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Chair Gary Gensler & Commissioner Allison Herren Lee
Securities and Exchange Commission
100 F Street NE
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RE: Public Input on Climate Change Disclosures

Public Input from the R Street Institute on Climate Change Disclosures

I. Summary of the R Street Institute

In responding to the request for public input on climate change disclosures, the R Street Institute has prepared this document answering select questions offered by the Commission. In this document, we address questions one, two, four and seven of the request for public input. The R Street Institute is a free-market policy institute with the primary function of educating policymakers on the potential outcomes of considered policy options. With respect to climate change disclosures, the R Street Institute seeks to inform the Commission of areas where there are potential value proposition improvements, as well as inform the Commission of policy options that may have only limited utility relative to any capturable value. The R Street Institute has special expertise on the issues of climate change, energy policy, climate policy and financial regulation.

II. Question Responses

- 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?*

Among the most important responsibilities of the Commission as it pertains to climate change-related disclosures is to ensure that the expectations of registrants are clearly defined, and the information furnished is relevant to the regulatory responsibilities of the Commission, as well as material to investors. While the unique nature of climate change as it pertains to financial risk is outlined elsewhere in this comment, it should be noted here that climate change is a slow moving, incremental financial risk that is manifested heterogeneously throughout the economy. Not all registrants will be equally impacted by climate change, meaning the relevance of disclosed information is variable. Similarly,

registrants will differ in their ability to disclose specific information, particularly as it pertains to measuring emissions or progressing towards other specific environmental outcomes.

The key aspect that would make the Commission's efforts more fruitful is, as alluded to in the question, the comparability of the information. An accurate understanding of the broad financial risks associated with climate change require an assessment of registrants' preparedness for both the physical impacts of or potential policy changes related to climate change. The most useful information for gauging financial market risk and investor risk is not an individual firm's preparedness or actions related to climate change, but rather the comparative relationships between competing firms in opportunities to avoid or absorb climate change-related risks. Addressing potential informational deficiencies can reduce transaction costs by simplifying disclosure expectations among registrants that already disclose climate change-related information, as well as improve capital allocation by ensuring that investors are able to comparatively assess investment opportunities with high-quality information.

Importantly, the Commission should also recognize that while standardization produces consistent and comparable information, there are already private sector institutions providing such information, like the Sustainability Accounting Standards Board, which operates as an independent organization that sets standards for environmentally related disclosures. The Commission should operate cognizant of the fact that the private sector is already determining the materiality of such disclosures. If the Commission promulgates new rules, it should be cautious that it may inadvertently produce a disclosure regime that offers inferior informational adequacy than existing regimes and should consider opportunities to enhance or improve the consistency, comparability and ease of compliance with existing private sector driven disclosures.

Information disclosures related to climate change should be addressed in a vein similar to how filers already disclose information related to their regulatory compliance as part of S-K requirements in their annual 10-K forms. In such a form, firms can outline their expectations of the impacts of climate change-related risks on their profitability, and potential policies they expect to comply with. Importantly, the frequency of disclosure requirements should be annual at most, in part because climate change is a slow-moving risk, but also because the necessary information that would inform filers' disclosures—such as governmental reports on emissions or energy production—are often released in annual intervals.

Importantly, the creation of new forms, or the requirement of frequent disclosures, are unlikely to provide any particularly noteworthy information that would inform investment activity. Registrants that view their environmental performance as germane to the decisions of their investors typically already disclose such information in their own statements, or as part of Environmental Social and Governance (ESG) metrics in which they voluntarily participate. According to the Global Reporting Initiative, 82 percent of the world's largest 250 companies report on ESG topics using their metrics.¹ An attempt to mandate such requirements across all registrants would offer little utility due to the heterogeneity of

¹ Michael Clements, *Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them*, United States Government Accountability Office, July 2020, p. 6. <https://www.gao.gov/assets/gao-20-530.pdf>.

registrants, and also would detract from environmentally conscientious firms that view their voluntary disclosures as a comparative value added for their products.

- 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 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?*

Climate change is a complex global environmental challenge with widely varying direct and indirect economic impacts that are expected to manifest incrementally through the year 2100 and beyond. In understanding the risk that climate change presents, the Commission should recognize that merely identifying the presence of risk does not inform the magnitude of the risk, and particularly for a problem like climate change the temporality is a major factor in risk estimation. The appropriate policy response to mitigate climate change-related financial risk should recognize the heterogeneity of the risk, the global nature of the problem and the varying levels of confidence in specific impacts.

