RHOIMPACT

Jun 16, 2022

To: Vanessa A. Countryman, Secretary, U.S. Securities, and Exchange Commission, (rule-comments@sec.gov)

Re: **Comments on Proposed Rule for The Enhancement and Standardization of Climate-Related Disclosures for Investors, File Number S7-10-22**

Dear Secretary Countryman,

We at Rho Impact are a group of ESG practitioners, environmental scientists and data scientists devoted to democratizing access to ESG capabilities and tools. We have developed advisory frameworks and software tools to help public and private entities plan, track, and report on their ESG performance. Given that we engage with public and private entities, investment firms, and most recently the UN Global Climate Alliance, our work reaches a wide variety of stakeholders. These experiences have provided us with unique insight into the ESG pain points experienced by a diverse set of organizations.

We support the SEC's vision of having one comprehensive framework of disclosure requirements that would promote and standardize these practices and wish to submit the following comments based on our collective experience.

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Executive Summary:

Rho Impact commends the Security Exchange Commission's (Here and after: SEC) efforts to update and standardize the climate-related non-financial disclosure requirements. Nonetheless, we, at Rho Impact, wish to express our concern that the SEC's proposed regulations are primarily focused on the output, with minimal attention to the process used to arrive at those outputs. While a significant factor, the efforts required to reach such outputs does not yield the same level of disclosure (and information) that is required for meaningful auditability, traceability, and ultimately, transparency. In other words, as the SEC strives for "*consistent, comparable, and reliable"* [1] reporting, more emphasis should be given to the process companies undergo to meet these requirements.

We at Rho Impact suggest that the SEC's recommendations should provide investors and other stakeholders greater detail and clarity regarding the processes, key inputs, and internal controls used to determine their disclosed performance data. This approach, which should include assumptions and sources of data, will allow for more comprehensive evaluation of that performance and the validity of the disclosures.

The following three recommendations represent our position on key elements of the SEC's proposed rules and some commentary on the necessity to incorporate them into the final set of disclosure regulations:

1. **Materiality**- Although companies will inherently require discretion on what they deem material based on the unique context of the company, the SEC should prescribe process guidelines for how material issues are identified. This will reduce both gaps in the analysis and promote greater transparency regarding the actions undertaken to arrive at those conclusions. Furthermore, leveraging an existing industry-specific standard, like the 77 SASB standards, would guide companies to disclose on consensus-built, material issues that are relevant at the industry level. If a company wishes to digress from said process and metrics guidelines, it will ideally provide an explanation as to why an issue is not deemed material. This combination would promote greater transparency, stakeholder understanding and accountability for actions and results.

2. **Scope 3 Emissions-** Protocols for disclosing scope 3 emissions must include detailed information on both the inputs (i.e., materials or products purchased from suppliers) and outputs (i.e., materials or products sold, waste created). Not accounting for the inputs and assumptions (hidden or otherwise) could create discrepancies between emissions calculations and the final, reported emissions numbers. Similar to our stance on materiality, prescribing a core set of process guidelines for scope 3 emissions would enable greater contextualization of the data and enhance comprehension of their performance. If a company simply needs to report a value for their scope 3 emissions, understanding that figure in the context of their business, upstream and downstream partners, and broader industry benchmarks will be unachievable.

3. **Financial Forecasts-** Similarly, asking for a single and quantified financial value regarding how ESG issues impact future profitability could result in manipulated and misrepresented data. It could also increase the confusion and skepticism in the markets due to a lack of supporting detail. Listing key assumptions, secondary data points, and any methodologies used to support quantitative results would reduce the uncertainty and increase transparency.

Finally, our team has provided additional commentary which explicitly addresses issues and questions as they appear in the proposed regulation.

