Toward a Model for Sustainable Capital Allocation

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The dramatic growth of responsible investment over the past ten years—the so-called "mainstreaming" of SRI—has, in my view, been driven by the size of the sustainability crises we face. Significant problems can offer significant opportunities. With a number of notable exceptions, however, this movement has not generally been geared towards finding aggressive *solutions* to these underlying crises or a rethink of the market functions that contributed to them. Few, for example, have embraced the full implications of the following statement, which guides the $436 billion Norwegian Government Pension Fund Global:

> the management of the assets in the Fund shall be based on the goal of achieving the highest possible return…. A good return in the long term is dependent on sustainable development in economic, environmental and social terms, as well as well-functioning, legitimate and effective markets.[1]

Portfolio performance and societal well-being are inter-dependent. This is the ultimate case for integrated reporting. If financial success is dependent upon sustainability, then the omission of sustainability information from financial reporting is materially misleading. When sustainability information is presented in isolation from financial reporting, it is often ignored and fails to enter into the corporation's core decision-making functions.

The "mainstream" responsible investment movement has focused on the financial materiality of sustainability factors, and their use in generating alpha. It remains to be seen how far we are from a general acceptance that the ultimate alpha generator is our planet's life support system, or from the recognition that financial performance is meaningless if society is impoverished by its generation.

[1] Guidelines for Norges Bank's work on responsible management and active ownership of the Government Pension Fund Global (GPFG), available at: http://www.regjeringen.no/en/dep/fin/Selected-topics/the-government-pension-fund/responsible-investments/Guidelines-for-Norges-Banks-work-on-responsible-management-and-active-ownership-of-the-Government-Pension-Fund-Global-GPFG.html?id=594253. The Fund's ethical guidelines are premised on two concepts: "The Government Pension Fund – Global is an instrument for ensuring that a reasonable portion of the country's petroleum wealth benefits future generations. The financial wealth must be managed so as to generate a sound return in the long term, which is contingent on sustainable development in the economic, environmental and social sense. The financial interests of the Fund shall be strengthened by using the Fund's ownership interests to promote such sustainable development" and the Fund "should not make investments which constitute an unacceptable risk that the Fund may contribute to unethical acts or omissions, such as violations of fundamental humanitarian principles, serious violations of human rights, gross corruption or severe environmental damages." http://www.regjeringen.no/en/dep/fin/Selected-topics/the-government-pension-fund/responsible-investments/the-ethical-guidelines.html?id=434894

There is now ample data to support the argument that sustainability factors can be financially material,[2] and a significant number of business leaders seem to recognize this as well. According to a recent survey of 750 global CEOs by the United Nations Global Compact and Accenture, approximately 93% of CEOs say sustainability is critical to their companies' future success, and 86% see accurate valuation of sustainability by investors as important to reaching a tipping point. The Conference Board, however, reports that most corporate boards still lack independent sources of information and detailed metrics to allow them to effectively oversee the integration of environmental, social and governance data into daily business activities.[3] There is a consensus forming around the notion that in a global, interconnected economy, usable, reliable sustainability data is lacking, and is sorely needed.

The Promise of Integrated Reporting

Integrated reporting may be an important catalyst to accelerate the shift in our financial markets from "efficient" capital formation to "sustainable" capital formation, but we must be clear at the outset about our ultimate goals. We must be clear that the central problem we face is not the threat to shareholder value due to climate change. The problem is climate change, and the role of the capital markets in exacerbating that crisis. The problem is not the risk that human rights violations may impact portfolio performance. The problem is the persistence of slavery and child labor, and the capital markets' continued tolerance of these violations. The list goes on and on. The sustainability crises and the fragility of our global financial systems require us to rethink the role of the capital markets in our lives. The markets have been dramatically misallocating capital, and we must redirect them.

