footnote to the Exchange Act Rule 12b-2 definition of material which focuses on purchase of sale of a security. Interestingly, the Commission omits reference to the regulation S-X definition of materiality in the entire discussion of the Proposed Rule. We query why the Commission has chosen to insert materiality in a place where it did not exist before even when there is not substantial over reporting and elevate the materiality definition to a term not normally used in periodic reporting.

I. Principles-Based or Line Item

ICGN generally prefers disclosure that produces the greatest transparency in individual situations. There is no hard and fast rule. Our members operate in jurisdictions with principles-



based disclosures, line item based as well as hybrid approaches. We would welcome a rule change that results in greater disclosure. However, this is not the case with the Proposed Rule. If there is any benefit to disclosure, it would be felt by those valuing less disclosure. In the most critical section where principles-based or line item comes up is in Item 101(c) in the discussion of human capital.

Around 200 ICGN members from over a dozen markets convened in Miami on October 15 and 16, 2019. During that meeting, we held a panel discussion on human capital and discussed the specifics of the proposed changes to human capital disclosures. It was observed then that non-corporate governance or sustainability professionals might initially view the changes as an expansion in human capital reporting. However, we believe the reality is that our quest for additional disclosure in human capital amounts to very little. We surveyed the people in the room and 85% of the respondents voted that line item disclosures are needed in this area.

II. Disclosure of General Development of Business Item 101(a)

Regarding Item 101(a), if anything, there is an absence of reporting in this area, especially by large companies. We cite an excellent law review article by George S. Georgiev, highlighting the lack of disclosures by large companies: “Too Big to Disclose: Firm Size and Materiality Blindspots in Securities Regulation.”^{iv}

Corporate disclosure is not as deep as should be. We believe the Proposed Rule will mean that they will disclose even less. Finally, the 101(a) proposal does not work operationally unless one assumes only a two-year disclosure period, in which a full description is given in a year and then an update with a hyperlink to full disclosure is provided in year two. If there is a longer period for disclosure, the process of using one hyperlink does not work.

III. Disclosure Regarding Narrative Description of Business Item 101(c)

A principles-based approach could work in enhancing disclosures which are outside of manufacturing and other old-line businesses. Further, we appreciate that the Commission focused on human capital, however, as stated above, for American reporting, some line-item reporting is needed to provide investors with information to be able to understand how a registrant is being managed. This would include expanded information on workers including, full-time, part-time and contingent workers, and on employee diversity and turn-over. The registrants already collect this information and investors repeatedly requested for it to be disclosed.

IV. Legal Proceedings

As noted, ICGN favors enhanced transparency, the proposed changes primarily result in reduced transparency, from raising thresholds to reducing disclosure requirements on the basis of redundancy despite the fact that investors are not complaining about redundancies. The registrants are in the best position to organize and comfortably provide the information to make it easier for investors to find. In this case, the Commission adopts an approach that if a registrant discloses litigation at any time that such registrant should not have a duty to disclose it in response to a totally different disclosure request. Registrants can cut and paste the information in seconds



as they have done historically. The Commission now forces search expeditions and encourages new litigation based on broken or changed hyperlinks.

V. Risk Factors

The risk factor changes are interesting because the other parts of the Proposed Rule favor registrants telling their “stories”, yet we believe the Commission adopts an inconsistent approach to Item 105 by demanding that they tell their stories, but in under 15 pages. We do not favor this approach. It may not eliminate the boilerplate. It would in fact limit the telling of a story in a manner that investors will understand how the registrant is dealing with the risk. If the shift from most significant to material is made, the Commission should adopt a more appropriate standard for material. The Commission could look to regulation S-X for such definition. It is important to note that investors review risk factors to determine whether the company is being operated correctly and to inform their vote, not just to make a purchase decision. In most cases, that purchase decision has already been made.

For disclosure, there needs to be a duty report. It appears that on page 70 of the discussion of the Proposed Rule the Commission uses a materiality standard to establish the duty to report, and that standard is higher than the fraud standard for reporting. This would not only reduce disclosures but make it harder for investors to obtain recourse even when the registrant violates the fraud standard. In total, the Commission appears to complicate risk factor reporting which can have the effect of substantially reducing transparency.

In conclusion, we welcome the opportunity to provide input by participating in any discussion on the Proposed Rule prior to it becoming a final rule. We have strong relationships with a vast network of experts in disclosures that we expect will share similar concerns about the Proposed Rule for investors. We would welcome the opportunity to serve as a resource to the Commission in developing investor appropriate disclosure standards for Items 101, 103 and 105.

We hope that our input is helpful in your decision-making, and we look forward to engaging with you in this or other matters where we could provide meaningful input. Should you wish to discuss our comments further, please contact me or George Dallas, ICGN’s Policy Director, by email at george.dallas@icgn.org.

Yours faithfully,

Kerrie Waring,
Chief Executive Officer, ICGN

Copy:

James Andrus, Co- Chair, ICGN Disclosure and Transparency Committee:

James.Andrus@calpers.ca.gov



ⁱ For access to ICGN's Global Governance Principles and Global Stewardship Principles, along with other policy statements, including ICGN's 2018 Policy Priorities, please visit: www.icgn.org

ⁱⁱ See ICGN comment letter 21 March 2019:

<https://www.icgn.org/sites/default/files/ICGN%20Comment%20on%20Request%20for%20Rulemaking%20on%20ESG%20Disclosure%20March%202019.pdf>

ⁱⁱⁱ Ibid.

^{iv} See George S. Georgiev: "Too Big to Disclose: Firm Size and Materiality Blindspots in Securities Regulation." : <https://www.a51.nl/sites/default/files/pdf/SSRN-id2894538.pdf>