The Commission's regulatory response to climate change-related risk should fundamentally understand that there are two separate types of climate change-related financial risk: the risk from physical impacts of climate change, and the risk stemming from climate change-related policy that will financially impact registrants—and thus affect investor response and activity.

The physical impacts of climate change, from a financial regulatory respect, are relatively easily managed and have limited opportunities for the Commission to mitigate. Examples of physical impacts include increased incidence of drought impacting agriculturally reliant registrants, or sea-level rise exacerbating storm surge risk for registrants that rely on coastal infrastructure such as oil and gas exporters. Climate change's effect in such economic sectors is not always the creation of new threats, but rather the exacerbation of existing ones. The Intergovernmental Panel on Climate Change (IPCC) has "very high confidence" that,

In urban areas climate change is projected to increase risks for people, assets, economies and ecosystems, including risks from heat stress, storms and extreme precipitation, inland and

*coastal flooding, landslides, air pollution, drought, water scarcity, sea level rise and storm surges.*²

Further, the IPCC has “medium confidence” that,

*For wheat, rice and maize in tropical and temperate regions, climate change without adaptation is projected to negatively impact production for local temperature increases of 2 degrees Celsius or more above the late 20th century levels, although individual locations may benefit.*³

Because firms at risk of these climate change-related impacts are already vulnerable to a certain degree to extreme weather phenomena, investors should already expect that such firms are prepared to handle such events.

While climate change may increase the risk associated with things like extreme weather, it does little to alter the conventional response for at risk entities, which is primarily to mitigate risk through a risk pool that uses insurance markets to disperse risk across multiple entities. Insurers then further disperse risk globally through a reinsurance market, and it is these reinsurers that are best suited to appropriately adjust rates in response to climate change and send price signals to induce risk mitigation behavior from firms. It is also through (re)insurance markets that many of the externalities associated with climate change are appropriately priced.⁴

While the physical impacts of climate change may be manageable through existing frameworks for mitigating natural disaster-related risks, more uncertain are the risks associated with policy expectations. Since the 2007 Supreme Court case *Massachusetts v. EPA* there has been a defined governmental requirement to address greenhouse gas emissions like other regulated pollutants.⁵ In the intervening 14 years, there has been no federally implemented cap-and-trade, carbon tax, clean energy standard, or other broadly encompassing policy to statutorily define greenhouse gas emission limits or expectations. The most significant greenhouse gas emission-related regulation, the Clean Power Plan of 2015, was stayed by the Supreme Court in 2016 before the Trump administration replaced it with the Affordable Clean Energy Rule. Registrants know and expect that at some point governmental policy will impose costs on their emitting activities, but it is unreasonable to expect that registrants can adequately anticipate the precise forms such a policy will take.

² R.K. Pachauri et al., *Fifth Assessment Report of the Intergovernmental Panel on Climate Change*, Intergovernmental Panel on Climate Change, 2014, p. 15. https://www.ipcc.ch/site/assets/uploads/2018/02/SYR_AR5_FINAL_full.pdf.

³ *Ibid*, p. 13.

⁴ Bradley Hope and Nicole Friedman, “Climate Change is Forcing the Insurance Industry to Recalculate,” *The Wall Street Journal*, October 2, 2018. <https://www.wsj.com/graphics/climate-change-forcing-insurance-industry-recalculate/>.

⁵ *Massachusetts v. EPA*, United States Supreme Court, April 2, 2007. <https://www.law.cornell.edu/supct/html/05-1120.ZS.html>.

Nevertheless, the climate change-related risk from policy expectations exceeds that of the physical impacts. Near-term investment decisions related to climate change will more likely be driven by investor expectations of policies that would constrain the profitability of energy-intensive industries, rather than the short-lived or temporary effects of natural disasters. When considering the traditional role of the Commission in improving investor confidence in markets, disclosures that assure investors that registrants are prepared for climate change-related policy are more likely to be germane to materiality concerns. Importantly, the Commission should also recognize that it is these aspects which are most likely to affect nontaxable accounts, and thus indicate financial risks that may be felt more broadly throughout the economy.

