June 16, 2022

Vanessa A. Countryman, Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

VIA ELECTRONIC MAIL: rule-comments@sec.gov

Re: File Number S7–10–22: The Enhancement and Standardization of Climate-Related Disclosures for Investors

Dear Ms. Countryman:

The Committee on Capital Markets Regulation (the "**Committee**") is grateful to the Securities and Exchange Commission (the "**SEC**") for the opportunity to comment on the proposed amendments to rules under the Securities Act of 1933, as amended (the "**Securities Act**"), and the Securities Exchange Act of 1934, as amended (the "**Exchange Act**"), that would require public companies to provide specified climate-related information in their registration statements and annual reports (the "**Proposed Rule**").[1]

Founded in 2006, the Committee is dedicated to enhancing the competitiveness of U.S. capital markets and ensuring the stability of the U.S. financial system. Our membership includes thirty-seven leaders drawn from the finance, investment, business, law, accounting, and academic communities. The Committee is chaired jointly by R. Glenn Hubbard (Emeritus Dean, Columbia Business School) and John L. Thornton (Former Chairman, The Brookings Institution) and is led by Hal S. Scott (Emeritus Nomura Professor of International Financial Systems at Harvard Law School and President of the Program on International Financial Systems). The Committee is an independent and nonpartisan 501(c)(3) research organization, financed by contributions from individuals, foundations, and corporations.

The Committee agrees with the Proposed Rule that it is important to "provide consistent, comparable, and reliable—and therefore decision-useful—information to investors to enable them to make informed judgments about the impact of climate-related risks on current and potential investments."[2] Currently, issuers voluntarily disclose material climate risks as contemplated by the SEC's 2010 interpretive guidance on climate change disclosure.[3] In principle, the Committee supports the enhancement of mandatory public disclosure of climate-related risks; however, we are concerned that the Proposed Rule would fail to achieve this goal in a number of respects.

Part I of this letter provides a description of key aspects of the Proposed Rule, and Part II is an analysis of the policy and legal basis for the Proposed Rule, setting forth recommendations that would better align the Proposed Rule with the intended goal of enhancing disclosure of climate-related risks by public companies. Part II also includes a review of the Proposed Rule's cost-benefit analysis (the "**CBA**").

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[1] U.S. SEC. & EXCH. COMM'N, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, 87 FED. REG. 21,334 (Apr. 11, 2022), https://www.federalregister.gov/documents/2022/04/11/2022-06342/the-enhancement-and-standardization-of-climate-related-disclosures-for-investors (the "**Proposing Release**").

[2] Proposing Release at 21,335.

[3] Commission Guidance Regarding Disclosure Related to Climate Change, 75 Fed. Reg. 6,290 (Feb. 8, 2010).

1. SUMMARY OF THE PROPOSED RULE

A. Structure of the Proposal

The Proposed Rule would involve significant and complementary reforms of (i) Regulation S-K, requiring primarily qualitative and narrative disclosure of climate risk as well as certain emissions data, and (ii) Regulation S-X, requiring disclosure of metrics about climate risk in the footnotes to a registrant's audited financial statements. Registrants would be required to provide these climate-related disclosures both in their registration statements and annual reports under the Exchange Act.[4] The Regulation S-K and S-X disclosures would be subject to liability under Exchange Act Section 18 as well as potential Section 11 liability if included in the registration statement.[5]

Adoption of TCFD Framework and GHG Protocol

The contents of the proposed disclosures would be broadly modeled upon the recommendations of the Task Force on Climate-Related Financial Disclosures (the "**TCFD**") and the Greenhouse Gas Protocol (the "**GHG Protocol**"). The TCFD is a global privately developed climate-related reporting framework, and the GHG Protocol is described by the SEC as "a leading accounting and reporting standard for greenhouse gas emissions."[6]

The TCFD is a task force that was established in 2015 at the initiative of the Financial Stability Board and that is composed of representatives of various industry sectors including both financial and non-financial companies, accounting and consulting firms, and credit rating agencies.[7] In a 2017 report, the TCFD published recommendations as to the evaluation of climate-related risks over the short-, medium-, and long-term with respect to the financial condition of securities issuers. The TCFD framework covers "eleven disclosure topics related to four core themes that provide a structure for the assessment, management, and disclosure of climate-related financial risks: Governance, strategy, risk management, and metrics and targets."[8]

The GHG Protocol, among other things, introduced the concept of the "scope" of emissions with respect to greenhouse gases ("**GHG**").[9] The three scopes of greenhouse gases under the GHG Protocol are as follows:

- "**Scope 1 emissions**" are direct GHG emissions that occur from sources owned or controlled by the company.
- "**Scope 2 emissions**" are those emissions primarily resulting from the generation of electricity purchased and consumed by the company.
- "**Scope 3 emissions**" are all other indirect emissions not accounted for in Scope 2 emissions.[10]

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[4] Proposing Release at 21,345.

[5] *Id*. at 21,411.

[6] *Id*. at 21,343.

[7] *Id*.

[8] *Id*.

[9] *Id*. at 21,344.

[10] *Id*.

