June 17, 2022

VIA ELECTRONIC SUBMISSION

Attn: Securities and Exchange Commission

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

Subj: Reasoned Explanation for the Proposed Rule

The Institute for Policy Integrity ("Policy Integrity") at New York University School of Law,[1] Environmental Defense Fund ("EDF"), and Professor Madison Condon respectfully submit the following comments to the Securities and Exchange Commission ("SEC" or "the Commission") regarding The Enhancement and Standardization of Climate-Related Disclosures for Investors (File No. S7-10-22) ("Proposed Rule").[2]

Policy Integrity is a non-partisan think tank dedicated to improving the quality of government decisionmaking through advocacy and scholarship in the fields of administrative law, economics, and public policy. One of the world's leading international nonprofit organizations, EDF creates transformational solutions to the most serious environmental problems. To do so, EDF links science, economics, law, and innovative private-sector partnerships. Professor Madison Condon joins these comments in her individual capacity. Professor Condon is an Associate Professor of Law at Boston University School of Law,[3] an Affiliated Scholar at Policy Integrity, and an Affiliate Scholar at the Initiative on Climate Risk and Resilience Law ("ICRRL").[4] Her scholarship focuses on climate change and its relationship to corporate governance, market risk, and financial regulators.

This letter focuses on two aspects of the SEC's justification for the Proposed Rule. First, the letter evaluates the Commission's rationale for using prescriptive—as opposed to principles-based—disclosure requirements for climate-related financial risk. Second, the letter evaluates the Commission's rationale for using various third-party frameworks and definitions to structure

[1] This document does not purport to present the views, if any, of New York University School of Law.

[2] The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21,334 (Apr. 11, 2022) [hereinafter Proposed Rule].

[3] This document does not purport to present the views, if any, of Boston University School of Law.

[4] ICRRL is a joint initiative of Policy Integrity, EDF, Columbia Law School's Sabin Center for Climate Change Law, and Vanderbilt Law School, focused on legal efforts on climate risk and resilience, particularly at the intersection of practice and scholarship. This document does not necessarily represent the views of each ICRRL partner organization. For more information on ICRRL, *see* https://icrrl.org.

and inform the Proposed Rule. On these topics, we make the following observations and recommendations:

- The Commission has provided good and legally sufficient reasons for the Proposed Rule's largely prescriptive approach to climate disclosure. However, the Commission should more thoroughly discuss the relationship between this rulemaking and the Commission's 2020 reforms to Regulation S-K ("2020 Rule"),[5] which shifted to a more principles-based approach for Items 101 and 105. Specifically, the Commission should explain that the Proposed Rule preserves the changes made in the 2020 Rule and is consistent with its underlying reasoning.

- The Commission adequately explains its decision to incorporate into the Proposed Rule elements from the disclosure framework created by the Task Force on Climate-Related Financial Disclosures ("TCFD") and from the Greenhouse Gas Protocol ("GHG Protocol"). However, the Commission could bolster its rationale by explaining that the TCFD framework's widespread adoption makes it *uniquely* suitable for incorporation into the Proposed Rule. Additionally, the Commission could further support its decision to incorporate elements from third-party frameworks by citing to additional precedent.

This group of signatories has submitted three letters in total. The other two focus on the SEC's regulatory precedents and economic analysis for the Proposed Rule.

I. The Commission adequately justifies using prescriptive disclosure requirements for climate-related financial risk but could strengthen the Proposed Rule by more thoroughly discussing its relationship to the 2020 Rule.

The Proposed Rule would require public companies to disclose in their registration statements and periodic reports certain climate-related information, including climate-related financial risks and their effect on the business, greenhouse gas emissions associated with the company, and climate-related financial statement metrics.[6] These disclosure requirements are largely prescriptive in nature.[7] As explained below, the Commission articulates sufficient reasons for using prescriptive requirements for climate-related risk disclosure. However, the Commission should expand its discussion of the relationship between the Proposed Rule and the 2020 Rule. This expanded discussion should explain that the Proposed Rule preserves the principles-based amendments the 2020 Rule made to Regulation S-K and is consistent with the 2020 Rule's underlying reasoning.

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[5] Modernization of Regulation S-K Items 101, 103, and 105, 85 Fed. Reg. 63,726 (Oct. 8, 2020) [hereinafter 2020 Rule].

[6] Proposed Rule, 87 Fed. Reg. at 21,345–46.

[7] *See, e.g.*, *id.* at 21,467 (proposed section 229.1501(a)(1) requiring registrants to "[d]escribe the board of director's [sic] oversight of climate-related risks"); *id.* (proposed section 229.1501(b)(1) requiring registrants to "[d]escribe management's role in assessing and managing climate-related risks"); *id.* at 21,468 (proposed section 229.1503(a) requiring registrants to "[d]escribe any processes the registrant has for identifying, assessing, and managing climate-related risks"); *id.* (proposed section 229.1504(a) requiring a registrant to "[d]isclose [its] GHG emissions . . . for its most recently completed fiscal year, and for the historical fiscal years included in its consolidated financial statements in the filing, to the extent such historical GHG emissions data is reasonably available").

A. The Commission has provided good and legally sufficient reasons for the Proposed Rule's prescriptive approach to climate disclosure.

The SEC has often acknowledged the general tradeoffs between prescriptive disclosure requirements and principles-based requirements, the latter of which allow a company to disclose information based on its own determination of whether that information is material to an understanding of the company's business.[8] In the Proposed Rule, the Commission has articulated several reasons why prescriptive requirements are needed to provide better information for investors regarding climate-related financial risk.

