June 11, 2021

Via Electronic Mail (rule-comments@sec.gov)

Hon. Gary Gensler, Chair
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chair Gensler:

In 1971, the Natural Resources Defense Council (NRDC) and the Project on Corporate Responsibility petitioned the Securities and Exchange Commission (SEC or Commission) to expand securities disclosure regulations on employment practices and the environment.[1] After several rounds of litigation, the SEC denied our petition.[2] Its rationale at the time was that disclosure of environmental and social issues was beyond its investor protection mandate. Investors were concerned with companies' financial performance, not their environmental or social performance, and so disclosure was unnecessary.[3]

Times have changed substantially since 1971, when we first filed our petition for rulemaking. At the time that the SEC denied that petition, the Commission identified only four mutual funds that claimed to take environmental and social governance (ESG) into consideration when making investment decisions, and two of those funds had no assets at all.[4] Today, 26 percent of the mutual fund market consists of funds that expressly incorporate ESG and sustainability into their

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[1] *See* Notice of Comm'n Conclusions & Rulemaking Proposals in the Pub. Proceeding Announced in Sec. Act Release No. 5569 (Feb. 11, 1975) Regarding (1) Such Further Disclosure, If Any, of Env't Matters in Registration Statements, Reps. & Other Documents Required to Be Filed or Furnished to Invs. Pursuant to the Sec. Act of 1933 & the Sec. Exch. Act of 1934 As May Be Necessary, Consistent with the Nat'l Pol'y, Release No. 5627 (Oct. 14, 1975) [hereinafter Notice of Conclusions].

[2] *See NRDC v. SEC*, 389 F. Supp. 689, 693-94 (D.D.C. 1974) (remanding the petition denial the SEC); *NRDC v. SEC*, 432 F. Supp. 1190, 1194-95 (D.D.C. 1977) (invalidating the SEC's denial of the petition as arbitrary and capricious); *NRDC v. SEC*, 606 F.2d 1031, 1036 (D.C. Cir. 1979) (reversing the district court's 1977 decision and upholding the SEC's ultimate denial of the rulemaking petition).

[3] Notice of Conclusions, *supra* note 1, at *16 ("The Commission's experience over the years in proposing and framing disclosure requirements has not led it to question the basic decision of the Congress that, insofar as investing is concerned, the primary interest of investors is economic.").

[4] *Id.* at *15.

investment decision making.[5] In 1975, social issue proposals subject to corporate proxy voting received two or three percent support, on average.[6] Today, corporate resolutions on ESG issues receive 24 percent support, on average,[7] investors have succeeded in electing sustainability-focused directors,[8] and as we explain later, many corporations have voluntarily joined reporting agreements in response to investor and other market participants' demands. Survey data shows that most investors – even investors without a social or sustainability focus – use ESG information and consider it relevant to their investment decisions.[9] Corporate disclosure on ESG is widespread, albeit not universal. And a large segment of investors and other market participants are demanding more decision-useful information, in a form that is consistent and comparable across companies. Whatever may have been the case in 1975, in 2021 there is overwhelming evidence that ESG information is material to investors and other market participants.

In considering enhanced climate-related disclosures, the SEC must recognize that its mission is not simply to protect investors – or provide the information that only investors desire. Rather, the SEC's mission also includes the promotion of "fair, orderly, and efficient" markets, capital formation, and protection of the public interest. The SEC must recognize that many parties that are not investors, who provide essential roles in promoting fair, orderly and efficient markets, rely upon its disclosure regime.

For example, lenders review companies' public disclosures when making decisions about the extension of credit. Workers, executives, and board members (and their representatives) often look to companies' disclosures when making employment and benefits decisions. Competitors often benchmark their decisions on peer reviews based on SEC-mandated disclosures. Credit rating agencies often read disclosures when making determinations of risks. Index providers may read disclosures to assess whether and how to include a particular investment. Market

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[5] Aisha I Saad & Diane Strauss, *The New "Reasonable Investor" and Changing Frontiers of Materiality: Increasing Investor Reliance on ESG Disclosures and Implications for Securities Litigation*, 17 Berkeley Bus. L.J. 391, 410 (2020).

[6] Notice of Conclusions, *supra* note 1, at *15.

[7] Saad & Strauss, *supra* note 5, at 411.

