November 1, 2022

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

**Supplemental Comments by the Sierra Club on Proposed Climate Risk Disclosure Rule and ESG Disclosure Rule (File Nos. S7-10-22 and S7-17-22)**

The Sierra Club appreciates the opportunity to submit these supplemental comments on the Securities & Exchange Commission's proposed climate risk disclosure rule and proposed ESG disclosure rule.[1] Our purpose is to highlight recent developments that strengthen the case for comprehensive GHG emissions disclosure requirements in both rules.

The global transition from carbon-intensive sources of energy to zero-carbon and low-carbon sources, arguably the largest capital reallocation in world history, will soon reach a key milestone. In its October 2022 annual World Energy Outlook, the International Energy Agency anticipates that global GHG emissions from energy will peak *in 2025*, thanks to massively increased government spending on clean energy technologies in response to Russia's invasion of Ukraine. Just a month earlier, Credit Suisse pointed to the Inflation Reduction Act as one of the key drivers of the accelerated transition away from carbon-intensive energy sources, concluding that the IRA "will have a profound effect across industries in the next decade and beyond" and could ultimately shape the direction of the American economy.

[1] Sierra Club's initial comments on the climate risk disclosure rule were submitted on June 16, 2022; our comments on the ESG disclosure rule were submitted on August 16, 2022.

Major questions remain about whether reductions in global GHG emissions will take place at a pace sufficient to avoid the irreversible tipping points that threaten to destabilize the financial system. However, there is no doubt that investors face enormous challenges navigating through the energy transition. Comprehensive GHG emissions disclosures from public companies will be essential to help investors assess such companies' exposure to the financial impacts of the energy transition and to enable them to allocate capital according to their risk-return preferences.

*Investors need protection from concealment of climate risk by companies unprepared for the transition and making emissions reduction pledges unsupported by financial statements*

Without standardized climate disclosure requirements encompassing all GHG emissions, investors face a significant risk that registrants will not adequately inform them about the climate-related financial risk they are facing. An October 2022 Carbon Tracker Initiative study of climate risk disclosure, Still Flying Blind - The Absence of Climate Risk in Financial Reporting, highlights the major problems arising under today's sustainability disclosure regime, which combines voluntary reporting and poorly-enforced regulatory requirements. It reviews the 2021 financial statements of 134 multinational companies responsible for roughly 80% of corporate industrial GHG emissions - those facing the greatest transition risk - and finds that 98% did not provide sufficient evidence that they considered the material impacts of the energy transition and other climate-related matters when preparing their financial statements, despite regulatory requirements to do so.

Many of the companies in the *Still Flying Blind* study made net-zero or similar emissions reduction pledges in their annual reports and other corporate communications. Yet researchers were unable to find consistency between those communications and the financial statements. For example, only three companies provided sensitivities of their productive asset values to net-zero scenarios; similarly, financial statements did not appear to be using assumptions and estimates, such as estimated lives of productive assets or projected commodity prices, that would reflect the net-zero pledges. The study finds that such inconsistencies, which were greater in U.S. disclosures than in non-U.S. disclosures, may represent evidence of greenwashing.

Comments submitted in response to the Commission's proposed climate risk disclosure rule show that investors almost uniformly believe that they need Scope 3 emission disclosures to evaluate transition risk. In an October 2022 review of comments on the proposed climate risk rule, Ceres finds that 97% of institutional investors support the SEC's proposed Scope 3 disclosures, roughly the same level of support as for Scope 1 and 2 disclosures (99%).

Investors have been calling for improved GHG emissions disclosure from public companies in proxy votes as well, supporting a range of shareholder resolutions that would either directly encourage companies to disclose emissions or indirectly encourage such disclosure through establishment of emissions reduction targets or transition plans (which imply the need for emissions disclosures to track progress). According to a Sustainable Investments Institute analysis prepared for its subscribers, during the 2020-22 proxy seasons, investor votes on proposals to strengthen emissions disclosures and related proposals received the following levels of support:

- Adopt GHG emissions reduction targets: 43.6%
- Adopt net-zero GHG emissions reduction targets: 68.5%
- Adopt Scope 3 targets and/or reduce Scope 3 emissions: 34.8%
- Report on net-zero GHG emissions reduction targets: 57.2%
- Adopt Paris-compliant strategy to cut GHG emissions: 26.4%
- Report on GHG emissions targets: 69.9%
- Report on methane emissions/reduction targets: 98.0%

This three-year record of voting behavior shows intense interest among shareholders in obtaining GHG emissions information. Failure by companies to provide such information has spurred large numbers to cast their votes for greater disclosure.