The Commission's reasons for using a prescriptive approach in the Proposed Rule appropriately center on the goals of consistency, comparability, and completeness of information. For example, the Proposed Rule notes that there is currently "considerable variation" in the content and detail of climate-related disclosures, and "significant inconsistency in the depth and specificity of disclosures by registrants across industries and within the same industry."[9] It further notes that while registrants have tended to provide "extensive information" in their sustainability reports and on their websites, their reports and forms filed with the Commission are often much less detailed and frequently contain "boilerplate discussions that provide limited information as to the registrants' assessment of their climate-related risks or their impact on the companies' business."[10] In the Commission's view, the proposed requirements are well suited to address this lack of consistency and completeness.[11] The Commission further notes that the increased consistency, comparability, and reliability expected to result from more prescriptive requirements "could increase confidence in the capital markets and help promote efficient valuation of securities and capital formation."[12] As indicated by the Commission, this conclusion finds ample support in the literature.[13]

With respect to completeness in particular, the Commission rightly explains that collective action problems, agency problems, and uncertain investor responses may incentivize companies to

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[8] *See, e.g.*, 2020 Rule, 85 Fed. Reg. at 63,747–49.

[9] Proposed Rule, 87 Fed. Reg. at 21,339.

[10] *Id.*

[11] *Id.* at 21,340 ("In light of the present and growing significance of climate-related risks to registrants and the inadequacies of current climate disclosures, we are proposing to revise our rules to include climate-related disclosure items and metrics to elicit investment decision-useful information that is necessary or appropriate to protect investors."); *see also id.* ("Having considered the public feedback and the staff's experience with climate-related disclosures, we believe that the current disclosure system is not eliciting consistent, comparable, and reliable information that enables investors both to assess accurately the potential impacts of climate-related risks on the nature of a registrant's business and to gauge how a registrant's board and management are assessing and addressing those impacts.").

[12] *Id.*

[13] *See, e.g.*, *id.* at 21,430 n.855 (citing R. Lambert, C. Leuz & R.E. Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital*, 45 (2) J. OF ACCT. RES. 385–420 (2007)); *see also* G. DeFranco, S.P. Kothari & R. Verdi, *The Benefits of Financial Statement Comparability*, 49 J. ACCT. RES. 895, 895–931 (2011); C. Chen, D. Collins, T. Kravet & R. Mergenthaler, *Financial Statement Comparability and the Efficiency of Acquisition Decisions*, 35 CONTEMP. ACCT. RES. 164–202 (2018).

provide incomplete disclosure under a principles-based framework,[14] particularly in the context of climate-related disclosure.[15] These market failures are further explored in a separate letter by the undersigned organizations and individuals addressing the Proposed Rule's economic analysis.[16] Ultimately, we agree with the Commission that the additional specificity of the Proposed Rule's prescriptive requirements would address these market failures and improve the completeness and reliability of disclosure.[17]

The Commission provides other reasons supporting the proposed requirements that are rooted in reducing costs to registrants and investors. For instance, the Commission observes that the proposed requirements may reduce some of the "existing costs to registrants that have resulted from the inconsistent market response to investor demand for climate-related information."[18] This conclusion is appropriately supported by various stakeholder letters attesting to the increased burden on companies caused by the proliferation of private reporting frameworks that differ substantially from one another.[19]

There are other justifications not mentioned (or not discussed in detail) in the Proposed Rule that would further support adopting a prescriptive approach to climate risk disclosure. For example, the Commission should emphasize in the final rule that prescriptive requirements may reduce costs because they are easier to apply and involve fewer judgments by registrants than principles-based requirements.[20] The Commission should also note that prescriptive requirements can mitigate the enforcement challenges brought on by principles-based requirements.[21] Finally, the Commission can further support the need for the prescriptive climate risk disclosures by referencing some of the many reports that have observed underreporting of climate risk in the absence of prescriptive requirements.[22] These additions would strengthen the already sufficient reasons offered in support of the Proposed Rule's prescriptive requirements.

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[14] Proposed Rule, 87 Fed. Reg. at 21,426–27.

[15] *Id.* at 21,427–28.

[16] *See* Inst. for Pol'y Integrity, Env't Def. Fund & Prof. Madison Condon, Comments on the Economic Analysis of The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21,334 (Apr. 11, 2022), at 4–9 (June 17, 2022).

[17] Proposed Rule, 87 Fed. Reg. at 21,428 ("The proposed rules aim to address these market failures by requiring more specificity around the way registrants disclose climate-related risks and their impacts on business activities and operations in the short, medium, and long-term.").

[18] *Id.* at 21,340.

[19] *Id.* at 21,340 n.53.

[20] *See, e.g.*, 2020 Rule, 85 Fed. Reg. at 63,748 (acknowledging that prescriptive requirements "may be easier to apply and therefore less costly for registrants as they involve fewer judgments than principles-based requirements").

[21] *See, e.g.*, Business and Financial Disclosure Required by Regulation S-K, Concept Release, 81 Fed. Reg. 23,916, 23,927 (Apr. 22, 2016) ("The [2003] study [prepared by SEC staff] noted that principles-only standards may present enforcement difficulties because they are, by their nature, imprecise.").

