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Sustainable Accounting Standards Board

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Via email: comments@sasb.org

December 31, 2020

Subject: Sustainable Accounting Standards Board (SASB) Bases for Conclusions & Invitation to Comment on Exposure Drafts (Exposure Drafts)

On behalf of the California Public Employees' Retirement System (CalPERS), I write to express our views on issues of interest to CalPERS as the Value Reporting Foundation (VRF) (which combines the International Integrated Reporting Council [IIRC] and the Sustainability Accounting Standards Board [SASB]) plans to become a global sustainability standard-setter.

CalPERS is the largest public defined benefit pension fund in the United States with approximately \$430 billion in global assets. CalPERS manages investment assets on behalf of more than two million members. As a global institutional investor with a long-term investment horizon, CalPERS relies on the integrity and efficiency of our financial markets to provide long-term sustainable, risk-adjusted returns. We are guided by the CalPERS Governance and Sustainability Principles¹ (Principles) which drive our engagement and advocacy efforts in our approach to governance issues that impact the integrity and efficiency of the capital markets. We expect fair, accurate, timely, and assured reporting about how companies employ financial, human, and physical capital to generate sustainable returns, and how they identify, monitor, and mitigate risks to those three forms of capital.²

With regard to corporate reporting, we believe that "[c]ompanies should provide for the integrated representation of operational, financial, human capital management practices, environmental, social, and governance performance in terms of both financial and non-financial results in order to offer investors better information for assessing risk."³ We use our Principles as the basis for our responses to the questions posed in the Exposure Drafts.

¹See, CalPERS' Governance & Sustainability Principles, September 2019.

²Id. at 5.

³Id. at 27.

As an active supporter of SASB and IIRC from inception, we greatly appreciate the opportunity to participate in this consultation and promote VRF's ambition to develop into a global sustainability standard-setter. CalPERS' view is that corporate reporting needs to include the sustainability factors which drive long-term risk and return. Furthermore, we support this being a responsibility of the regulatory bodies with responsibility for standards setting, both through the International Accounting Standards and U.S. Generally Accepted Accounting Principles (GAAP). We see great value in the VRF supporting the work of modernizing corporate reporting which is under discussion at both the IFRS Foundation and under several projects at the Securities and Exchange Commission (SEC.) With that in mind, please consider our responses to the questions below.

EXPOSURE DRAFT QUESTIONS

- 1. Do you believe the concepts described in the *Conceptual Framework* exposure draft are appropriate for a global standard-setting organization? Are there concepts or principles that warrant discussion in—or removal from—the *Conceptual Framework* to help the Standards Board more effectively develop standards that have global applicability?**

Overall, the Conceptual Framework moves VRF in the right direction, but we urge VRF to incorporate additional concepts to better reflect VRF's development from a U.S. standard-setter to a global standard-setter. As a U.S. standard-setter, VRF has created metrics for regulatory reporting primarily for the use of investment analysts. As a global standard-setter, VRF must create various metrics that serve a broader purpose and audience. For instance, the metrics will be used by corporate governance and stewardship practitioners around the world and may be included in materials other than regulatory reports. Given these differences, we believe there are benefits to broadening the Conceptual Framework. In addition to financial analysis, VRF should more fully recognize and incorporate the work of allied disciplines that are critical to achieving sustainable economies. For instance, the work of corporate governance and stewardship teams would be valuable contributions. Unfortunately, the concepts currently described in the Conceptual Framework retain too much of a U.S.-focus in tone and substance and do not appear to align with some of the ambitious work in the sustainability space around the globe.

We also encourage VRF to more directly address the gap between its line-item approach and the principles-based approaches that are common globally. VRF should become more flexible in its approach or defend it as the correct one in the Conceptual Framework.

VRF also employs a unique approach to materiality. This approach produces its prescriptive line-item metrics for companies to disclose on a report or explain basis. This approach differs from most other disclosure regimes, which are more likely to be principles-based, allowing a company to report certain information if it assesses it to be material to investors. The difference between the line-item and principles-based approaches results in a gap of disclosed material information. Through our work with the Human Capital Management Coalition and the SEC's Investor Advisory Committee, we have argued for certain line-items in terms of human capital reporting to enhance consistency and comparability, and we applaud and encourage

VRF's recent efforts to address this gap; however, the principles-based approach has primacy globally, so VRF will need to consider how to engage across the two major corporate reporting regimes through IFRS and U.S. GAAP or at the SEC to adopt a shared approach or flexibly balance the current proposal.

In addition to broadening the Conceptual Framework to better align with the ambitious work around the globe, we suggest that the VRF restate its mission clearly. The Conceptual Framework appears to highlight two related missions, so it is unclear which mission is VRF's primary mission.

