

Comments on S7-10-22, The Enhancement and Standardization of Climate-Related Disclosures for Investors, by Ed Hirs

I have read the proposed rule entitled "[The Enhancement and Standardization of Climate-Related Disclosures for Investors](#)," Release Nos. 33-11042, 34-94478 (March 21, 2022) and offer these comments below for consideration by the SEC. A previous version of my comments was published by [Forbes](#).

The proposed rule is a departure from the SEC's current regulatory purpose of protecting investors from financial and securities frauds.

To start, the commission is unable to quantify the benefits for society, while conceding that the costs to companies in terms of compliance and more accurately measuring emissions, as well as to the SEC itself, will be in the millions. Implementing the new disclosures and monitoring compliance will not come cheap, and the SEC will need additional funding from Congress if it is to morph from financial regulator into the economy's main environmental cop. However the prospect of such funding seems unlikely given the staunch opposition to the proposal from key members of Congress in the [House](#) and [Senate](#).

Companies are already required to disclose material climate risks to their businesses. Other disclosures related to ESG—shorthand for using environmental, social and governance criteria to guide business decisions—are currently voluntary and amorphous in nature because the definition of “good” ESG has not been settled. The proposed regulations, which lean heavily on the environmental component in ESG, will do little to change that. In fact, the SEC's just proposed rule [“Enhanced Disclosures by Certain Investment](#)

[Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices](#)” acknowledges the ambiguity of ESG.

This is why the SEC has historically relied on a “principles-based” approach to disclosure of non-financial topics with an emphasis on the concept of materiality to allow companies the flexibility to disclosure information in a meaningful way as issues evolve over time. This approach is embodied in the SEC’s 2010 [guidance](#) on climate change which is grounded in materiality and provides companies with examples of climate related information that may or may not be material to their specific company.

The SEC has historically been most concerned with G, the governance component, by promulgating rules regarding financial reporting and corporate governance of issuers and advisors for years. The agency consistently relies upon investors having enough sense to look after their own interests. S, the social component of ESG, is absent from the SEC climate rules proposal. “Social” focused disclosures have been downplayed with this recent effort: with more than 2 billion humans joining us on this planet over the next [30 years](#), the ability of humanity to provide food and iPhones to them will necessarily increase greenhouse gas emissions. U.S. companies are unquestionably the global technological leaders in agriculture and energy, and they need access to capital provided by the most liquid and transparent capital markets in the world. G will determine the tradeoff between E and S in pursuit of earning returns to shareholders.

This proposal also focuses on the governance of companies to the point of micromanagement. [Proponents of the proposal](#) are quick to point out that the SEC is not technically requiring companies to make any changes to their governance structures to handle climate risk, but this argument is

disingenuous at best. The proposal requires a series of highly specific disclosures related to a company's governance of climate related risks such as:

- Whether the board has a committee to oversee climate risk;
- Whether the board has a member who is a climate expert;
- A description of how often the board discusses climate related risk;
- A description of how and whether the board considers climate related risks;
- A description of how and whether the board sets climate related targets;
- A description about which management are informed and monitor climate related risks;
- A description of how management and the board speak about climate and how often.

These specific disclosure requirements will compel many companies to make the suggested changes to their board structure, members, management, and how resources are used. While it may make sense for certain companies (such as large fossil fuel producers) to disclose the above information, those companies are already voluntarily disclosing such information at the request of their shareholders. Furthermore, those companies should be also afforded more flexibility to disclose such information to allow for different approaches to tackle the problem. Essentially requiring all companies to make such disclosures and divert significant resources to an issue that may not be material to the business will simply be a large financial and opportunity cost to those companies and not provide much benefit to them or their investors.

The most substantial requirements imposed in the proposal is the forced disclosure of a company's Scope 1&2 and in some instances Scope 3 greenhouse gas emissions. But are further climate disclosures necessary for all

companies? We already know how much coal, oil, and natural gas is consumed and we, or any high school chemistry student, can calculate the associated emissions. The proposal simply would provide additional information (of dubious quality with respect to Scope 3 emissions) on the specifics of where GHG emissions are emitted in the economy, which is largely irrelevant with respect to global climate change. In fact, the proposal could have a negative unintended consequence of pushing investors to disinvest in the largest emitters of GHGs who are also the most likely to dedicate significant resources to reducing emissions associated with their operations. However, disinvestment in the most responsible companies will do nothing to impact demand for fossil fuels and could push investment out of our public market and into private markets with no climate oversight or to state owned oil and gas companies with no climate oversight. This unintended consequence would also hurt retail investors, who will be deprived of the opportunity to invest in a profitable sector.