1. **Materiality**

Known to be one of the main inhibitory factors of standardized and unified disclosure is the issue of materiality. Given that disclosure is mainly voluntary, entities get to decide what they deem material and thus what they are willing to disclose. This is a significant challenge in pursuing transparency and comparability. A company can easily justify excluding an issue from its report under the false pretenses it is non-material. This has also led to gaps regarding areas that investors

might deem material, but the reporting entity does not. Hence, exposing investors to additional risks. In its proposed regulations, the SEC is using the same, or similar, materiality thresholds that have been used in the past to address materiality. This continues to lend itself to ESG rating and ranking point chasing, making disclosures more of a box-checking exercise than anything else.

Without a benchmark for materiality, companies who choose not to disclose may get a competitive advantage and additional exposure over companies that are more transparent, reporting all material issues regardless of performance. This ultimately hinders investors in their ability to accurately evaluate a company's performance. According to the SEC, the updated disclosure rules are aimed to mend those gaps: "*Designed to foster greater consistency, comparability, and reliability of available information* [2]". However, by using the same materiality thresholds that have been used in the past, it is in fact perpetuating those same problems.

While acknowledging there is not a one-size-fits-all approach to identifying every single material issue for each unique company, establishing a uniformed process is an inherent component of identifying and determining "materiality". Working through a thorough stakeholder engagement exercise would also increase the clarity and credibility of what is "material". To illustrate this issue, on page 43, in regards to reporting on emissions it is stated that "*scope 3 GHG emission and intensity if material* [3] *"*. With this language, a company can deem scope 3 emission as non-material and avoid disclosure. Instead, if scope 3 GHG emission would be mandatory to include, with prescribed guidelines on disclosing the process to arrive at those figures, the final emissions data would provide the context needed to inform decision-making and comparable evaluations.

It is our standpoint that there is a distinct format that can be used to ensure that companies are accurate and honest in the issues they deem material. First, the regulation should encourage companies to report on **how** they conducted their materiality assessment (e.g., provide information on the input). Doing so will require a thorough stakeholder engagement exercise and business continuity assessment that would unveil gaps in an internal investigation. Secondly,

establish a benchmark of **issues that are most relevant for each industry or sector in the regulations.** Doing so would be a good litmus test to quickly identify companies that have refrained from disclosing certain issues. Thirdly, the regulations should include language that encourages companies to **engage with material issues that they have low performance on.** This would require constructing a mechanism that assesses companies based on their level of **transparency, rather than solely how they perform on material issues.** In practice, this would mean that companies would report on material issues with high and low performances. When a company identifies a significant risk that they have low performance on, it would provide an outline of how it intends to address that risk. This structure will promote transparency and encourage companies to identify their weak spots and make commitments to address it, rather than ignore or hide significant issues. It will also provide an opportunity to track any changes of the material issues themselves. By improving the transparency and traceability of the materiality determinations, we can better ensure that stakeholders are well-informed of the risks and opportunities facing these companies.

2. **Scope 3 emissions**

Our experience designing the CRANE Tool[4] has given our team a pointed perspective on modeling, calculating, and forecasting emissions. Hence, we wish to express our concern that the suggested regulations lack a systems thinking approach. It should be a priority to design a regulatory system that will allow us to improve emissions estimates and forecasting as data collection and modeling capabilities progress. A systems thinking approach is required to allow future progress on calculating scope 3 emissions.

Following the GHG Protocol[5] and allowing businesses discretion regarding scope 3 emissions disclosure could create a non-networked view of the emissions profile. An **isolated approach** to a set of emissions that cover multiple interacting systems would likely lead to **discrepancies**

between calculations and double counting of emissions. This would damage the accuracy of the data and impair the ability of investors to evaluate risks.

It is our belief that developing a system thinking approach to disclosing scope 3 emissions is one of the most important aspects of designing these regulations. A regulatory structure that accounts for this comprehensive approach will create a system that is better suited to account for the complexities that plague ESG reporting. This structure will also allow regulators, practitioners, and stakeholders to continuously improve policies and regulations, and remain agile in responding to additional intricacies that are sure to come as these processes develop. As time goes on, different methods for calculating emissions will arise, more types of data will become available, and new technologies will develop, adding to the intricacies that come with reporting scope 3 emissions.

