



June 17, 2022

Ms. Vanessa A. Countryman  
Secretary  
Securities and Exchange Commission  
100 F St. N.E.  
Washington, D.C. 20549-1090

Submitted via email: [rule-comments@sec.gov](mailto:rule-comments@sec.gov)  
File Number S7-10-22

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Dear Ms. Countryman:

Ethic Inc. (“Ethic”) appreciates the opportunity to provide input in response to the Securities and Exchange Commission (“SEC” or “Commission”)’s request for public comment on its proposed rule amendment under the Securities Act of 1933 (“Securities Act”) and Securities Exchange Act of 1934 (“Exchange Act”), which would require registrants to provide certain climate-related information in their registration statements and annual reports.

Ethic is an SEC-registered investment adviser based in New York City. We work with financial professionals to deliver personalized equity portfolios tailored to their clients’ values, risk preferences and tax management objectives. The nature of this work, which often involves engaging directly with individuals and families to discuss their unique needs and priorities, has afforded us valuable firsthand insight into investor sentiment. Advisors and their clients are increasingly frustrated by the subjective and inconsistent nature of ESG rating and scoring methodologies, and are seeking customized offerings that provide greater transparency as to the underlying methodologies, assumptions, and data inputs.

We therefore applaud and support the SEC’s ongoing efforts to deliver “consistent, comparable, and reliable—and therefore decision-useful—information to investors”<sup>1</sup> concerning the material and systemic financial risks associated with climate change. At Ethic, we believe investors deserve access to reliable information about how companies in their portfolios are poised to adapt to or endure physical risks associated with a fast-changing natural environment, as well as the transition risks presented by a rapidly evolving regulatory landscape, technological developments, and changing consumer behavior. Our comment outlines our views on increased transparency and accountability related to net-zero targets, emissions reporting, and the reporting of data, and concludes with other disclosures that we believe the Commission may wish to consider.

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<sup>1</sup><https://www.federalregister.gov/documents/2022/04/11/2022-06342/the-enhancement-and-standardization-of-climate-related-disclosures-for-investors>

## Net-zero targets

Broadly speaking, Ethic supports efforts to enhance companies' transparency and accountability as it pertains to their public net-zero commitments. Currently, investors have limited information concerning the degree to which corporate net-zero pledges rely on the use of offsets, much less the actual quality of any offsets used. This can make it challenging to ascertain whether a company is on track to meet its stated net-zero goals and whether it is exposing itself to undue transition risk.

We believe that the SEC's mandated transparency around the use of offsets and Renewable Energy Credits ("RECs") could be useful in helping investors evaluate the robustness of companies' net-zero transition plans and the degree to which leadership is pursuing meaningful decarbonization strategies. Companies should be required to deliver annual progress reports that detail the volume and type of offsets used. These reports should provide information regarding retirement of carbon offset credits and the degree to which they met the company's goal of avoiding, reducing, or removing greenhouse gas ("GHG") emissions. Further, pursuant to the Science-Based Targets initiative ("SBTi")'s Net-Zero Standard<sup>2</sup>, "net-zero" goals must first focus on "rapid, deep cuts to value chain emissions." Accordingly, the Commission should not permit a registrant to claim "net-zero" attainment until it has provably met its long-term science-based target. The latter usually necessitates 95% reduction of company-wide Scope 1 and 2 emissions, and 90% of Scope 3 emissions, at which point the company may use carbon credits to neutralize any remaining emissions.<sup>3</sup>

## Emissions Reporting

### Standardization

In our initial comment letter<sup>4</sup> to the Commission, Ethic emphasized that certain information would benefit particularly from standardization requirements. The designation of a common unit of measurement could potentially streamline corporate reporting while meeting the Commission's aforementioned goal of providing investors with consistent, comparable and decision-useful information. To that end, as it pertains to emissions reporting, we support the Commission's proposal that a registrant express its data as carbon dioxide equivalent ("CO<sub>2</sub>e"). This method allows for the comparison of different greenhouse gasses on a like-for-like basis; it can also help to provide a fuller picture of a company's emissions by ensuring that reports do not focus solely on CO<sub>2</sub>.

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<sup>2</sup> <https://sciencebasedtargets.org/resources/files/Net-Zero-Standard.pdf>

<sup>3</sup> <https://sciencebasedtargets.org/resources/files/Net-Zero-Standard.pdf>

<sup>4</sup> <https://www.sec.gov/comments/climate-disclosure/cll12-8928838-245347.pdf>



Ethic also believes the Commission’s proposed alignment with the GHG Protocol represents a strong step toward meaningful standardization of definitions and reporting. As the SEC noted in its proposed rule, the GHG Protocol is “a leading accounting and reporting standard for greenhouse gas emissions.” It is now the most widely used<sup>5</sup> international accounting tool for government and business leaders to identify, quantify, and manage greenhouse gas emissions. A *mandatory* emissions reporting standard in line with the GHG Protocol may further advance the Commission’s aims of delivering consistent, comparable, and reliable climate-related information for investors. In any event, all disclosures should include information as to the data sources used and any third-party verification received.

