Committee on Securities Law
of the Business Law Section of the
Maryland State Bar Association

June 17, 2022

VIA EMAIL AT RULE-COMMENTS@SEC.GOV

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

Re: The Enhancement and Standardization of Climate-Related Disclosures for Investors (Proposed Rules and Amendments), File No. S7-10-22

Ladies and Gentlemen:

This letter expresses the views of the Committee on Securities Law (the "Committee") of the Business Law Section of the Maryland State Bar Association (the "MSBA") with respect to the above-referenced proposing release, SEC Release Nos. 33-11042; 34-94478; File No. S7-10-22 (sometimes referred to herein as the "release") relating to the Securities and Exchange Commission's (the "Commission") proposed rules and rule amendments regarding new climate-related disclosures in registration statements and periodic reports. The membership of the Committee consists of securities practitioners who are members of the MSBA and includes lawyers in private practice, business, government, and academia. The Business Law Section and the Board of Governors of the MSBA have not taken a position on the matters discussed herein, and individual members of the MSBA and the Committee, and their associated firms or companies, may not necessarily concur with the views expressed in this letter.

The Committee has significant concerns about the proposed disclosure requirements set forth in the release, particularly with respect to their scope and cost. We discuss in this letter our most significant concerns regarding the proposal.

I. Placement of Proposed Requirements in Regulation S-K; Scope of Certain Proposed Requirements

We agree that it is appropriate to require registrants to include a discussion of their material climate-related risks in their registration statements and periodic reports. We do not believe, however, that it is necessary or appropriate to require such discussion pursuant to a new Item 1502 instead of as part of the existing risk factor discussion already required pursuant to existing Item 105 of Regulation S-K, nor that registrants be required to discuss the broad proposed prescribed details relating to such risks. Similarly, we believe that the discussion of board oversight of climate-related risks should be addressed pursuant to Item 407(h) of Regulation S-K, which already requires registrants to "disclose the extent of the board's role in the risk oversight of the registrant, such as how the board administers its oversight function," rather than pursuant to a new Item 1501 of Regulation S-K.

The release provides no discussion or justification (other than, broadly, that investors are demanding climate-related disclosure) as to why a registrant's discussion of climate-related risks and board oversight thereof, as opposed to all other "material factors that make an investment in the registrant or offering speculative or risky" that should be disclosed under Item 105, should go into the extraordinary level of detail set forth in proposed Items 1501 and 1502 of Regulation S-K, or why registrants that qualify as smaller reporting companies should be required to discuss climate-related risks when they are not required to discuss *any* other risks to their business or with respect to an investment in their securities as per Item 1A of Form 10-K. While we agree that it is appropriate, to the extent material, that registrants be required to discuss much of the information prescribed by proposed Items 1501(a), 1502(a), and 1502(b), this could be accomplished by incorporating such disclosure requirements into existing Items 105 and 407(h) of Regulation S-K or instructions thereto.

We do not believe there is any justification for the Commission to treat the disclosure of climate-related risks differently than all other risks that might affect registrants or to otherwise create a new, separate regulatory scheme for climate-related disclosure, which new subpart 229.1500, "Climate-Related Disclosure," would do. We agree that it is of the utmost importance for the United States, and for that matter the rest of the world, to address climate change, and we understand that the failure to do so may have catastrophic consequences for our planet and all of those who inhabit it. We are also aware that climate change is currently an intense focus for certain elements of our society. None of this,

however, justifies an outside focus on climate change under the disclosure requirements of the federal securities laws. For some registrants, yes, climate change may be the most urgent, most material risk to their business, prospectus, financial condition, etc. For many others, however, it will be one of many such risks, particularly in the short term. The placement of climate-related risks in its own subpart of Regulation S-K and the incredible level of detail about such risks that would be required thereby, as compared to the disclosure required about all other risks pursuant to Item 105 of Regulation S-K, however, implies importance with respect to disclosure in Commission filings that we believe is unwarranted (at least with respect to all registrants on an across-the-board basis). Therefore, we believe that the requirements for a discussion of material climate-related risks and board oversight thereof should be folded into the existing provisions of Regulation S-K.

II. Materiality

While we acknowledge that the Commission is not necessarily prohibited from requiring that registrants disclose information that may not be material,[1] it has generally been acknowledged that the concept of materiality is the driving force behind the federal securities law disclosure regime and guides the Commission's rules in this regard.[2] To this end, in the past, the Commission has made efforts to reduce the amount of immaterial information included in Commission filings.[3] As noted in the release, "[a]s defined by the Commission

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[1] *See* Speech by Commissioner Allison Herren Lee, *Living in a Material World: Myths and Misconceptions about "Materiality"* (May 24, 2021) ("Indeed our statutory rulemaking authority under Section 7 of the Securities Act of 1933 gives the SEC full rulemaking authority to require disclosures in the public interest and for the protection of investors. That statutory authority is not qualified by "materiality." Similarly, the provisions for periodic reporting in Sections 12, 13 and 15 of the Securities Exchange Act of 1934 are not qualified by "materiality.") (citations omitted).