Therefore, we believe that the SEC's proposed recommendations should **contextualize a company's scope 3 emissions within its network of suppliers and partners- and not disclose their scope 3 figures in isolation**. The focus on scope 3 emissions should center around **disclosing a well-articulated understanding of the inputs and outputs that contribute to these emissions**.

Additionally, simply producing GHG equivalence should not account as a sufficient scope 3 emissions disclosure. The goal should be for an entity to provide the inputs and outputs that contribute to its scope 3 emissions. Having a company list scope 3 elements such as where they are getting material inputs for manufacturing, or where they dispose of their waste, will give a much clearer view of the value chain. Stating these inputs and outputs will help stakeholders understand where these scope 3 emissions are coming from and how they contribute to the larger system of upstream and downstream suppliers. This is also important for showing the relationships between companies and their suppliers, revealing emissions hotspots for a particular industry or sector. By providing this set of inputs and outputs in a scope 3 disclosure, it paints a picture of the value chain and gives stakeholders a much better understanding of what that scope 3 value actually means. The focus here should be enabling companies to show where their emissions are coming from, not just simply stating a GHG level. One way to standardize this approach is to have the

reporting entities list out their tier 1 suppliers based on a percentage of spend. Understanding where a company gets the majority of their inputs (i.e. which suppliers they purchase from the most) helps stakeholders better assess that first level of the value chain. In turn, we'll be able to better understand what is contributing to that company's scope 3 emissions.

Such methods will contribute to a clearer understanding of where the majority of these emissions occur and what issues might arise further down the line as a result. This emphasizes the need to have structured, machine-readable data sets- or a structured data language as noted by the SEC. If suppliers will disclose their emissions, and companies will disclose pertinent information on their value chain, it will result in uniquely identifiable data both at the organization level and at the asset level. This systems view is critical for accurately reporting on scope 3 emissions.

This also goes back to our argument regarding materiality determinations. Allowing companies to choose whether to disclose scope 3 emissions only if deemed material could result in an inaccurate or incomplete disclosure of scope 3 estimates. Obligating companies to **disclose their inputs and outputs**, will allow them to calculate their scope 3 emissions with **full transparency and clarity**. This will enable stakeholders to easily identify hot spots, account for increased risk exposure and most importantly, quickly recognize inconsistencies.

3. **Financial forecasts**

Our third comment concerns the required in-line financial risk calculations. We support the SEC's efforts on introducing a more comprehensive approach to disclosing both financial and non-financial risks. Yet, it is our perspective that the SEC's suggested proposal is not entirely attainable. In analysis, the final figure or the bottom line does not provide sufficient information. Therefore, reporting entities should be obligated to **include the assumptions and estimates that were used to develop the financial calculations.** This also aligns with the SEC's "*commitment to improving the information provided to investors in disclosures"* [6], and is consistent with their

goal to *"provide investors clear and comparable information about how a fund considers ESG factors"* [7].

Calculating the financial implications of risks that are more qualitative in nature is extremely difficult, making them unreliable and challenging to audit. By adding **qualitative elements** to these calculations, companies will highlight the process they pursued to produce the financial projections of risk. For example, if a company is reporting on the financial implications of supply chain disruptions caused by natural disasters, they need to provide the assumptions and estimates that were made to tie a monetary value to that risk. Outlining the assumptions reduces misconduct (e.g., greenwashing), enhances transparency, and boosts credibility. It also allows investors to better evaluate the risks of potential investments. This will aid in addressing "*the significant variability in the ways different funds approach the incorporation of ESG factors in their investment decisions by contemplating a range of strategies that funds use"* ***[8]***.