Amendments to Regulation S-K

The Proposed Rule would introduce a new subpart to Regulation S-K that, if adopted, would require disclosure of specified climate-related information, including "information about [the issuer's] climate-related risks that are reasonably likely to have material impacts on its business or consolidated financial statements," as well as greenhouse gas ("**GHG**") "emissions metrics that could help investors assess those risks."[11]

Amendments to Regulation S-X

Separately, the Proposed Rule would add a new article to Regulation S-X that would require the inclusion of certain climate-related metrics and related disclosures in the notes to a registrant's audited financial statements,[12] including financial impact metrics, expenditure metrics, and financial estimates and assumptions.[13] The proposed financial statement metrics would disaggregate climate-related effects on existing financial statement line items.[14] As part of the registrant's financial statements, these metrics would be subject to audit by the issuer's independent registered public accounting firm and would be within the scope of the registrant's internal controls over financial reporting.[15]

B. Content & Form of Proposed Disclosure: Regulation S-K Amendments

Consistent with the foregoing reliance on the TCFD recommendations and the GHG Protocol, the Proposed Rule's amendments to Regulation S-K would mandate disclosures on the following topics:

- The oversight and governance of climate-related risks by the registrant's board and management;
- How any climate-related risks identified by the registrant have had or are likely to have a material impact on its business and consolidated financial statements, which may manifest over the short-, medium-, or long-term;
- How any identified climate-related risks have affected or are likely to affect the registrant's strategy, business model, and outlook;
- The registrant's processes for identifying, assessing, and managing climate-related risks and whether any such processes are integrated into the registrant's overall risk management system or processes;
- The impact of climate-related events (severe weather events and other natural conditions as well as physical risks identified by the registrant) and "transition activities (including transition risks identified by the registrant)" on the line items of a registrant's consolidated financial statements and related expenditures, and disclosure of financial estimates and assumptions impacted by such climate-related events and transition activities – we note here that the Proposed Rule does not define the term "transition activities" or indicate whether it differs from "transition risks";

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[11] *Id*. at 21,345.

[12] *Id*.

[13] *Id.* at 21,347.

[14] *Id*. at 21,345.

[15] *Id*.

- Scope 1 and Scope 2 GHG emissions metrics, separately disclosed, expressed:
    - Both by disaggregated constituent greenhouse gases and in the aggregate, and
    - In absolute and intensity terms;
- Scope 3 GHG emissions and intensity, if material, or if the registrant has set a GHG emissions reduction target or goal that includes its Scope 3 emissions; and
- The registrant's climate-related targets or goals, and transition plan, if any.[16]

GHG Protocol Disclosures

In addition to the foregoing qualitative disclosures required by the Proposed Rule, the proposed amendments to Regulation S-K also outline extensive GHG Protocol disclosures that would require a registrant to disclose its GHG emissions for its most recently completed fiscal year.[17]

The required disclosures would be based upon the GHG Protocol definitions of Scope 1, 2, and 3 emissions.[18] Under the proposal, all registrants must disclose their total Scope 1 and Scope 2 emissions separately, regardless of materiality. Registrants are required to disclose Scope 3 emissions to the extent that such emissions are material or if a registrant has established a GHG emissions reduction target or goal that includes Scope 3 emissions, except for certain smaller issuers ("**smaller reporting companies**"), which are exempt entirely from reporting Scope 3 emissions.[19] Per the release, "consistent with the [SEC]'s definition of 'material' and Supreme Court precedent, a registrant would be required to disclose its Scope 3 emissions if there is a substantial likelihood that a reasonable investor would consider them important when making an investment or voting decision."[20]

C. Content & Form of Proposed Disclosure: Regulation S-X Amendments

Under the proposed amendments to Regulation S-X, where a registrant is required to submit audited financial statements as part of the relevant disclosure form, the Proposed Rule's amendments to Regulation S-X would further require disclosure "in a note to its financial statements certain disaggregated climate-related financial statement metrics that are mainly derived from existing financial statement line items."[21] These metrics would be further classified as "Financial Impact Metrics; Expenditure Metrics; and Financial Estimates and Assumptions"[22]:

- *Financial impact metrics* would include disclosure of *physical* risks associated with the "impact of severe weather events and other natural conditions, such as flooding, drought, wildfires, extreme temperatures, and sea level rise on any relevant line items in the registrant's consolidated financial

[16] *Id*. at 21,345.

[17] *Id*. at 21,373.

[18] *Id*. at 21,374.

[19] *Id*.

[20] *Id*. at 21,378.

[21] *Id*. at 21,363.

[22] *Id*.

statements during the fiscal years presented."[23] The proposed amendments to Regulation S-X would also require disclosure of *transition* risks discussing the "impact of any efforts to reduce GHG emissions or otherwise mitigate exposure to transition risks on any relevant line items in the registrant's consolidated financial statements during the fiscal years presented,"[24] on a basis similar to physical risks.

- *Expenditure metrics* would be required on a similar basis to financial impact metrics. Under the proposed amendments, issuers would be required to disclose separately the aggregate amount of expenditure expensed and the aggregate amount of capitalized costs incurred during the fiscal years presented with respect to both physical risks and transition risks.[25]

- *Financial estimates and assumptions* must be disclosed under the Proposed Rule, specifically with regard to whether "the estimates and assumptions the registrant used to produce the consolidated financial statements were impacted by exposures to risks and uncertainties associated with, or known impacts from" physical risks of climate change.[26] A parallel requirement would apply to estimates and assumptions relating to transition risks.[27]

2. ANALYSIS OF THE PROPOSED RULE

Section 2 analyzes the Proposed Rule from three perspectives. Subsection A assesses the Proposed Rule from the perspective of the core principles of disclosure policy. Subsection B recommends several specific changes to the Proposed Rule. Subsection C evaluates the Proposed Rule's CBA, finding that the CBA fails to substantiate certain purported benefits and to consider or quantify several principal costs of the proposals.

