Public Statement

Statement on Rules Governing the Disclosure of Payments by Resource Extraction Issuers

Commissioner Allison Herren Lee

Dec. 16, 2020

The statutory mandate under which we act today is fundamentally about transparency. Enhancing transparency to promote accountability and fight corruption. Under Section 1504 of the Dodd-Frank Act, Congress tasked us with crafting rules that would require issuers in the extractive industries to disclose their payments to foreign governments so those governments can be held accountable for the money flowing in.[1] In other words, empowering citizens through information. That goal is in keeping with the United States' long history as a leader in international efforts to combat corruption. And it is in keeping with the SEC's role in anti-corruption efforts: enforcing the Foreign Corrupt Practices Act, ensuring compliance with anti-money laundering rules, and participating in the important work of the Financial Action Task Force, a global effort to fight money laundering and terrorist financing. There is nothing new or unusual about the SEC's role in this space, and Congress treads familiar ground with this mandate.

Congress also understood that these new disclosure rules could promote good governance on the part of issuers and yield information material to investors.[2] In other words, empowering investors through information. That goal is likewise in keeping with the Commission's long history of promoting transparency for the benefit of investors and our capital markets.

Unfortunately, the rule we adopt today does not adequately support either of these goals. Instead, today's final rule allows payment information to be aggregated to such a degree that the resulting disclosures will obscure information crucial to anti-corruption efforts and material to investment analysis. As a result, today's rule, by the Commission's own determination, will severely restrict the transparency and anti-corruption benefits that the disclosures might provide,[3] and thus fails to advance the statute's goals.

Failing to Advance Anti-Corruption Goals

There is, of course, a long legal history associated with this rule that complicates our work in finalizing it.[4] In the latest chapter of that history in 2017, Congress employed the then rarely-used Congressional Review Act (CRA) to disapprove the final rule the SEC adopted in 2016.[5] As a result, we must adopt a new rule – because the original statutory mandate remains – but the new rule may not be "substantially the same" as the 2016 rule.[6] As the adopting release explains, we have very little law to guide us in determining what that means, except we know that the CRA disapproval did not repeal Section 1504 or modify its mandate.[7] In other words, whatever we must do in response to the CRA disapproval, the one thing we cannot do is fail to fulfill our original statutory mandate.

At proposal, in seeking to craft a rationale for the new rule, the release cited concerns raised by members of Congress during the disapproval process.[8] Specifically, the release identified concerns regarding compliance costs for issuers and potential anti-competitive effects.[9] The proposing release explained that the proposed modifications to the 2016 rule were guided by, and responsive to, those concerns.[10] However, the record now amply demonstrates that such concerns were not borne out. Although the Commission largely declined to analyze available data at the proposal stage, commenters supplied information derived from years of disclosures under foreign regimes indicating that significant compliance costs and anti-competitive effects simply have not arisen.[11]

As such, those member concerns do not provide a sound rationale for the policy reversals proposed, and the adopting release now pivots to a new theory, positing that we must reverse "at least one of the two central discretionary determinations at the heart of the [] disclosure system that the Commission made when it issued the 2016 Rules."[12] Those two central determinations are purportedly as follows: (1) the definition of the term "project," which determines the specificity of the payment disclosures produced, and (2) the requirement that the issuers' payment disclosures be public.

Under this new reasoning, the final rule opts to reject the contract-level project definition that the Commission said in 2016 is "necessary and appropriate to achieve a level of transparency that will help advance the important anticorruption and accountability objectives underlying" our statutory mandate.[13] Instead, we adopt a definition of project that will allow a much higher level of payment aggregation, and therefore will not yield the type of granular disclosure that the Commission has determined is "necessary to advance in a meaningful way the statute's anti-corruption and accountability objectives."[14] Thus, ostensibly because of the CRA disapproval, we are doing the one thing the CRA cannot compel us to do: modify the rule in way that rejects the goals of the original statutory mandate.

And we don't stop there. The adopting release contends that the change in project definition alone would satisfy the CRA.[15] Nevertheless the final rule reverses course on a host of other significant features of the 2016 rule, all of which will reduce transparency. These changes will reduce the number of companies required to disclose, reduce the amount of disclosure, reduce the liability that attaches to the disclosure, and reduce the promptness of the disclosure.[16] At proposal, these changes were premised on Congressional concerns about compliance costs and anti-competitive effects. But since we have abandoned that rationale[17] – and the release reasons these changes are not required to satisfy the CRA – it is not clear that we have any reasonable basis for these additional reversals from the Commission's well-reasoned 2016 position.