[22] *See, e.g.*, KPMG, THE TIME HAS COME: THE KPMG SURVEY OF CORPORATE RESPONSIBILITY REPORTING 36 (2020), https://perma.cc/9NFL-8QDK (finding that 56 percent of G250 companies and less than half of N100 companies (*i.e.*, the top 100 countries by revenue in each of the 52 jurisdictions included in KPMG's study) acknowledge the financial risks of climate change in their reporting); SUSTAINABILITY ACCOUNTING STANDARDS BOARD, THE STATE OF DISCLOSURE REPORT 2017: AN ANALYSIS OF THE EFFECTIVENESS OF SUSTAINABILITY

B. The Proposed Rule's prescriptive approach to climate risk disclosure is consistent with—and therefore does not represent a change in policy from—the 2020 Rule.

In 2020, the Commission adopted a number of reforms to Regulation S-K. While these reforms included shifts to a principles-based approach for some longstanding disclosure items, the Proposed Rule's prescriptive approach to climate-related risk disclosure is consistent with the 2020 Rule and the justifications that supported it.

The 2020 Rule sought to "modernize the description of business, legal proceedings, and risk factor disclosures that registrants are required to make pursuant to Regulation S-K."[23] These amendments—consistent with the recommendations of an earlier report by SEC staff regarding Regulation S-K[24]—generally embraced a principles-based approach to disclosure. For example, the 2020 Rule revised Item 101(a) to be "largely principles-based, requiring disclosure of information material to an understanding of the general development of the business."[25] Similarly, the 2020 Rule "[clarified] and expand[ed] the principles-based approach of Item 101(c)," which requires a narrative description of the business done by the registrant.[26] The 2020 Rule also "[r]efine[d] the principles-based approach of Item 105" by requiring disclosure of "the material factors that make an investment in the registrant or offering speculative or risky."[27]

Some of the 2020 Rule's amendments, however, were prescriptive in nature. For instance, the 2020 Rule modified but maintained the "existing quantitative threshold [in Item 103] for disclosure of environmental proceedings to which the government is a party."[28]

While the preamble to the 2020 Rule was largely silent on the subject of climate risk,[29] the rule nevertheless had implications for companies' climate-related disclosure obligations. The 2020 Rule's connection to climate risk stems from preexisting SEC guidance ("2010 Guidance")

DISCLOSURE IN SEC FILINGS 14 (2017), https://perma.cc/F8Q2-RCCX ("Despite this widespread recognition that a company's management . . . of sustainability issues can have material impacts, the quality of corporate disclosures on such topics remains lacking in FY 2016. For example, less than a third (29.5 percent) of available disclosures contained performance metrics, while more than half (50.4 percent) used boilerplate language and an additional 20.1 percent included tailored narrative.").

[23] 2020 Rule, 85 Fed. Reg. at 63,726.

[24] SECS. & EXCH. COMM'N, REPORT ON REVIEW OF DISCLOSURE REQUIREMENTS IN REGULATION S-K 98 (Dec. 2013) [hereinafter S-K STUDY], https://perma.cc/9GCW-ZCN5 ("[A]s a general matter, the staff believes that any recommended revisions [to Regulation S-K] should emphasize a principles-based approach as an overarching component of the disclosure framework . . . *while preserving the benefits of a rules-based system* affording consistency, completeness[,] and comparability of information across registrants." (emphasis added)).

[25] 2020 Rule, 85 Fed. Reg. at 63,728.

[26] *Id.*

[27] *Id.* at 63,728, 63,744.

[28] *Id.* at 63,728; *see also id.* at 63,742 (noting some flexibility in the $300,000 threshold but requiring disclosure, "irrespective of any alternative threshold adopted by the registrant, . . . in all cases for any proceeding when the potential monetary sanctions exceed the lesser of $1 million or one percent of the current assets of the registrant and its subsidiaries on a consolidated basis").

[29] *See* Comm'r Allison Herren Lee, *Regulation S-K and ESG Disclosures: An Unsustainable Silence*, SEC (Aug. 26, 2020) [hereinafter Comm'r Lee, *An Unsustainable Silence*], https://perma.cc/99UW-WRNZ ("We have declined to include even a discussion of climate risk in the [2020 Rule] despite significant comment on this subject.").

advising that Items 101, 103, and 503(c),[30] among others, "may require disclosure regarding the impact of climate change."[31] Specifically, the 2010 Guidance observed that legislation and regulation; international accords; the indirect consequences of regulatory policies and business trends; and the physical impacts of climate change may trigger a registrant's disclosure obligations under these items.[32] Because this guidance remains in effect, registrants are obliged to provide climate risk disclosures pursuant to the revised requirements established by the 2020 Rule, principles-based for Items 101 and 105 and prescriptive for Item 103.

The Proposed Rule's prescriptive requirements are consistent with this regime, for several reasons. First, the Proposed Rule does not amend Items 101 or 105 or otherwise affect their principles-based nature.[33] Indeed, it affirms that those items still oblige a company to disclose climate risks it considers material,[34] and states that the proposed requirements would "augment[] and supplement[]" those disclosures, not supersede them.[35]

Second, while the 2020 Rule embraced principles-based disclosures for certain items within Regulation S-K, the Commission did not—there or elsewhere—announce a policy requiring all of Regulation S-K's disclosure obligations to be principles-based. In fact, the 2020 Rule affirmed the propriety of prescriptive requirements by amending Item 103 to maintain a rules-based approach for determining when disclosure of certain environmental proceedings is required.[36] Item 703 of Regulation S-K is similarly prescriptive, requiring registrants to disclose all repurchases of equity securities by issuers and affiliated purchasers.[37] As the undersigned organizations and individuals detail in a separate letter addressing the Proposed Rule's regulatory precedents, the SEC uses a prescriptive approach for many disclosure requirements that were not

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[30] In 2019, the SEC eliminated Item 503(c), which had required disclosure of significant investment risk factors, and moved that item's reporting obligations to the newly-created Item 105. FAST Act Modernization and Simplification of Regulation S-K, 84 Fed. Reg. 12,674, 12,688 (Apr. 2, 2019).