Baking such qualitative elements into the financial disclosure process also saves companies from the burden and bloat resulting from reporting numbers that can't be systematically audited. Adding qualitative aspects such as assumptions made, processes used, contingencies, considerations, and estimates included to attach a financial value to a qualitative risk would create opportunities for increased transparency, making auditing and investigating simpler. A practice of sharing assumptions and estimations supports the SEC's notion of "**consistent comparable and reliable" reporting, which will also "protect investors and addresses the "impact of the impact"** **[9]**. Companies that sufficiently provide transparent assumptions, calculations, and qualitative details will clearly show that they are committed to authentic climate-risk disclosures, even if their impact isn't substantial. Companies that do not disclose sufficient information will signal that they are most likely hiding something, and their numbers are not to be trusted at face value.

In conclusion, Rho Impact sees these efforts from the SEC as a necessary and important first step in the productive iteration of these disclosure requirements. Keeping in mind its complexity, there will never be a one-size-fits-all approach, and instead, this will be an ongoing effort to update these practices as new information becomes available.

We look forward to seeing this progress develop and are eager to see how commentary like this will make its way into the official SEC non-financial disclosure rules. Please find additional perspectives and commentary below based on additional clauses of relevance in the proposal.

Thank you for your consideration,

- Noah Miller, Co-Founder and Chief Strategy Officer
- Jason Nachamie, Senior ESG Advisor
- Gal Shargil, Senior ESG Advisor
- Seth Sheldon, Co-Founder and Chief Scientific Officer

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Additional Commentary

Page specific comments to the SEC. Page numbers are shown in parentheses, and verbatim text is shown in *italics*. Specific comments and/or recommendations are shown in **bold**.

(p. 14-15) *"While our proposals include disclosure requirements designed to foster greater consistency, comparability, and reliability of available information, they also include a number of features designed to mitigate the burdens on periods for the proposed climate-related disclosure requirements, a safe harbor for certain emissions disclosures, and an exemption from certain emissions reporting requirements for smaller reporting companies."*

The SEC should be careful in determining the appropriate cut-off size for reporting requirements of smaller companies. Given the aggregate nature of emissions in supply chains – including from smaller companies – we believe that the cutoff should be determined through a science-based approach (e.g., based on first order estimates of life cycle emissions based on revenue, head count, and sector). New tools are making it easier than ever for both public and private companies of any size to estimate their emissions.

(p. 42) *"Scopes 1 and 2 GHG emissions metrics, separately disclosed, expressed both by disaggregated constituent greenhouse gasses and in the aggregate…"*

Although we applaud the SEC's intention here, in practice, life cycle GHG emissions are very often dependent on CO2e emissions factors that are not expressed in disaggregated terms, particularly for scope 3 emissions. We suggest requiring disaggregated reporting, except in instances where data are not reasonably available, and perhaps changing that requirement as disaggregated GHG emissions factors become more available.

(p. 45) *"An exemption from the Scope 3 emissions disclosure requirement for a registrant meeting [the definition of a smaller reporting company ("SRC")"*

This statement presupposes that scope 3 analysis will only be feasible and/or affordable by large firms. We don't believe that this is the case, and we think it will set a poor precedent for future requirements. SRCs should not, in our view, be exempt from scope 3 disclosure. Further, in many industries, scope 3 emissions are the most significant component of a company's footprint. Nevertheless, they may have leverage over their scope 3 profile based on both their choice of suppliers and customers of their products.

(p. 67) *"Should we specify a particular time period, or minimum or maximum range of years, for "short," "medium," and "long term?" For example, should we define short term as 1 year, 1-3 years, or 1-5 years? Should we define medium term as 5-10 years, 5-15 years, or 5-20 years? Should we define long-term 10-20 years, 20-30 years, or 30-50 years?"*

Yes, it would be worthwhile to specific certain time periods for each of these, or at least numerical ranges. In the absence of specifics, companies will face the additional burden of first having to define their own ranges and then justify that selection. Their justifications may or may not be valid or guided in any way by science (e.g., decadal scenarios and goals set forth by the IPCC or in the IEA's WEO Scenario models.)