[8] *See, e.g.*, Jennifer Hiller & Svea Herbst-bayliss, *Exxon loses board seats to activist hedge fund in landmark climate vote*, Reuters (May 26, 2021) *available at*: https://www.reuters.com/business/sustainable-business/shareholder-activism-reaches-milestone-exxon-board-vote-nears-end-2021-05-26/.

[9] Hanna Vizcarra, *The Reasonable Investor and Climate-Related Information: Changing Expectations for Financial Disclosures*, 50 Env't Law Rep. 10106, 10109 (2020).

data and analysis firms may review disclosures to provide insights for investors, lenders, or others doing business with a company. And, of course, there are customers, who may decide to engage in business with companies based on a variety of factors, including those companies' disclosures.

Each of these market participants – and many others – rely on the SEC's mandatory disclosure regime to help protect investors, drive fair, orderly, and efficient markets, promote capital formation, and protect the public interest.

We urge the SEC to adopt climate-related disclosures that will provide all of these essential market participants with the information they need to make informed business decisions. In particular, we recommend amending Regulations S-K and S-X to require public companies to file public disclosures regarding their emissions of greenhouse gases, their vulnerability to the physical and transition risks of climate change, their process for identifying climate-related risks and opportunities, and their corporate governance structure for sustainability. We suggest that the SEC promulgate a regulation specifying the climate change disclosures that it expects companies to provide, subject to some tailoring at the SEC's discretion. The Division of Corporation Finance can subsequently issue guidance on the SEC's disclosure requirements, including identifying existing disclosure frameworks which cover the information required by the SEC's rule and have acceptable methodologies for identifying and quantifying risks. Requiring that companies file these disclosures with the SEC as part of the annual reporting process will help to ensure to the accuracy of those disclosures. It will also allow the Division of Corporation Finance to review them and, when appropriate, take enforcement action to address failures.

NRDC is an international nonprofit environmental organization with more than 3 million members and online activists. Since 1970, our lawyers, scientists, and other environmental specialists have worked to protect the world's natural resources, public health, and environment. NRDC has offices in New York City, Washington D.C., Los Angeles, San Francisco, Chicago, Montana, and Beijing. Through its finance and legal experts, NRDC remains engaged in financial regulation and views working with regulators as an integral part of achieving our climate strategy.

Our comments will first identify the decision-useful information that investors and the public need related to climate change, and the climate risks and opportunities public companies face. Section II of our comments discusses how investors and others use climate and sustainability disclosures. Section III discusses why the SEC should promulgate mandatory disclosure recommendations rather than rely on voluntary reporting. Section IV presents the substance of the disclosures that we recommend that the SEC adopt. Section V presents our recommendations for promulgating and updating those regulations. Section VI discusses the possibility of adopting a "comply or explain" option for some parts of a mandatory disclosure regulation. Section VII discusses private market sales. Throughout, we have tried to identify the relevant questions from the RFI in each section heading.

I. Identifying critical data on climate change (RFI Question 2)

There are many ways of sorting climate change-related data, but our discussion defines the relevant universe as information about climate risks for the company, and information about the company's contribution to climate change. The former category splits between physical risks and transition risks. The latter category boils down to emissions data. Regulators already require some degree of reporting about greenhouse gas emissions, and we begin there.

A. Emissions Data

Many companies make emissions data available through voluntary disclosure frameworks and some companies (primarily companies that own or operate large industrial facilities) must report their emissions data to the Environmental Protection Agency (EPA) and state regulators. Most emissions reports use a three-part framework first developed by the Greenhouse Gas Protocol: Scope 1, Scope 2, and Scope 3 emissions. Collectively, disclosure of Scope 1, Scope 2, and Scope 3 emissions catalogs all emissions from an organization's operations and activities. Companies report on their emissions of six different greenhouse gases: "carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, sulphur hexafluoride."[10]

"Scope 1 emissions are direct greenhouse (GHG) emissions that occur from sources that are controlled or owned by an organization (e.g., emissions associated with fuel combustion in boilers, furnaces, vehicles)."[11] Scope 2 emissions do not come directly from facilities owned by the company but "are indirect GHG emissions associated with the purchase of electricity, steam, heat, or cooling."[12] One company's Scope 2 emissions are another company's Scope 1 emissions, but "they are

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[10] The Greenhouse Gas Protocol, *A Corporate Accounting and Reporting Standard* 3, https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf.

