

Acting Chair Commissioner Lee: Consultation on Climate Change Disclosures

April 2021

Cardano Risk Management Limited (“Cardano” or “we”) response to Acting U.S. Securities and Exchange Commission (“SEC” or “Commission”) Chair Commissioner Lee’s Consultation on Climate Change Disclosures posted on March 15, 2021.

Founded in 2000, the Cardano Group is a privately-owned, purpose-built risk and investment specialist. We are widely recognised as a market leader in the provision of specialised services to private-sector and collective pension schemes in the United Kingdom and the Netherlands. Our c. 350 professionals strive to deliver better and more secure financial outcomes: stability in an uncertain world.

For Cardano, sustainability areas of particular focus are:

- The climate crisis, including net zero carbon emissions by 2050, with ambitious interim targets
- Fairer society, including respect and support for human rights and to fight against human rights abuses
- Sustainable development in emerging markets

While Cardano is a UK and European-based investor, we invest globally, including many US-domiciled funds. We see climate change as a global challenge, which is why we have interest in the SEC’s approach to climate change disclosure. We will find it increasingly hard to invest in US-domiciled funds, where sustainability-related disclosures, and in particular, climate change disclosures, fall behind that of UK and European standards.

We have grouped questions to avoid repetition. We understand our response will be public. We would be happy to contribute further evidence and recommendations to support the Commission’s approach to climate change and ESG-related disclosures. Response submitted on 19 April 2021.

For questions or comment, email Will Martindale, Group Head of Sustainability at:

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Question 1: How can the Commission best regulate, monitor, review, and guide climate change disclosures in order to provide more consistent, comparable, and reliable information for investors while also providing greater clarity to registrants as to what is expected of them? Where and how should such disclosures be provided? Should any such disclosures be included in annual reports, other periodic filings, or otherwise be furnished?

We believe that the SEC should mandate climate change disclosures consistent with the recommendations of the TCFD, including greenhouse gas emissions metrics across Scope 1, 2 and 3 emissions, and scenarios, including a 1.5 degree scenario, and at least one other scenario. Disclosures should include the actions the company is taking to fully align with the goals of the Paris Agreement.

We believe the SEC should update S-K disclosures to incorporate:

- The TCFD recommendations. We recommend reviewing corporate disclosure legislation in the UK and EU, including the UK DWP's consultation on climate-related governance and reporting by occupational pension schemes¹.
- The SASB Standards². The standards set out financially-material, industry-specific, decision-useful, evidence-based and market-informed sustainability information.
- The asks of Climate Action 100+³. The three asks include actions to reduce greenhouse gas emissions and to disclose comprehensive business strategies that fully align with the goals of the Paris Agreement and reaching net-zero emissions by 2050 or sooner.

The SEC may find it useful to review the UK Treasury Roadmap towards mandatory climate-related disclosures⁴:

- The Roadmap presents a coordinated strategy for seven categories of organisation: listed commercial companies; UK-registered companies; banks and building societies; insurance companies; asset managers; life insurers and FCA-regulated pension schemes; and occupational pension schemes.

Question 2: What information related to climate risks can be quantified and measured? How are markets currently using quantified information? Are there specific metrics on which all registrants should report (such as, for example, scopes 1, 2, and 3 greenhouse gas emissions, and greenhouse gas reduction goals)? What quantified and measured information or metrics should be disclosed because it may be material to an investment or voting decision? Should disclosures be tiered or scaled based on the size and/or type of registrant? If so, how? Should disclosures be phased in over time? If so, how? How are markets evaluating and pricing externalities of contributions to climate change? Do climate change related impacts affect the cost of capital, and if so, how and in what ways? How have registrants or investors analyzed risks and costs associated with climate change? What are

¹ <https://www.gov.uk/government/consultations/taking-action-on-climate-risk-improving-governance-and-reporting-by-occupational-pension-schemes-response-and-consultation-on-regulations>

² <https://www.sasb.org/standards/>

³ <https://www.climateaction100.org/approach/the-three-asks/>

⁴

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/933783/FINAL_TCFD_ROADMAP.pdf



registrants doing internally to evaluate or project climate scenarios, and what information from or about such internal evaluations should be disclosed to investors to inform investment and voting decisions? How does the absence or presence of robust carbon markets impact firms' analysis of the risks and costs associated with climate change?

Question 5: What are the advantages and disadvantages of rules that incorporate or draw on existing frameworks, such as, for example, those developed by the Task Force on Climate-Related Financial Disclosures (TCFD), the Sustainability Accounting Standards Board (SASB), and the Climate Disclosure Standards Board (CDSB)?^[7] Are there any specific frameworks that the Commission should consider? If so, which frameworks and why?

