SASB SYMPOSIUM SPEECH 2017

Opening remarks as delivered by Dr. Jean Rogers at the 2017 SASB Symposium on Thursday, November 30th, 2017, at Fordham University School of Law in New York, NY

OPENING REMARKS

Good morning. Thank you to Barbara and the Center for Professional Accounting Practices for so graciously hosting us today in this fantastic space. And thank you Matthew for your incredible dedication to our shared mission and for your kind introduction.

On behalf of the SASB, I would like to welcome everyone to our second annual Symposium. We're grateful that you could attend, and we're very proud that this event is sold out for the second year in a row.

This year's theme is "Market Forces at Work," so I'd like to focus my remarks on that idea. We live in a time of very powerful market forces, especially the broader macroeconomic forces that are helping to reshape our markets and our society like population growth, globalization, and technology.

What's interesting is how these forces are converging with traditional economic drivers like supply and demand. In recent decades, markets have developed a healthy appetite for data-driven, evidence-based approaches to investing. At the same time, investors with a long-term view have developed increasingly sophisticated approaches to incorporating environmental, social, and governance factors into their decision-making processes. They're no longer using ESG to align with their values, but to improve the risk-return profiles of their portfolios.

At the SASB, our work sits at the intersection of two extraordinary market forces – companies, and their investors. We enable the <u>supply</u> side—the companies—to better meet increasing investor <u>demand</u> for material, decision-useful data on sustainability performance.

Now let's talk about that demand. Today, about 26 percent of global assets under management are invested using sustainable strategies -- an increase of 25 percent in just two years.[1] In fact, since the SASB started its standard-setting work, the assets of signatories to the Principles for Responsible Investment have more than doubled to $68.4 trillion.[2]

In just the past 12 months, we've seen numerous examples of large, mainstream investors explicitly asking for more of this type of information. In June, Bank of America Merrill Lynch researchers found that sustainability factors are strong indicators of future volatility, earnings risk, price declines, and bankruptcies. In fact, they said that "ESG is the best signal we have

[1] Global Sustainable Investment Alliance, *Global Sustainable Investment Review* (2016).
[2] UN PRI website, "About the PRI," accessed November 11, 2017.

found for future risk.”[3] In July, the Human Capital Management Coalition—which is comprised of a diverse group of institutional investors—petitioned the SEC to require corporate issuers to disclose information about their management of human capital.[4]

In August, Vanguard issued an open letter calling on public companies to “embrace the disclosure of sustainability risks that bear on a company’s long-term value creation prospects,” and they recommended using a framework like the SASB standards.[5]

In theory, an efficient market would meet this rising demand by increasing supply. And in some ways, I suppose that is what we’re seeing.[6] In fact, 95 percent of the top 250 companies in the world now produce sustainability reports.[7]

We’re also seeing more sustainability disclosure in mainstream financial filings. For example, in the SASB’s annual analysis of SEC filings, which we just published today, we found that 73 percent of companies reported on at least three-quarters of the SASB disclosure topics for their industry, and 42 percent reported on every SASB topic. Across all filings, topics, industries, and sectors, disclosure on sustainability-related matters was provided in 83 percent of the cases where the SASB standards indicated it would be appropriate.[8] So, again, the supply of ESG information for investors appears to be ramping up.

This is good news, right? Yes, but we still have a problem. Despite the proliferation of sustainability information, 79 percent of investors are dissatisfied with the comparability of ESG data,[9] and 71 percent say the quality isn’t good enough.[10]

There are several reasons for this. First, companies do not always address the issues that are material to investors—especially in their standalone sustainability reports.[11] In financial filings, even when companies address the issues that matter to investors, they typically use boilerplate language. In the SASB’s new analysis, we found that more than 50 percent of sustainability disclosure in SEC filings uses boilerplate. Less than 30 percent uses quantitative metrics—and even those are rarely comparable among peer companies.

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[3] Bank of America Merrill Lynch, “Equity Strategy Focus Point – ESG Part II: a deeper dive” (June 15, 2017), available at https://www.bofaml.com/content/dam/boamlimages/documents/articles/ID17_0028/equityStrategyFocusPointADeeperDive.pdf.
[4] Human Capital Management Coalition, letter to the SEC dated July 6, 2017, available at https://www.sec.gov/rules/petitions/2017/petn4-711.pdf.
[5] Vanguard, “An open letter to directors of public companies worldwide” (letter from Chairman and CEO F. William McNabb III dated Aug. 31, 2017), available at https://about.vanguard.com/investment-stewardship/governance-letter-to-companies.pdf.
[6] Corporate Register website, accessed November 7, 2017.
[7] EY, *Tomorrow’s Investment Rules* (2014).
[8] Sustainability Accounting Standards Board, *State of Disclosure Report 2017* (November 2017).
[9] PwC, *Sustainability Goes Mainstream* (June 9, 2014).
[10] PwC, *Investors, corporates, and ESG: bridging the gap* (October 2016).
[11] Olivier Boiral, “Sustainability Reports as Simulacra? A Counter-Account of A and A+ GRI Reports,” *Accounting, Auditing & Accountability Journal*, Vol. 26, No. 7, p. 1036–71 (2013), available at http://www.emeraldinsight.com/doi/pdfplus/10.1108/AAAJ-04-2012-00998.