[11] Environmental Protection Agency, *Scope 1 and 2 Inventory Guidance*, https://www.epa.gov/climateleadership/scope-1-and-scope-2-inventory-

[12] *Id.*

accounted for in an organization's GHG inventory because they are a result of the organization's energy use."[13]

The final category – Scope 3 – is a catch-all covering "all sources not within an organization's scope 1 and 2 boundary."[14] "Scope 3 emissions are the result of activities from assets not owned or controlled by the reporting organization, but that the organization indirectly impacts in its value chain. . . . Scope 3 emissions, also referred to as value chain emissions, often represent the majority of an organization's total GHG emissions."[15] Because one company's Scope 1 emissions are another company's Scope 3 emissions, this is a difficult category to completely track down and companies often use shortcuts to catalog and estimate these emissions.

EPA requires some industrial sources to quantify and report their Scope 1 emissions.[16] The greenhouse gases subject to reporting are carbon dioxide, methane, nitrous oxide, sulfur hexafluoride, hydrofluorocarbons, perfluorocarbons, and other fluorinated greenhouse gases.[17] Three categories of sources must report. The first is "[a] facility that contains any source category" listed in Table A-3 of the regulations.[18] The second category is "[a] facility that contains any source category that is listed in Table A–4 of this subpart and that emits 25,000 metric tons carbon

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[13] *Id.*

[14] *Environmental Protection Agency*, Scope 3 Inventory Guidance, https://www.epa.gov/climateleadership/scope-3-inventory-guidance.

[15] *Id.*

[16] *See* 40 C.F.R. § 98.2 (greenhouse gas inventory regulations).

[17] 40 C.F.R. § 98.6.

[18] The source categories in A-3 are: Electricity generation units that report CO2 mass emissions year round through 40 CFR part 75; Adipic acid production; Aluminum production; Ammonia manufacturing; Cement production; HCFC-22 production; HFC-23 destruction processes that are not collocated with a HCFC-22 production facility and that destroy more than 2.14 metric tons of HFC-23 per year; Lime manufacturing; Nitric acid production; Petrochemical production; Petroleum refineries; Phosphoric acid production; Silicon carbide production; Soda ash production; Titanium dioxide production; Municipal solid waste landfills that generate CH4 in amounts equivalent to 25,000 metric tons CO2e or more per year, as determined according to subpart HH of this part; Manure management systems with combined CH4 and N2O emissions in amounts equivalent to 25,000 metric tons CO2e or more per year, as determined according to subpart JJ of this part. Electrical transmission and distribution equipment use at facilities where the total nameplate capacity of SF6 and PFC containing equipment exceeds 17,820 pounds, as determined under § 98.301; Underground coal mines liberating 36,500,000 actual cubic feet of CH4 or more per year; Geologic sequestration of carbon dioxide; Electrical transmission and distribution equipment manufacture or refurbishment, and; Injection of carbon dioxide. 40 C.F.R. § 98.2 Subpt.A, Tbl. A-3.

dioxide equivalent (CO2e) or more per year in combined emissions from stationary fuel combustion units, miscellaneous uses of carbonate, and all applicable source categories that are listed in Table A–3 and Table A–4 of this subpart."[19] The third category is "[a] facility that in any calendar year" after 2010 is not otherwise required to report, has an "aggregate maximum rated heat input capacity" of "30 mmBtu/hr or greater," and "emits 25,000 metric tons" carbon dioxide-equivalent "or more per year in combined emissions from all stationary fuel combustion sources."[20] EPA's regulations also require that "[s]uppliers" (primarily suppliers of petroleum, petroleum products, and natural gas) report their emissions to the inventory, whether or not those facilities are otherwise covered.[21]

Some states maintain their own inventory of greenhouse gas emissions from industrial facilities. California, for example, has a greenhouse gas inventory program that applies to electricity generation units, cement production, lime manufacturing, nitric acid production, petroleum refineries, geologic sequestration of carbon dioxide, and injection of carbon dioxide.[22] California's program also applies to stationary fuel combustion systems that emit more than 10,000 metric tons of carbon dioxide-equivalent in a year, fuel suppliers and operators of petroleum and natural gas systems, and facilities subject to EPA's reporting requirements that emit more than 10,000 metric tons of carbon dioxide-equivalent in a year.[23] New York is seeking comment on the format of a statewide report on greenhouse gas emissions.[24]