Shortcomings in the CBA are a serious concern because under the National Securities Markets Improvement Act of 1996, the SEC is required "to promote efficiency and capital formation in the financial markets," and "[w]henever . . . the [SEC] is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the [SEC] shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation."[28]

The U.S. Court of Appeals for the District of Columbia Circuit (the "**D.C. Circuit**") has held that the statutory language of the Administrative Procedure Act (the "**APA**") imposes an obligation on the SEC to weigh the costs and benefits of proposed regulation, and to quantify those costs and benefits where possible.[29] In Chamber of Commerce v. SEC (2005), the D.C. Circuit considered the validity of an SEC rule requiring that mutual fund boards be composed of no less than 75% independent directors and be chaired by an independent director. The court found that the proposed rule violated the APA because the

[23] Proposed Rule 210.14-02(c).

[24] Proposed Rule 210.14-02(d).

[25] Proposed Rule 210.14-02(e) and (f).

[26] Proposed Rule 210.14-02(g).

[27] Proposed Rule 210.14-02(h).

[28] National Securities Markets Improvement Act of 1996, Pub. L. 104-290, 110 Stat. 3416 (codified as amended in scattered sections of 15 U.S.C.).

[29] *Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005); *see also* Paul Rose & Christopher Walker, *The Importance of Cost-Benefit Analysis in Financial Regulation*, CTR. FOR CAPITAL MKTS. COMPETITIVENESS 24–33 (2013), http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/CBA-Report-3.10.13.pdf.

SEC had failed to "adequately consider the costs mutual funds would incur in order to comply with the [proposed rule]"[30] and rejected the SEC's contention that such costs were not practically quantifiable.[31] Similarly, in Business Roundtable v. SEC (2011), the D.C. Circuit remanded an SEC rulemaking on shareholder proxy access due to inadequate economic analysis, including a failure to quantify the costs of the rulemaking.[32] The court found that the SEC "inconsistently and opportunistically framed the costs and benefits of the rule" and "failed adequately to quantify the certain costs of its proposed rule or to explain why those costs could not be quantified."[33] For these and other reasons, the court found that the proposed rule violated the APA.

A. General Policy Analysis: Core Principles of Climate Disclosure Reform

The Committee believes that three core principles should inform any disclosure mandate with respect to climate-related risks:

i. Climate-related disclosure requirements should be firmly grounded in the SEC's statutory authorities.

As with any rule promulgated by the SEC—and particularly those that have not been specifically mandated by Congress, as in this case—the SEC must ensure that the disclosure requirements set forth in the Proposed Rule are firmly grounded in the SEC's statutory authorities and, particularly, the concept of "materiality." The Committee applauds the SEC for its frequent references both to traditional economic understandings of materiality throughout the proposing release as well as to leading Supreme Court precedent such as *Basic Inc. v. Levinson*[34] and *TSC Industries, Inc. v. Northway, Inc.*[35]

The SEC's regulations define "materiality" qualitatively as follows: "The term 'material,' when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered."[36] Further rules under the Securities Act and Exchange Act specify that "in addition to the information expressly required to be included in a registration statement, there shall be added such further material information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading."[37]

Staff Accounting Bulletin 99 ("**SAB 99**")[38] further clarified the SEC's traditional understanding of "materiality":

> The omission or misstatement of an item in a financial report is material if, in the light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment

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[30] *Chamber of Commerce*, 412 F.3d at 136.

[31] *Id*. at 143.

[32] *Bus. Roundtable v. SEC*, 647 F.3d, 1144 (D.C. Cir. 2011).

[33] *Id*. at 1148-49.

[34] 485 U.S. 224 (1988).

[35] 426 U. S. 438 (1977).

[36] 17 C.F.R. § 240.12b–2.

[37] 17 C.F.R. § 230.408(a); 17 CFR § 240.12b-20.

[38] SEC, Staff Accounting Bulletin 99 (Aug. 12, 1999), https://www.sec.gov/interps/account/sab99 htm#body4.

> of a reasonable person relying upon the report would have been changed or influenced by the inclusion or correction of the item.
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> This formulation in the accounting literature is in substance identical to the formulation used by the courts in interpreting the federal securities laws. The Supreme Court has held that a fact is material if there is –
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>> a substantial likelihood that the . . . fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available.
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> Under the governing principles, an assessment of materiality requires that one views the facts in the context of the 'surrounding circumstances,' as the accounting literature puts it, or the 'total mix' of information, in the words of the Supreme Court. In the context of a misstatement of a financial statement item, while the 'total mix' includes the size in numerical or percentage terms of the misstatement, it also includes the factual context in which the user of financial statements would view the financial statement item. The shorthand in the accounting and auditing literature for this analysis is that financial management and the auditor must consider both 'quantitative' and 'qualitative' factors in assessing an item's materiality. Court decisions, Commission rules and enforcement actions, and accounting and auditing literature have all considered 'qualitative' factors in various contexts.[39]

Although the Committee believes that there are grounds to conclude that certain mandatory climate-related disclosures are justifiable on grounds of economic materiality, the SEC must ensure that the climate disclosures they require meet the statutory materiality test. Overly prescriptive or burdensome climate disclosure requirements could increase liability risk for public companies and make disclosures less useful to investors.

As Justice Thurgood Marshall famously observed, setting the materiality bar too low risks "bury[ing] the [investor] in an avalanche of trivial information—a result that is hardly conducive to informed decision-making."[40] Whether in the context of materiality or compelled line-item disclosure, Justice Marshall's dictum should animate U.S. securities policy, whether in the context of traditional matters of corporation finance or climate-related disclosure.