Failing to Serve Investors

In addition to undermining the anti-corruption goals of the statute, today's release also reduces the utility of these disclosures for investment analysis. In fact, the release largely dismisses the idea that we should even consider the potential materiality of these disclosures to investors, stating "we do not believe that the purpose of the required disclosures is to provide material information to investors."[18] However, in connection with the passage of Section 1504, Congress made specific findings about the reputational and operating risks to companies that flow from "opaque and unaccountable management of natural resource revenues by foreign governments" and concluded that the "effects of these risks are material to investors."[19]

Moreover, irrespective of whether it was an intended purpose of the statute to provide material investment information, investors have consistently throughout the course of this rulemaking explained that the contract-level disclosures do yield material information.[20] The release largely brushes aside these arguments, in part based on the idea that, if the information is material, it's already being disclosed under existing principles-based requirements.[21] This response to investors' views regarding materiality wrongly assumes that the principle of materiality is applied in a manner both sweeping and precise, such that the general principle elicits from all companies disclosures with the specific granularity – no more and no less – required of each individual company. In fact, general principles-based obligations do not invariably yield the specific information material to investors. For example, the requirement that certain issuers disclose "material" risks has, as the Commission itself recently observed,[22] yielded cursory and generic narrative warnings that lack sufficient detail as to their true impacts.

This argument also ignores the compelling evidence supplied by investors showing just how these contract-level disclosures inform their investment analysis. These are not speculative claims about the potential utility of disclosures under our rule. Rather, because there are years' worth of contract-level disclosures under foreign regimes, analysts have explained to us how these disclosures provide more specific information on, for example, taxes and royalties, than can be derived from income statements, and how such granular disclosures allow them to better model cash flow and understand regime-specific risks.[23] Under the law, materiality is to be gauged by *investor* views, from the standpoint of a reasonable investor.[24] There is nothing remotely unreasonable about investors wanting to scrutinize and understand the risks to their capital arising from otherwise undetected, unchecked, and potentially unscrupulous payments.

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In the end, it's hard to understand who we are serving with this final rule. We are not effectuating Congress's intent in passing Section 1504. We are not ensuring sufficiently granular disclosure to enable citizens to combat corruption. We are not providing investors with the information that is material to their investment and voting decisions. We are not heeding the numerous calls from issuers who have asked us to harmonize our rules with the international standard.[25] And, most unfortunately, we are not taking the opportunity to further the SEC's and the United States' tradition as leaders in the fight against global corruption. I must respectfully dissent.[26]

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[1] Section 1504 of the Dodd Frank Act, Pub. L. No. 111-203, amended the Exchange Act in 2010 to add Section 13(q), 15 U.S.C. 78m(q). Section 13(q) requires resource extraction issuers to provide information in an annual report about the type and amount of payments made to foreign governments for each of their projects related to the commercial development of oil, natural gas, or minerals. Section 13(q) also provides that "[t]o the extent practicable, the rules . . . shall support the commitment of the Federal Government to international transparency promotion efforts relating to the commercial development of oil, natural gas, or minerals."

[2] Congress made the following findings in connection with Section 1504:

(1) It is in the interest of the United States to promote good governance in the extractive industries sector. Transparency in revenue payments benefits oil, gas, and mining companies, because it improves the business climate in which such companies work, increases the reliability of commodity supplies upon which businesses and people in the United States rely, and promotes greater energy security.

(2) Companies in the extractive industries sector face unique tax and reputational risks, in the form of country-specific taxes and regulations. Exposure to these risks is heightened by the substantial capital employed in the extractive industries, and the often opaque and unaccountable management of natural resource revenues by foreign governments, which in turn creates unstable and high-cost operating environments for multinational companies. The effects of these risks are material to investors. 156 Cong. Rec. S3801, 3814.

[3] *See* Disclosure of Payments by Resource Extraction Issuers, Final Rule, Rel. No. 34-78167 (June 27, 2016) (2016 Final Rule) (Rejecting the rationale on which the American Petroleum Institute (API) advocated for its preferred definition of project, which the Commission adopts today, and stating that to "cabin Section 13(q)'s goals as the API would do, in our view, would severely limit the potential transparency and anti-corruption benefits that the disclosures might provide to citizens of resource-rich countries.").

[4] I want to thank the staff for their work on this rulemaking, which has spanned many years. In particular, the staff of the Division of Corporation Finance, the Office of the General Counsel, and the Division of Economic and Risk Analysis. This rule has presented unique challenges, difficulties, and perhaps disappointments. The staff's work has been consistently exemplary in the face of these challenges. Unfortunately, I cannot agree with where today's version of this rule has landed, nor can I agree that the Congressional Review Act or any other rationale compels this outcome. But my disagreement with the policy choices of the majority in no way lessens my appreciation for the excellent work of the staff.

[5] *See* H.R.J. Res. 41, 115th Cong. (2017).