The greenhouse gas inventories that EPA and state regulators have compiled are helpful in providing a national or state-wide view of greenhouse gas emissions, but they are not contemporaneous reports and they present aggregated information. The most recent report available on EPA's website covers 2019. The most recent

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[19] The source categories in A-4 are: Ferroalloy production; Glass production; Hydrogen production; Iron and steel production; Lead production; Pulp and paper manufacturing; Zinc production (subpart GG); Electronics manufacturing; Fluorinated gas production; Magnesium production; Industrial wastewater treatment; Industrial waste landfills, and Petroleum and Natural Gas Systems. 40 C.F.R. § 98.2 Subpt. A, Tbl. A-4.

[20] 40 C.F.R. § 98.2(a)(1)-(3).

[21] 40 C.F.R. § 98.2(a)(4).

[22] 17 Cal. Code Reg. § 95101.

[23] *Id.*

[24] N.Y. Dep't of Env't Conservation, Reducing Greenhouse Gas Emissions, https://www.dec.ny.gov/energy/99223.html.

report available from California covers 2018. In both cases, the reports provide aggregate details of annual emissions by industry sector. Many companies are already tracking their Scope 1 emissions because of these inventories – or at least they *should* be tracking them. Investors cannot easily access company-specific information, however, and these reports do not cover significant emitting sectors, including land use and transportation.

Voluntary frameworks ask for greenhouse gas emissions data but ask for different levels of detail. The Task Force on Climate-related Financial Disclosures recommends that companies disclose their Scope 3 emissions "if appropriate."[25] Their industry-specific guidance recommends that some companies in the energy and agriculture, food, and paper products sectors disclose Scope 3 emissions.[26] The Carbon Disclosure Project uses the Greenhouse Gas Protocol's methodology for calculating Scope 3 emissions, which has 15 categories.[27] The Partnership for Carbon Accounting Financials also uses the Greenhouse Gas Protocol framework.

Scope 3 emissions disclosures are inconsistent because companies take different approaches to calculating them. Those different approaches cause "significant inconsistencies," such as automakers who do not include emissions from vehicles they've sold in their Scope 3 emissions.[28] Financial companies are another example of inconsistency. Their Scope 3 emissions from financing energy or manufacturing companies are likely to be their most significant sources. Yet the Carbon Disclosure Project recently reported that, among the companies reporting to them, only a quarter of financial companies estimated financed emissions from their investment portfolios.[29]

Voluntary initiatives have shown promise in developing Scope 3 disclosures, however. The Partnership for Carbon Accounting Financials published a framework for financial companies to disclose their Scope 3 emissions from investing

[25] Task Force on Climate-related Financial Disclosures, *Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures* 12 (2017).

[26] *Id.* at 54, 62.

[27] Carbon Disclosure Project, *CDP Technical Note: Guidance on methodology for estimation of Scope 3 Category 11 emissions for coal mining companies* 6 (2021).

[28] Daniel C. Esty, *Creating Investment-Grade Corporate Sustainability Metrics* in *Values at Work: Sustainable Investing and ESG Reporting* (Daniel C. Esty and Todd Cort, eds.) 56-57 (2020).

[29] Carbon Disclosure Project, *The Time to Green Finance: CDP Financial Services Disclosure Report 2020* 3 (2021).

activities.[30] Their framework includes methodologies for estimating and allocating emissions in an investment portfolio.[31] Apple has also endorsed accounting for Scope 3 emissions for its own products.[32] There is progress, albeit with lingering inconsistencies on Scope 3 reporting.