Integrated reporting offers a number of important benefits:

- Although many analysts ignore separate corporate sustainability reports, integrated reporting puts this information in front of analysts and highlights its relevance to financial factors.
- Integrated reporting will ensure that corporate sustainability performance is not an isolated consideration in a company's CSR department, but also the concern of senior management and the board. An integrated report should make this aspect of the company's performance more relevant to senior management as the relationship

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[2] The MSCI KLD 400 Social Index (originally known as the Domini 400 Social Index) is the world's oldest financial benchmark based on social and environmental factors. Since its inception in May 1990, the Index has outperformed the S&P 500 on an annualized basis for the 3 and 5 year and since inception periods (Average annual total return as of July 31, 2010). See http://www.kld.com/indexes/ds400index/performance.html. See also, Asset Management Working Group, UNEP-FI and Mercer, *Demystifying Responsible Investment Performance: A review of key academic and broker research on ESG factors* (October 2007), available at http://www.unepfi.org/fileadmin/documents/Demystifying_Responsible_Investment_Performance_01.pdf, and UNEP FI Asset Management Working Group, *Show Me The Money: Linking Environmental, Social and Governance Issues to Company Value* (2006), available at http://www.unepfi.org/fileadmin/documents/show_me_the_money.pdf. For a comprehensive list of key studies on socially responsible investing, see: http://www.sristudies.org/Key+Studies.

[3] As reported in Global Proxy Watch, Vol XIV No 26, June 25 2010. The studies are available at: http://www.unglobalcompact.org/docs/news_events/8.1/UNGC_Accenture_CEO_Study_2010.pdf and http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1626050.

between the company's sustainability performance and the long-term value of the company is more clearly expressed and measured.
- If done properly, integrated reporting should improve both financial and sustainability performance, and ensure that they are aligned.

Bob Eccles and Mike Krzus have made a compelling case for the need for integrated reporting, in *One Report*.[4] The ultimate goal, however, is still somewhat unclear to me. For example, the International Integrated Reporting Committee (IIRC)'s website notes the following:

> The IIRC has been created to respond to the need for a concise, clear, comprehensive and comparable integrated reporting framework structured around the organization's strategic objectives, its governance and business model and integrating both material financial and non-financial information.
>
> First objective: "support the information needs of long-term investors, by showing the broader and longer-term consequences of decision-making;"

These are laudable goals, but they do not seem sufficiently ambitious to address the size of the problems we face. In particular, I share Bob Massie's concern that this initiative appears to be focused on investor needs, and "structured around the organization's strategic objectives." These statements lead me to believe that there is a risk that the true value of sustainability reporting will be subordinated to financial concerns. This would set us back dramatically.

In this essay, I would like to respectfully offer a few considerations for the IIRC to keep in mind as it pursues its important work. I will argue that investor needs are important, but not paramount. The investor has a critical capital allocation role to play in the system, and needs a more holistic understanding of firm performance to perform that role. I will also address a number of shortcomings in the current U.S. securities disclosure regime as applied to sustainability reporting. Along the way, I hope to reaffirm our collective faith in the Brandeis model that presented sunlight as the best of disinfectants for all manner of "social and industrial diseases."

The Role of the Investor – Sustainable Capital Allocation

Paul Volcker recently became the first recipient of the Stanford Institute for Economic Policy Research Prize for Contributions to Economic Policy. In his acceptance speech, he made the following important statement:

[4] Robert G. Eccles and Michael P. Krzus, One Report: Integrated Reporting for a Sustainable Strategy (Wiley, 2010).

The Stanford Institute prize announcement sets out a simple proposition I suspect we all would support: "Economics is fundamentally about efficiently allocating resources so as to maximize the welfare of individuals."[5]

The official Prize announcement follows that statement with the following clarification: "It is about improving people's standard of living**."**[6] Although it is tempting to quote Mr. Volcker at length, it is sufficient to note for this essay that he called for a reconsideration of the basic tenets of financial theory in the wake of the financial crisis. He questioned whether the financial sector was creating value for society, or value for itself. He notes, for example, that in the past thirty years, "there was one great growth industry. Private debt relative to GDP nearly tripled in thirty years." He also points to our lack of preparedness for the ongoing climate crisis.

Finance should be the engine that drives that larger economic purpose. This is not a new idea—securities regulation in the United States was instituted in the midst of the Great Depression to address the serious risks to society posed by unregulated capital markets.[7] Finance theory, however, has narrowly channeled that public purpose into one all-consuming problem: how to understand and predict the movements of the stock market, and how to outperform. Little attention has been paid to how investors can most effectively allocate resources to maximize the welfare of individuals, or society.[8]

Humanity is now using natural resources 50 percent faster than what Earth can renew, meaning that we are currently operating as if we lived on 1.5 Earths.[9] In the developed, market-based societies, the news is worse. This is the ultimate verdict on our capital allocation decisions. And incidentally, these trends are affecting portfolio values today and will certainly dramatically impact them in the years to come.