It is essential that the SEC carefully assess the necessity of any disclosure mandate for fear of unintended consequences of well-meaning policy. Excessively burdensome disclosure may deter registrants from establishing climate targets or even going public in the United States in the first place. Any disclosure proposal must also be considered from the perspective of the potential for shareholder litigation and private rights of action. The litigation risks attendant on climate-related disclosure are particularly high given the nascent state of climate risk prediction and evaluation. Climate modeling is imperfect and changes rapidly as scientific techniques advance and observational data increase. Avoiding potential liability for a misstatement or omission of climate-related risk is a particularly acute challenge for registrants in complying with any climate-related disclosure proposal.

More fundamentally, disclosure mandates have multiplied significantly since 1934, leading many to conclude that investors are subject to the very "avalanche" of information about which Justice Marshall expressed concern. It is essential that any climate-related disclosure mandate focus on targeted, plain

[39] *Id*.

[40] *TSC Industries*, 426 U.S. at 448-9.

English disclosures and quantitative data of precisely what the reasonable investor needs to know in order to make an investment decision.

ii. Climate-related disclosure requirements should reflect coordination among foreign and domestic regulatory agencies.

Many jurisdictions throughout the developed world have adopted or plan to adopt climate-related disclosure standards under their respective securities law regimes. Moreover, other U.S. federal regulators—both prudential and market—are actively exploring the intersection of their respective regulatory remits with global climate change. While some differences between U.S. disclosure requirements and international standards are inevitable, owing to differing policy priorities, regulatory authority, the disclosure- vs. merits-based regulatory regimes, and other factors, the Committee believes that it is essential that the SEC (i) ensure the interoperability of the Proposed Rule with substantially similar regulatory regimes of foreign regulators, and (ii) harmonize the Proposed Rule with climate-related requirements of its sister agencies in the United States (*e.g*., the Office of the Comptroller of the Currency and National Association of Insurance Commissioners, as discussed in Section B.iii).

iii. Climate-related disclosure reform should be subject to a robust and structured rulemaking process that provides for meaningful public input and applies rigorous cost-benefit analysis.

The Committee is a firm believer that a robust, structured, and open regulatory process in keeping with the requirements of the Administrative Procedure Act[41] best serves the American public. Given the magnitude of this rulemaking, alongside the many other important rulemaking initiatives in which the SEC is currently engaged, we commend the SEC for recognizing that the initial comment period, which potentially required comments to be returned within 30 days of the Proposed Rule's publication in the Federal Register, was inadequate, and for extending the comment period to June 17, 2022. We encourage the SEC to provide for comment periods beyond the statutory minimum with respect to similar proposals in the future. Rigorous and quantitative cost-benefit analysis that considers both the costs of mandated climate-related disclosure to both issuers *and* the investing public is also an essential part of this rulemaking. In Section C, the Committee sets forth its review of the SEC's economic analysis of the Proposed Rule.

B. Specific Recommendations

The Committee believes that the following recommended amendments to the Proposed Rule would promote enhanced disclosure of climate-related risks.

i. Recommendation: Observe the limits of the SEC's historical understanding of its statutory authority with regard to "material" disclosure mandates

The Proposed Rule should unify the approach to "materiality" across all required disclosures. For example, the proposed Regulation S-K disclosures would apply where a climate-related risk is "reasonably likely to have a material impact on its business, results of operations, or financial condition"—a very traditional economic understanding of materiality. Moreover, Scope 3 emissions are only required where material (or where otherwise covered by a registrant's GHG emissions reduction target or goal). By contrast, disclosure of Scope 1 and 2 emissions would be compelled as line-item disclosures irrespective of a registrant's materiality assessment. Consistent with the core principles articulated in Section A.i above as well as Supreme Court precedent, the Committee has long favored rationalizing and simplifying the SEC's

[41] 5 U.S.C. § 500 *et seq*.

approach to materiality[42] and would strongly advocate for a unified approach in the Proposed Rule, whereby all mandated disclosures, including the disclosure of Scope 1 and 2 omissions, are subject to a standard economic materiality threshold.

ii. Recommendation: Enhance the quality of climate-related disclosures without dramatically increasing the liability risks of registrants

a. <u>Expand the Scope 3 liability safe harbor to cover all three scopes under the GHG Protocol and the Regulation S-X financial statement metrics</u>

As the proposing release acknowledges at several points, disclosure standards and metrics for climate-related risks are at a nascent stage and may be expected to evolve considerably in periods to come. In recognition of the limited reliability of climate-related data sources, the SEC included a safe harbor from securities liability for "fraudulent statements" in the Scope 3 context, observing that "it may be difficult to obtain activity data from suppliers and other third parties in a registrant's value chain, or to verify the accuracy of that information" and that "it may also be necessary to rely heavily on estimates and assumptions to generate Scope 3 emissions data."[43]

While these concerns are particularly acute with respect to Scope 3 emissions, the Committee believes that both registrants *and* the consumers of information related to climate-related risks would stand to benefit from the extension of this safe harbor to cover the Scope 1 and 2 disclosures and the Regulation S-X financial statement metrics as well, all of which are speculative data with limited reliability, at least at present. To the extent that there are legal barriers to extending the liability safe harbor to disclosures under Regulation S-X, then such disclosures should be made under Regulation S-K.