B. Climate Risks for Companies

The risks of climate change separate into two categories: physical risks, such as loss of capacity or destruction of infrastructure, degradation of human health, and reduction of agricultural productivity; and transition risks, such as legal and regulatory changes necessary to stem climate change, changes in consumer preferences or activity in response to climate change, and stranded assets as climate change makes certain projects infeasible.[33]

Nearly all industries face physical risks from climate change. Telecommunications, energy, and transportation – industries that build and maintain physical infrastructure – face risks from the destruction of that infrastructure at specific locations, and also because infrastructure will wear out faster and will not perform as well when subjected to extreme weather.[34] Agriculture faces risks from declining crop yields, poorer health of farmworkers, and degraded soil and water quality.[35] Manufacturers may encounter supply chain disruptions from more powerful storms. Investors with commercial real estate holdings in low-lying coastal areas may find that those properties will become unusable and uninsurable. Other types of risk are common to all industries, although suffered in different degree by different industries. Climate change will lead to degraded air quality, disease, food contamination and scarcity, and physical and mental health injuries from extreme events like wildfires, floods, and hurricanes. In addition to their significant human toll, these health effects could

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[30] PCAF, *The Global GHG Accounting and Reporting Standard for the Financial Industry*, First edition (2020).

[31] *Id.* Ch. 4.

[32] Ross Kerber & Stephen Nellis, *Apple backs far-reaching emissions disclosure rules*, Reuters (Apr. 12, 2021), https://reut.rs/3cyiSlE.

[33] CFTC, Market Risk Advisory Committee, Managing Climate Risk in the U.S. Financial System [MRAC Report] at 12, 19 (2020).

[34] *Id.* at 14, 16-17.

[35] *Id.* at 13-14.

reduce labor productivity.[36] Damage to labor markets would also reduce personal incomes and expenditures, which would in turn hurt consumer industries.[37] Extreme weather events create physical risks because "individual assets, industries, and communities, as well as entire regional and national economies, remain highly vulnerable to the weather."[38] Swiss Re estimated that in 2017, extreme weather events caused $326 billion in damages globally.[39] That is the highest figure on record.

Estimates of the economic impact of climate change depend on both the timeframe under examination as well as the severity of warming. One study estimated the economic effects of climate change in the United States by 2090 under two scenarios: one assuming that temperatures rise an average of 4.3 degrees Celsius from pre-industrial levels, and one assuming that temperatures rise an average of 2.4 degrees Celsius above pre-industrial levels. Under the more dramatic warming scenario, the costs attributable to climate change would be $513 billion per year; they would be $283 billion per year under the lower warming scenario.[40] That is in the long-term. In the more immediate term, the Carbon Disclosure Project reported that 215 of the world's 500 largest companies collectively identified approximately $1 trillion in climate risks to their businesses as of 2018.[41] Over half of these risks were projected as likely to occur within the next five years.[42]

Reporting of physical risks by individual companies is relatively sparse, however. "The few companies that report risks do so in a qualitative manner – giving investors little information about the financial implications of physical

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[36] *Id.* at 17-18.

[37] *Id.* at 19.

[38] Rhodium Group, *Clear, Present, and Underpriced: The Physical Risks of Climate Change* 2 (2019).

[39] *Id.*

[40] Jeremy Martinich & Allison Crimmins, *Climate Damages and Adaptation Potential Across Diverse Sectors of the United States*, Supplementary Information, Tbl. 5, author manuscript with supplementary information available at https://www.ncbi.nlm.nih.gov/pmc/articles/PMC6483104/, published as 9 Nature Climate Change 397 (2019) (tallying economic impacts from RCP4.5 and RCP8.5 scenarios); SENSES, Climate Change Scenarios, Mitigation, https://climatescenarios.org/primer/mitigation/ (estimating that RCP4.5 is about 2.4 degrees C and RCP8.5 is about 4.3 degrees C above preindustrial times by the end of the century).

[41] Carbon Disclosure Project, *Major Risk or Rosy Opportunity* at 5 (2019).

[42] *Id.*

climate risk and likely underestimating their magnitude."[43] The Task Force on Climate-related Financial Disclosures recommends disclosures about a company's process for identifying and managing physical risks, along with its processes for integrating physical risks into overall risk management.[44] Companies may also disclose the "metrics and targets" they use to assess physical risks and to manage them. The Carbon Disclosure Project asks companies to identify "substantive" physical risks from climate change along with the likelihood of those risks occurring.[45]

The World Economic Forum published recommendations on corporate sustainability disclosure in January 2020. Their core reporting recommendations are "TCFD-aligned," and ask disclosing companies to follow the Task Force on Climate-related Financial Disclosures' framework. The World Economic Forum's recommendations include supplemental disclosure on overall land use from operations and fresh water consumption in water-stressed areas.[46] Supplemental disclosures include valued social impact of air pollution, water pollution, solid waste disposal, single use plastics, and resource circularity.[47]

Third parties have developed their own data sets that map physical risks onto extreme weather events projected by climate models. The Rhodium Group has modeled the effect of extreme weather events – extreme heat, coastal flooding, and hurricanes – on asset classes like municipal bonds, commercial real estate, and utilities.[48] Four Twenty Seven, another data firm, "has developed a dataset that matches the precise locations of corporate assets with granular climate and

[43] Rhodium Group, *supra* note 38, at 3.