Disclosure requirements attached to specific measurements, however, may be ill advised. It may be tempting to require registrants to estimate emissions, be they scope 1, 2, or 3, but such information is likely of little use despite its difficulty in being measured. Emissions accounting is more difficult and complex the further from the point of incidence that the emission occurs. Scope 3 emissions are harder to measure than scope 1. The relevance of emissions is most useful for emission-intensive registrants, such as oil and gas companies, but emission information in isolation tells investors nothing because it does not indicate the variability of product demand. Oil, for example, has a high greenhouse gas emissions impact, and oil companies will undoubtedly have high emissions under such disclosure requirements, but the global supply and demand for oil is also typically inelastic in the short term. Even policies such as a carbon tax may have only small impacts on the profitability of oil companies because there are few oil substitutes, so such taxes would be passed onto consumers.⁶ Emissions accounting would not provide information that fits the traditional definition of materiality as it pertains to investment. Furthermore, emitting firms are already required to estimate emissions under 40 CFR part 98.⁷

Registrants that are less emissions intensive, even if they were able to provide scope 2 or 3 emissions, may also bear high costs to produce information that is of little value. In estimating the emissions intensity of cross-border transactions, the Congressional Budget Office found that many high value industries have comparatively low emissions intensity.⁸ As such, an accounting of emissions may be novel, but it may not be material because policies constraining emissions would have only a small effect on the profitability of most registrants.

⁶ Perry Lindstrom, "EIA Analysis Shows how Carbon Fees would Reduce Carbon Dioxide Emissions in the Near Term," *U.S. Energy Information Administration*, March 17, 2020. <https://www.eia.gov/todayinenergy/detail.php?id=43176>.

⁷ "Greenhouse Gases Reporting Program Implementation Fact Sheet," *U.S. Environmental Protection Agency*, November 2013, p. 1. <https://www.epa.gov/sites/production/files/2014-09/documents/ghgrp-overview-factsheet.pdf>.

⁸ *Border Adjustments for Economywide Policies that Impose a Price on Greenhouse Gas Emissions*, Congressional Budget Office, December 2013, p. 8. <https://www.cbo.gov/sites/default/files/113th-congress-2013-2014/reports/44971-GHGandTrade.pdf>.

Furthermore, it should be noted that attempts to have registrants disclose something like their emissions could, ironically, exacerbate risk rather than mitigate it. The Commission's limited scope of regulatory authority means that a potential response from registrants to such a disclosure requirement would be to shift their activities, consumption, and production in ways that minimize their reported emissions. As an example, if a registrant that has delivery components of its products seeks to use electric vehicles to minimize their need for emissions reporting, they would also be creating a new reliance on cobalt, which is mostly produced by the Democratic Republic of the Congo and refined by Chinese state owned enterprises.⁹ If multiple registrants adopt such behaviors, the observed climate change-related risk would appear to be in decline, but this would mask an increased homogenization of supply chains and reliance on foreign production that lies outside of the Commission's regulatory scope. Such supply chains, whether in the United States or abroad, may also be vulnerable to the physical impacts of climate change just the same as ones in the United States would be.

A more appropriate focus for the Commission in attempting to mitigate risk is to focus on registrants' internal processes for anticipating climate change-related risks, both from physical impacts and policy expectations. Emission intensive industries frequently craft scenario analysis, and often these are even shared publicly as firms want to assure investors that all possible scenarios are seriously considered. British Petroleum, ExxonMobil, Royal Dutch Shell and Chevron all regularly release climate change-related reports detailing emission scenarios, policy options, and their own expectations of preparedness to operate under potential policy constraints. Disclosure requirements that aim to standardize and improve uniformity of some of the key findings of these reports from energy-intensive registrants as part of 10-K filings could be material to investors, improving informational quality and making comparative analysis easier—one of the key functions of 10-K reporting. If investors are better able to assess the comparability of climate change-related risk among firms where risk is more likely to be concentrated, then they can more efficiently allocate capital in a way that rewards risk mitigation.

4. What are the advantages and disadvantages of establishing different climate change reporting standards for different industries, such as the financial sector, oil and gas, transportation, etc.? How should any such industry-focused standards be developed and implemented?

Any reporting standards should be differentiated among industries because the reported information is not relevant to investors for every industry or sector. Investors in an oil and gas company are likely more concerned with that firm's actions regarding climate change than investors in an entertainment experience firm. Because climate change is a heterogeneous risk that does not impact all industries equally, any adopted reporting standards should be appropriately varied.

More important than the heterogeneity of climate change-related risk, though, is that the point of incidence for climate change-related impacts matters for mitigating risk. Reporting standards or other

⁹ Jack Farchy and Hayley Warren, "China Has a Secret Weapon in the Race to Dominate Electric Cars," *Bloomberg*, December 2, 2018. <https://www.bloomberg.com/graphics/2018-china-cobalt/>.

disclosure requirements should not be adopted merely as information seeking ventures, but instead as efforts to address informational deficiency that could exacerbate risk. As noted above, climate change-related policy response entails greater near-term risks than the physical impacts of climate change, and those policies will principally impact energy intensive firms. The preparedness of these firms to mitigate the costs of climate change-related policies will have the most impact on the overall health of financial markets more broadly.