All of this raises a larger question: Why isn't the market for this information functioning efficiently? Why are companies struggling to respond to investor demand for high-quality ESG data? Broadly speaking, there are three reasons.

- First, the market lacks the *infrastructure* for delivering good information. Traditional financial accounting and reporting standards were not designed to capture this type of performance information, which tends to be more forward-looking and less readily quantifiable.
- Second, the market lacks *understanding*. Until very recently, sustainability was not viewed through the lens of financial materiality, and many market participants remain constrained by a legacy mindset when it comes to ESG.
- Finally, the market lacks *information*. Every significant leap forward in modern finance has been made possible by the availability of good data, and when it comes to ESG, high-quality performance data is still quite scarce.

So, let's start with market infrastructure, because that's what the SASB is all about. By developing and maintaining sustainability accounting standards for 79 industries, we're putting needed infrastructure in place and establishing it as a long-term fixture in the capital markets. We have spent the past five years working through our rigorous process to surface the key sustainability issues in each industry and to establish standardized, best-practice performance metrics around them.

We plan to codify the standards early next year, and we're close to finalizing high-quality standards thanks in large part to the contributions of people like you. More than 2,800 people participated in our Industry Working Groups. And 141 companies, 19 industry associations, and 38 institutional investors recently engaged with us in deep consultation to suggest improvements to our proposed standards before codification.

I point this out to emphasize how much our work relies on market participants dedicated to establishing a market solution. I also bring it up so that I can say thank you. Quite literally, we couldn't do it without you.

Now, a few comments about *understanding*. There remains a persistent belief that sustainable investing means taking a haircut on returns -- that it might as well be philanthropy. This idea is rooted in a few very important misconceptions, like the assumption that sustainable investing only means applying "negative screens" that reduce the investible universe. But it's also grounded in a relatively extensive body of research from the 1980s, '90s, and 2000s that found little or no correlation between sustainability performance and financial performance.

We know now that those studies were fundamentally flawed for one simple reason: materiality. By failing to correct for materiality, or to draw a distinction between sustainability initiatives that are inherently tied to a company's ability to create value and those that are not, these studies dampened the correlation where it does exist and led a generation of professionals to believe that sustainability is little more than corporate largesse.

Here's a quick story illustrating this issue. Like many of you, my husband and I have our retirement savings with a major retail brokerage. A few weeks ago, our advisor called to discuss our portfolio. He asked to speak with my husband, perhaps the first red flag. He wanted to discuss rebalancing, because the market is due for a correction. I asked what he recommended, and he recited the vanilla selections represented in the magical, color-coded pie chart on his screen, which would no doubt secure our future if only we stuck to the prescribed allocation. Just for fun I asked, "What about sustainability products? What about ESG funds?" You can probably guess his reply. "Oooooh, you don't want to do that. You could take a haircut. You know, a lot of women are interested in those, but they don't perform well."

So I said, "Really? What if I told you that a product could be designed that selects companies that are top performers on material sustainability factors, and that it would outperform the market by nearly 5 percent?[12]" He said, "Well, I have never heard of that, but I could do some research. You tell your husband to call me."

So, I did. I told my husband to call him to let him know we need a new advisor.

Of course, this guy is not alone. A few days later, I came across a financial literacy article in the Wall Street Journal—one of those "ask the experts"[13] columns. One of the hypothetical questions read as follows:

> *"Michael is passionate about protecting the environment. He wants his investments to be true to his values. He chooses a mutual fund that excludes stocks of companies harming the environment, knowing that this fund's annual returns are likely to be 1 percentage point lower than those of a conventional fund. This choice makes sense … true or false?"*

Wow. It's 2017 and the Wall Street Journal is dispensing advice on the premise that firms that pollute outperform. Not only is it bad financial advice, it perpetuates a myth that drives the wrong kind of corporate behavior. The idea that value and values are mutually exclusive is a false dichotomy. It's simply not true.