[44] *See* Task Force on Climate-related Financial Disclosures*, Recommendations of the Task Force on Climate-related Financial Disclosures* 14 (2017).

[45] Carbon Disclosure Project, *supra* note 41, at 5, 9, 11-12, 20.

[46] World Economic Forum, *Toward Common Metrics and Consistent Reporting of Sustainable Value Creation*, Pillar 2 – Planet, Core Metrics and Disclosures (2020).

[47] *Id.* at Pillar 2 – Planet, Expanded Metrics and Disclosures.

[48] *See* Rhodium Group, *supra* note 38, at 9-11.

environmental risk data globally."[49] Their data examines hurricanes and typhoons, heat stress, and water stress as relevant environmental risks.[50]

All industries also face some degree of transition risk from climate change. That has mostly to do with their uncertainty about how U.S. state and federal governments – and for some companies, foreign governments – will respond to climate change; carbon taxes and emissions limits are a source of legal and regulatory risk that most companies readily identify when surveyed.[51] Stranded assets – from, for example, supply chain changes or shifts in consumer preference – are another source of transition risk. Fossil fuel producers[52] and other high-impact industries, such as steel production,[53] risk having stranded assets as countries transition to a low-carbon economy. But financial firms must also account for transition risk in their loan and investment portfolios, and many firms must invest in technology to be able to utilize zero emissions energy and transportation.[54] Government policy is not the only source of transition risk; changes in market preferences also create transition risk. Hydrocarbon reserves, to offer one example, may be stranded and devalued as consumers and energy producers adopt clean energy technologies.[55]

The widespread nature of these risks, and the likelihood that public companies are not disclosing enough about them, creates systemic risk. Without adequate information, investors and other market participants will make worse business decisions. They will misallocate their capital. They will misprice risks.

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[49] Natalia Ambrosio Preudhomme & Emilie Mazzacurati, *Asset-Level Physical Climate Risk Disclosure*, in *Values at Work: Sustainable Investing and ESG Reporting* 69 (Daniel C. Esty & Todd Cort, eds.) 2020.

[50] *Id.* at 70-71.

[51] *Id.* ("53% of companies reporting to CDP identify inherent climate-related risks with the potential to have a substantive financial or strategic impact on their business, with almost double the number of transition risks versus physical risks reported overall.").

[52] MRAC Report, *supra* note 33, at 19.

[53] *See, e.g.*, *U.S. Steel Scraps Investment Project In Mon Valley Works*, CBSlocal, Apr. 30, 2021, *available at* https://pittsburgh.cbslocal.com/2021/04/30/us-steel-cancels-mon-valley-works-project/ , (Statement of David Burritt, President and CEO of U.S. Steel Corporation, explaining that a planned steel mill investment in Pittsburgh was scuttled, in part, because "we expanded our understanding of steelmaking's future in a rapidly decarbonizing world.").

[54] MRAC Report, *supra* note 33, at 20.

[55] *Id.* at 19-20.

Worse, if that mispricing persists, it may be corrected at some point in the future – and corrected sharply, given that the risks of climate change stem in large part from catastrophic events, which strike quickly and could hit financial markets just as quickly.[56]

Voluntary disclosure frameworks rely on companies to quantify transition risks and to disclose the methodologies they use to identify transition risks. The Task Force on Climate-related Financial Disclosures recommends that companies disclose transition risks, including policy and legal risks, technology risk, market risk, and reputation risk, along with opportunities (in terms of resource and energy efficiency, products and services, new markets, and resilient operations).[57] The Carbon Disclosure Project also asks companies if they foresee a "substantive" transition risk to their operations.[58]