### **Scope 1, 2 and 3 reporting**

**Scope 1 and 2:** Ethic supports the Commission’s proposed approach of requiring registrants to separately disclose total Scope 1 and total Scope 2 emissions for their most recently completed fiscal year. In its current iteration, however, the proposed rule allows registrants significant latitude to choose a preferred method for reporting Scope 2 emissions. We feel strongly that registrants should be required at the very least to quantify emissions using a Scope 2 location-based method,<sup>6</sup> which bases calculations on the emissions intensity of the local grid area in which a company’s electricity usage occurs, with the option for dual reporting that includes market-based calculations. This approach may help to minimize the likelihood that companies use contractual instruments such as RECs to erroneously and misleadingly claim zero total emissions from electricity use.

**Scope 3:** Ethic recognizes that visibility into a company’s Scope 3 emissions—i.e., those generated by assets and activities throughout its value chain—is vital to understanding its environmental impacts. This is especially true given that Scope 3 emissions often represent the bulk of an organization’s greenhouse gas emissions.<sup>7</sup> Clarity regarding a company’s Scope 3 emissions, therefore, may help investors better assess the financial risks and disruptions companies could face amid rising carbon prices, shifting consumer sentiment, and stricter emissions regulations.

There is growing acceptance among investors that companies’ upstream and downstream activities can be highly impactful to the natural environment and to their financial stability. This is evidenced by the uptick in shareholder proposals requesting that companies provide greater transparency into their supply chain emissions.<sup>8</sup> However, companies’ ability to source, validate and report on this data in a consistent and reliable way remains limited. This presents challenges that we believe may undermine the SEC’s stated aim of providing “consistent, comparable and reliable” information to investors.

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<sup>5</sup> <https://ceq.doe.gov/guidance/ghg-accounting-tools.html>

<sup>6</sup> [https://ghgprotocol.org/sites/default/files/Scope2\\_ExecSum\\_Final.pdf](https://ghgprotocol.org/sites/default/files/Scope2_ExecSum_Final.pdf)

<sup>7</sup> [https://ghgprotocol.org/sites/default/files/standards\\_supporting/FAQ.pdf](https://ghgprotocol.org/sites/default/files/standards_supporting/FAQ.pdf)

<sup>8</sup> <https://www.politico.com/newsletters/the-long-game/2022/03/17/proxy-season-kicks-off-00017996>



A positive effect of strengthening disclosures around Scope 1 and Scope 2 emissions is that Scope 3 emissions will, in turn, likely become easier for companies (and investors) to measure. In the meantime, the Commission could play an important role in working with various stakeholders to establish consensus around Scope 3 reporting standards that support meaningful cross-company comparisons. Our initial recommendations for capturing decision-useful Scope 3 data are as follows:

**Disclosure for companies with emissions reduction targets:** The rule as proposed would require issuers to disclose Scope 3 GHG emissions if they have established a GHG emissions reduction target or goal that includes Scope 3 emissions. Ethic believes it is both prudent and reasonable to expect that issuers monitor and report on the full extent of their GHG emissions and corresponding mitigation efforts. Robust and standardized disclosures can help investors track companies' progress toward achieving emissions reductions, assess the integrity of decarbonization strategies, and evaluate leadership's commitment to enhancing resiliency and mitigating risks.

It also stands to reason that, where companies have announced an emissions reduction target that encompasses Scope 3, they have likely already established calculation and reporting processes in accordance with GHG Protocol accounting standards. To that end, requiring that companies disclose emissions data to which they already have access is unlikely to significantly increase their reporting burden.

**Materiality standard:** Ethic believes that the proposed rule's reliance on the materiality standard for mandated Scope 3 emissions disclosures could, in the near term, prevent investors from accessing the timely and important information they need to evaluate critical risks and opportunities. The materiality determination, which is "made with regard to the information that a reasonable investor considers important to an investment or voting decision,"<sup>9</sup> may provide issuers with significant discretion to decide what information is reported. This standard presupposes that companies will conduct appropriately rigorous analyses, draw reasonably accurate conclusions regarding the most relevant Scope 3 activities, and subsequently disclose decision-useful data. However, prior analyses have indicated that, when Scope 3 emissions reporting hinges on self-assessed measures of materiality and relevance, companies often underestimate and underreport their total emissions footprints.<sup>10</sup> Indeed, the SEC's own recent correspondence with registrants indicated that, absent clear and consistent reporting guidelines, most companies fail to identify climate risks as financially material.<sup>11</sup>

