Calvert
An Eaton Vance Company

Calvert Research and Management
1825 Connecticut Avenue NW,
Suite 400
Washington, DC 20009-5727
800 368 2745
calvert.com

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Chairman Gary Gensler
U.S. Securities and Exchange Commission
100 F St NE
Washington, DC 20549

Re: Comments on Climate Change Disclosures

Dear Chairman Gensler:

Thank you for the opportunity to comment on the Securities and Exchange Commission's (Commission) regulation of climate change disclosures as the Commission considers disclosure rules and potential new disclosure requirements.

Calvert Research and Management ("Calvert") is an investment management firm based in Washington, D.C., with $33 billion assets under management (as of March 31, 2021). We incorporate into our investment decisions across global capital markets information about corporations' (and other issuers of securities) exposure to, and management of, financially material environmental, social, and governance ("ESG") factors.

We appreciate the opportunity to provide comments as the Commission evaluates its regulation of climate change disclosures. We include here our perspective on the materiality of climate change and the importance of climate-related disclosure, as well as specific recommendations for the Commission to consider in its evaluation of potential climate disclosure standards.

Climate change is a financially material concern.

As a responsible investor, Calvert invests in companies that meet our Principles for Responsible Investment and offers investment strategies that seek superior long-term performance and positive global impact. Calvert also sponsors proprietary indices that include securities determined by Calvert to meet our Principles. Our Calvert U.S. Large-Cap Core Responsible Index, for instance, has returned 15.45% average annual returns over the last ten years, compared to 14.22% average annual returns of the Russell 1000 Index.[1]

It is our perspective and experience that climate change is a financially material concern across industries. Climate change represents a systemic market risk that is both ubiquitous and undiversifiable. Research from the Sustainability Accounting Standards Board (SASB) demonstrates that nearly every industry (68 out of 77 in its Sustainable Industry Classification System) is significantly affected in some way by climate risk. This prevalence of material climate change represents a risk to 89% of the market capitalization of the S&P Global 1200, or US$45.2 trillion.[2] The UN-supported Principles for Responsible Investment conducted a separate analysis that forecasts the financial impacts of a policy response to

[1] https://www.calvert.com/Calvert-US-Large-Cap-Core-Responsible-Index-CALCOR.php
[2] https://www.sasb.org/wp-content/uploads/2021/05/Climate-Risk-Technical-Bulletin2021-042821.pdf

climate change to prepare investors for the associated portfolio risks. This analysis found that implementation of climate-related policies could erase between 3.1% and 4.5% (or $1.6 to $2.3 trillion) of value from a range of companies in the MSCI ACWI index.[3]

While climate change is a material issue in almost every sector, the particular concerns and manifestations will likely vary from issuer to issuer. For example, some issuers will experience physical risk (including the physical effects from the increasing frequency and intensity of weather events), while others will experience transition risk (including the challenges of navigating changing market forces in the transition to a low-carbon economy), and others will experience regulatory risk (including legal and regulatory requirements and costs). Most issuers will experience a combination of these risks to varying degrees over time.

Issuers are better positioned than investors to understand their own climate-related exposures, so we need reliable, consistent, and comparable climate disclosures from issuers to reduce this informational asymmetry. Our job as investors is to make capital allocations, but we cannot make those decisions with sufficient rigor unless we can compare our investment options against one another — and that includes their climate-related opportunities and vulnerabilities. The Generally Accepted Accounting Principles (GAAP) and Financial Accounting Standards Board (FASB) acknowledged the importance of data consistency and comparability when they established the bedrock of our modern financial system. We now need similar levels of consistency and comparability for climate-related disclosures so we can more accurately price assets, allocate capital, run scenarios, and mitigate risk, as well as inform our issuer engagement efforts. Calvert works directly with issuers to improve in the areas most material and relevant to them and to investors, in many cases actively working with companies to strengthen their climate strategies. We need comparable and consistent climate information to more effectively evaluate risks, identify opportunities, and prioritize these engagement efforts.

We believe the Commission has an opportunity to play an essential role in standardizing climate disclosures in a way that would provide meaningful, comparable information for investors to incorporate into decision-making analysis.

<u>Climate change disclosure.</u>

We have several suggestions for the components that we believe would be important to include in climate change disclosure rules from the Commission. We offer these suggestions for specific disclosure requirements below.

Climate change disclosure should mirror financial disclosure practices.