[31] Commission Guidance Regarding Disclosure Related to Climate Change, 75 Fed. Reg. 6290, 6295 (Feb. 8, 2010) [hereinafter 2010 Climate Disclosure Guidance].

[32] *Id.* at 6295–97.

[33] *See* Proposed Rule, 87 Fed. Reg. at 21,345 ("We are proposing to add a new subpart to Regulation S-K, 17 CFR 229.1500–1507 . . . . We are also proposing to add a new article to Regulation S-X, 17 CFR 210.14–01 and 02.").

[34] *See id.* at 21,413 ("A number of the Commission's existing disclosure requirements may elicit disclosure about climate-related risks; however, many of these requirements are principles-based in nature and thus the nature and extent of the information provided depends to an extent on the judgment of management.").

[35] *Id.* at 21,338; *see also id.* at 21,335 ("We believe that *additional* disclosure requirements may be necessary or appropriate to elicit climate-related disclosures" (emphasis added)).

[36] 2020 Rule, 85 Fed. Reg. at 63,728; *id.* at 63,727 (acknowledging that Regulation S-K's disclosure requirements are "prescriptive in some respects"); *see also* Modernization of Regulation S-K Items 101, 103, and 105, 84 Fed. Reg. 44,358, 44,360 (Aug. 23, 2019) [hereinafter 2019 Proposal] ("[W]e are proposing a more prescriptive approach for Item 103 because that requirement depends less on the specific characteristics of individual registrants.").

[37] *See* 17 C.F.R. § 229.703(b)(1) (requiring disclosure of "all issuer repurchases, including those made pursuant to publicly announced plans or programs and those not made pursuant to publicly announced plans or programs").

disturbed by the 2020 Rule.[38] Thus, new disclosure requirements that take a prescriptive approach are not inconsistent with the 2020 Rule.

Finally, the 2020 Rule took no position on whether climate risk disclosure in particular is best elicited through principles-based or prescriptive requirements. As already noted above, the 2020 Rule *affected* certain preexisting climate-related disclosure obligations under Items 101, 103, and 105.[39] But the Commission's *rationale* for adopting a principles-based approach for Items 101 and 105 was grounded exclusively in non-climate-related matters material to the understanding of a registrant's business and investment risk factors,[40] and the benefits that generally attend more flexible standards.[41] Nowhere did the 2020 Rule address the merits of using principles-based- versus prescriptive requirements to address climate risk. In fact, despite the submission of thousands of comments on the subject, the 2020 Rule contains only two mentions of climate risk.[42] In response to a comment suggesting that the Commission "should specifically direct registrants to discuss how climate change will affect access to raw materials,"[43] the Commission stated only that "[this suggestion] is not consistent with the principles-based nature of Item 101(c), so we are not adopting it."[44] The Commission also rejected a suggestion that it "require registrants with seasonal businesses to discuss the impact of climate change on their businesses"[45] in similarly perfunctory terms, stating only that "we are not adding this additional specificity to avoid undermining the principles-based nature of Item 101(c)."[46] In other words,

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[38] *See* Inst. for Pol'y Integrity & Env't Def. Fund & Prof. Madison Condon, Comments on Regulatory Precedents for The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21,334 (Apr. 11, 2022), at 10–15 (June 17, 2022).

[39] 2010 Climate Disclosure Guidance, 75 Fed. Reg. at 6293–94 (discussing why Items 101, 103, and 503(c) may each require disclosure related to climate change; Item 503(c)'s reporting obligations were subsequently moved to Item 105, *see supra* note 30).

[40] *See, e.g.*, 2020 Rule, 85 Fed. Reg. at 63,733 (revising Item 101(c) to be more clearly principles-based because "some of the prescribed disclosure topics in Item 101(c) are not relevant to all registrants, and these disclosure requirements may elicit disclosure that is not material to a particular registrant"); *id.* at 63,744 (amending Item 105 to be more principles-based to "reduce the disclosure of generic risk factors and potentially shorten the length of the risk factor discussion").

[41] *See, e.g.*, *id.* at 63,747 ("For certain existing disclosure requirements, shifting to a more principles-based approach could benefit registrants with no loss of investor protection because the current requirements may result in some disclosure that is not material to an investment decision and costly for registrants to provide. Elimination of disclosure that is not material could reduce compliance burdens and potentially benefit investors, to the extent it improves the readability and conciseness of the information provided and allows investors to focus on information that is material to an understanding of the registrant's business."); *but see id.* at 63,748 ("On the other hand, shifting to a more principles-based approach may result in the elimination of previously prescriptive disclosure that is material to an investment decision if registrants misjudge what information is material to investors. . . . Further, prescriptive standards could enhance the comparability and verifiability of information, but those benefits may be limited (or impose costs) if the specified metrics result in comparisons that are not appropriate due to differences between or among registrants.").

[42] *See* Comm'r Lee, *An Unsustainable Silence*, *supra* note 29 ("We have declined to include even a discussion of climate risk in the [2020 Rule] despite significant comment on this subject.").

