May 25, 2022

Submitted via email to rule-comments@sec.gov

Ms. Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

Re: The Enhancement and Standardization of Climate-Related Disclosures for Investors (Press Release No. 2022-46; File No: S7-10-22)

Dear Ms. Countryman,

I write in response to the notice of proposed amendment of the Securities and Exchange Commission (the "**SEC**") rules under the Securities Act of 1933 (the "**Securities Act**") and Securities Exchange Act of 1934 (the "**Exchange Act**") that would require domestic and foreign registrants to provide certain climate-related information in their registration statements and periodic reports (the "**Proposal**").[1]

There are many items to address in the Proposal, but I will focus my comments on the principle of materiality in the disclosure regime created under the Securities Act and the Exchange Act, which, in my view, the Proposal undermines.

Existing Regulations Requires Disclosure of Material Climate-related Information

Under the existing SEC regulations, all public companies have a duty to disclose material facts in their periodic reports where there is a trend, demand, commitment, event, or uncertainty that is both presently known to the company's management and reasonably likely to have material effects on the company's financial condition or results of operation.[2] Therefore, to the extent that a company is aware of certain climate-related information which may satisfy these criteria, the company is already under an obligation to disclose such information to its investors.

It is worth noting that the focus of the current disclosure regime is materiality, and it is for the management of a company to decide whether certain information is material to the specific company. In other words, the current regime emphasizes a more fluid discussion of what a company believes is material to its business over a more standardized disclosure rubric. In the event that a company (1) fails to disclose the required material information in its periodic reports, or (2) makes false or material misleading statement or omission when it chooses to speak about an issue, the SEC or private investors can pursue a number of express or implied claims under the Securities Act and the Exchange Act.

The Supreme Court defines material fact as one that a reasonable investor would consider to be altering the total mix of information available in making their voting or investment decision. [3] What facts a reasonable investor would think important are not necessarily what any individual plaintiff actually considered to be important.

[1] *See* Press Release No. 2022-46 (March 21, 2022).
[2] Regulation S-K, Item 303(a), 17 C.F.R. § 229.303(a) and Instructions.
[3] *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976), *Basic Inc. v. Levinson,* 485 U.S. 224 (1988).

The Proposal Undermines the Principle of Materiality

The Proposal requires public companies to disclose a list of qualitative and quantitative information relating to climate change, which does not include a materiality qualifier. I submit that this approach is a major departure from the current materiality-focused disclosure regime unjustified by investor protection and will unnecessarily subject US-listed companies to increased costs of disclosure. The paradox here is that assuming climate-related information, such as a company's Scope 1 emissions,[4] is *material* to some (but not all) companies' financial or operational position, these companies are already obligated to disclose the information under the existing rules; on the other hand, to the extent that climate-related information is *immaterial* to certain companies (e.g., where climate risks were completely hedged against internally), requiring additional disclosure will not add value to their investors because, by definition, such information is not considered significant by the investors of those companies as they make investment or voting decisions.

The SEC attempts to justify this mandatory disclosure requirement by stating that investors need information about climate-related risks because such risks have present financial consequences that investors consider in making investment and voting decisions, and many companies are already reporting such information voluntarily.[5] Implied in this argument is a view that investors generally regard climate-related risks as *material* to the company that they invest in, such that the SEC is ready to exercise its statutory authority to require disclosure across the board. I will not attempt to discuss whether the SEC's view is empirically true, however, I submit that this justification is at best tangential to the broad scope of disclosure required under the mandatory disclosure regime, considering that a large part of the it does *not* contain a materiality qualifier. In addition, the fact that many companies are already voluntarily reporting climate-related information within their filings with the SEC should not be taken to mean that such information is generally material to the investors of any single company. In any event, a one-size-fits-all approach is not conducive to striking the right balance between reducing information asymmetry and improving liquidity in the entire US stock market.

Where materiality standard is included, the Proposal seems to have substituted the test in *TSC Industries* and *Basic* for a generalized, stakeholder-based inquiry. For example, the Proposal requires a public company to disclose its Scope 3 GHG emissions[6] and intensity*, if material*, or if the company has set a GH emissions reduction target or goal that includes its Scope 3 emissions. I submit that this requirement in effect distorted the concept of materiality as developed through federal case law, which focused on information about the company that would alter the total mix of information available to its shareholders in making voting or investment decision, rather than the conduct of third parties.

Would a reasonable investor consider GHG emission by third parties to be significant in his or her assessment of a company's financial and operational positions? Again, I do not suggest that there is an easy answer to that question, but I do suggest that a reasonable investor will take into account the fact that such statement by a company is of a different nature from representations of the company's own affairs and in many cases cannot be accurately

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[4] Defined as direct GHG emissions that occur from sources owned or controlled by the company. *See* Press Release No. 2022-46 (March 21, 2022), at 41.
[5] *Cf.* the definition of materiality above.
[6] Defined as indirect emissions from upstream and downstream activities in a company's value chain, excluding emissions primarily resulting from the generation of electricity purchased and consumed by the company (i.e., Scope 2 emissions). *See* Press Release No. 2022-46 (March 21, 2022), at 41.

determined. The potential difficulty in collecting information on Scope 3 emissions is also recognized by the SEC, as evidenced by the inclusion of a safe harbor which provides that disclosure of Scope 3 emissions by or on behalf of a company would be deemed not to be a fraudulent statement unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.[7] Having these factors in mind, any connection between a company's financial prospect and third party emissions, which is already very thin, would be further discounted by a reasonable investor.