In general, disclosure around climate change should mirror the same practices that are used for financial disclosures. Like financial disclosures, climate disclosures should be historical, auditable, and comparable against peers. Currently, climate change disclosures are largely voluntary, unverified, and idiosyncratic. While some existing disclosure requirements can apply to climate change-related issues, there is not a mandatory framework, nor is there a standardized disclosure framework. Existing disclosures are also largely hypothetical, projecting forward-looking targets rather than backward-looking accomplishments. Current disclosures do not provide investors with the consistency, detail, reliability, or completeness that is needed to effectively evaluate and compare disclosure information.

[3] https://www.unpri.org/inevitable-policy-response/implications-for-strategic-asset-allocation/5191.article

Furthermore, like financial disclosures, climate disclosures should appear in annual reports, at a minimum, and quarterly reports as appropriate. Annual disclosure would provide investors with the regular information necessary to make informed decisions based on climate-related risks, opportunities, and uncertainties. For industries where climate change is particularly material or companies that are particularly exposed to climate risk, climate disclosures should appear in quarterly reports to provide more frequent information.

Finally, like financial disclosures, climate disclosures should be required. Disclosures should be filed, not furnished, and automatically incorporated by reference into a reporting issuer's filings with the Commission. The European Union is already requiring certain large companies to disclose non-financial information, including on environmental matters, as directed by the Non-Financial Reporting Directive. Requiring climate disclosures in the U.S. would align with this requirement and would improve the quality and consistency of information available to investors.

We suggest the inclusion of specific information and data as part of climate disclosure rules.

We understand that the Commission has asked which specific disclosures might be helpful to the market. We suggest the inclusion of both qualitative and quantitative disclosures, both of which provide valuable information to investors. The Task Force on Climate-Related Financial Disclosures (TCFD) framework recommends disclosures that are both data-based and qualitative in nature.

Qualitative disclosures, for example, could include the company's approach to addressing climate change, including its adaptation and resilience narrative, governance of climate-related issues, risk-management strategy, and integration of climate risks and opportunities into strategic planning and execution.

Quantitative disclosures could include metrics such as those catalogued below. The following list is by no means comprehensive, but it does represent a sample of the types of disclosures that we have already found useful in our analysis:

i. Resource consumption
   a. Energy consumption: Energy consumption can be further broken down into source of energy (oil, gas, nuclear, coal, and renewables) and the purpose of the energy use (production, transportation, etc.)
   b. Water consumption: Including total water consumed and exposure to water stress

ii. Physical risk: Assets or exposure of entity toward flood, drought, high fire-threat, etc.

iii. CO2-Equivalent Emissions: Full life-cycle emissions of products created and CO2-equivalent emissions in a year (i.e., Scope 1, Scope 2, Scope 3 when possible, including upstream, Scope 3 downstream, and total Scope 3)

iv. Mitigation targets: Reduction targets for CO2-equivalent emissions for short-, medium-, and long-term

v. Pollution: Air, water, and other ecosystem pollutants other than CO2-equivalent emissions

vi. Capital Expenditures & Climate Risk/Opportunity Expenditure/Investments: Capital expenditures relevant to climate goals, as well as climate-related R&D expenditures, provisions, and investments, such as in clean technology, green procurement, insurance payments, etc.

vii. Circular Economy: Total non-degenerate-able waste produced (e.g., plastic), recycling of various materials (metal, non-metal, paper, glass, e-waste, plastic, water, hazardous materials), and recycled material use

viii. Green Financing: Total climate-risk-related debt/loans (e.g., green bonds)

As investors, the above information provides data that we use for security selection, overweighting and underweighting of securities, and/or as part of our engagement process with companies. For example, we use the key performance indicators (KPIs) reported in sustainability reports as well as our own analysis to identify companies that are performing well with respect to climate change and the energy transition. Companies that are not performing well on those KPIs are considered to be facing high climate risks or high climate-related costs, and may be deemed not fit as going concerns and removed from our investable universe.

Climate change disclosures should be subject to third-party standards.

As with financial disclosures, climate change disclosures should be subject to third-party standards. As the International Financial Reporting Standards (IFRS) ensure standardization of reporting on a company's financial performance and position, third-party climate disclosure standards would create a similarly standardized landscape for evaluating climate risk and opportunities. Standards that create comparability are essential to creating a level playing field so that the climate-related information available to investors is comparable across markets and useful for investment decisions.