[43] *See* 2020 Rule, 85 Fed. Reg. at 63,734.

[44] *Id.*

[45] *Id.* at 63,736.

[46] *Id.*

the Commission declined to add certain prescriptive, climate-focused disclosure requirements to Item 101(c) merely because a prescriptive requirement was inconsistent with its principles-based vision *for that item*, not because it took a position on whether prescriptive disclosure requirements are generally appropriate for regulating climate-related financial risks.

* * *

In summary, while some climate-related disclosures are already compelled by the principles-based requirements of Items 101 and 105, the Commission has determined that additional climate risk disclosure requirements would be useful to investors.[47] These additional requirements—largely prescriptive in nature—are consistent with the 2020 Rule because they do not amend Item 101 or 105; there is no Commission policy requiring Regulation S-K disclosure obligations to be principles-based; and the 2020 Rule took no position on whether climate risk disclosure is best elicited through principles-based or prescriptive requirements.

The Commission could bolster its already compelling justification for the Proposed Rule by discussing the above points in its final preamble.[48] To the extent that the Commission disagrees with the analysis and conclusions presented above and believes that the Proposed Rule represents a change in policy from the 2020 Rule, it should explicitly say so[49] and communicate its rationale for that change.

II. The Commission's use of third-party frameworks is adequately supported but could be strengthened by citing to additional precedent.

The Proposed Rule is informed by third-party frameworks for climate risk disclosure. Specifically, the proposed requirements incorporate elements of the disclosure framework created by the Task Force on Climate-Related Financial Disclosures ("TCFD").[50] They also incorporate elements of the Greenhouse Gas Protocol ("GHG Protocol"), a widely used accounting and reporting standard for greenhouse gas emissions.[51] The Commission's use of elements of these frameworks is well supported, but would be strengthened by reference to precedents for incorporating private, third-party frameworks into agency rulemakings.

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[47] Proposed Rule, 87 Fed. Reg. at 21,413 ("While these provisions may elicit some useful climate-related disclosure, these provisions have not resulted in the consistent and comparable information about climate-related risks that many investors have stated that they need in order to make informed investment or voting decisions.").

[48] *See id.* at 21,338 n.31 (noting that, "[i]n 2020, the Commission amended [Item 101(c)(1)] to require, to the extent material to an understanding of the business taken as a whole, disclosure of the material effects that compliance with government regulations, including environmental regulations, may have upon the capital expenditures, earnings, and competitive position of the registrant and its subsidiaries").

[49] *See* F.C.C. v. Fox Television Stations, Inc., 556 U.S. 502, 515 (2009) ("[T]he requirement that an agency provide reasoned explanation for its action would ordinarily demand that it display awareness that it *is* changing position. An agency may not, for example, depart from a prior policy *sub silentio* or simply disregard rules that are still on the books." (emphasis in original)).

[50] Proposed Rule, 87 Fed. Reg. at 21,343–44.

[51] *Id.* at 21,344–45.

A. The Commission has adequately supported its decision to incorporate elements from third-party frameworks.

It is well established that a federal agency may incorporate even the active input of outside actors into its decisionmaking, so long as the agency "makes the final decisions itself."[52] Here, the Commission has merely analyzed existing frameworks developed by third parties and incorporated suitable elements into the Proposed Rule. Such action is reasonable provided that the Commission has "articulate[d] a satisfactory explanation for its action including a rational connection between the facts found and the choice made,"[53] as it has here.

1. TCFD framework

The Commission has provided a reasoned explanation for modeling the Proposed Rule after the TCFD disclosure framework. First, the SEC offers the overarching reason that the TCFD framework is "globally recognized" and "widely used by companies in the United States and around the world."[54] The Commission explains that this broad-based acceptance should limit the overall compliance burden associated with the Proposed Rule, since so many companies in the United States are already making disclosures pursuant to this framework.[55] The Commission also states that basing the Proposed Rule on the globally recognized TCFD framework should increase the consistency and comparability of disclosures.[56]

While both of these rationales appear in the Proposed Rule, the Commission's discussion of each would benefit from further elaboration. Specifically, the SEC should better explain why the TCFD framework is superior on these two points *relative to other disclosure frameworks the Commission might have chosen*. The answer lies not in the mere fact that the TCFD framework

[52] U.S. Telecom Ass'n v. F.C.C., 359 F.3d 554, 568 (D.C. Cir. 2004) ("[A] federal agency may turn to an outside entity for advice and policy recommendations, provided the agency makes the final decisions itself."); *see also* Bellion Spirits, LLC v. United States, 393 F. Supp. 3d 5, 15 (D.D.C. 2019) (quoting *U.S. Telecom Ass'n*., 359 F.3d at 568), *aff'd*, 7 F.4th 1201 (D.C. Cir. 2021).

[53] Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983) (internal quotation marks omitted).

[54] Proposed Rule, 87 Fed. Reg. at 21,347–48. The SEC notes that more than 2,600 organizations globally—with a total market capitalization of $25 trillion—have signaled their support for the framework. *Id.* at 21,344; *see also id.* at 21,415 (discussing the formal adoption of TCFD standards by eight jurisdictions, including Brazil, the European Union, Hong Kong, Japan, New Zealand, Switzerland, and the United Kingdom); *id.* at 21,422–23 (noting that 30% of Russell 1000 reporting companies either mention or align with TCFD recommendations).