[2] *See, e.g.*, Gary Gensler (Commission Chair), *Statement on Proposed Mandatory Climate Risk Disclosures* (March 21, 2022) ("In making decisions about disclosure requirements under the federal securities laws—including decisions about today's climate-related disclosures—I am guided by the concept of materiality."); *The Materiality Standard for Public Company Disclosure: Maintain What Works* (October 2015), Business Roundtable, available at https://s3.amazonaws.com/brt.org/archive/reports/BRT.The%20Materiality%20Standard%20for%20Public%20Company%20Disclosure.2015.10.29.pdf ("Materiality has been the cornerstone of the federal securities laws since Congress incorporated this principle in the first of these laws in the 1930s. It subsequently has been incorporated in SEC rules and pronouncements and interpreted by the U.S. Supreme Court").

[3] *E.g.*, Commission Release Nos. 33-10618; 34-85381; IA-5206; IC-33426, *FAST Act Modernization and Simplification of Regulation S-K* (March 20, 2019) ("The amendments are also intended to improve the readability and navigability of disclosure documents and discourage repetition and disclosure of immaterial information").

and consistent with Supreme Court precedent, a matter is material if there is a ***substantial likelihood*** that a reasonable investor ***would*** consider it important when determining whether to buy or sell securities or how to vote." (emphasis supplied) We are concerned that the Commission appears to be significantly departing from the concept of materiality, as it has traditionally been interpreted with respect to the application of the federal securities laws, in the proposed climate-related disclosures. The release includes numerous statements supporting the proposed disclosure requirements because the disclosure in question "could" help investors figure something out or "may" be important to investors, as opposed to disclosure of which there is a substantial likelihood that investors would consider it important. We believe that requiring highly technical climate-related disclosure that is difficult to accurately assess and possibly not material, particularly given the costs of complying with the proposed disclosure requirements, is not appropriate.

Further, it appears that with respect to much of the proposed disclosure, the Commission is moving away from the traditional focus on the "reasonable" investor. We believe that much of the proposed disclosure will be relevant primarily to institutional and/or sophisticated investors who have the climate expertise and resources to analyze the significance and impact of the proposed disclosure. For example, we do not believe that GHG emission numbers, alone (*i.e.*, without laws limiting such emissions that such numbers can be compared to), would be considered material because, as noted in the release, they are simply an "indication" of risk. In other words, they provide information that can be plugged into models to provide additional information that may be useful to certain investors in making investment decisions, but we do not believe that this is something that investors generally would have access to. Similarly, we note the proposed requirement that registrants present Scope 1, 2, and 3 emissions both (i) disaggregated by each of seven constituent greenhouse gases (carbon dioxide, methane, nitrous oxide, nitrogen trifluoride, hydrofluorocarbons, perfluorocarbons, and sulfur hexafluoride) and (ii) in the aggregate, expressed in terms of carbon dioxide equivalent. The release provides with respect to this part of the proposal that "[b]y requiring the disclosure of GHG emissions both disaggregated by the constituent greenhouse gases and in the aggregate, investors could gain decision-useful information regarding the relative risks to the registrant posed by each constituent greenhouse gas in addition to the risks posed by its total GHG emissions by scope." We do not believe that a *reasonable* investor would have the necessary climate-related expertise such that they could find this information, particularly the disaggregated information, decision-useful. While we agree that it is appropriate for the Commission to consider

what information investors want registrants to provide when crafting new disclosure rules, we do not believe that it is appropriate for the Commission to require all registrants to disclose information that a select subset of investors is demanding so that they can plug them into their own analytical models when that information alone is not material.[4] Rather, we believe that such investors should ask the companies in which they invest or consider investing to provide such information. We realize that, to date, such "private ordering" has resulted in inconsistent disclosure such that investors are not able to compare the information across registrants, but we believe that the proper resolution of that issue is for the investors to specify the information they need from such companies, and to disinvest or decline to invest if they are not provided the information they need. We do not believe that it is the Commission's responsibility to require all registrants to provide disclosure that a select group of relatively sophisticated investors is demanding because such investors are not getting the "comparable" information they want from such companies.