As COVID-19 reached pandemic status in March of 2020, stocks crashed, with the Dow Jones Industrial Average falling approximately 26 percent.¹⁰ A report published as part of the Elsevier Public Health Emergency Collection found that this was driven mostly by sectors heavily affected by COVID-19, with petroleum, real estate, hospitality and entertainment experience market capitalization falling by over 70 percent.¹¹ Were these sectors better prepared for COVID-19—granted a near impossibility as the risk was not easily foreseen—the broader financial impacts to the economy may have been somewhat mitigated.

Similarly, with climate change, it is the sectors that are most likely to be directly affected that will drive broader impacts that could have secondary or tertiary economic effects, and as such disclosure requirements or reporting standards that are constrained to at-risk registrants would be more impactful than broad requirements that would raise burdens without additional benefit.

As an important note, one should exercise caution when looking to COVID-19's impact on oil and gas companies as indicative of any broader risk to those industries related to climate change. As a result of COVID-19, global oil demand fell by 20 million barrels per day (about 20 percent) almost immediately.¹² Conversely, the Energy Information Administration's (EIA) 2019 International Energy Outlook expects global liquids demand (oil, petroleum fuels, etc.) to rise at an annualized rate of 0.6 percent through 2050.¹³ It is unlikely that climate policies will have nearly as severe or rapid a financial impact on energy firms as COVID-19 had.

Disclosure requirements or reporting standards that are adopted by the Commission should be constrained to the registrants that have energy-intensive activities, and expectations of information furnished should be cognizant of the long-term nature of climate change-related risks. Most useful for

¹⁰ Mieszko Mazur et al., "COVID-19 and the March 2020 Stock Market Crash. Evidence from S&P1500," *National Institutes of Health Elsevier Public Health Emergency Collection*, July 9, 2020. <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC7343658/>.

¹¹ Ibid.

¹² Mark Mozur et al., "Moving Mountains: COVID-19 and Peak Oil Demand," *S&P Global*, 2020. <https://www.spglobal.com/en/research-insights/featured/moving-mountains-covid-19-and-peak-oil-demand>.

¹³ *International Energy Outlook 2019*, U.S. Energy Information Administration, September 24, 2019, Table: World total energy consumption by region and fuel (reference case). <https://www.eia.gov/outlooks/aeo/data/browser/#/?id=2-IEO2019®ion=0-0&cases=Reference&start=2010&end=2050&f=A&linechart=Reference-d080819.74-2-IEO2019&ctype=linechart&sourcekey=0>.

investors will be knowledge that firms are anticipating and prepared for potential policies that may impose additional burdens on their activities or could constrain product demand.

7. What is the best approach for requiring climate-related disclosures? For example, should any such disclosures be incorporated into existing rules such as Regulation S-K or Regulation S-X, or should a new regulation devoted entirely to climate risks, opportunities, and impacts be promulgated? Should any such disclosures be filed with or furnished to the Commission?

Any new disclosure requirement should be satisfied through existing Regulation S-K compliance, and should be constrained to annual documents, such as the 10-K. The utility of new information for investors as it pertains to climate change will depend on the information's brevity and comparability to reporting from other firms, as is seen with existing 10-K reporting.

The creation of new regulation devoted specifically to climate change may offer little actionable information for investors. Registrants may be incentivized to disclose unrelated or frivolous information that paints them in a positive light as environmentally conscientious, but simultaneously offering no information that is relevant to a firm's profitability or investment risk.

The primary responsibility of the Commission is to ensure that the appropriate level of transparency is exercised among registrants, and to preserve investor confidence that all pertinent information to their decision making is disclosed. Too much information is just as problematic as too little, as investors have limited time to evaluate investment opportunities and highly pertinent information can be drowned out by too much unnecessary information.

Conversely, it is not the responsibility of the Commission to incentivize or induce registrants to undertake activities that may be politically or socially preferred, but are nonetheless outside of conventional material concerns. It is the responsibility of other regulatory bodies to ensure environmental outcomes are appropriately achieved, and it is those bodies that have the statutory authority as well as the institutional expertise to achieve those aims. The Commission's role, as it pertains to climate change, is to determine if existing information disclosure requirements under its regulations have created an informational deficiency that exacerbates risk and if so to improve the existing disclosure regime when such issues arise. If the Commission seeks to create new rules that are narrow in scope, it should seek to adequately prove that existing regulatory mechanisms are insufficient in fulfilling its institutional responsibilities before creating a new regulatory regime.

III. Conclusion

The R Street Institute respectfully requests the Commission consider the public input offered herein.

Respectfully submitted,

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