Our deficit relationship with the Earth is the result of many macroeconomic factors that lie outside the scope of this discussion. A key contributing factor, however, has been investors' exclusive focus on portfolio returns—stock price—while ignoring the consequences of their investment decisions and the real-world impact of the corporations whose shares they buy and

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[5] A transcript of Mr. Volcker's remarks is available at http://siepr.stanford.edu/system/files/shared/PAUL_VOLCKER_Transcript_of_Remarks.pdf. Volcker also presented these remarks as an essay in the New York Review of Books, at http://www.nybooks.com/articles/archives/2010/jun/24/time-we-have-growing-short/

[6] http://siepr.stanford.edu/prize_announcement

[7] Describing "the need for regulation', Section 2 of the Securities Exchange Act of 1934, the Act that created the Securities and Exchange Commission states: "[n]ational emergencies, which produce widespread unemployment and the dislocation of trade … and adversely affect the general welfare are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices and by excessive speculation on such exchanges and markets…."

[8] See, generally, Justin Fox, The Myth of the Rational Market: A History of Risk, Reward, and Delusion on Wall Street (HarperCollins, 2009).

[9] According to the 2010 edition of the Living Planet Report, a biennial report on the planet's health produced by WWF in collaboration with Global Footprint Network and the Zoological Society of London. Available at http://www.footprintnetwork.org/en/index.php/GFN/blog/human_demand_outstripping_natures_regenerative_capacity_at_an_alarming_rate

sell. The economic theory that says an exclusive focus on financial success will implicitly reflect all other considerations, incorporating the interests of "the butcher, the brewer and the baker," to paraphrase Adam Smith, has failed.[10] The annual Financial Times 500, a list of the largest corporations in the world by market capitalization, can also be seen as a list of the choices global investors have made. The largest companies on the list are a mix of value-creators and value-destroyers, including companies allegedly responsible for some of the most egregious harms, including genocide. By any measure, too much of the world's population lives in abject poverty and wealth disparities in the United States have reached frightening levels.

In the face of climate change, water scarcity, global poverty and modern slavery, integrated reporting—or any system of reporting at all for that matter—seems a rather tepid response. Nevertheless, it is a necessary, if not sufficient response. Without dramatically improved corporate reporting, we will not have the data we need to find a sustainable path forward. In order to shift from "*efficient* capital formation" to "*sustainable* capital formation," we need a full accounting—an accounting that provides readers with a complete view of risks and opportunities to the corporation, as well as the risks and opportunities the company presents to society and the environment.

The Brandeis Model

The reason we are discussing reporting in the midst of multiple crises is because we still have faith in the Brandeis model. In "What Publicity Can Do," one of a series of articles he published in 1913 on the problem of the money trusts, Louis Brandeis made the case that "publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman."[11] Brandeis' reasoning, now taken as self-evident, was that investors will make better decisions if they have relevant information and their informed decision making will serve as a check on fraudulent behavior. "Require full disclosure to the investor of the amount of commissions and profits paid," Brandeis reasoned, "and not only will investors be put on their guard, but …[e]xcessive commissions—this form of unjustly acquired wealth—will in large part cease."

Brandeis stressed that disclosure to *investors* advanced the *public* interest: "Compliance with this requirement should also be obligatory, and not something which the investor could waive. For *the whole public* is interested in putting an end to the bankers' exactions." (emphasis added) Investor disclosure, in Brandeis' view, is a means to an end.

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[10] Although this paragraph in the Wealth of Nations is one of the most frequently used rhetorical tools of free market apologists, it should be noted that the free market has not served the butcher, the brewer or the baker particularly well. In most communities in America, at least, they have been replaced by large corporations.
[11] Louis D. Brandeis, Other People's Money and How the Bankers Use It (August M. Kelley, 1986. Originally published, 1914), at 92. The original article is available at www.sechistorical.org/collection/papers/Pre1930/1913_12_20_What_Publicity_Ca.pdf.