Paragraph 5 states:

The mission of the Sustainability Accounting Standards Board (SASB) Foundation is to facilitate effective communication between companies and investors on financially material environmental, social, and governance topics. (See Figure 1.) SASB's industry-specific disclosure standards are fundamental to achieving that mission.

However, Figure 1 states:

Figure 1. SASB mission statement

The mission of the Sustainability Accounting Standards Board (SASB) Foundation is to establish industry-specific disclosure standards across environmental, social, and governance topics that facilitate communication between companies and investors about financially material, decision-useful information. Such information should be relevant, reliable and comparable across companies on a global basis.

These two separate missions are related but are circular when read together. In both mission statements, governance is on an equal footing with environmental and social considerations, but the Exposure Draft later qualifies VRF's work on governance. The Exposure Draft's clarification, however, is not yet included in the Conceptual Framework. Question 2 further illustrates the confusion as it asks for comment on the fact that VRF does not focus on governance. Given the inclusion of governance in both mission statements, it would be helpful for VRF to include one clear mission statement in the Conceptual Framework that accurately describes its governance focus.

2. Should SASB describe its approach to governance in the *Conceptual Framework*? Is SASB's approach to governance, as described above, sufficiently clear?

Yes, VRF should describe its approach to governance in the Conceptual Framework, otherwise, the reader is left with a distorted view of what VRF does, therefore VRF should expand its role in governance more substantially than what is included in the Exposure Draft. As discussed in response to Question 1, the Conceptual Framework should consolidate its mission statements into one clear statement that addresses governance, and that mission should flow through the

Conceptual Framework, so additional drafting may be needed than just including an expanded discussion of governance.

Governance is a central component of sustainability because it is critical to achieving alignment of interest between investors, corporate boards and management. Governance ensures the transparency and accountability which are essential to that alignment. VRF should address governance effectively. Otherwise, we are concerned that VRF would then simply be a tool for disclosure rather than a catalyst for changing behavior.

3. Are all aspects of the proposed definition of financial materiality clear and understandable? Does the definition accurately reflect SASB's mission to facilitate communication between companies and investors about financially material, decision-useful sustainability information?

VRF states that its definition of materiality focuses on information, but, in practice, VRF focuses on topics to determine materiality. After identifying material topics, VRF adopts metrics that represent those topics to determine which "financially material" information to disclose by industry. As a result, the specific metrics may or may not actually provide financially material information. Further, this approach creates opportunities to manipulate the system. Because issuers are informed in advance of the specific metrics on which they will be tested, they may focus on maximizing their efforts on just those specific metrics to the detriment of the other items represented in those metrics' topics. The companies' inadequacies in these other metrics are not disclosed, however, because the VRF standards only disclose the specified metrics. Thus, there is a limitation in this approach. Great scores on a particular metric may not represent great work on a topic.

Another key concern with VRF's approach to determining materiality is that issuers may simply report on the given metrics without conducting materiality analysis. The information is often just taken from other reports, so the VRF reporting may not require additional analysis on the quality of the work being done on an entire topic. In other contexts, issuers must conduct materiality assessments prior to disclosing information, so issuers should be prompted to do so in this context as well.

Additionally, VRF uses the term "financial materiality" but the real financial standard-setters (International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB)) would not agree with the financial materiality of the VRF metrics. IASB and FASB do not qualify their materiality definitions by including financial in front of material. VRF should consider removing its financial qualifier in order to be more consistent with other financial standard-setters, especially since the information reported is not currently envisaged as forming part of the financial statements and if it did, it would not include a "financial qualifier." We also encourage VRF to revise the communication element of its standards by including additional information used by corporate governance and investment stewardship professionals. VRF metrics focus on different elements, which is problematic because those investment teams are the ones who have responsibility for engaging companies on sustainability issues.

- 4. Are the characteristics of topic and metric selection (as framed and defined in the exposure draft) supportive in establishing standards that produce financially material, decision-useful, and cost-effective information (i.e., SASB's three core objectives)? Are the definitions of the characteristics sufficiently clear? Are any characteristics that may be supportive of the objectives of the Standards missing, and therefore should be added? Are any characteristics redundant or misaligned with these objectives, and therefore should be removed?**

As currently drafted, the standards do not. As described in response to Question 3, VRF has a unique approach to determining materiality. The VRF standards often address information not commonly followed by sustainability practitioners, so practitioners need to be educated about the standards before they can use them. Education is also required to report on the standards. Given the need for education and explanation of the standards, by definition, as a stand-alone, they are not clear. To improve the clarity of the standards, VRF should incorporate investors' input, specifically from practitioners who engage with companies on environmental, social, and governance (ESG) issues, regarding topic and metric selection.

We do applaud the new language in the General Issues Categories committing VRF to identifying "industry-agnostic and cross-cutting themes that allow comparisons across sectors/industries." This approach will help fill a gap in the current metrics. However, it appears that the process to produce such cross-cutting metrics may take time. To the fullest extent feasible, we ask VRF to work quickly on updating its cross-cutting themes. This addition will do a great deal in moving VRF towards its goal to become a global sustainability standard-setter.