Clearly, the market lacks *understanding*. But that can be overcome with *information*. With that in mind, I find it instructive—and inspiring—to look to history.

It was only about 50 years ago that investors picked individual stocks with little or no serious consideration given to the risk embedded in the total portfolio. When Harry Markowitz came along in the 1950s with the core ideas that formed the basis of Modern Portfolio Theory, it was considered "way out there" by the mainstream.

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[12] Khan, Mozaffar, George Serafeim, and Aaron Yoon. "Corporate Sustainability: First Evidence on Materiality." The Accounting Review. 2016

[13] https://www.wsj.com/articles/how-financially-literate-are-you-really-lets-find-out-1508421702

This was the beginning of a quantitative revolution. Soon after, the Center for Research in Security Prices established the CRSP database at the University of Chicago. For the first time, comprehensive risk and return data enabled longitudinal analysis. And guess what? Researchers discovered it's very hard to beat the market. As a result, many investors began to diversify risk and go *with* the market.

Quantitative analysis thrived in the '70s with Barr Rosenberg[14]. Quantitative researchers understood that industry exposure was a critical "common factor" to describe residual returns in securities. In fact, beyond company-specific factors, industry exposure has been the most influential driver of equity market returns, accounting for 22 percent of gains for U.S. stocks over the past 20 years.[15]

Today, the SASB is applying that same, industry-specific lens to sustainability. We are drawing on data-driven insights to unleash what is the next step in finance: open-source standards enabling open-source and industry-specific sustainability performance data. This will drive markets toward a new efficient frontier, spark new insights, and inspire new products fit for the 21st century. The key to this future is good data – and here's what I mean by that…

There are plenty of information providers out there rushing to meet demand by producing a variety ESG scores, ratings, and rankings. However, the rigor of these products often leaves a lot to be desired. This not only masks the need for better disclosure, it masks the risks faced by investors and inhibits the market from functioning as it should. What markets need is not opaque data points that equate volume of disclosure with quality of performance. It needs actual performance data on industry-specific challenges.

As we listen to the speakers today and engage with each other, let's give some thought to what each of us can do in the areas of *infrastructure*, *understanding*, and *information*.

To improve market infrastructure, we need to advocate for a market standard. The SASB standards have been carefully crafted to balance investor demand for sustainability disclosure and peer comparability against the costs and risks associated with providing such information. The continued engagement of companies and investors is needed to continue to evolve the standards to benefit the market. Participate in our public comment period, which is open through December 31. Join one of our advisory groups to help guide the evolution of the standards.

To improve market *understanding*, let's apply the same rigorous thinking we use for financial materiality to sustainability issues. Don't let fuzzy thinking and myths persist.

[14] Rosenberg, Barr, and Vinay Marathe (1976), "Common Factors in Security Returns: Microeconomic Determinants and Macroeconomic Correlates," University of California Institute of Business and Economic Research, Research Program in Finance, Working paper No. 44.
[15] Fidelity, "Equity Sectors: Essential Building Blocks for Portfolio Construction" (June 2013).

Finally, we need to improve the *information* available to the market. Material information is the right of every investor, and SASB is committed to democratizing this right.

The SASB sits at the nexus of supply and demand, so we see the market forces at work. We see that the BlackRocks and the State Streets have gotten religion. But I'm less worried about them than I am about Mr. and Mrs. 401(k)—as SEC Chairman Clayton calls them—the ones who don't have a Bloomberg terminal on their desk.

Last month I received an email through LinkedIn. It was a mom, like me, reaching out from South America on behalf of her son, who is 14. She said, "My son is saving for college. He learned about the SASB online. He would like to invest in companies that perform well on material sustainability factors. How can he do this?"

With all the progress we have made, let's remember that we have not "won" until *every investor*—no matter how small—has access to sustainability fundamentals alongside financial fundamentals. This will mean the markets are both fair and efficient. That's why I started the SASB.

As former SEC Chair and SASB Foundation Vice-Chair Mary Schapiro says, "Transparent markets more efficiently distribute capital. Fair markets bring investors and their capital into the game."

The SASB standards may challenge legacy thinking and bust some myths, but I hope we can convince all of you that they are also a natural evolution of modern finance. Whether you're a multi-billion-dollar pension fund or a kid in South America relying on your mom for financial advice, ESG is not a separate wedge in the color-coded pie chart of asset allocation. Material ESG risks—and opportunities—are embedded in all asset classes. It's the whole pie. To understand and manage exposure to risk, you need good data on material factors. You need the SASB. It's as simple as that.

So, to sum it all up: motherhood, pie, and SASB. What's not to love? Thank you all for being here, and I hope you have a productive and enjoyable day.