Finally, we are concerned about the Commission's extension via the release and proposed rules of the concept of "materiality" as being applicable to an individual investor's investment portfolio. In this regard, we note the statements in the release that "we understand investors often employ diversified strategies, and therefore do not necessarily consider risk and return of a particular security in isolation but also in terms of the security's effect on the portfolio as a whole, which requires comparable data across registrants," and the fact that companies currently provide climate-related information on an inconsistent (across companies) basis, outside of SEC filings, etc., "could . . . impair [investors'] ability to make investment or voting decisions in line with investors' risk preferences." Incorporating concepts such as individual risk tolerances and the impact of information with respect to an investor's individual investment portfolio is inconsistent with the manner in which materiality has been interpreted to date. Further, we believe that this expansion of the Commission's interpretation of the concept of materiality could have drastic and unforeseen consequences if investors could demand and/or registrants could become liable for not disclosing information immaterial to the individual company or its securities but that is required to address individual investor's risk tolerances and portfolios. We submit that such a radical expansion of the concept of materiality under the federal securities laws is inappropriate, especially by

[4] In this regard, we note the statement in the release that "[i]nvestors have noted that climate-related inputs have many uses in the capital allocation decision-making process including, but not limited to... integration into various valuation models, and credit research and assessments."

casual reference in a 500+ page release without any discussion, analysis, or justification for doing so.

III. Application to Smaller Reporting Companies

While we appreciate that the Commission has proposed to exempt smaller reporting companies from two of the most onerous provisions of the proposed rules—the proposed disclosures with respect to Scope 3 emissions and the attestation for Scope 1 and Scope 2 emissions disclosure—we believe that a broader exemption from the proposed requirements for smaller reporting companies is warranted, particularly in light of the estimated costs of such disclosure, which will disproportionately burden smaller companies, the lack of a materiality standard for much of the proposed disclosure requirements, and the fact that the investors to whom this information would be most useful are less likely to invest in smaller reporting companies.

Even using the Commission's estimates for smaller reporting companies' compliance with the proposed disclosure requirements, the cost of such compliance would be a significant burden for these companies. The estimated costs—$490,000 in the first year and $420,000 in subsequent years (this on top of the costs to comply with existing Commission disclosure requirements)—are extraordinary under any circumstances, but particularly here where the information required to be disclosed may not be material (the proposed disclosure of Scope 1 and Scope 2 emissions, for example, have no materiality requirement at all). The proposed disclosure requirements seem particularly inappropriate in light of all the expressed concerns, including by Commission personnel, about fewer companies going or remaining public and companies that do go public doing so later, and the resulting lack of transparency into a huge portion of the market and retail investors losing out on the ability to benefit from companies post-IPO growth,[5] as the proposed requirements will only exacerbate these issues. For smaller companies, in particular, the estimated initial and yearly costs of the proposed disclosure requirements would be significant and would serve to discourage these companies from entering the public markets.

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[5] *See, e.g.*, Speech by Commissioner Allison Herren Lee, *Going Dark: The Growth of Private Markets and the Impact on Investors and the Economy* (Remarks at The SEC Speaks in 2021) (October 12, 2021); Small Business Capital Formation Advisory Committee, *Expanding Retail Access to Private Markets* (November 2019), available at https://www.sec.gov/spotlight/sbcfac/expanding-retail-access-to-private-markets-finley.pdf ("Less access to private companies means retail investors are missing out on the opportunity for excess or uncorrelated returns"); Alexandra Scaggs, *Private Markets Are Booming. Mom-and-Pop Investors Are Missing Out* (May 22, 2019), Barron's, available at https://www.barrons.com/articles/unicorns-private-equity-debt-markets-booming-51558466419.

Given all of this, we believe that the Commission's justification for not excluding smaller reporting companies from the proposed disclosure requirements, that is, that it would undermine the goal of the proposed rules "to achieve consistent, comparable, and reliable disclosures of climate-related information," seems thin, particularly given that smaller reporting companies are exempt from other provisions of the disclosure requirements set forth in Regulation S-K. We also do not believe that the fact that "climate-related risks are impacting or are expected to impact every sector of the economy," as set forth in the release, "highlights the need for enhanced disclosures from all registrants." The fact that climate-related risks exist across all sectors of the economy does not appear to relate to the size and resource imbalance between smaller and larger companies and, as a result, whether it is appropriate to require this disclosure from smaller reporting companies.

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We appreciate the Commission's consideration of the foregoing comments.

Very truly yours,

Committee on Securities Law of the Business Law Section of the Maryland State Bar Association

Penny Somer-Greif, Chair

Gregory T. Lawrence, Vice-Chair