The Committee believes that there is a strong basis for believing that the extension of this safe harbor would, in fact, yield better disclosure. For example, the existing statutory safe harbors for forward-looking statements under the Securities Act and Exchange Act[44] have successfully encouraged registrants to make disclosures about future risks and opportunities that such registrants would otherwise refrain from making due to liability concerns. During the first several years post-adoption of the Proposed Rule, it is to be expected that registrants and investors will both require time to acclimatize to the new disclosure regime. Sheltering issuers from the potential for costly private litigation and liability risk is likely to promote more comprehensive and forthcoming disclosures, serving the interests of the investing public and registrants alike.

b. <u>Remove the disclosure requirement for Scope 3 emissions</u>

As observed above, the proposed GHG Protocol disclosure requirements and the Regulation S-X financial statement metrics present considerable operational challenges to registrants from the perspective of data collection and reliability, assessment of materiality, and estimation of effects on a registrant's business, financial condition, and results of operations. This issue is particularly acute in the case of Scope 3 emissions data, which are so speculative and inconsistent as risking to be of little use to public investors at the present time. Indeed, for many registrants, Scope 3 emissions may simultaneously be the most

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[42] *See*, *e.g.*, COMMITTEE ON CAPITAL MARKETS REGULATION, *Interim Report of the Committee on Capital Markets Regulation* (Nov. 2006), https://www.capmktsreg.org/wp-content/uploads/2018/10/Interim-Report-of-the-Committee-on-Capital-Markets-Regulation.pdf.

[43] 87 Fed. Reg. at 21,390.

[44] *See* 15 U.S.C. § 77z–2; 15 U.S.C. § 78u–5.

significant measure of their emissions as well as the most difficult data to collect and summarize. Relatedly, although the Proposed Rule appears to assume that Scope 3 emissions can be material merely because investors currently seek their disclosure, significant Scope 3 emissions do not automatically represent a *transition risk* that is *material* to any given issuer. Given the reliability and materiality concerns as to Scope 3 data, the Committee recommends that the Proposed Rule be amended so as not to include a specific requirement to disclose Scope 3 data.

c. Potential Alternative: Annual Climate Reports Furnished to the SEC

Under the Exchange Act, reports or other information "filed" with the SEC are subject to enhanced liability under Section 18 of the Exchange Act and, if included in or incorporated by reference into a registration statement, liability under Section 11 of the Securities Act.[45] By contrast, reports or other information "furnished" to the SEC are subject to the general securities fraud protections of Section 10(b) of the Exchange Act.[46] By treating climate-related disclosures as "filed" rather than "furnished,"[47] the Proposed Rule risks chilling disclosure that would otherwise be forthcoming but for liability concerns.

As noted in the proposing release, firms already face substantial investor pressure to disclose climate-related information.[48] Therefore, an alternative way to promote *consistent* disclosure without dramatically increasing *liability* risk would be to move the proposed disclosures from existing reports "filed" with the SEC (e.g., Forms S-1, 10-K, and 10-Q) into separate climate reports "furnished" to the SEC.

In examining whether to deem climate-related disclosures "furnished" or "filed," the proposing release states that "we agree with those commenters who indicated that the treatment of climate-related disclosures as filed could help promote the accuracy and reliability of such disclosures for the benefit of investors."[49] The proposing release notes elsewhere that "reduced liability in general may lead to the applicable disclosures being perceived as less reliable by investors, which could have adverse effects on registrants' stock liquidity or costs of capital."[50] However, the proposing release does not cite, and the Committee is not aware of, evidence of systematic inaccuracy in information currently permitted to be furnished rather than filed, such as Item 2.02 (Results of Operations and Financial Condition) or Item 7.01 (Regulation FD Disclosure).[51]

By moving climate-related disclosure requirements into separate "furnished" climate reports, the SEC could address other important concerns with the Proposed Rule (in addition to liability). First, enhanced climate-related disclosures necessarily increase compliance costs for issuers and investors.[52] Since climate-related disclosures generally reflect long-term considerations less likely to fluctuate on a quarterly basis, issuers could furnish climate reports annually (rather than quarterly) on a timeline reasonably aligned with

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[45] *Id*. at 21,411.

[46] MORRISON & FOERSTER LLP, *Frequently Asked Questions about Form 8-K*, 8 (2017), https://media2.mofo.com/documents/faq-form-8-k.pdf.

[47] *Id*. at 21,411.

[48] Proposing Release at 21,448.

[49] Proposing Release at 21,411.

[50] Proposing Release at 21,449.

[51] *See* U.S. SEC. & EXCH. COMM'N, *Form 8-K*, 2 (accessed May 2022), https://www.sec.gov/files/form8-k.pdf.

[52] Proposing Release at 21,439.

shareholder meetings.[53] Second, as noted above, the Proposed Rule raises questions concerning which disclosures are genuinely material to which issuers. With separate furnished climate reports, issuers could disclose information more freely, and to the extent specific disclosures meet the traditional definition of "materiality," then issuers could expressly incorporate those line items by reference into filed reports.[54]

iii. Recommendation: Coordinate more closely with major international standards and other domestic regulators

a. <u>The Proposed Rule is only "modeled in part" on the TCFD framework, which may reduce consistency with foreign disclosure standards that are based on the TCFD framework</u>

Per the proposing release, part of the SEC's motivation in adopting the TCFD and GHG Protocol frameworks is that these initiatives share "concepts and a vocabulary that are commonly used by companies when providing climate-related disclosures in their sustainability or related reports."[55] From the standpoint of harmonization and interoperability with the disclosure requirements of foreign regulators, pegging the Proposed Rule to well-known and commonly adopted international standards is a sensible and, in theory, cost-efficient approach to climate-related disclosure mandates.