The "remedial measure" of Brandeis' system depends upon at least three factors to work properly: an interested, independent party to monitor the data (investors), regulation (the disclosure should be 'obligatory'), and, for certain types of disclosures, a sense of shame. The primary problem with sustainability reporting, at least in the United States, is not the lack of standards—it is the lack of regulation.

The Current U.S. Regulatory Approach to Sustainability Reporting

Although securities regulation in the United States was inspired by the Brandeis model, where Brandeis proposed targeted disclosure to address specific problems, we are left with the concept of materiality to remedy all manner of social and industrial diseases. The IIRC's approach to materiality will, in my view, be perhaps its most critical contribution.

In the United States, there are currently no explicit rules requiring corporate issuers to disclose their social or environmental policies, procedures or performance in their securities filings. A company's safety record, record of regulatory fines or warnings, employee turnover rates, greenhouse gas and other toxic emissions over time, etc., are not currently required to be disclosed to investors.[12]

As discussed below, we can no longer afford to rely exclusively upon management's judgment of risk, management's definition of materiality, and issuer-focused disclosure in a world where investors are broadly diversified and subject to a variety of portfolio-level risks. A proper report should aim to provide investors with sufficient information to make truly sustainable asset allocation decisions.

Materiality is in the Eye of the Beholder

In its recent interpretive guidance on climate change, the SEC provided the following definition of materiality: "Information is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to vote or make an investment decision, or, put another way, if the information would alter the total mix of available information."[13]

Materiality is not, as many believe, "what affects stock price." It would be unreasonable to define the concept so narrowly. The reasonable investor wants information to help her evaluate her investment. If "materiality" is defined as "what affects stock price," then the moment a material factor is revealed, the stock will move. A *reasonable* investor would

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[12] There are a few specific rules relating to disclosure of environmental risks to the issuer. Although there are no explicit rules regarding "social" risks, such as human rights violations or community opposition to new capital-intensive projects, general requirements to disclose material risk information apply equally to all sustainability issues, as long as management determines that these issues present "material" risks to the issuer.

[13] Commission Guidance Regarding Disclosure Related to Climate Change, Release Nos. 33-9106; 34-61469; FR-82 (Feb. 8, 2010), available at http://www.sec.gov/rules/interp/2010/33-9106.pdf, citing TSC Industries v. Northway, Inc., 426 U.S. 438 (1976).

certainly like a bit of advance notice. In my experience, however, materiality is generally viewed as a limiting, narrowly construed factor to be defined by lawyers, not an analytical tool.

In practice, we take this tool designed to gauge investor needs, and place it in the hands of corporate counsel to implement. The results, perhaps not surprisingly, are often not particularly useful to investors. Management's incentives are to disclose as little as possible, in direct opposition to what investors need. This can be particularly dangerous when there is an Ahab at the helm, as there arguably was at Massey Energy when disaster struck earlier this year, killing 29 miners. A CEO blind to risk should not be placed in charge of determining what information should be disclosed about his operations. The companies that are the most likely to experience avoidable catastrophic disasters are the least likely to provide advance warnings. This is simple common sense. A "reasonable" investor needs something more than management's perception of risk. A reasonable investor needs information to allow her to second-guess management, and to arrive at a more complete view of the company.

It is important to recognize that Brandeis was not relying on the good will or farsightedness of corporate managers to disclose all "material" information. He chose a specific data point to address a particular problem. And clearly, Brandeis did not see the investor as the ultimate beneficiary of the disclosure regime. The investor, by reviewing and acting on the data, was serving a broader public interest. In a sense, he was offering a regulatory version of Smith's invisible hand.

When investors fail to perform their appropriate function in the system and companies realize that nobody is paying attention, Brandeis' "remedial measure" breaks down. That may have been the case with BP. When there are no negative consequences in the marketplace for the publication of damaging information, the incentives to improve performance are severely impaired. Clearly, investor attitudes must change, but data must at least be made *relevant* to investors, or they will not use it.

The SEC's guidance on climate change should help to illustrate the problem. Because the guidance made no new law, merely interpreting existing interpretations of materiality in the context of climate change, it clearly highlights both the benefits and limits of materiality. The guidance very helpfully outlines the various risks climate change presents to a range of industries, and details the type of disclosures that issuers should be providing. The guidance should prompt many companies to conduct internal risk assessments, and put in place mitigation measures.