Practical Concerns in Securities Fraud Litigation: Proving Materiality

In both SEC enforcement actions and private class actions for fraudulent misrepresentation brought under Section 10(b) and Rule 10b-5 of the Exchange Act, the plaintiffs must allege and prove materiality of the misstatement or omission in question.[8] To prove materiality, it is now common to use the event study methodology to demonstrate that the alleged misstatement or omission artificially impacted the trading price of the securities. While some courts accept price change following corrective disclosure as direct evidence of materiality,[9] a better approach is to require the plaintiffs to prove that such a stock price change constituted investors' reaction to the misstatement or omission itself *ex-ante* rather than the *ex-post* resolution of uncertainty once the truth is revealed. In other words, whether the "total mix of information" is altered should be evaluated at the time of investment, when the value of the disclosued information is considered against uncertainties of the relevant adverse event taking place. With regard to the disclosure of material climate-related information outlined in the Proposal, however, I submit that it would be inappropriate to use event studies to assess materiality for reasons discussed below, and we currently do not have a viable alternative. Therefore, any claims against fraudulent misstatement or omission of information required under the Proposal will be extremely difficult to pursue, leaving significant doubt as to how the Proposal can be enforced.

Event study works by identifying abnormal returns in the price of a security. This is based on the important assumption that all systematic risk factors that investors are concerned about can and have been identified, leaving behind only the price component representing idiosyncratic risks that a company is exposed to. Event study therefore cannot be used to measure the extent to which specific systemic risk may impact the price of individual securities. If, as the SEC suggested in the Proposal, climate risk is a systemic risk that may affect the economy as a whole, the impact of such a risk will be present in the expected return of every listed stock and therefore cannot be isolated from any single security. If, on the contrary, climate risk is an idiosyncratic risk the impact of which is capable of being determined in the price of individual securities, the justification for a unified disclosure regime is significantly weakened.

I further submit that climate-related information may not even have price impact at all, even if reasonable investors may have considered such information when making their investment decisions. Two fundamental assumptions in financial economics in their simplest form state that (1) the rational investors will always prefer more to less in their wealth, and (2) investors

[7] *See* Press Release No. 2022-46 (March 21, 2022), at 220.

[8] Although materiality is not usually a contested issue in motion-to-dismiss stage (*Matrixx Initiatives, Inc. v. Siracusano,* 563 U.S. 27 (2011)), and in private class actions, materiality is no longer assessed at class certification stage following *Amgen v. Connecticut Retirement Plans and Trust Funds,* 132 S. Ct. 2742 (2012), it must be established at merits stage of the litigation.

[9] *In re Burlington Coat Factory Sec. Litig.,* 114 F.3d 1410 (3d Cir. 1997), ratified in *Oran v. Stafford*, 226 F.3d 275 (3d Cir. 2000).

would not assume any risk unless they could be compensated adequately. Consequently, the less risk-averse investors will be willing to pay more than the more risk-averse investors for the same security because they do not demand as much risk premium. In the limit order book model, the least risk-averse (or the most impatient) buyers will therefore be the price-setting investors because their orders at higher prices are more likely to be executed. When it comes to climate-related issues, the differences in risk appetite among different groups of investors can certainly be extraordinary. It is therefore likely that the *ex-ante* price impact of any misstatement or omission as to climate-related disclosure may not be present at all because there are investors whose investment decisions are not swayed by climate risks, correctly disclosed or not.

Conclusion

Admittedly, climate change and its effects on our economy are crucial issues of the day, but they are also complex issues that are currently subject to intense social and political debate. While I greatly appreciate its thoughts and efforts, I am not convinced that the SEC, as a securities regulator, is best positioned to use its policymaking tools to direct managerial attention to climate or other stakeholder-focused issues.

To understand why the Proposal is far from sound policymaking, we need look no further than the SEC's mission: protecting investors, facilitating capital formation, and fostering fair, orderly, and efficient markets. To mandate climate-related disclosure from listed companies simply because the information could be useful to certain group of investors particularly mindful of this issue is perhaps neither necessary nor appropriate for the protection of investors generally. The rules described in the Proposal could also undermine the important principle of materiality, increase the compliance costs of US-listed companies, and result in practical difficulty in enforcement actions. Indeed, as some scholars suggested, to compel disclosure only tangentially related to the SEC's statutory objectives could give rise to First Amendment challenges.

Accordingly, I urge the SEC to withdraw the Proposal and focus on its traditional obligations of protecting investors' financial interests, and maintaining fair, orderly, and efficient markets.

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I greatly appreciate the opportunity to provide comments regarding the proposal, and I hope these comments are constructive to the SEC.

Respectfully Submitted,

/s/ David W. Wen

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