While the SEC describes the Proposed Rule as "modeled in part on the TCFD's recommendations,"[56] the Committee is concerned that the introduction of potential gaps between the Proposed Rule and the TCFD framework will *increase* complexity rather than reduce it. While the Proposed Rule is plainly informed by the TCFD framework, the two are not precisely identical, thus raising the specter of increasing deviation from international standards over time. In general, where the TCFD framework calls for a particular disclosure, the Proposed Rule exceeds the TCFD framework in its prescriptiveness and granularity. For example, where the TCFD framework suggests a general discussion of a corporate board's oversight of climate-related risks and opportunities, the Proposed Rule further specifies that such discussion must include:

> (i) the identity of any board members or board committee responsible for the oversight of climate-related risks;
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> (ii) whether any member of the board of directors has expertise in climate-related risks, with disclosure in such detail as necessary to fully describe the nature of the expertise;
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> (iii) the processes by which the board of directors or board committee discusses climate-related risks, including how the board is informed about climate-related risks, and the frequency of such discussion;
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> (iv) whether and how the board of directors or board committee considers climate-related risks as part of its business strategy, risk management, and financial oversight; and

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[53] *See* BLACKROCK, *Letter to the U.S. Sec. & Exch. Comm'n re: Request for Input on Climate Change Disclosure*, 6 (June 11, 2021), https://www.sec.gov/comments/climate-disclosure/cll12-8906794-244146.pdf.

[54] *See, e.g.*, 17 C.F.R. § 240.12b-23.

[55] Proposing Release at 21,343.

[56] *Id*. at 21,343.

(v) whether and how the board of directors sets climate-related targets or goals, and how it oversees progress against those targets or goals, including the establishment of any interim targets or goals.[57]

Similarly prescriptive requirements in excess of what the TCFD would require exist for topics such as climate-related strategy, risk management, and metrics and targets. For example, whereas the TCFD recommends that organizations describe the targets they use to manage climate-related risks and opportunities and their performance against those targets, the Proposed Rule specifies that in describing its climate-related targets, the disclosing firm must indicate the unit of measurement, the specific time horizon for achievement of the target, the baseline period against which progress will be tracked, as well as interim targets.[58] Whereas the TCFD recommends generally that organizations describe the climate-related risks and opportunities to which they are subject, the Proposed Rule requires that the discussion of climate-related risks specify, among other things, the location of properties subject to physical risk, including their ZIP code.[59]

It is essential that registrants operating and issuing securities in multiple securities markets worldwide not be subjected to the whipsaw of inconsistent disclosure standards. In consequence, the Committee would strongly advise that the SEC coordinate its rulemaking activity in this area with the leading global securities regulators to minimize unnecessary burdensome deviations from the TCFD framework.

b. <u>The SEC should coordinate the Proposed Rule's requirements with the policy initiatives of the U.S. federal banking regulators and state insurance regulators</u>

On April 8, 2022—far in advance of any possible implementation of the Proposed Rule—the National Association of Insurance Commissioners ("**NAIC**") adopted a new standard for disclosure of climate-related risks by insurance companies.[60] In late 2021 and early 2022, the Office of the Comptroller of the Currency ("**OCC**") solicited public comment on the general subject of managing climate-related financial risks at large banks[61] and, consistent with its general policy of maintaining secrecy around stress tests conducted by systemically important financial institutions, does not require disclosure of the results of climate-related stress tests and sensitivity analyses. As these two examples evidence, the SEC's sister regulatory agencies at both the state and U.S. federal level have evinced interest in the general question of climate-related risk at their respective regulated entities. Pursuit of common public policy goals without due coordination by U.S. regulatory agencies risks introducing conflicting or duplicative disclosure requirements. The Proposed Rule's discussion of "Duplicative, Overlapping, or Conflicting Federal Rules" concludes without discussion that the proposed rules do not duplicate or conflict with other existing federal rules.[62] The Proposed Rule acknowledges that a large subset of insurance firms are required to disclose their climate-related risk assessment and strategy via the NAIC Climate Risk Disclosure Survey and

[57] Proposed Rule 229.1501(a)(1)(i) – (v).

[58] Proposing Release at 21,406.

[59] Proposing Release at 21,350.

[60] NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS, *U.S. Insurance Commissioners Endorse Internationally Recognized Climate Risk Disclosure Standard for Insurance Companies* (Apr. 8, 2022), https://content.naic.org/article/us-insurance-commissioners-endorse-internationally-recognized-climate-risk-disclosure-standard.

[61] OFFICE OF THE COMPTROLLER OF THE CURRENCY, *OCC Seeks Feedback on Principles for Climate-Related Financial Risk Management for Large Banks* (Dec. 16, 2021), https://www.occ.treas.gov/news-issuances/news-releases/2021/nr-occ-2021-138.html.

[62] *See* Proposing Release at 21,463.

suggests that this pre-existing requirement will ease compliance with the Proposed Rule on the basis that both the NAIC guidance and the Proposed Rule are based on the TCFD recommendation.[63] However as noted above, there are substantive distinctions between the Proposed Rule and the TCFD recommendations. The discussion does not address whether those distinctions may result in conflicting or redundant requirements. The Proposed Rule also acknowledges the OCC's request for feedback on the identification and management of climate-related risks, but similarly does not discuss how the Proposed Rule might interact or conflict with the OCC's policy of not requiring the disclosure of the result of climate-related stress tests and sensitivity analyses.[64] The Committee strongly encourages the SEC to coordinate its adoption of the Proposed Rule with other relevant agencies and to describe the extent of that coordination as well as analyze the degree of overlap or inconsistency with other regulatory regimes in the final rule release.

iv. Recommendation: Separate the Proposed Rule into several rules rather than promulgate it as a single omnibus rulemaking

The Proposed Rule would establish an important new disclosure regime intended to serve the interests of the investing public for decades to come, as governments and registrants grapple with the issue of global climate change. The Committee would urge caution in this endeavor, all the while supporting the SEC's policy objectives. An incremental process that builds the new disclosure regime from constituent rulemakings, each individually considered and refined, would likely result in a more comprehensive, informative, and efficient disclosure regime than one adopted all at once in a single rulemaking.