[6] Specifically, the CRA provides that the Commission may not reissue the disapproved rule in "substantially the same form" or issue a new rule that is "substantially the same" as the disapproved rule unless the reissued or new rule is specifically authorized by a law enacted after the date of the disapproval. *See* 5 U.S.C. 801(b)(2).

[7] The adopting release provides that the "CRA resolution does not modify the Section 13(q) mandate that the Commission issue rules regarding the disclosure of resource extraction payments." *See* Disclosure of Payments by Resource Extraction Issuers, Final Rule, Rel. No. 34- [], 13 (Dec. 16, 2020) (Adopting Release); *see also id*. at 158 ("Congress did not repeal the mandate under Section 13(q), and in fact, some members of Congress who supported the joint resolution to disapprove the 2016 Rules also expressed their 'strong support' for the transparency and anti-corruption objectives of the rules.").

[8] The proposing release provided that "we looked to the concerns raised by members of Congress during the floor debates on the joint resolution to assist us in developing a rule that is not 'substantially the same' as the 2016 Rules." *See* Disclosure of Payments by Resource Extraction Issuers, Proposed Rule, Rel. No. 34-87783, 20 (Dec. 18, 2019) (2019 Proposing Release).

[9] *See id*. 17-18 ("[M]embers expressed the view that the 2016 Rules would impose undue compliance costs on companies, undermine job growth and burden the economy, and impose competitive harm to U.S. companies relative to foreign competition.").

[10] *See id*. at 25 ("In proposing these provisions and other aspects of this rulemaking, we have striven to achieve an appropriate balance between implementing the statute as required by Congress and addressing the concerns expressed by commenters and members of Congress."), and 62 ("In light of the concerns expressed by prior commenters and members of Congress that the 2016 Rules imposed undue competitive harm, we have reconsidered the balance that the Commission previously struck.").

[11] Commenters supplied data and analysis related to disclosures by issuers under foreign disclosure rules substantially similar to the Commission's 2016 rule demonstrating that significant compliance costs and anti-competitive effects have not materialized. *See, e.g.,* Letter from Oxfam and Earthrights International (Mar. 23, 2020) (providing that "the European Commission noted in their review that '[t]here is no evidence that competitors from third countries benefit from substantial competitive advantages by not being required to report on payments to governments.' The review further found that 'European companies have not reported that they suffered material damages or losses of opportunity due to the introduction of the reporting requirements. The requirements entail compliance costs, but they are not seen as highly disproportionate by the industry. Similarly, companies did not find it harder to operate in third countries. An analysis of recent contracts in the extractive sector in some countries of operation shows that EU companies have maintained or increased their presence in countries where they were operating.'"), citing European Commission, Review of country-by-country reporting requirements for extractive and logging industries (Final report) (2018). *See also* Letter from Total (Feb. 17, 2020) (stating that "the internal cost for this reporting is low, in the region of $200k per year"); Letter from Equinor, US (Mar. 13, 2020) ("Lastly, allow us to share some of our experience of having disclosed payments to governments since 2005. The costs involved preparing our annual disclosure of payments to governments (following the initial implementation of necessary systems and procedures), have been modest and acceptable for a business operation of our size and nature"). In addition, the Adopting Release states the following: "[A]dditional data and other information that has become available regarding resource extraction issuers' experiences with the European and Canadian disclosure regimes indicate that the cost and anti-competitive effects of payment disclosure, while still relevant considerations, may well be lower than the Commission projected in 2016. Thus, in formulating the final rules, we generally have not based our discretionary determinations for the final rules on the floor statements from various members of Congress expressing concerns about the economic effects of the 2016 Rules (although we do acknowledge various points where those concerns may align with our discretionary determinations)." Adopting Release at 24. In addition to data related to compliance costs and anti-competitive effects, commenters also supplied analysis of publicly-available disclosures relevant to other aspects of the proposed rule's effects. *See, e.g.*, Letter from Natural Resource Governance Institute (Mar. 16, 2020) (analyzing disclosures under the rules in the EU, UK, Canada, and

Norway, simulating the effect of the proposed de minimis threshold in conjunction with the new project definition, and finding that the nearly half of all projects would not meet the proposed de minimis threshold). The disclosures under foreign disclosure rules were available to the Commission at the time of the proposal.

[12] *See* Adopting Release at 15-16.

[13] *See* 2016 Final Rule at 77.

[14] *See id*. at 83.

[15] *See* Adopting Release at 16-17 ("[W]e believe that the form and manner of the revision to the project definition is not just a reasonably necessary change, but also one that alone is sufficient to comply with the CRA's requirements that the disapproved rule not be reissued in 'substantially the same form' and a new rule may not be 'substantially the same' as the disapproved rule.").