The Commission should rely on third-party standard setters with credibility among investors in the area of climate. As an example of the effectiveness of third-party standard setting, the Global Investment Performance Standards (GIPS), released by the CFA Institute, are globally accepted standards considered industry best practice for investment performance reporting and presentation. A similar standard for climate disclosure could establish consistent and transparent reporting requirements that would be perceived as credible by all stakeholders.

The IFRS Foundation currently has an initiative under consideration, and the Sustainability Accounting Standards Board (SASB) standards are existing third-party standards that provide useful disclosure frameworks and guidance. SASB standards, which provide industry-specific metrics, are used by investors and companies in the U.S. and around the world, and the number of companies reporting SASB metrics has grown to more than 928 companies. SASB offers an independent, evidence-based process grounded in financial materiality for developing standards, a conceptual framework to guide development of standards, due process in standard-setting, and standards that permit reasonably consistent, comparable, and specific qualitative and quantitative measurements of performance on material sustainability matters, criteria that an acceptable third-party standard setter should meet.

Recognizing a third-party standard setter would provide a standardized framework for climate disclosure. It would permit an efficient rule-making process, allow the Commission to focus on implementation and evaluation, accelerate the adoption of existing best practices, and facilitate the ability of private-sector frameworks and disclosure practices to evolve without the need for additional SEC rulemaking. Acknowledging a third-party standard setter does not prevent the Commission from promulgating rules that require specific disclosures on certain topics as necessary or appropriate, especially for topics where there is strong investor demand for cross-industry information.

Climate change disclosures should be verified by third-party auditors.

Climate change disclosures should also be verified by third-party auditors, with companies required to use accredited auditors. Third-party assurance of climate disclosures, as with financial disclosures, would ensure reliability and provide investors with confidence in the rigor and accuracy of the information disclosed. For climate change disclosures to be meaningful and reliable, third-party audits must be part of standard assessment and enforcement.

The U.S. standards should align with the highest global standard.

The standards for climate disclosure in the U.S. should align with the highest global standard, like those in place or which are developing in European markets. The European Union's Corporate Sustainability Reporting Directive (CSRD), Sustainable Finance Disclosure Regulation (SFDR), and Sustainable Finance Taxonomy are three existing standards and tools that have significant implications for many U.S.-based investors and companies. A disjointed sustainability disclosure landscape increases complexity of sustainability reporting, in particular for multinational companies. The IFRS Foundation is currently considering establishing an International Sustainability Standards Board (ISSB) to set IFRS sustainability standards and accelerate alignment of global reporting.[4] This approach would provide a baseline for international comparability while still allowing for jurisdictional flexibility. The Commission should consider potential global standards as it develops its own requirements and should work to align U.S. standards with this broader global framework. This alignment would facilitate standardization and ease of climate disclosure reporting.

The standards should have universal components whenever possible and sector-specific components whenever necessary.

Whenever possible, climate disclosure standards should require specific, universal components for all companies. Such universal components would contribute to the consistency and comparability of climate change disclosures and help ensure the information is useful to investors in assessing climate-related risks and opportunities. Potential universal components that we would suggest the Commission consider including are:

- Scope 1 and Scope 2 emissions. The GHG Protocol supplies greenhouse gas accounting standards that are used to measure and manage emissions and ensure consistency in GHG accounting. We currently use Scope 1 and 2 emissions in our investment analyses. In the future, disclosure standards should include Scope 3 emissions as well (including Scope 3 upstream, Scope 3 downstream, and Scope 3 total). At present, there are not established standards for measuring Scope 3 emissions, though groups like the Partnership for Carbon Accounting Financials (PCAF) are working on developing a standardized framework.
- Greenhouse gas emission targets across multiple timeframes (5Y, 10Y, 20Y, 30Y)
- A quantitative range or ranges of outcomes for various fundamental metrics (e.g., EBITDA) tied to different climate change scenarios
- Director, CEO, and senior management compensation tied to climate and emissions targets
- Board committee or entity that is responsible for climate oversight
- Climate-related expertise among directors on the board
- Internal price for carbon/GHG and how this price is incorporated into business planning
- Disclosure of whether emission targets and metrics are reviewed by an external auditor
- Exposure to physical climate risk
- Total offsets purchased, including the average price of offsets, and whether offsets are verified by an external auditor

[4] https://www.ifrs.org/news-and-events/news/2021/03/trustees-announce-working-group/

We would also encourage the Commission to include a universal requirement for companies to report on the company-specific metrics that they consider most relevant to their business models.