Question 11: Should the Commission consider other measures to ensure the reliability of climate-related disclosures? Should the Commission, for example, consider whether management's annual report on internal control over financial reporting and related requirements should be updated to ensure sufficient analysis of controls around climate reporting? Should the Commission consider requiring a certification by the CEO, CFO, or other corporate officer relating to climate disclosures?

As inputs to the SEC's approach to climate change, we believe the SEC should review:

- The Paris Aligned Investment Initiative⁵ and the Net Zero Investment Framework⁶. The framework sets out how investors will meet their net zero targets. It establishes a clear need for timely and assured climate change disclosures, comparable across industry, portfolio, time-series and geography.
- The UN PRI's Inevitable Policy Response programme⁷. Financial markets today have not adequately priced-in the near-term policy response to climate change. U.S. companies will need to prepare for and disclose against climate policy reform that PRI (and others, including Cardano) considers inevitable.

We strongly support global harmonisation on reporting standards, using frameworks that have already had several years of extensive development. Developing a different set of standards and measurements will confuse and obscure. To support global harmonisation, we believe the SEC should:

- Support, engage and work with the IFRS Foundation on global standards for sustainability reporting. In September 2020, the IFRS published a consultation on sustainability reporting⁸.
- Work with IOSCO⁹ and the International Platform on Sustainable Finance¹⁰ to harmonise international disclosures.
- Review the EU Taxonomy. In particular, we welcome disclosure at level of economic activity, the approach to transition activities, and the future 'ratchet mechanism' or 'tightening' of carbon emissions

⁵ <https://www.parisalignedinvestment.org/>

⁶ https://www.parisalignedinvestment.org/media/2021/03/PAII_Net-Zero-Investment-Framework-1.0_Implementation-Guide.pdf

⁷ <https://www.unpri.org/inevitable-policy-response/what-is-the-inevitable-policy-response/4787.article>

⁸ <https://cdn.ifrs.org/-/media/project/sustainability-reporting/consultation-paper-on-sustainability-reporting.pdf?la=en>

⁹ <https://www.iosco.org/news/pdf/IOSCONEWS594.pdf>

¹⁰ https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/international-platform-sustainable-finance_en



per unit of economic activity that are considered green as we make progress to meeting net zero carbon emissions.

To ensure high confidence in disclosures, we believe the SEC should:

- Subject climate disclosures to the same levels of assurance as other financially material data sets, available in annual reports, and published in accessible formats on company websites, with clear board and C-Suite level oversight. This is consistent with the TCFD's governance recommendations. We believe that TCFD provides clear prescriptive guidance, while allowing for some flexibility, for example, on approach to Scope 3 emissions.
- For companies most exposed to the climate crisis – for example, energy, mining, industrials (specifically, steel, cement and chemicals), utilities, buildings and transport – we recommend sector specific reporting obligations and incorporating climate change requirements in senior management remuneration.

Finally, we acknowledge that disclosure is the first step. A robust carbon market (for example, cap and trade or border adjustment) would greatly level the playing field in properly pricing carbon externalities and would likely create the economic incentives to properly and fairly transition. The US setting standards on this would allow other countries to more quickly develop a global standard for carbon pricing.

In the interim, we believe that even without a carbon market, US companies can still disclose their carbon pricing assumptions allowing investors to understand the financial risks they are exposed to.

Question 3: What are the advantages and disadvantages of permitting investors, registrants, and other industry participants to develop disclosure standards mutually agreed by them? Should those standards satisfy minimum disclosure requirements established by the Commission? How should such a system work? What minimum disclosure requirements should the Commission establish if it were to allow industry-led disclosure standards? What level of granularity should be used to define industries (e.g., two-digit SIC, four-digit SIC, etc.)?

Question 12: What are the advantages and disadvantages of a “comply or explain” framework for climate change that would permit registrants to either comply with, or if they do not comply, explain why they have not complied with the disclosure rules? How should this work? Should “comply or explain” apply to all climate change disclosures or just select ones, and why?

There is overwhelming evidence that ESG issues are financially material, and as such, institutional investors have a fiduciary duty to incorporate ESG issues in their investment decisions. Companies that measure and manage ESG issues are better placed to respond to – and to support – the sustainability transition. Equally, companies that do not account for climate change risk asset stranding. Corporate ESG disclosure is therefore a necessary prerequisite for investment decision-making.