Why did the Commission see the need to thoroughly explain to issuers that the most significant sustainability crisis humanity has ever faced might be material to their businesses? Because it is up to each company to define the material risks it faces. And now that the SEC has reminded companies of the true scope of the concept of materiality, I suspect we will see many more companies begin to discuss climate change in their securities filings. I do not expect to see many other material sustainability risks discussed, despite the fact that the law already requires such disclosure.

By contrast, the Global Framework for Climate Risk Disclosure,[14] developed by a significant coalition of institutional investors, as well as the Carbon Disclosure Project—now backed by 534 institutional investors managing more than $64 trillion[15]—seeks targeted performance disclosure, including baseline greenhouse gas emissions, strategy discussions and targeted carbon pricing scenarios, regardless of their "materiality." This information would provide investors a deeper understanding of each company's approach to climate change and the actual risks presented, in a comparable format. This information should also allow investors to understand trends over time, a critical analytical need that materiality does not address.

Externalities

Modern portfolio theory has much to answer for in the wake of the recent financial meltdown. One of its tenets—the benefits of diversification—has had both positive and negative implications for sustainability. On one hand, broad diversification has provided many investors with the excuse to ignore issuer-level risks, and has tied a significant percentage of investors to public benchmarks that employ no social or environmental standards. On the other hand, broad diversification has produced the notion of the "universal owner," a concept that has led a number of very large institutional investors to accept their broad obligations to society.

Regardless of its shortcomings, diversification is not likely to go away. It has transformed the public equities markets, but securities regulation has not kept up.

In the midst of a series of *systemic* crises—financial, ecological and social—we can no longer afford a reporting system that fails to take a holistic approach. And yet, investors who are responsible for decision-making that drives the largest capital allocation mechanism on the planet do not receive systemic information. They receive issuer-focused, inward-looking reports—"corporate self-portraits," as Sanford Lewis puts it in another essay in these pages. Because current rules focus on financial risks *to the issuer*, there are no securities rules requiring an issuer to disclose the impact its operations may have on its competitors, the environment, customers, employees, or communities. "Negative externalities" from corporate operations, broadly defined as costs that are imposed on third parties, are not explicitly captured by current rules, unless the issuer believes these issues present a material financial risk to the company. Broadly diversified investors, therefore, do not have access to sufficient information to adequately gauge portfolio-level risks of these issues. The Carbon Disclosure

[14] http://www.unepfi.org/fileadmin/documents/global_framework.pdf
[15] https://www.cdproject.net/en-US/WhatWeDo/Pages/overview.aspx

Project and the Framework noted above are two investor-driven responses to this information gap.

Material to Whom?

I would recommend that a sign be posted on the wall during all IIRC deliberations, asking the simple question, "Material to Whom?"[16] It is a simple question to ask, but it may not be such a simple question to answer. As discussed above, information that is material to a particular stakeholder may not be relevant to investors, and data that is ignored by investors is unlikely to be taken very seriously by corporate management.

Nevertheless, it is critically important that the Committee recognize that all stakeholders—including shareholders—need to understand how companies are affecting all of their various stakeholders. The only way to truly understand those impacts is to look outward, beyond the shareholder, and certainly beyond stock price. The Global Reporting Initiative offers a different definition of materiality than the SEC definition quoted above, focusing instead on material risks imposed by corporations on their stakeholders. Combined with the SEC definition, a fully integrated report should give corporate stakeholders close to a 360 degree view of both risks and opportunities.

Corporations have an obligation to society to publicly report on these material impacts. Smart investors will pay attention as well, because these issues can provide insights into the quality of management, can signal future risks, and can help the investor to assess system-level risks that would otherwise go unreported. If integrated reporting is focused around company-defined strategy, however, there is a risk that these stakeholder issues will get lost.