[55] *Id.* at 21,347. The Proposed Rule discusses the TCFD framework within the context of the potential costs of implementing the disclosure requirements. The Commission notes that "third-party cost estimates of preparing TCFD reports . . . can offer a rough approximation of potential compliance costs due to their similarity with the proposed rule." *Id.* at 21,439. For example, a commenter estimated that the cost for companies with no prior experience in implementing climate-related disclosure would face a cost of $150,000 to $200,000 to prepare TCFD-aligned disclosures. *Id.* at 21,440. However, firms that have already established in-house climate related disclosure systems can easily be leveraged to comply with any new disclosure rule, indicating that "anticipated incremental costs of a mandatory climate disclosure rule are therefore expected to be minimal." *Id.*

[56] *Id.* at 21,347 ("Basing the Commission's climate-related disclosure rules on a globally recognized framework should help elicit climate-related disclosures that are consistent, comparable, and reliable while also limiting the compliance burden for registrants that are already providing climate-related disclosures based on this framework.").

is "widely used,"[57] but that it is more widely used than other existing frameworks.[58] Thus, with respect to limiting overall compliance costs, the Commission should explain that modeling the Proposed Rule on the TCFD framework *better* achieves this end because U.S. companies are already using this framework more than others.

Similarly, the Commission should better articulate that, because foreign companies use the TCFD framework more than other frameworks,[59] basing the Proposed Rule on this framework best facilitates consistency and comparability as between U.S. and foreign companies.[60] A TCFD-like framework is therefore likely to be the best option for lowering the cost of capital for U.S. companies by eliminating investor uncertainty regarding the climate-related risks of U.S. companies relative to foreign competitors.[61]

Second, the Proposed Rule justifies incorporating elements of the TCFD framework by discussing the merits of each component requirement. With respect to the proposed governance disclosures, for example, the Commission states that this information is "necessary to aid investors in evaluating the extent to which a registrant is adequately addressing the material climate-related risks it faces, and whether those risks could reasonably affect the value of their investment."[62] With respect to disclosure of climate-related risks, the Commission observes that "climate events and contingencies can pose financial risks to issuers across industrial sectors."[63] The Commission reasons that "disclosure about a registrant's exposure to transition risks, as well as how the registrant is assessing and managing those risks, would help investors assess and plan for how the registrant would be financially impacted by a transition to a lower-carbon economy."[64] And with respect to disclosure of GHG metrics, the Commission explains that, among other things, GHG emissions data is "useful in conducting a transition risk analysis" because it is "quantifiable and comparable across industries," and "may be relevant to investment

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[57] Proposed Rule, 87 Fed. Reg. at 21,347.

[58] *See* TASK FORCE ON CLIMATE-RELATED DISCLOSURES, 2021 STATUS REPORT 2 (Oct. 2021), https://perma.cc/W5ER-EYHH ("As of October 6, 2021, the Task Force had over 2,600 supporters globally, including 1,069 financial institutions, responsible for assets of $194 trillion. TCFD supporters now span 89 countries and jurisdictions and nearly all sectors of the economy, with a combined market capitalization of over $25 trillion—a 99% increase since last year.").

[59] *See id.*

[60] As presently articulated, the Commission's justification on this point could be read to state that the TCFD framework would increase consistency and comparability *among U.S. companies*. But presumably any prescriptive disclosure regime established by the Commission would achieve this goal, since all companies in the United States would be required to make their disclosures pursuant to that regime. Thus, it is imperative that the Commission specify that modeling the Proposed Rule on the TCFD framework will increase consistency and comparability among U.S. on the one hand and foreign companies on the other.

[61] Proposed Rule, 87 Fed. Reg. at 21,446–47 ("Failure to implement the proposed rules could lead to an informational gap between U.S. registrants and companies operating in foreign jurisdictions which require climate-related disclosures. For example, such a gap may increase investors' uncertainty when assessing climate-related risks of U.S. registrants vis-á-vis foreign competitors and place U.S. registrants at a competitive disadvantage, with the potential to deter investments and hence increase U.S. registrants' cost of capital.").

[62] *Id.* at 21,359.

[63] *Id.* at 21,349.

[64] *Id.*

or voting decisions because GHG emissions could impact the company's access to financing, as well as its ability to reduce its carbon footprint in the face of regulatory, policy, and market constraints."[65]

The Proposed Rule also draws from the TCFD in requiring disclosure of climate-related targets and goals.[66] The Commission states that this information "could help investors better understand the scope of a registrant's climate-related targets or goals, including those related to GHG emissions, and assist in assessing progress toward achieving those targets or goals."[67] As noted by the Commission, two-thirds of S&P 500 companies previously set carbon reduction targets for 2020.[68] Despite these commitments, however, many companies do not provide investors with information to understand how the company intends to actualize these commitments or the progress toward them.[69] The climate-related targets and goals requirements are therefore intended to provide "insight into the scope and specifics of a registrant's climate-related targets or goals."[70]

By explaining its rationale for the parts of Proposed Rule that are modeled after a component of the TCFD framework—in addition to the overarching reasons discussed above—the Commission has adequately justified its reliance on the TCFD framework.

2. GHG Protocol

The SEC provides a similarly compelling explanation for incorporating elements of the GHG Protocol, which the Commission notes "has become the leading accounting and reporting standard for greenhouse gas emissions."[71]

The Proposed Rule borrows the GHG Protocol's concept of dividing GHG emissions into three "scopes," which helps to determine those emissions that are directly attributable to the reporting entity.[72] The Commission explains that, because this concept is already so widely employed, the Proposed Rule minimizes compliance costs with the emissions reporting requirements,

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

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

[67] *Id*. at 21,405.