To help address these concerns, Ethic proposes initially pursuing a narrower yet more concrete Scope 3 reporting mandate whereby *all* issuers must disclose emissions for the three Scope 3 categories that make up the majority (~75 percent) of U.S. companies' total value chain emissions. These key categories, as defined by the GHG Protocol, are 1 (purchased goods and

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<sup>9</sup> <https://www.sec.gov/rules/proposed/2022/33-11042.pdf>, p.66

<sup>10</sup> <https://www.msci.com/www/blog-posts/which-scope-3-emissions-will/03153333292>. This study uses the MSCI USA Investable Market Index, which contains 2,550 constituents as of May 2022, as a proxy for all U.S. market registrants

<sup>11</sup> <https://news.bloombergtax.com/financial-accounting/sec-scrutiny-of-big-companies-sheds-light-on-climate-priorities>

services), 11 (use of sold products), and 15 (investments).<sup>12</sup> This more limited yet uniform approach could generate useful and comparable data that captures the bulk of companies' total value chain emissions, rather than a patchwork of discretionary disclosures, thus affording investors a fuller picture of their exposures to climate-related risks and opportunities. It could also limit ambiguity as to reporting requirements and ease companies' compliance burdens.

Mandated disclosures should *not*, as the Commission queried in its proposed rule, allow registrants to “disclose Scope 3 emissions only for categories of upstream or downstream activities over which it has influence or indirect control, or for which it can quantify emissions with reasonable reliability.”<sup>13</sup> The idea behind Scope 3 reporting is not merely to denote where a company has control of emissions-generating operations but to provide stakeholders with visibility into emissions across the entire value chain. Any rules that allow registrants to disclose only activities over which they have direct control may inadvertently incentivize companies to spin off or transfer emissions-generating activities to their supply chains, obscuring their true climate impacts. In addition, such rules would enable producers of carbon-intensive products—including fossil fuels—to exclude emissions generated by end users.

## Reporting of data

**Use of inline XBRL:** Consistent with our belief that standardized, high-quality data can help investors to better evaluate and compare companies' material risks and opportunities, Ethic agrees with the SEC's assessment that “inline XBRL tagging of the proposed climate-related disclosures would benefit investors by making the disclosures more readily available and easily accessible to investors, market participants, and other users for aggregation, comparison, filtering, and other analysis.”

Inline XBRL allows tags to be embedded directly into an HTML filing, delivering data in a uniform format that is readable by machines and humans alike. The presentation of structured data in this consistent and usable format—including block text tagging and detail tagging of narrative and quantitative disclosures—can make it easier for users to compare a company's data across different time periods and against other companies. This stands to support investor analysis at scale and democratize access to important information.

Currently, the Commission already requires issuers to use inline XBRL for submissions of their financial statement information and risk/return summaries.<sup>14</sup> This requirement was implemented, in part, to improve company data's “usefulness, timeliness, and quality, benefiting investors, other market participants, and other data users.”<sup>15</sup> It seems prudent, then, that climate risk disclosures should be reported in the same format. This stands to not only limit companies'

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<sup>12</sup> <https://www.msci.com/www/blog-posts/which-scope-3-emissions-will/03153333292>

<sup>13</sup> <https://www.federalregister.gov/documents/2022/04/11/2022-06342/the-enhancement-and-standardization-of-climate-related-disclosures-for-investors>

<sup>14</sup> <https://www.sec.gov/rules/final/2018/33-10514.pdf>

<sup>15</sup> <https://www.sec.gov/news/press-release/2018-117>

additional reporting burdens but may also allow for integrated investor analysis of traditional financial information in tandem with climate risks and opportunities.

**Use of custom tags:** In some cases, when there is no appropriate tag in the core reporting taxonomy, companies with particularly complex operations or unique accounting procedures are granted the flexibility to create custom tags or “extensions.” However, these extensions may provide companies with the ability to disassemble and obscure key information, making it challenging for interested parties to compare companies’ data on a like-for-like basis. A separate SEC analysis found that the use of custom tags may reduce the comparability of inter-company data,<sup>16</sup> which could in turn undermine the SEC’s efforts to promote market transparency and efficiency. For the purposes of this rulemaking, therefore, Ethic believes the use of custom tags should be limited to the extent possible.

To that end, the SEC may wish to consider aligning its requirements for climate risk disclosures with the European Single Electronic Format (ESEF) taxonomy, which requires issuers on European Union (EU)-regulated markets to anchor custom tags to a core inline XBRL taxonomy element most closely related in meaning. These technical standards were introduced in large part to address concerns that extensions are not comparable across companies and therefore not easily identified by software.<sup>17</sup> By requiring registrants to anchor their custom tags to a standard element that most closely matches the intended meaning, the SEC can similarly facilitate greater accessibility, analysis and comparability of companies’ annual filings.

