

United States Senate

June 10, 2021

The Honorable Gary Gensler
Chair
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

The Honorable Allison Herren Lee
Commissioner
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Dear Chair Gensler and Commissioner Lee:

We write in response to Commissioner Lee's March 2021 request for public input as the Securities and Exchange Commission (SEC) evaluates its regulation of issuers' climate change disclosures.

As you know, climate change poses systemic risks to our financial sector and economy—risks that are well known and highly probable, but poorly understood and inaccurately priced. These risks stem not only from physical threats to property and infrastructure, but also from potentially sudden and disorderly changes in carbon-intensive asset values resulting from government policies and consumer preferences. To avoid financial instability and an erosion of investor confidence, the public needs to know exactly how exposed individual companies are to climate risks and how companies plan to manage those risks. Namely, investors need to know how climate risks affect issuers' business activities, assets, supply chains, corporate strategy, and financial planning. That information must be publicly available, detailed, and easily comparable across different companies in discrete industry sectors.

In this letter, we discuss several specific disclosures that we believe are essential components of a comprehensive climate risk-related disclosure framework. We look forward to remaining engaged with the Commission as it designs a mandatory climate disclosure regime for the U.S. capital markets.

1) Incorporating climate risk into audited financial statements

Climate disclosure would be of little use to investors if it amounts to boilerplate, narrative disclaimers in filers' risk factors. For many companies, particularly in the energy sector, climate risks have material impacts on the fair value of assets, provisions for liabilities, and medium- and long-term price assumptions. To ensure companies' stated strategies around climate are consistent with their internal planning, their risk management must filter through their financial statements and be evaluated by auditors.

Bridging the gap between climate risks and financial reporting should include understanding the "significant assumptions" underlying companies' financial statements, and allowing auditors to

assess whether they are reasonable.¹ The SEC should mandate transparency around these assumptions, so that markets can assess whether the estimates informing companies' financials are clear-eyed about the likelihood of climate risks or merely wishful thinking. This should include a robust focus on climate risks in management's discussion and analysis (MD&A), so that investors can determine whether issuers' reported financial information will be indicative of future results.

To date, voluntary (and unaudited) climate risk disclosures have been woefully inadequate. For example, ExxonMobil has produced an annual climate risk report for the last few years since a successful shareholder resolution called on it to do so. And yet these reports do not actually analyze ExxonMobil's transition risk in a 2 degree Celsius warming scenario; understate the growing economic advantage of renewables; do not quantify the company's investment in carbon capture;² and even fail to consider that oil demand from commercial transportation, including trucks, buses, and planes, might begin to slacken before 2040 due to electrification or other fuel switching.³ At the time ExxonMobil published its first climate risk report, there were already hundreds of thousands of electric buses on the road in China alone. The myriad inadequacies of these reports demonstrate why it is essential that climate risk reporting be connected to companies' financial reports, and subject to an auditor's review, if climate risk reporting is to have any value to investors.

Moreover, we have already seen significant asset impairments from energy companies that were forced to reevaluate their commodity price outlooks,⁴ and these hidden losses will only grow as the climate crisis accelerates. Unless companies are forced to disclose the estimates underlying their accounting, our financial system will be vulnerable to sudden price shocks.

2) Financed emissions disclosure

Financial companies like banks and asset managers are profiting now from the activities that drive the climate crisis, and assuming they can socialize the losses later. Although they may take steps to phase out financing of the most unpopular activities, such as thermal coal production and Arctic drilling, these decisions appear primarily motivated by concerns about corporate image and corporate social responsibility. They continue to underwrite, advise, invest in, and lend to companies at every stage of the fossil fuel value chain without proper consideration of the manifest risks.

¹ Samantha Ross, *The Role of Accounting and Auditing in Addressing Climate Change*, Center for American Progress, 1 Mar. 2021. <https://www.americanprogress.org/issues/economy/reports/2021/03/01/496290/role-accounting-auditing-addressing-climate-change/>

² See, e.g., *Comparison of 2019, 2018 ExxonMobil Energy and Carbon Summary Report*, Union of Concerned Scientists, 7 Feb. 2019. <https://www.ucsusa.org/sites/default/files/attach/2019/02/gw-accountability-ExxonMobil-Report-Comparison-Table.pdf>; Nicole Pinko, *ExxonMobil, Chevron, and ConocoPhillips Climate Risk Reports Miss the Mark*, Union of Concerned Scientists, 14 May 2019. <https://blog.ucsusa.org/nicole-pinko/exxonmobil-chevron-conocophillips-climate-risk-reports/>

³ *2018 Energy and Carbon Summary*, pg. 5, ExxonMobil, https://corporate.exxonmobil.com/-/media/Global/Files/energy-and-carbon-summary/2018-Energy-and-Carbon-Summary_archive.pdf

⁴ Ross, *The Role of Accounting and Auditing in Addressing Climate Change*.

Financial institutions face direct losses from physical climate risks, as well as losses from market instability, an erosion of investor confidence, and changes in carbon-intensive asset values. It is important to note that climate change is not an exogenous shock. There are lucrative fees and short-term returns to be made financing and investing in the activities that accelerate climate change. As such, mandatory disclosure of financed emissions should be a key component of SEC rulemaking on climate disclosure.

Publicly traded financial firms should disclose the scopes 1, 2, and 3 greenhouse gas emissions enabled by their investing and financing work. To the extent balance sheet holdings like banks' loan portfolios are exposed to climate risk, disclosure is crucial to identify exposure to potential stranded assets and other material risks. However, when banks facilitate activities that exacerbate a systemic vulnerability, they undermine financial stability to their own detriment—even if the risks they take may ultimately be borne by other economic participants and taxpayers. Therefore, financed emissions disclosure should also include off-balance sheet activities like equity and debt underwriting, as well as advisory work (to the extent practicable without divulging material nonpublic information). In these cases, although a bank may not take risk directly onto its books, it can still actively contribute to risks that threaten its core business.