II. Sustainability information is relevant to investors and other market participants (RFI Question 2)

There is growing empirical evidence that ESG information influences the decisions of investors, companies, and other market participants. A meta-review of over 2,200 studies on ESG and financial performance found a positive relationship between environmental responsibility and financial performance, and concluded that "the orientation toward long-term responsible investing should be important for all kinds of rational investors in order to fulfill their fiduciary duties and may better align investors' interests with the broader objectives of society."[59] Another recent study – focused on specific examples of sustainability issues around sourcing of palm oil and coal – found that stock prices can change suddenly and dramatically because of regulatory risk and changes in consumer preferences, and that sustainability information can mitigate this risk.[60]

The last decade has demonstrated that many investors and asset managers use environmental disclosures when making decisions, and there is growing demand for environmental disclosures from public companies. As of 2018,

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[56] *Id.* at 26-27.

[57] Task Force on Climate-related Financial Disclosures, *supra* note 44, at 5-7.

[58] Carbon Disclosure Project, *supra* note 41, at 11-12.

[59] Gunnar Friede, *et al.*, *ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies*, 5 J. Sustainable Fin. & Inv. 210, 226-27 (2015).

[60] Ravi Jagannathan, Ashwin Ravikumar, & Marco Sammon, *Environmental, Social, and Governance Criteria: Why Investors are Paying Attention* at 2 (NBER Working Paper No. 24063).

sustainable investment funds controlled $30.7 trillion in assets under management across five major markets.[61] Those funds depend on accurate information from public companies and have been pushing for it. Climate Action 100+, a network of 575 investors with more than $54 trillion in assets under management, has called on public companies to make greater disclosures about climate change.[62] The United Nations Principles for Responsible Investment requires corporate governance and strategy reports on climate change from its members, who manage more than $100 trillion in assets.[63] Aside from these coalitions, individual investors, including BlackRock, the California State Teachers Retirement System, and the Norwegian government pension fund have all demanded greater transparency and action from public companies on sustainable business practices.[64]

Finally, the existence of a private market for sustainability reporting demonstrates investor interest in this topic. Two firms – Sustainalytics and MSCI – have published ESG data for years, and Bloomberg launched its own proprietary ESG scores in August 2020.[65] (Unfortunately, those firms demonstrate the market demand for ESG information but also the limits of non-standardized, voluntary disclosure. A study of MSCI and Sustainalytics' scoring found a correlation of 0.2, indicating wide disparities in their ESG scoring.)[66]

Investors, index providers, and other market participants often use sustainability information to eliminate or weight their risk to physical and transition risks as well as to weight investments.

Somewhat simplified, these approaches can be broken down as "screening," which "entails removing exposure to specific high-carbon-emitting industries such as utilities or traditional fossil-fuel industries;" mitigation, which "set[s] an explicit objective to reduce the flow of heat-trapping greenhouse gases into the atmosphere and increase exposure to 'green' companies," and adaptation, which "extends

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[61] *Global Sustainable Investing Alliance*, 2018 Global Sustainable Investment Review, at 3.

[62] Climate Action 100+, https://www.ceres.org/initiatives/climate-action-100 (last accessed June 10, 2021).

[63] UNPRI, https://www.unpri.org/annual-report-2020/foreword.

[64] MRAC Report, *supra* note 33, at 8.

[65] Press Release, *Bloomberg Launches Proprietary ESG Scores*, https://www.bloomberg.com/company/press/bloomberg-launches-proprietary-esg-scores/ (Aug. 11, 2020).

[66] Esty, *supra* note 28, at 52.

mitigation to include an explicit objective to increase exposure to companies adjusting to actual or expected future climate change impacts."[67]

Investors often use some combination of the mitigation and adaptation approaches and incorporate sustainability information to drive portfolio returns.[68] Screening is not a dominant strategy, and "[m]ainstream investors . . . prefer a more structured approach that will enable them to balance their sustainability objectives against their financial priorities . . . by strategically divesting from unsustainable companies and investing in sustainable ones."[69] Investors, index providers, credit rating agencies, and other market participants are often making judgment calls on whether and how to best assess and include companies based on these sustainability criteria.