Although our globalized economy has narrowed the gap between financial materiality and stakeholder materiality in many cases, there will always be critical stakeholder impacts that will not be easily measured in terms of stock price. Here are a few examples:

Shell v. BP

The New York Times reports that oil companies have deposited an Exxon-Valdez size spill into the waters of the Niger delta each year, for the past fifty years.[17] Shell is the major player in the region. The capital markets do not seem to have noticed. By contrast, BP's stock price dropped by almost 50% within days of the Deepwater Horizon disaster in April. A focus on "stock price materiality" would lead one to conclude that oil spills in developing countries and investments in safety measures in those countries are immaterial and need not be

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[16] Sr. Ruth Rosenbaum, Executive Director of CREA, would put it slightly differently. Her ultimate question is "Cui Bono?" – "Who benefits?"
[17] Adam Nossiter, "Far From Gulf, a Spill Scourge 5 Decades Old", *New York Times*, June 16, 2010, available at http://www.nytimes.com/2010/06/17/world/africa/17nigeria.html?scp=1&sq=spill%20scourge&st=cse

disclosed. Clearly, Shell's experience in Nigeria has been costly, widely publicized and litigated, but has it had the severe financial impact of BP's experience in the Gulf?

Clearly, any worthwhile model of integrated reporting would not distinguish between risks to developed and developing country stakeholders, but this will require a broader conception of materiality.

The Atlantic Bluefin Tuna

Costco recently adopted a sustainable seafood policy after dialogue with a coalition of investors led by Green Century Asset Management, and a very public campaign by Greenpeace. The policy bans purchases of Atlantic Bluefin Tuna, a threatened species. Is the survival of the Atlantic Bluefin "material" to Costco? Costco's offerings are broadly diversified. If the species is rendered extinct by over-fishing, Costco may suffer some reputational risk, or even boycotts, but it is not the largest offender and its consumers will most likely move on to another type of fish. After all, none of Costco's competitors will be able to offer an extinct species. Costco's ban may even create some short term risk of customer dissatisfaction. The survival of the Atlantic Bluefin, however, is material to the health of the oceans, and the health of the oceans is material to all life on Earth.

Coffee Farmers

In *Black Gold*, a recent documentary, a group of Ethiopian coffee farmers are asked the price of a cup of coffee in Europe or America. Their guesses are far short of the mark, and they are astonished to hear the answer. Ethiopian coffee is among the most expensive in the market, and many coffee-drinkers consider Ethiopian coffee to be the finest coffee in the world. And yet the farmers that produce this bounty need to scrape together every last cent to build a school for their children. Screaming children in their community are turned away from emergency nutritional centers because they are not yet hungry enough. Many farmers are growing chat, a fast-growing profitable narcotic, on land that should be growing coffee trees. In the language of economics, this shift to chat is a misallocation of capital based on a significant information asymmetry. Coffee trees take five years to produce their fruit. The markets, however, as we know from so many examples, are driven by short-term considerations. This problem is replicated in coffee-growing regions around the world.

When I was in dialogue with Procter & Gamble about Fair Trade Certified coffee, P&G's head coffee buyer demonstrated the ease with which he could access the current market price on his BlackBerry. A basic requirement of any fair commercial transaction is equal access to information. If our global system of trade cannot provide these farmers with honest prices, the system is badly broken. Perhaps this consideration is beyond what corporate reporting can fix. Or perhaps public reporting by corporations that benefit from these information asymmetries should report on their efforts to level the playing field. Recall Brandeis: "Require full disclosure to the investor of the amount of commissions and profits paid, and not only will investors be put on their guard, but …[e]xcessive commissions—this form of unjustly acquired wealth—will in large part cease.”

The $6.5 Billion Indicator

The GRI combines a degree of flexibility and room for management to tell its story, while also defining specific indicators. This is critically important for a variety of reasons already discussed. One additional reason is that targeted sustainability disclosure can educate management about what information is widely viewed as important.