(p. 70) *"Should we require these disclosures from all registrants operating in certain industrial sectors and if so, which sectors?"*

It is our strong opinion that requirements should not be sector specific, due to the rapidly changing nature of many sectors in response to climate change, and the possibility of misclassifications and exceptions if a company claims (truly or falsely) that they operate in an excepted sector. All sectors contribute to GHG emissions in some way, with their contributions being more or less direct.

(p. 130) *The proposed financial impact metrics would not require disclosure if the absolute value of the total impact is less than one percent of the total line item for the relevant fiscal year. Is the proposed threshold appropriate?*

The 1% threshold strikes us as somewhat arbitrary, but more importantly, it does not, in our view, sufficiently accommodate the real possibility of hundreds of low probability, high-impact events. The threshold or criteria for inclusion should be based on science.

(p. 151-152) *"Because measuring the constituent greenhouse gases is a necessary step in calculating a registrant's total GHG emissions, the proposed disaggregation by each constituent greenhouse gas should not create significant additional burdens."*

We believe that this statement is incorrect. While it is true that calculating the constituent GHGs is a necessary step in calculating emissions factors (for instance, in life cycle assessments, emissions factor databases, peer reviewed literature), it is not true that companies always have easy access to these numbers. Often only the CO2-equivalent

numbers are published and used, meaning that a company's disclosure will likely require additional cumbersome and potentially inconsistent work to disaggregate the whole factor.

(p. 162) *"…the proposed rules would require disclosure of Scope 3 emissions only if those emissions are material, or if the registrant has set a GHG emissions reduction target or goal that includes its Scope 3 emissions."*

In the absence of widespread, high-quality knowledge among investors on what scope 3 emissions are and how they relate to the many sectors and businesses they may be interested in, the definition of "material" in this case is fraught. scope 3 emissions are poorly understood, and therefore the threshold of materiality here – while certainly appropriate in the context of established and widely accepted standards (e.g., GAAP) and education – will not, in our view, have the intended effect of protecting investors and lowering negative impacts to society.

(p. 175) **"***Should we require a registrant to express its emissions data in CO2e as proposed?"*

Yes, this is a standard practice, and should be accompanied by the choice of Global Warming Potential (GWP) used to determine the aggregate number (i.e. 25-year, 100-year, etc.).

(p. 206) *"Should we require a registrant to disclose any material change to the methodology or assumptions underlying its GHG emissions disclosure from the previous year, as proposed?"*

Yes, this is vital for trend analysis, continuity between years in terms of the consistency of process, and will be critical for building out and refining high quality predictive GHG impact models.

(p. 286) *"Should we leave the structured data language undefined?"*

No. We believe that doing so would result in an extreme degree of incompatibility between and across models (including within individual disclosing organizations), and would therefore undermine the SEC's goal of creating an environment in which investors are protected and negative impacts of disclosing organizations on society are minimized. We think that the XBRL standard is an ideal structured data language for use.

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[1] See page 7, the U.S. Securities and Exchange Commission, Proposing Release: Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, May 25, 2022.

[2] See pages 14-15, The U.S. Securities and Exchange Commission, Proposing Release: Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, May 25, 2022.

[3] See pages 43, The U.S. Securities and Exchange Commission, Proposing Release: Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, May 25, 2022.

[4] https://cranetool.org/

[5] https://ghgprotocol.org/standards

[6] See page 8, The U.S. Securities and Exchange Commission, Proposing Release: Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, May 25, 2022.

[7] See pages 23, The U.S. Securities and Exchange Commission, Proposing Release: Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, May 25, 2022.

[8] See pages 23, The U.S. Securities and Exchange Commission, Proposing Release: Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, May 25, 2022.

[9] See pages 120, The U.S. Securities and Exchange Commission, Proposing Release: Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices, May 25, 2022.