[16] The additional modifications to the 2016 Final Rule include: exemptions from compliance for foreign conflicts of law and pre-existing contractual provisions; exemptions from compliance for smaller reporting companies and emerging growth companies (except where they already disclose under an alternative reporting regime); a new definition of control that excludes entities only proportionately consolidated in an issuer's financial statements; requiring disclosures be furnished rather than filed with the SEC (thereby reducing liability); transitional relief for initial public offerings; and a much delayed deadline for furnishing disclosures. *See* Adopting Release at 20-22.

[17] The Adopting Release identifies commenter concerns regarding the proposal's reliance on statements by members of Congress regarding compliance costs and anti-competitive concerns: "(1) these floor statements are not necessarily consistent with the views of most members of Congress and are not legally binding in any case; (2) the floor statements themselves give no clear indication of how the Commission should modify the rules; and (3) the concerns expressed in these floor statements about costs and competitive effects may be based on estimates and economic analyses in the 2016 Rules Adopting Release that have been called into question by actual cost data and information regarding the potential anti-competitive effects derived from resource extraction issuers' experiences with the disclosure regimes in Europe and Canada." The Adopting Release goes on to concede that compliance costs and anti-competitive effects "may well be lower" than estimated in 2016, and provides that "[t]hus, in formulating the final rules (and in contrast to our approach in the proposing release), we have not based our discretionary determinations for the final rules on previously expressed concerns, including from various members of Congress, about the economic effects of the 2016 Rules (although we do acknowledge various points where those concerns may align with our discretionary determinations)." *See* Adopting Release at 23-24.

[18] *See* Adopting Release at 41. In support of this statement, the release cites a statement by a member of Congress from 2017, which does not seem to be relevant to Congressional intent at the time Section 1504 was adopted in 2010. Later, the Adopting Release cites a statement by Senator Dodd from the relevant Congressional record in support of its view: "The amendment would require companies to better account for the risks associated with such investments by disclosing basic information about payments to governments. I believe that many Americans-including investors and other stakeholders in these firms-would consider this kind of information material and relevant to their decisions about whether or not to invest, or whether to divest their current holdings, from firms engaged in this sort of activity. On its face this interest appears not to rise to the level of materiality for investors that currently governs the disclosure requirements of public companies under Federal securities laws. That is a question we may want to look at more closely in the Banking Committee. There are also questions about the precedent this would set for Congress to require disclosures usually considered to be non-material." In response, I note that the understanding of the materiality of environmental, social, and governance risks has evolved significantly since 2010.

[19] *See* Congressional Record, supra note 2.

[20] *See* Letter from Alexander Schay (Mar. 16, 2020); Letter from Frederic Samama, et al. (Mar. 16, 2020); Letter from US SIF (June 17, 2020). In addition, a letter from Calvert Investments in the 2016 comment file aggregates

extensive investor comment over many years supporting robust contract-level disclosure requirements. *See* Letter from Calvert Investments (Feb. 16, 2016).

[21] *See* Adopting Release at 42 ("[W]e believe that the Commission's existing rules should elicit all material risk-related disclosure. For example, issuers are required to disclose the most significant risks affecting an issuer or the securities being offered as well as any known trends or uncertainties that have had or are reasonably likely to have a material impact on the registrant's liquidity, capital resources, or results of operations.").

[22] *See* Modernization of Regulation S-K Items 101, 103, and 105, Proposed Rule, Rel. No. 33-10668 (Aug. 8, 2019) ("A contributing factor to the increased length of risk factor disclosure appears to be the inclusion of generic, boilerplate risks that could apply to any offering or registrant. Although Item 105 instructs registrants not to present risks that could apply to any registrant, and despite Commission and staff guidance stating that risk factors should be focused on the 'most significant' risks and should not be boilerplate, it is not uncommon for companies to include generic risks. Registrants often disclose risk factors that are similar to those used by others in their industry without tailoring the disclosure to their circumstances and particular risk profile.").

[23] *See, e.g.,* Letter from Alexander Schay (Mar. 16, 2020).

[24] *See* Basic v. Levinson, 485 U.S. 224 (1988) ("[M]ateriality depends on the significance the reasonable investor would place on the withheld or misrepresented information.").

[25] A review of the comment file indicates that eight of ten issuers that submitted letters favored harmonization with the international standard, and six of ten specifically expressed concern about the divergence from the international standard with respect to the definition of project.

[26] I am also dissenting on the order being voted on in conjunction with the final rule, which recognizes the resource extraction payment disclosure requirements of the European Union, the United Kingdom, Norway, and Canada as alternative reporting regimes for purposes of the final rule. That vote does not reflect disagreement with the order's determination that those disclosure requirements are consistent with Section 13(q)'s transparency objectives. Rather it reflects my objection to the final rule, and the rulemaking package as a whole.