3) Use-of-proceeds statements

Financial firms justify their continued investment in and engagement with fossil fuel producers by citing the substantial capital required to transition to low-carbon business models. During a hearing on May 27, 2021, JPMorgan CEO Jamie Dimon told members of the House Financial Services Committee: “We’ve been quite clear that there will be fossil fuel companies for decades to come, and we finance them, and we’re proud of it. We’re working with them to try to reduce their CO2.”⁵ Bank of America CEO Brian Moynihan said at a February 2021 conference: “We have to have a balanced, fair transition across the globe and realize it’s going to take time and investment and innovation. And that’s what capitalism brings.”⁶

The transition to a low-carbon economy will indeed require enormous investment. To the extent financial firms facilitate the transition, we absolutely encourage it. But there is little evidence to suggest banks are selecting their business based on which clients are actually committed to transitioning. Realistically, banks will continue chasing fees and league table credit wherever they can find it—regardless of whether a client is raising capital to invest in renewable energy, or to accelerate their oil drilling. Meanwhile, investors might buy an issuer’s bonds or primary equity offerings with only a vague idea of how the company plans to use the proceeds. And for their part, fossil fuel companies have a track record of accelerating drilling with little concern for profitability or cost control, no matter what lip service they pay to the low-carbon transition. Oil and gas companies’ investment outside their core business remains less than 1 percent of their total capital expenditures, according to the International Energy Agency.⁷

⁵ Nick Sobczyk, “Bank CEOs stand by fossil fuels. ‘We’re proud of it,’” *E&E News*, 28 May 2021.

<https://www.eenews.net/climatewire/stories/1063733775/search?keyword=dimon>

⁶ Zachary Warmbrodt, “Wall Street leaders resist divestment push in climate fight,” *Politico*, 18 Feb. 2021.

<https://www.politico.com/news/2021/02/18/wall-street-divestment-climate-469956>

⁷ Henry Edwardes-Evans and Emma Slawinski, “Cross currents: Big oil and the energy transition,” *S&P Global*, 23 Apr. 2020. <https://www.spglobal.com/en/research-insights/articles/cross-currents-big-oil-and-the-energy-transition>

The SEC can help address this by requiring greater transparency and specificity regarding use-of-proceeds declarations in prospectuses. Issuers should clearly communicate to the market what they intend to finance with the proceeds of debt or equity offerings. If the Commission permits issuers to cite “general corporate purposes” with no accountability, there can be no way of knowing whether capital will, in fact, be dedicated to the transition. More specificity around proceeds will also go a long way towards ensuring financial firms (whether underwriters or asset managers) are meeting their stated climate commitments.

4) Lobbying and political spending

There is no force in the realm of climate-related policymaking more pernicious than anonymized, unlimited political spending. Prior to *Citizens United*, there had been a long history of bipartisanship on climate. That 2010 U.S. Supreme Court decision allowed fossil fuel interests to exert brute political pressure via unlimited spending in elections, letting them wield real and threatened spending campaigns to keep politicians in line, and in opposition to climate action.

Corporate interests hide their spending behind opaque front groups and powerful trade associations. Shareholder resolutions demanding transparency in election spending and lobbying have proliferated in recent years,⁸ with investors demanding disclosure of companies’ political influencing activities. The SEC should require registered companies to disclose all spending on political activities, including money funneled to trade associations and other politically active nonprofits. As you likely know, prior petitions to initiate such a rulemaking at the Commission in 2011 and 2014 were unsuccessful, thanks in no small part to the vehement opposition of fossil fuel-funded front groups and trade associations.

It is vital that the public know which companies are working quietly to undermine climate action in the Congress. In many cases, individual companies purport to lofty climate commitments while contributing to anti-climate lobbying efforts through trade associations. These efforts are material—they mislead investors and undermine financial stability. As with financed emissions disclosures for equity and debt underwriting, even if a company funding anti-climate trade associations or dark money groups may not itself bear significant climate-related risks, its funding of such groups is a major contributor to climate-related financial and economic risks which will ultimately be borne by other economic participants and taxpayers.

In sum, investors are due at least three things: one, reporting adequate to assess the likelihood of an individual company successfully managing an orderly climate transition; two, reporting adequate to assess the risk of a disorderly climate transition and the company’s ability to survive in plausible conditions of climate and economic disorder; and three, information adequate to assess the extent to which companies are contributing to climate failure and disorder through their political efforts or non-effort, and the reputational, brand, and liability risk when discrepancies between public-facing statements and political effort are discovered.

⁸ Cydney Posner, “Is it Time for Corporate Political Spending Disclosure?” Harvard Law School Forum on Corporate Governance, 17 Mar. 2019. <https://corpgov.law.harvard.edu/2019/03/17/is-it-time-for-corporate-political-spending-disclosure/>

Thank you for your consideration of these issues. We are encouraged by your interest in improving climate-related risk disclosure, and look forward to a robust regulatory framework that will protect shareholders and provide needed transparency.

Sincerely,

A handwritten signature in blue ink, reading "Brian Schatz", positioned above a horizontal line.

BRIAN SCHATZ
U.S. Senator

A handwritten signature in blue ink, reading "Sheldon Whitehouse", positioned above a horizontal line.

SHELDON WHITEHOUSE
U.S. Senator