[68] *Id*. at 21,405–06.

[69] *Id*. at 21,406.

[70] *Id.*; *see also, e.g.*, *id.* at 21,406–07 (noting that some commenters suggested that disclosure about the nature of a purchased carbon offset could also help to mitigate instances of greenwashing); *id.* at 21,406 ("A reasonable investor could well assess differently the effectiveness and value to a registrant of the use of carbon offsets where the underlying projects resulted in authenticated reductions in GHG emissions compared to the use of offsets where the underlying projects resulted in the avoidance, but not the reduction, in GHG emissions or otherwise lacked verification.").

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

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

"especially for those registrants that are already disclosing or estimating their GHG emissions pursuant to the GHG Protocol."[73]

With respect to Scope 1 and 2 emissions specifically, the Commission notes that these data "should be reasonably available to registrants, and the relevant methodologies are fairly well-developed."[74] In particular, EPA provides "detailed" methodologies and guidance for calculating Scope 1 and 2 emissions for companies in certain industries.[75] The Commission also explains that many investors find this information useful in conducting transition risk analysis and, ultimately, making investment and voting decisions.[76]

With respect to Scope 3 emissions, the Commission explains why this information might be "necessary to present investors a complete picture of the climate-related risks . . . that a registrant faces."[77] While the GHG emissions from sources within a company's value chain may affect the company's operations and financial performance, these emissions are not included its Scope 1 and Scope 2 emissions.[78] The absence of Scope 3 emissions data may therefore obscure a company's transition risks.[79] By requiring the reporting of Scope 3 emissions data, the Proposed Rule helps to ensure that investors have a more robust understanding of the total emissions associated with a company's operations.

The transition risks companies face are indeed a strong justification for incorporating the GHG Protocol's concept of scopes. Net zero emissions goals are proliferating, being adopted in some form or another by U.S. states and countries around the world.[80] U.S. cities and municipalities are considering laws limiting emissions from buildings, cars, and other sources.[81] The likelihood of a successful lawsuit against emitting companies is therefore rising, both in the U.S. and abroad. The Proposed Rule requires companies to disclose their footprint emissions by scope, and then by subcategory. So, within Scope 3, for example, emissions from employee commutes are reported separately from the embodied emissions that went into producing raw input materials. In this way, investors are able to distinguish different types of transition risk, or design investment, engagement, or hedging strategies around different types of transition risk exposure.

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[73] *Id.* at 21,345; *see also id.* at 21,374 ("By sharing certain basic concepts and a common vocabulary with the GHG Protocol, the proposed rule should help limit the compliance burden for those registrants that are already disclosing their GHG emissions pursuant to the GHG Protocol.").

[74] *Id.* at 21,377.

[75] *Id.*

[76] *Id.* at 21,376.

[77] *Id.* at 21,377.

[78] *Id.*

[79] *Id.* at 21,381 ("It also has been widely recognized that, for some companies, disclosure of just Scopes 1 and 2 emissions could convey an incomplete, and potentially misleading, picture.").

[80] *See* United Nations, *For a Livable Climate: Net-Zero Commitments Must Be Backed by Credible Action* (last visited June 16, 2022), https://perma.cc/U8V8-ASGZ ("More than 70 countries, including the biggest polluters—China, the United States, and the European Union—have set a net-zero target, covering about 76% of global emissions.").

[81] *See, e.g.*, 2019 N.Y.C. Local Law No. 97, https://perma.cc/J2EK-RNEA (establishing a schedule for decarbonization of buildings in New York City).

Without the aid of these consistent subcategories, investors would not be able to monitor corporate risk management strategies over time or compare the resilience of peer corporations' supply chains to transition risk.

The Proposed Rule has other elements in common with the GHG Protocol. For instance, companies would be required "to express each scope of its GHG emissions in terms of carbon dioxide equivalent."[82] The Commission's rationale for adopting this concept is that "[r]equiring a standard unit of measurement for GHG emissions, rather than different units of measurement for the different greenhouse gases, should simplify the disclosure for investors and enhance its comparability across registrants with different types of GHG emissions."[83] Similarly, in addition to aggregating total emissions by scope, the Proposed Rule requires companies to disaggregate their GHG emissions within each scope by the constituent greenhouse gases.[84] The Commission observes that this requirement could help investors understand "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."[85] If, for example, a government regulator aims to reduce emissions of a particular pollutant, "knowing that a registrant has significant emissions of such gas would provide insight into potential impacts on the registrant's business."[86] These reasons adequately support the Proposed Rule's use of various GHG Protocol elements.

B. *The Commission's use of the TCFD framework and GHG Protocol is consistent with its historical practice of incorporating third-party frameworks and concepts.*

The Commission's decision to incorporate third-party and external agency definitions and frameworks into the Proposed Rule has ample precedent. For example, while the SEC has statutory authority to set accounting standards, it has looked to the private sector for establishing and improving those standards.[87] More specifically, the SEC has historically used Generally Accepted Accounting Principles ("GAAP"), which are developed by the Financial Accounting Standards Board.[88] In 2018, the SEC adopted a rule to amend disclosure requirements "that ha[d] become redundant, duplicative, overlapping, outdated, or superseded, in light of other Commission disclosure requirements, [U.S. GAAP], or changes in the information

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[82] Proposed Rule, 87 Fed. Reg. at 21,375.