## Other things we’d like to see

The SEC’s rulemaking might also wish to consider requiring:

**Disclosure of climate-related lobbying activity**, the outcomes of which could hamper efforts to achieve net-zero emissions by 2050 and thus companies’ abilities to avoid the most catastrophic impacts of climate change. In many instances, there is a vast disconnect between corporations’ public commitments on climate and their lobbyists’ efforts to dismantle or weaken climate policy.<sup>18</sup>

It’s increasingly clear this is an issue that matters to the investment community: institutional investors with a combined \$130 trillion in assets recently joined forces to promote a global standard<sup>19</sup>, albeit voluntary, for companies’ disclosure of climate-related lobbying activity and the degree to which it aligns with the Paris Agreement or the company’s public positions on environmental issues.

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<sup>16</sup> [https://www.sec.gov/structureddata/gaap\\_trends\\_2020](https://www.sec.gov/structureddata/gaap_trends_2020)

<sup>17</sup> [https://www.esma.europa.eu/sites/default/files/library/2016-1668\\_esma\\_feedback\\_statement\\_on\\_the\\_rts\\_on\\_esef\\_0.pdf](https://www.esma.europa.eu/sites/default/files/library/2016-1668_esma_feedback_statement_on_the_rts_on_esef_0.pdf), p.30

<sup>18</sup> <https://influencemap.org/report/Corporate-Climate-Policy-Footprint-2019-the-50-Most-Influential-7d09a06d9c4e602a3d2f5c1ae13301b8>

<sup>19</sup> <https://climate-lobbying.com/about/>



**Disclosure and active management of deforestation risks**, which are increasingly considered financially material by reasonable investors. According to the United Nations' Principles for Responsible Investment (UN PRI), deforestation “drives reputational risks related to consumers and environmental organizations as well as legal risks as new legislation for climate-related financial disclosure is expected.”<sup>20</sup> In 2019, further underscoring the view of deforestation as financially material, some of the world’s largest investment managers and asset owners urged companies to minimize exposure to deforestation in their own operations and throughout their supply chains<sup>21</sup>, citing deforestation and the associated impacts on climate change and biodiversity as “systemic risks” to their portfolios.

Deforestation has been accelerating<sup>22</sup> at an alarming rate, a trend that presents various environmental and social impacts such as biodiversity loss and land use violations. Biodiversity loss and climate change are interdependent and mutually reinforcing—one exacerbates the other, and vice versa.<sup>23</sup>

To that end, while efforts to understand public companies’ greenhouse gas emissions and management of climate-related risks is a critical first step, a more holistic view is required. By considering the significant role of deforestation in accelerating climate change— as a driver of anthropogenic carbon emissions and reduced carbon uptake alike<sup>24</sup>—the SEC currently has an opportunity to provide investors with a clearer picture of public companies’ risks while *also* aligning its rulemaking with regulatory actions coming out of jurisdictions such as the United Kingdom<sup>25</sup> and European Union.<sup>26</sup>

Thank you in advance for reviewing our comments as you consider how best to move forward with this important proposal. We would be glad to respond to any subsequent questions that you may have.

Sincerely,

Doug Scott, CEO

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<sup>20</sup><https://www.unpri.org/sustainable-land-use/deforestation-as-a-systemic-risk-an-opportunity-for-investors-collective-action/7711.article>

<sup>21</sup>[https://d8g8t13e9vf2o.cloudfront.net/Uploads/r/q/s/investorstatementondeforestationandforestfiresintheamazon\\_29\\_oct\\_2019\\_665598.pdf](https://d8g8t13e9vf2o.cloudfront.net/Uploads/r/q/s/investorstatementondeforestationandforestfiresintheamazon_29_oct_2019_665598.pdf)

<sup>22</sup> <https://www.globalforestwatch.org/dashboards/global/>

<sup>23</sup> <https://wedocs.unep.org/xmlui/bitstream/handle/20.500.11822/34948/MPN.pdf>

<sup>24</sup> [https://www.ipcc.ch/site/assets/uploads/2018/02/ipcc\\_wg3\\_ar5\\_chapter11.pdf](https://www.ipcc.ch/site/assets/uploads/2018/02/ipcc_wg3_ar5_chapter11.pdf)

<sup>25</sup> <https://www.gov.uk/government/consultations/tackling-illegal-deforestation-in-uk-supply-chains>

<sup>26</sup> [https://environment.ec.europa.eu/publications/proposal-regulation-deforestation-free-products\\_en](https://environment.ec.europa.eu/publications/proposal-regulation-deforestation-free-products_en)