As VRF identifies cross-cutting themes, we encourage it to consider (and adopt) diversity and to renew its focus on human rights. To date, VRF only emphasizes diversity in 20 percent of its industries despite its universal applicability. We understand VRF is considering whether to treat human capital as a cross-cutting issue rather than just an issue of importance to 13 industries. We are glad VRF is revisiting this issue and we encourage VRF to make the transition quickly. Additionally, we urge VRF to restore the inclusion of contractors in the draft Conceptual Framework's description of human capital because contractors play a major role in global economies. Human rights are also material issues worthy of cross-cutting consideration. As a global sustainability standard-setter, it is important that VRF recognizes that violations of human rights have long-term financial implications. We refer VRF to the recommendations of the SEC's Investor Advisory Committee on human capital management reporting which includes these elements among others.

- 5. When read alongside the *Rules of Procedure* exposure draft, are there important aspects of SASB's approach to standard-setting that are missing from the *Conceptual Framework* exposure draft? Are there any material inconsistencies between the *Conceptual Framework* and *Rules of Procedure* exposure drafts?**

The Rules of Procedure are generally fine, but it is important to note that it will take a very long time for standards to change under the identified procedures. For example, it might take two years or longer to enhance diversity standards. It may take longer to find suitable metrics that

are not just U.S.-based. VRF should consider adopting modified procedures to more quickly transition some of the standards to better align with the global market.

6. Please share any additional comments, concerns, or questions regarding the *Conceptual Framework* exposure draft.

Thank you for providing an opportunity to comment. We look forward to supporting VRF in its goal to become a global sustainability standard-setter.

7. Does the *Rules of Procedure* exposure draft provide a clear description of the Standards Board's operating procedures? Are there any areas that should be further clarified?

The Rules of Procedure opens with the same issue as in the Conceptual Framework. VRF highlights two related but different missions. It appears that it will take quite some time to modify the existing standards from its U.S. focus. As such, it may be quite some time before VRF has a set of truly global standards. As suggested in our previous responses, VRF should modify the procedures to accelerate the transition.

We also encourage VRF to make use of the momentum and knowledge available in other jurisdictions because a significant amount of ESG activity occurs outside of the U.S.

8. Does the exposure draft clearly explain the activities that the Standards Board and technical staff engage in to determine when and if standard-setting is necessary? Are these activities consistent with the mission of SASB and the objectives of the SASB Standards? Are there other activities that should be pursued to monitor the relevant industries and issues?

Yes, the Exposure Draft explains the activities; however, there is no information about how VRF intends to shift from its largely U.S.-based metrics to global metrics. The Exposure Draft should discuss this process in detail.

9. Are the ways in which stakeholders can participate in SASB's due process for standard-setting activities clear? Is it sufficiently clear how such participation may inform standard-setting outcomes? Are there other methods the Standards Board and/or technical staff should pursue to obtain market input on the Standards?

The information is generally clear, but there is no clear roadmap for stakeholder participation. Moreover, the procedures need to be more flexible and open to change in order to transition the existing standards to a more global focus. VRF has excelled at engaging leaders who are too often removed from the actual practice of developing or using disclosures, but the procedures may benefit from input by practitioners.

10. Is SASB's governance structure sufficiently and clearly articulated in the document and in a way that appropriately contextualizes subsequent content in the document? Is

the independence of the Standards Board clear? Is the oversight role of the Foundation Board of Directors clear?

The information in the document does not contain the details required to properly address the questions posed, but we have been impressed with VRF's focus on its own governance.

11. When read alongside the *Conceptual Framework* exposure draft, are there important aspects of policies and practices followed by the Standards Board that are missing from the *Rules of Procedure* exposure draft?

As stated above, VRF's transition to a global standard-setter likely requires greater flexibility in policies and procedures during the transition phase, but the documents, when read together, offer a thoughtful approach.

12. Please share any additional comments, concerns, or questions regarding the *Rules of Procedure* exposure draft.

CalPERS supports VRF in its goal to become a global sustainability standard-setter. The strength of VRF's work lies in its industry approach and its fruitful contact with both companies and investors. These advantages cannot be replicated quickly. As such, VRF has a unique and valuable starting point, but the journey ahead is long. We also look forward to continuing to serve in capacities that further the drive to improving sustainability reporting globally.

We applaud the work of VRF in producing a set of global sustainability standards. We look forward to supporting VRF in this important journey. Please contact Anne Simpson, Managing Investment Director, at Anne.Simpson@Calpers.ca.gov, if you have any questions regarding our responses.

Sincerely,

Marcie Frost
Chief Executive Officer

cc: Anne Simpson