[83] *Id.*

[84] *Id.*

[85] *Id.*

[86] *Id.*

[87] *Are Current Financial Accounting Standards Protecting Investors?, Before H. Subcomm. on Commerce, Trade and Consumer Protection* 107th Cong. 11-15 (2002) (testimony of Robert K. Herdman, Chief Accountant, U.S. Securities and Exchange Commission).

[88] GAAP is a comprehensive set of accounting practices that were developed jointly by the Financial Accounting Standards Board and the Governmental Accounting Standards Board. *GAAP*, CORP. FIN. INST. (last visited June 16, 2022), https://perma.cc/BBT9-XD6U. Federal securities statutes direct the SEC to establish accounting requirements, but do not require use of GAAP. Rather, GAAP are embodied in public law by SEC regulation, policy, and enforcement actions. *See* Lawrence A. Cunningham, *Private Standards in Public Law: Copyright, Lawmaking and the Case of Accounting*, 104 MICH. L. REV. 291, 292 n.3 (2005).

environment."[89] Among other things, the Commission "eliminat[ed] certain of [its] disclosure requirements . . . on the basis that U.S. GAAP requires the same or similar disclosures."[90]

Another SEC rule proposed in March of this year would similarly incorporate GAAP. The proposal seeks to enhance disclosure and investor protection in initial public offerings by special purpose acquisition companies and in business combination transactions involving shell companies.[91] Under this proposal, "a presentation of projections that includes a non-GAAP financial measure should include a clear definition or explanation of the measure, a description of the GAAP financial measure to which it is most closely related, and an explanation of why the non-GAAP financial measure was used instead of a GAAP measure."[92] This proposal further demonstrates SEC's consistent use of GAAP—a framework developed external to the agency—in various contexts and the value a consistent metric provides regulators.

The Commission has incorporated third-party frameworks in other contexts as well. In 2018, the SEC finalized a rule to modernize property disclosures required for mining registrants.[93] The proposed rule had "in several respects" already been aligned with the standards used by the Committee for Mineral Reserves International Reporting Standards ("CRIRSCO").[94] For instance, the Commission had "proposed to use the CRIRSCO standards' classification scheme regarding mineral resources and reserves, and proposed substantially similar definitions of many of the technical terms used under the CRIRSCO-based codes."[95] Nonetheless, the agency indicated that the final rule differed from the proposed rule in order to "*more* closely align the Commission's mining property disclosure requirements with the CRIRSCO standards and thereby help decrease, relative to the proposed rules, the compliance burden and costs for the many registrants that are subject to one or more of the CRIRSCO-based codes, while preserving important investor protections."[96]

Finally, since 1975, the SEC has used the credit ratings provided by nationally recognized statistical rating organizations ("NRSROs"), which can be used to satisfy regulatory requirements like how much capital to hold against certain assets.[97] The SEC has long recognized the extensive use of NRSROs in its rulemakings, considering it "an important component of the Commission's regulatory program."[98] It was not until the Credit Rating

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[89] Disclosure Update and Simplification, 83 Fed. Reg. 50,148 (Oct. 4, 2018).

[90] *Id.* at 50,154–55.

[91] Special Purpose Acquisition Companies, Shell Companies, and Projections, 87 Fed. Reg. 29,458 (May 13, 2022).

[92] *Id*. at 29,495.

[93] Modernization of Property Disclosures for Mining Registrants, 83 Fed. Reg. 66,344 (Dec. 26, 2018).

[94] *Id.* at 66,345.

[95] *Id.* at 66,346.

[96] *Id.* (emphasis added).

[97] Alice M. Rivlin and John B. Soroushian, *Credit Rating Agency Reform Is Incomplete*, BROOKINGS INST. (Mar. 6, 2017), https://perma.cc/8GZW-KYGZ.

[98] Nationally Recognized Statistical Rating Organizations, 59 Fed. Reg. 48,314, 48,314–15 (Sept. 7, 1994) (detailing the expansive use of NRSROs and their use in various SEC rules). For example, the SEC noted that Rule 10b-6 under the Exchange Act, which prohibits persons participating in a distribution of securities from artificially conditioning the market for securities to facilitate the distribution, employs an NRSRO concept. *Id*.

Agency Reform Act of 2006 that Congress expressly authorized the Commission to establish a voluntary registration and oversight program for rating agencies.[99] Congressional focus on NRSROs was particularly strong during the 2008 financial crisis and, since the passage of the Dodd-Frank Act, the SEC has worked to develop standards to govern how NRSROs operate considering their extensive use in financial regulation.[100] In discussing the importance of NRSROs, the SEC has emphasized the systematic importance of these credit ratings and the reliance placed on these ratings by investors and financial regulators alike, making the credit ratings a matter of "national importance."[101] This long-standing relationship between the SEC and NRSROs provides further evidence that the SEC has traditionally drawn upon external third parties.

The Commission's use of the TCFD framework and GHG Protocol is consistent with these precedents.

Respectfully,

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[99] Jessica Kane, *The SEC's Office of Credit Ratings and NRSRO Regulation: Past, Present, and Future*, SEC (Feb. 24, 2020), https://perma.cc/D768-BDET.

[100] *See, e.g.*, Nationally Recognized Statistical Rating Organizations, 70 Fed. Reg. 55,078 (Sept. 15, 2014) (to be codified at 7 C.F.R. §§ 232, 240, 249).

[101] *Id.* at 55,080.