Some indicators are selected to efficiently provide a breadth of insight into management of the company. Other indicators, if appropriately defined, can drive change all the way from senior management down to a community of stakeholders half a world away. Such indicators can help to uncover previously hidden operational inefficiencies and provide management with a basis for managing these costs in the future. In his latest report to the UN Human Rights Council, for example, Professor John Ruggie, the UN Secretary General’s Special Representative on Business and Human Rights reported that:

> “a study of 190 projects operated by the international oil majors indicates that the time for new projects to come on stream has nearly doubled in the past decade, causing significant cost inflation. Delays are attributed to projects’ ‘technical and political complexity.’ An independent and confidential follow-up analysis of a subset of those projects indicates that non-technical risks accounted for nearly half of all risk factors faced by these companies, with stakeholder-related risks constituting the largest single category. It further estimated that one company may have experienced a US $6.5 billion “value erosion” over a two-year period from these sources, amounting to a double-digit fraction of its annual profits.” [18]

Community opposition to oil industry projects may have cost this company up to $6.5 billion over a two-year period, but prior to Professor Ruggie’s study, the company had never sought to measure these “stakeholder” costs. There is no indication that this company’s financial reporting was inaccurate, or that it had to restate its earnings. These costs were embedded in a variety of other costs. Nobody thought to pull them together until the right questions were asked. Now, the company can move to mitigate a significant and previously unidentified cost, obtain a better understanding of community concerns, and hopefully do a better job of addressing them in the future. An exclusive reliance on issuer-defined materiality reporting is unlikely to produce such results. Sustainability issues, when they are placed in a financial context, are generally thought to present long-term risks, and they do. But this example also highlights that these issues present *every day* costs and opportunities.

[18] Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie: Business and Human Rights: Further steps toward the operationalization of the “protect, respect and remedy” framework (April 9, 2010), at paragraph 71 (footnotes omitted). Available at http://www.reports-and-materials.org/Ruggie-report-2010.pdf

A Cautionary Note on XBRL

The XBRL format offers significant promise, allowing investors to easily access relevant data points and compare them across firms and industries. The technology, broadly applied, should lead to far broader access to data and new insights. For example, the SEC's Investor Advisory Committee approved a resolution asking the SEC to study the costs and benefits of data-tagging of corporate proxy statements, mutual fund proxy voting records, and corporate filings revealing final vote results.[19] As a member of that committee, I strongly supported the idea, as it may provide researchers with new insights into the proxy voting process, a critical corporate accountability tool.[20]

It seems to me to be somewhat ironic, however, to be discussing the concept of "One Report" and XBRL in the same breath. XBRL may be a very positive development, but it is also likely to accelerate the atomization of corporate reporting, undermining the integrity of the report itself. Investors will have even less incentive to read the corporate report as published, preferring to extract the data points their models call for. What gets lost, is context, and context is critical to understanding corporate strategy and performance, particularly with respect to those sustainability factors that cannot generally be reduced to a data point.

It is also critical to recall the coffee farmer that lacks access to pricing information, relying instead on a chain of middle-men and brokers. When developing a new architecture of information distribution, we must consider the question of *access to data* if we truly wish to produce a more sustainable global market. Perhaps an access initiative for the developing world along the lines of the Enhanced Analytics Initiative would be in order. Without expanding access to corporate data, we will end up with more information, but in the hands of the same group of people, and their track record of sustainable capital allocation decisions is not promising.

Conclusion

It is tempting to argue that our systems of reporting—both financial and sustainability—have failed, or are failing us. I believe it would be more accurate to say that our systems of reporting have been inadequate to the task, and need to be dramatically improved. Certainly with respect to sustainability, the Brandeis model has not been given a chance to work.

For Domini Social Investments, and many other social and faith-based investors, sustainability reporting is first and foremost about accountability, and accountability to multiple stakeholders. Integrated reporting offers tremendous promise. It can dramatically enhance the

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[19] http://sec.gov/spotlight/invadvcomm/iacproposedresproxyvotingtrans.pdf

[20] My views as a member of the Investor Advisory Committee are mine alone, and are not necessarily those of the other Committee members, the SEC Commissioners, or SEC Staff.

value of both financial and sustainability reporting and, ultimately, drive better, more sustainable decision-making.

Investors are an important stakeholder, but not the only one, and not even the most important one. Investors have a particular role to play in the system, and to perform that role they need a more holistic view of corporate performance. It is critically important, therefore, that integrated reporting not subordinate sustainability factors to financial metrics. Financial reporting must incorporate sustainability factors to be accurate and honest. This, however, is not necessarily anything more than appropriate financial reporting. The goal should be something far more ambitious, incorporating a more enlightened view of value and materiality in a world that is desperate for a full and honest accounting of the consequences of our decisions.

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