For example, the SEC could issue rules relating to disclosures of Scopes 1 and 2 *only*, as these emissions data are less subject to uncertainty than is the case with Scope 3, as discussed elsewhere in this letter. The Scope 1 and 2 disclosures should be subject to a liability safe harbor similar to what is currently proposed with regard to Scope 3, at least for a transitional period as reporting of these emissions data is regularized and standardized across the securities markets, both in the United States and abroad. Furthermore, a separate rulemaking addressing the particular concerns raised by financial statement disclosure would also be warranted, and any eventual adoption should be subject to a similar safe harbor and other protections from private rights of action liability.

C. CBA Analysis

The Proposed Rule's CBA fails to substantiate or properly define several of its purported benefits and fails to consider or quantify several important costs. Subsections (i) through (vi) below review these shortcomings in further detail.

i. The CBA does not consider evidence showing that the Proposed Rule would impose significant costs on investors and companies.

The CBA cites Grewal et al. (2017) for the proposition that increased mandatory ESG disclosure is "associated with aggregate stock price movement" and that this is an indication that investors place value on additional mandatory climate disclosures.[65] However, this study concluded that the imposition of such

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[63] *See id*. at 21,443.

[64] *See id.* at 21,446.

[65] *See* Proposing Release at 21,429.

a disclosure regime produced "on average [a] negative market reaction."[66] The CBA ignores this conclusion. Moreover, Grewal (2017) also finds that mandatory disclosure requirements for climate risk are costly and potentially unnecessary. For example, according to Grewal (2017), "prior to the mandate…firms are making optimal disclosure decisions" and "*costs exceed[] benefits* for firms affected by the disclosure regulation."[67] The CBA ignores these crucial findings of the Grewal study.

The CBA also cites Jouvenot (2019) as evidence for the relevance of climate-related information to investors. However, the CBA omits that the paper concludes that firms responding to a law mandating GHG disclosure experienced "costly operational adjustments that negatively affect their operating performance after the regulation takes effect" and a median shareholder value reduction of approximately £50 million.[68] The CBA does not contend with the question of whether these financial costs outweigh the Proposed Rule's purported benefits. Indeed, the CBA's discussion of the costs of the Proposed Rule is focused primarily on direct administrative costs to filers. The analysis of the broader costs of the Proposed Rule to capital markets more generally, which could very likely be much greater than the direct compliance costs, is significantly lacking in consideration of empirical evidence compared to the corresponding discussion of benefits.

There is evidence of the potential for costs additional to those noted in the studies above. For example, certain shareholders might support a voluntary disclosure by a firm of GHG emissions that would reduce firm value, as evidenced by Jouvenot (2019). Other shareholders that in contrast seek only maximization of firm value may well not support this disclosure. Imposing a requirement that this information be disclosed would preempt the ability of these competing constituencies to reach an agreement through the means of a shareholder vote or other contractual measures, the general effectiveness of which is well attested.[69] This is a risk that the CBA does not consider.

ii. The CBA does not demonstrate a failure of the existing materiality standard or a relative advantage of the Proposed Rule's approach in ensuring that relevant risks are disclosed.

As the SEC noted in its 2010 interpretive release, if the issuer expects a climate-related risk, including indirect financial effects of climate change, to have a material effect on its business, the issuer is required to disclose that information.[70] The CBA does not demonstrate that the existing standard of materiality has systematically failed to identify climate-related information relevant to a firm's value or that the Proposed Rule is a relatively more efficient method of producing such information. Empirical evidence indicates that a consistent materiality standard is generally effective in identifying decision relevant information for investors, and that an overabundance of information can reduce the quality of investors' decision making.[71]

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[66] Jody Grewal et al., *Market Reaction to Mandatory Nonfinancial Disclosure* 65(7) MGMT. SCI. 3061 (2017) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=265771

[67] *Id.* at 3.

[68] Valentin Jouvenot & Philipp Krueger, *Mandatory Corporate Carbon Disclosure: Evidence from a Natural Experiment* (2019) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3434490.

[69] See, e.g., Roberta Romano, Less is more: Making institutional investor activism a valuable mechanism of corporate governance YALE J. OF REG. (2001), https://openyls.law.yale.edu/handle/20.500.13051/7997.

[70] Commission Guidance Regarding Disclosure Related to Climate Change, Release No. 33-9106 (Feb. 2, 2010) [75 FR 6290 (Feb. 8, 2010)], https://www.sec.gov/rules/interp/2010/33-9106.pdf.

[71] *See, e.g.*, Troy A. Paredes, *Blinded by the Light: Information Overload and its Consequences for Securities Regulation* 81 WASH. U. L. Q. 417 (2003); Aasmund Eilifsen et al., *The Importance of Quantifying Uncertainty: Examining the Effects of Sensitivity Analysis and Audit Materiality Disclosures on Investors' Judgments and*

The CBA also does not consider the risk that requiring the disclosure of certain information (such as Scope 1 and 2 emissions) regardless of materiality may make it more difficult for investors to judge whether a disclosure reflects a genuinely material risk to the firm.[72]

iii. The CBA does not adequately consider the relative costs and benefit of an alternative that focuses on industries for which climate risk is most relevant.