In addition to these universal components, climate disclosure standards should include sector-specific components whenever necessary. SASB provides a strong example of a sector-specific model, with 77 Industry Standards that identify the minimal set of financially material sustainability topics and their associated metrics for the typical company in a given industry. As the Commission considers potential sector-specific components of disclosure rules, we would suggest the following elements that we have used and found to be helpful in our analysis and evaluation:

- Water consumption for companies that have assets or production in water stress zones
- Total waste (e.g., plastic waste, packaging) for companies creating products or packaging
- Lifecycles recycling for companies creating products that contain components that are potentially toxic (e.g., batteries, phones, etc.) or non-degenerate-able (e.g., plastic etc.)
- Financial companies should disclose the total revenue that was derived from business in high-carbon sectors or from trading of securities from those sectors. Financial companies should also report total loans on book (e.g., mortgage, loans etc.) that are linked to disaster-prone areas (physical risk)
- Asset management and investment management entities should disclose the total weighted average Scope 1, 2, and 3 emissions of their investments and their exposure to high-carbon sectors
- Companies with existing or likely future stranded assets should report on their stranded asset risk
- Climate-related lobbying for companies that participate in climate lobbying activities or where there might be misalignment between lobbying activities and climate goals

This list is intended to be illustrative and is not necessarily a comprehensive list of universal or sector-specific components to include.

Compliance should be required, though standards could vary.

Companies should be required to comply with the Commission's climate disclosure standards. They should not be given an opportunity to "explain away" non-compliance. "Comply-or-explain" standards can cause concerns over the quality of explanations given by companies, with a risk that these explanations become boilerplate. Furthermore, for "comply-or-explain" standards to be effective, investors must actively monitor companies' compliance and hold them accountable when they fail to provide adequate explanations.[5] Calvert believes that climate risk is material enough across industries that certain climate disclosure standards should be required. While investors should evaluate climate disclosures and consider holding companies accountable for inadequate climate strategies, we do not believe that investors should be responsible for evaluating explanations for non-compliance, and therefore "comply-or-explain" should not be an option for climate disclosures.

However, while companies should be required to comply with climate disclosure standards in some form, the specifics of the standards could vary based on the size and age of the company. We understand that younger and smaller companies may not have as many resources to ensure disclosure of the complete set of standards, as some climate-related information may require more resources in order to collect, measure, and verify. There may be different standards depending on the lifecycle stage

[5] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2690687

and size of the company. For example, all companies should publish Scope 1 and Scope 2 emissions. Scope 3 emissions could be published for companies that produce products with a high GHG intensity. Other sectors could have at least 3 years to start to report on Scope 3 emissions, to allow time for measurement methodologies to emerge and be settled. This flexibility is consistent with materiality concerns, since, from a materiality standpoint, the larger the company, the more material would be the disclosure.

The Commission should consider climate as part of a broader ESG disclosure framework.

Climate change is not an isolated phenomenon. It relates closely to other important ESG considerations for investors. In particular we believe that a material ESG risk is the impact of corporate actions on communities and employees, and we believe it is important for companies to report on these impacts, focusing on how their actions and decisions affect the lives of the people in their workforces or communities. Disclosure of practices, policies, and performance around how companies engage with society and how they treat people, including information on a company's workplace, diversity achievements, employee engagement, supply chain, human rights, and other issues, provides relevant information for investors to assess company culture, strategy, and performance.

As one element of a company's impact on people and communities, human capital is essential to the long-term execution of companies' climate transitions, and effective human capital management strategies are necessary to preserve a company's human capital. In fact, we view climate change strategies and human capital management strategies as closely related and believe they must be considered together as part of a company's overall ESG approach.

Ensuring a "just transition" is another example of an issue within the broader ESG framework that, in our view, would merit disclosure. As economies transition to a low-carbon future, there is a growing focus on considering the impacts on workers and communities who are affected by this transition. What companies are doing to provide pathways for workers in fossil-fuel based industries to transition to other jobs and careers reflects a company's relationship with its workers and communities and is of interest to investors.

As the Commission considers ESG disclosure and ESG matters more generally, we encourage you to think of climate as one part of a broader ESG disclosure framework, inherently connected to social issues such that they cannot be considered in isolation.

<u>Conclusion</u>

Thank you for the opportunity to share our perspective on the importance and materiality of climate change disclosure, and the specific components that would be helpful, from an investor standpoint, to see in climate disclosure standards from the Commission.

Sincerely,

John Streur
President and CEO
Calvert Research and Management