*Limiting mandated emissions disclosures to Scopes 1 and 2 would exacerbate the problem of undisclosed outsourced emissions*

Some commenters have suggested that to address this transparency problem, the Commission should require Scope 1 and 2 emissions disclosures but not Scope 3 disclosures. This argument ignores the problem of outsourced GHG emissions, in which companies assign responsibilities for carbon-intensive operations to third parties that act largely outside of regulatory scrutiny. In "Outsourcing Climate Change" (January 2022), Dai et al. find that "U.S. firms outsource part of their pollution to global suppliers to evade their emissions responsibilities" and such emissions outsourcing "appears to be a substitute for pollution abatement and innovation in green technology." According to the authors, if forward-looking investors had information about these practices, they would likely respond by "seek[ing] compensation for holding stocks of carbon outsourcers associated with more substantial carbon risks." The authors do not address investors *lacking* information about outsourced emissions, but the implication is that the companies failing to disclose this information would incur a lower cost of capital, at the expense of those investors.

The Commission proposes to require disclosures about recent shifts of operations that result in Scope 1 emissions being recategorized as Scope 3 emissions. However, the substantial financial incentive for misleading investors about Scope 3 emissions (the savings both from avoiding regulatory scrutiny of emissions and from paying the full climate risk-adjusted cost of capital) could motivate registrants to take steps to evade this requirement. In any case, such a brief and time-limited disclosure would not provide the comprehensive GHG emissions picture that investors need. The common practice of outsourcing emissions, with poor transparency for investors, is yet another justification for the SEC to create a mandatory and comprehensive GHG emissions disclosure regime.

*Investors need mandatory Scope 3 disclosures to evaluate and compare companies' management of transition risk*

*Financial institutions*

Concerns about GHG emissions and transition risks faced by carbon-intensive industries are not limited to institutional investors. Policies and pledges to restrict financing for the oil and gas and coal industries have been adopted by ever-increasing numbers of banks and insurers. In just the past two months, financial industry leaders such as Deutsche Bank and Munich Re have adopted oil and gas financing restrictions and the Royal Bank of Canada has adopted coal financing restrictions.

Moreover, Scope 3 disclosures of financed emissions should not be left to the discretion of financial institutions making their own judgments about materiality to investors**.** Financed emissions represent 700 times the operational emissions of companies in the financial industry. Industry leaders, working through the Partnership for Carbon Accounting Financials have shown that disclosure of these Scope 3 emissions is very feasible, despite concerns about data quality and availability, using reasonable estimates and disclosures of data quality scores. Disclosures of these emissions is essential for protecting investors from hidden transition risk, meeting their own commitments as well as their fiduciary responsibilities.

*Manufacturers*

The manufacturing industry is another one in which key actors are increasingly taking action on transition risk. New incentives for clean energy and construction materials such as those provided by the Inflation Reduction Act provide a competitive advantage for companies prepared to reduce GHG emissions in their manufacturing supply chains and represent significant financial risks for less-prepared competitors. The Inflation Reduction Act alone provides $50 billion in tax credits, grants and loans for clean manufacturing, including: wind, solar and battery manufacturing (s. 13502), electric vehicle manufacturing (s. 50142 and 50143), clean hydrogen production (s. 13204), advanced energy technology manufacturing (s. 13501), industrial emissions reduction (s. 50161), and low-carbon construction materials (s. 60112, 60116, 60503, 60504, 60506,. 70006). These federal incentives are expected to spur sizable investments of private capital. In just the first few months following the IRA's enactment, $28 billion in investments in U.S. clean energy manufacturing have been announced. Credit Suisse anticipates that "with subsidized green financing and the multiplier effect on federal grants/loans [from the

Inflation Reduction Act], the total public plus private financing could reach ~$1.7 trillion over ten years."