If implemented, the proposal would also subject companies to significant disclosures regarding the location of company assets down to the specific zip-code where such assets are located. The rationale for such a draconian requirement is to allow investors to assess risks to company assets posed by climate related events such as extreme weather, flooding, wildfires, and others. But are further climate disclosures necessary for companies that are sited by threatened coastlines, near forests or rivers, or subject to erratic electricity services due to changing weather patterns? Issuers either self-insure or buy property and casualty insurance to protect against financial losses from these calamities. To make matters worse, the disclosure of such specific information would encourage investors to develop highly speculative models regarding potential climate risk far into the future that is unlikely to

yield useful information for asset allocation and may encourage capital misallocation if such speculation turns out to be incorrect.

Further, the commission's justifications for the costs of the new disclosure rules ring hollow. The stated reason is that investors are clamoring for these new climate disclosure rules. Recent polling, however, suggests otherwise. In February, Broadridge released a new [2021 ProxyPulse report](#) that analyzed the voting behavior of retail and institutional investors from over 4,000 public company annual meetings in 2021. The report found that retail investor support for environmental and social proposals in 2021 was less than half that of institutional investors, at 18% vs. 40%. This divergence makes sense because the two groups have different incentives: retail investors seek to maximize their financial returns, while institutional investors seek to maximize their revenue, through product offerings—like ESG-directed private equity funds and mutual funds—that obtain higher fees. When the SEC claims to implement policies in the name of investors, they should be clear who they mean. It is not the retail or institutional investor in this instance. The proposed rule will create a new bespoke industry of make-work.

A [cost-benefit analysis](#) has been [required](#) of proposed federal rules and regulations in one form or another since the Johnson administration. On page 349 of the proposed climate rule, the SEC states:

*In many cases, however, we are unable to reliably quantify these potential benefits and costs. For example, existing empirical evidence does not allow us to reliably estimate how enhancements in climate-related disclosure affect information processing by investors or firm monitoring.*

Indeed, the next 70 pages of the proposal cites dozens of indefinite “studies” as to possible benefits and costs. Noticeably absent from the cost studies is any

study broaching an estimate of what economy-wide, mandatory climate disclosures may cost in practice. Without that, the proposed rule is indefensible.

The SEC acknowledges explicitly that the imposition of the new rules will invite new litigation against public companies. Litigation costs will no doubt exceed the additional costs of compliance. The SEC offers a “safe harbor” exemption from such litigation, which sounds good. However, everyone in the revolving doors of the SEC universe knows that claiming and defending a safe harbor exemption occurs only after a lawsuit has been filed.

The genesis of the proposed rule appears to be President Biden’s [National Climate Task Force](#), an entity established by executive order rather than by legislation passed by the Congress.

The Biden administration has taken up where the Obama administration left off on climate policy. The [Waxman-Markey](#) climate bill passed the House in 2009 but failed in the Democrat-controlled Senate. From that moment forward, Democratic leaders have attempted to achieve their climate goals via the unwieldy tool of agency-promulgated rules and regulations. New rules issued by the Environmental Protection Agency (“EPA”) regarding climate are expected. The EPA will not be regulating issuers of securities anytime soon, and it is laughable that the SEC proposes climate disclosure rules.

The value of a security is related to the economic returns from that security. Is climate risk a greater threat to the bottom line than accounting fraud, technological obsolescence, or supply chain disruptions? The proposed rule is silent on this analysis.

If the goal of the National Climate Task Force is to reduce emissions, there are better tools. A better approach would be to enlist allies from business. For more than 10 years, the [major oil companies](#) have testified and lobbied in favor of a carbon tax. Applying a carbon tax at the wellhead, the mine-mouth, and the port-of-entry for imported hydrocarbons will push the costs of carbon-intensive activities from the beginning of the supply chain straight through to the ultimate decisionmakers, the consumers. These are the decisionmakers that have made the Ford F-150 truck the [best-selling vehicle](#) in America.

On climate, President Biden would do well to embrace the leadership example of President Jimmy Carter, who knew that his appointment of inflation hawk Paul Volcker as chair of the Federal Reserve during the stagflation crisis of the 1970's would mean a one-term presidency. Volcker raised interest rates. A recession followed, and the persistent inflation that had plagued the U.S. for more than 10 years was over. A similar, politically bruising series of tradeoffs awaits the U.S. on climate. Measuring, naming, and shaming in the public markets will not scratch the surface of real solutions.

The commission has its hands full just trying to keep up with old fashioned financial and securities frauds. This proposed rule should be withdrawn in its entirety.