The relevance of climate risk varies greatly across industries. Indeed, the Proposed Rule acknowledges that issuers in industries where climate risk and environmental policies are more relevant already provide more disclosure of such information.[73]

The CBA however does not consider alternatives that would instead focus on certain industries, such as the fossil fuel industry, where the benefits of standardized mandatory disclosures may be greater, and the costs lesser, while imposing less burdensome requirements on, or indeed exempting, firms in other industries such as social media, where climate-related risks are likely less relevant. Firms in the former category will likely have greater expertise in measuring GHG emissions and assessing climate risks, and thus face lower compliance costs, compared to firms in the latter category. There is also clearly a stronger relationship between climate-related risks and what constitutes a material risk to an investor (a factor that directly implicates the SEC's core mandate) for firms in the former category compared to the latter. The CBA does not consider the net cost-benefit differentials of the Proposed Rule for differing industries, or whether such differences warrant an alternative proposal that applies only to industries where the cost-benefit trade-off is demonstrably favorable.

In addition, the CBA is generally based on the view that standardized disclosure requirements are beneficial for investors. The Proposed Rule's requirement that all firms disclose a standardized set of physical and financial metrics and address a standard set of topics, such as the adoption of climate-related targets or action plans, is thus presented as a *per se* benefit for investors. However, the papers that the Proposed Rule cites, such as Frenyo (1992) and Einhorn (2013), in support of a broad disclosure mandate focus on the standardized disclosure of traditional financial information, like profitability, that is comparable across all types of firms.[74] The CBA does not consider whether investors can effectively assess the relevance of differences in environmental policies across different types of firms and industries as they can with standardized financial metrics such as EBITDA.

In addition, the CBA fails to consider adequately the possibility that the assessment of climate risk is already being performed by other agents such as sophisticated investors, credit rating agencies, insurance companies, or creditors, particularly with respect to firms for which climate risk is less relevant. By imposing a broad disclosure mandate on all firms, the Proposed Rule may create a market inefficiency by creating duplicative compliance costs.

Decisions (2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3358581; Dirk Beerbaum, *Disclosure overload – a literature review* (2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2669135.

[72] See id.

[73] *See id.* at 21,424.

[74] *See, e.g.*, *id.* at Note 811, citing Frenyo & Tse (1992), and at Note 814, citing Einhorn & Ziv (2012).

iv. The value of Scope 3 reporting to investors is questionable, and the CBA likely underestimates its costs.

The CBA indicates that the reporting of Scope 3 emissions might help investors gain a "more complete picture of the transition risks to which a registrant may be exposed."[75] However there are significant questions as to whether Scope 3 emissions can be reliably calculated with sufficient consistency to serve as a valuable indicator for investors. For example, the CBA does not address the arguments of Kaplan & Ramanna (2021) that the difficulty of tracking Scope 3 emissions from multiple suppliers and customers makes it a "virtual impossibility" for companies to estimate Scope 3 numbers reliably,[76] and that the imprecision of the Scope 3 methodology will "open the door to bias and manipulation."[77] These authors also point out that the Scope 3 reporting concept requires multiple issuers to estimate and report emissions from the same activity, which is inefficient and duplicative, and "an obvious defect in any accounting system."[78]

The CBA's analysis of the potential costs of the Scope 3 reporting requirement is based on a single PCAF survey that asked 13 financial institutions to estimate the cost of estimating their "financed emissions", which is a measurement specific to financial institutions, and is moreover only one component of Scope 3 emissions for such institutions, and is therefore very likely an underestimate of the actual costs to be incurred by issuers generally in making these estimates.[79] The cost estimates reported in the survey are also limited to the issuer's direct internal and external expenses in producing a Scope 3 estimate. There is no consideration of the risk of indirect costs, including to the capital markets because of the lack of precision and consistency inherent in the calculation of Scope 3 emissions. The CBA thus potentially underestimates the costs of the Scope 3 reporting requirement to a significant degree.

v. The CBA fails to consider the costs to climate-related innovation.

The Proposed Rule requires firms to disclose information about their strategies for dealing with climate risks, including climate-related targets and goals, transition plans, and financial assumptions. The CBA acknowledges the possibility that the disclosure of such information may place firms at a "competitive disadvantage."[80] However it does not consider the possibility that the Proposed Rule could result in less climate-related innovation, since any potentially cost-saving measures that a firm develops in pursuit of its climate goals will need to be disclosed to competitors and thus firms may be less likely to invest in climate-related innovation.

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[75] *Id*. at 21,378.

[76] Robert S. Kaplan & Karthik Ramanna, *Accounting for Climate Change* (Nov./Dec. 2021), https://hbr.org/2021/11/accounting-for-climate-change. ("The difficulty of tracking emissions from multiple suppliers and customers across multiple value chains makes it virtually impossible for a company to reliably estimate its Scope 3 numbers.")

[77] *Id.*

[78] Id.

[79] Proposing Release at 21,442.

[80] *See id.* at 21,444.

vi. The CBA likely underestimates the extent to which the Proposed Rule would disincentivize firms' entry into public markets.

The CBA asserts that the Proposed Rule will not create a meaningful incentive for firms to avoid the public market, because private firms already face substantial pressure from their own investors to disclose climate- and environmental-related information.[81] The CBA does not provide evidence for this claim, however, or for its implicit assumption that firms are indifferent between investor pressure to disclose climate information and a legal requirement to do so. Moreover, if private firms are indeed effectively incentivized to disclose climate-related risks without a legal requirement, it casts doubt on the necessity of such a requirement in the public markets.

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Thank you very much for your consideration of the Committee's position. Should you have any questions or concerns, please do not hesitate to contact the Committee's President, Professor Hal S. Scott [redacted], or its Executive Director, John Gulliver [redacted], at your convenience.

Respectfully submitted,

John L. Thornton	Hal S. Scott	Robert Glenn Hubbard R. Glenn Hubbard
CO-CHAIR	PRESIDENT	CO-CHAIR

[81] *See id.* at 21,448.