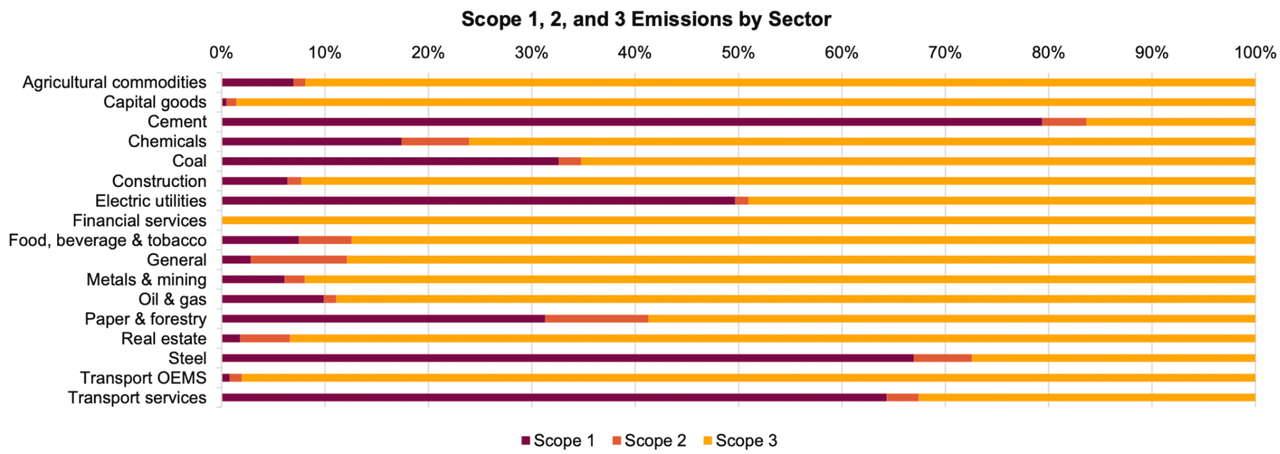
Some of the IRA's financial incentives, such as those offered for manufacturing of hydrogen and construction materials, are available only to those that can demonstrate a low carbon footprint. Companies that can compete on reducing Scope 3 emissions will therefore have a tremendous advantage in obtaining these incentives. Investors have a critical need for Scope 3 emissions disclosures to evaluate companies' preparedness for this new policy landscape and to make comparisons among companies feasible.

A similar imperative to GHG emissions in the manufacturing supply chain is provided by the EU's Carbon Border Adjustment Mechanism (CBAM), which imposes a carbon price on imports of products from the cement, aluminum, fertilizer, electricity, and iron and steel sectors based on their carbon intensity. Scope 3 disclosures will be essential to enable investors to evaluate which companies are minimizing CBAM-related risks by lining up low-emissions suppliers in the cement, aluminum, fertilizer, electricity, and iron/steel sectors.

With virtually every automobile manufacturer rapidly shifting its focus away from internal combustion engines to building electric vehicles in response to EV incentives from Congress and EV mandates from the European Union and beyond, some are now preparing for CBAM and related regulations that reward GHG reductions in the EV supply chain. For example, in October 2022, Ford announced a tentative agreement with Tata Steel in which Tata committed to provide fossil fuel-free steel for Ford's electric vehicles beginning in 2030. According to Ford, "improvements within our supply chain are key, and with the use of carbon neutral steel we will take a major step towards lowering the CO2 footprint of our vehicles." Investors need greater visibility into all manufacturers' Scope 3 emissions to evaluate their ability to compete with companies in their sectors that will be winning market share based on their reduction of these emissions.

*Other Sectors*

The investor need for Scope 3 disclosures extends far beyond the financial and manufacturing industries, of course. In an April 2022 technical note, CDP measured Scope 3 emissions' percentage of overall emissions in sectors with a high impact on the energy transition and produced the following table:




As this table shows, Scope 3 emissions represent the majority of emissions in many carbon-intensive sectors. Some companies are implementing forward-looking strategies to decarbonize operations and reduce transition risk, while others are unable or unwilling to prepare for the transition. Investors need Scope 3 emissions disclosures to help evaluate and compare performance on this critical measure of financial health.