The following reasons, we believe that ESG – and climate – disclosures should be mandatory and on a comply and explain basis:



- Mandatory ESG disclosures reward first-movers. Many US-regulated companies have, for many years, disclosed ESG-related risks and opportunities.
- Sustainability is fast-evolving. Mandatory ESG disclosures clarify regulatory expectations, improve information disclosure through the intermediation chain, remove ambiguities and boiler-plate disclosures, and will lead to the more efficient allocation of investors' capital.
- Finally, the climate crisis is urgent. Atmospheric carbon levels are their highest in human history. Climate change-related weather events are increasing in frequency and severity. This requires an urgent response – and as such, a regulated one.

We would strongly welcome a mandatory comply and explain disclosure framework, phased by size of company, introducing disclosure requirements for the largest companies and extending to smaller companies over time.

Analysis by the PRI finds rapid growth in ESG and sustainability-related regulation, with mandatory corporate ESG disclosure the most common regulatory intervention. In other words, mandatory ESG and climate-related disclosures on a comply and explain basis would be consistent with overseas financial regulators¹¹.

We also believe that the SEC should strengthen the ability of shareholders to request data or propose resolutions for companies that are failing to explain adequately (see our 'additional comments' section on a stewardship code).

Question 15: In addition to climate-related disclosure, the staff is evaluating a range of disclosure issues under the heading of environmental, social, and governance, or ESG, matters. Should climate-related requirements be one component of a broader ESG disclosure framework? How should the Commission craft climate-related disclosure requirements that would complement a broader ESG disclosure standard? How do climate-related disclosure issues relate to the broader spectrum of ESG disclosure issues?

For material ESG disclosures, we believe the SEC should review the SASB standards. In addition, we believe the SDGs provide the best available framework for understanding real-world impact. We see clear overlap between the integration of ESG risks and opportunities and the SDGs. We distinguish between the two as follows:

- **ESG issues are associated with risk management.** ESG issues capture the way in which companies and funds are responding to the sustainability transition. The focus is from the outside world to the investment decision: How the sustainability transition affects risk and return.
- **The SDGs are associated with real-world impact.** The SDGs set the global goals for society and all its stakeholders – including investors. The focus is from the investment decision to the outside world: How the investment decision contributes to, or hinders, sustainability goals.

¹¹ <https://www.unpri.org/pri-blog/regulation-database-update-the-unstoppable-rise-of-ri-policy/7352.article>



A number of U.S. companies are disclosing against the SDGs. We recommend the SEC review:

- The UN Global Compact guidance: How your company can advance each of the SDGs¹².
- The OECD Guidelines for Multinational Enterprises¹³.
- The European Supervisory Authority's draft regulatory technical standards, and in particular, the indicators set out on pages 60 – 82¹⁴.

In addition to climate change disclosures, we believe the SEC should prioritise disclosure on diversity and inclusion, include pay gap reporting on gender, ethnicity and race, as well as board and senior management diversity.

Additional comments:

In addition to enhancing corporate sustainability disclosure, we recommend the SEC establish a stewardship code for investors, asset owners and asset managers, that sets out the principles for good stewardship of assets, similar to that of the UK's¹⁵ or Japan's¹⁶.

Good stewardship can be subjective. We set out our preferences as follows:

- Quality over quantity – we're interested in a few meaningful quality engagements, with strong reporting (rather than, being interested in the quantity of votes). We want managers to prioritise the highest sustainability impacts in their portfolios
- Long-term – we encourage managers to form long-term relationships with companies. Successful stewardship can take many months, maybe even years
- Real world impact – we're interested in engagement on topics that contribute to positive real-world sustainability impact (such as, reduction in absolute carbon emissions)
- Honesty – some engagement, perhaps even most engagement, will be unsuccessful. We're realistic, and we'd prefer honesty from managers
- Collaboration – engagement is more efficient when managers collaborate – not just for the managers, but for the companies too (who will field fewer, but higher conviction, engagements from their investors). We encourage managers to participate in collaborative initiatives, such as Climate Action 100+

¹² <https://www.unglobalcompact.org/sdgs/17-global-goals>

¹³ <http://mneguidelines.oecd.org/MNEguidelines/>

¹⁴ https://www.esma.europa.eu/sites/default/files/library/jc_2021_03_joint_esas_final_report_on_rts_under_sfdr.pdf

¹⁵ <https://www.frc.org.uk/investors/uk-stewardship-code>

¹⁶ <https://www.fsa.go.jp/en/refer/councils/stewardship/index.html>



- Innovation – we welcome innovation, for example, third-party tools to assess a company’s conviction on sustainability topics
- Integrated – we’re interested in how (if at all) stewardship contributes to the investment thesis and whether managers link their stewardship to other engagement activity (for example, policy engagement)