*Requiring comprehensive emissions disclosures would contribute to the goal of harmonizing U.S. disclosure standards with standards in other jurisdictions*

In October 2022, the International Sustainability Standards Board (ISSB), established in 2021 to respond to investor demand for high-quality, globally-comparable sustainability information, announced that it had tentatively agreed that Scope 3 disclosures would be required under its climate risk disclosure standard, due to be finalized in early 2023. It identified the remaining Scope 3-related question - how to address issuer concerns about data quality and availability - and suggested that delayed implementation, relief for smaller reporting companies and a safe harbor from liability were under consideration.[2] Given that the ISSB climate risk disclosure standard will likely become mandatory in large parts of the world after it is finalized by the ISSB and reviewed by financial regulators, the Commission should take note of this important progress on Scope 3 emissions disclosure. By requiring Scope 3 emissions disclosures, the Commission would greatly assist both investors and issuers with harmonizing disclosures to the Commission with those that will soon be made to other regulators. For companies, such harmonization would reduce the global costs of disclosure. For investors, it would greatly simplify evaluation and comparison of companies.

[2] An ISSB staff analysis of comments received on the draft climate risk standard shows strong investor support for Scope 3 disclosures and provides important insights on how issuer concerns about data quality and availability could be addressed.

In September 2022, Morningstar released an analysis of twenty asset manager and institutional investor comments on the draft ISSB proposals and found that investors were nearly unanimous in supporting mandatory Scopes 1 and 2 disclosures, while views were mixed on Scope 3 disclosures. No investor questioned the importance of comprehensive emissions disclosures for investors to evaluate transition risk. Nearly half expressed the view that such disclosures are necessary for investors to develop a full picture of transition risk exposure and to evaluate investment risks and opportunities. Others focused on the problems of data quality and availability, arguing for reporting companies to be allowed to selectively disclose based on a materiality assessment or proposing delayed implementation.

Meanwhile, financial regulators appear to be moving forward with mandatory Scope 3 disclosures. In August 2022, the European Financial Reporting Advisory Group (EFRAG) concluded its consultation on a host of proposed sustainability reporting standards called for by the EU's Corporate Sustainability Reporting Directive, including a proposal to require Scope 3 emissions disclosures. Similarly, in June 2022, the UK government completed its consultation on a climate risk disclosure requirement, part of its Greening Finance Strategy, inviting comments on incorporation of Scope 3 emissions disclosures. Both the EU and UK are expected to finalize their standards, with some version of a Scope 3 disclosure mandate, in the next several months.

These regulatory initiatives are moving forward because private sector leaders have demonstrated the feasibility of Scope 3 disclosures, despite data quality and availability challenges, over the course of two decades of voluntary emissions disclosures. Voluntary Scope 3 emissions disclosures have gained momentum in recent years. A June 2022 white paper from World Resources Institute and Concordia University finds that the number of companies reporting Scope 3 emissions in the public CDP dataset increased from 936 companies in 2010 to 3,317 companies in 2021. In most industry sectors, two-thirds of companies or more reported Scope 3 emissions in 2021; the highest percentage was in the power generation sector, where 84% of companies voluntarily reported Scope 3 emissions. This experience shows that Scope 3 disclosures are already viable. Moreover, the rate of learning is inevitably accelerating now that the number of Scope 3 practitioners has scaled. This learning - including how to make reasonable estimates where high-quality data are unavailable - will greatly accelerate once the SEC sets a deadline for mandatory disclosures and once registrants and data analytics advisors begin preparing for the new era.

The Commission should issue a final climate risk rule with mandatory Scope 3 emissions disclosure. By aligning with other standard-setters and building on private sector experience with Scope 3 disclosures, it will reduce global compliance costs of multinational companies while simplifying the work of investors in evaluating and comparing those companies.

Thank you for your consideration of these comments.

Sincerely,

Ben Cushing, Sierra Club Campaign Manager, Fossil-Free Finance

Jessye Waxman, Sierra Club Senior Campaign Representative, Fossil-Free Finance

John Kostyack, Sierra Club Consultant