As we mentioned at the outset, sustainable investing has grown to about 25 percent of the mutual fund market. And even investors who are not out-and-out sustainable investing firms have demanded greater information about corporate sustainability performance and plans. Those funds and investors have now built a sizable market for sustainability data and analytics. Sustainability information matters to investors, and they are putting their money behind it.[70]

III. Markets are not fully pricing climate risk based on voluntary disclosures (RFI Question 2)

Whether markets are effectively pricing the externalities of climate change is a chicken-and-egg problem because of the existing data limitations. The answer appears to be that markets undervalue climate risks but that markets also attempt

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[67] Jennifer Bender, Todd Arthur Bridges, Kushal Shah, and Alison Weiner, *Avoiding the Tragedy of the Horizon: Portfolio Design for Climate Change-Related Risk Management and the Low-Carbon Energy Transition* in Cort & Esty, *supra* note 28, at 151-52.

[68] Daniel C. Esty & Quentin Karpilow, *Harnessing Investor Interest in Sustainability: The Next Frontier in Environmental Information Regulation*, 36 Yale J. on Reg. 625, 652 & n.143 (2019) (citing research that the majority of investment professionals using sustainability information did so for financial reasons).

[69] *Id.* at 653 & n.148.

[70] Commenters made this point in response to the Department of Labor's 2020 proposed rule on ESG in retirement plans, RIN 1210-AB95, Financial Factors in Selecting Plan Investments Proposed Regulation. *See* Letter from Brock Johnson, President, Morningstar Retirement Services, et al. to Office of Regulations and Interpretations, Employee Benefit Security Admin. 2-3 ((July 30, 2020); Letter from Margaret Raymond, T. Rowe Price to Office of Regulations and Interpretations, Employee Benefit Security Admin. 3-4 (July 30, 2020).

to price in information about them. Greater disclosure would increase market efficiency by allowing markets to fully price in risks.

Markets are responsive to disclosures about companies' carbon emissions. Companies with high total emissions trade at prices that reflect a risk premium for investors.[71] Moreover, this is a recent phenomenon, which indicates that investors are starting to pay more attention to carbon emissions.[72] Studies comparing assets with identifiable climate risks against similar assets without those risks provide evidence of underpricing. A 2019 study from BlackRock and the Rhodium Group used climate modeling and an asset-level database to look at climate risk in three markets: municipal bonds, commercial real estate, and utilities.[73] That study found that "more than 15% of the current S&P National Municipal Bond Index (by market value) would be issued by [metropolitan statistical areas] suffering likely average annualized economic losses of up to 0.5% to 1% of GDP" under a scenario with no significant climate action.[74] When they compared the bonds issued by those municipalities to bonds issued by municipalities without similar climate threats, BlackRock and the Rhodium Group found no "significant differences in valuation."[75] For example, when they compared a revenue bond issued by Jupiter, Florida against a revenue bond issued by Neptune, New Jersey – a city with a similar deific name but better protection against hurricanes – they found identical yields after adjusting for credit quality.[76] They found similar results with respect to utilities. "The most climate-resilient utilities tend to trade at a slight premium to their peers, while the most vulnerable carry a slight discount."[77] Those price differences revealed that "climate-related risks are real for utilities, but mostly not priced in."[78]

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[71] Patrick Bolton & Marcin Kacperczyk, *Do Investors Care About Carbon Risk* 7-8 (NBER Working Paper No. 26968).

[72] *Id.*

[73] BlackRock, *Getting Physical: Scenario Analysis for Assessing Climate-Related Risks* 3 (Apr. 2019).

[74] *Id.* at 10.

[75] *Id.* at 11.

[76] *Id.*

[77] *Id.* at 18.

[78] *Id.*

A meta-review of studies on how markets price climate risk found some evidence that equity and debt markets price-in information about climate risk.[79] Yet they also found "substantial scope for improvements of the measures of climate risk exposure in different asset classes, and in particular for equity assets. Over the coming years, increased disclosure by firms – whether mandated by regulators or demanded by large investors – will provide new opportunities to measure firms' exposure to various types of climate risks."[80] Finally, the International Monetary Fund concluded in 2020 that equity markets were not fully pricing in climate risk, at least when comparing market premia against modeled risks.[81]

A related point is that markets may have blind spots on certain kinds of climate risk because voluntary disclosure frameworks do not reveal decision-useful information. Todd Cort has identified examples of environmental catastrophes that market participants did not anticipate because they were largely exacerbated by issues of governance.[82] Prior to the Deepwater Horizon oil spill, BP had published regular sustainability reviews and followed voluntary disclosure frameworks. But the information in these reports was "backward looking, operational performance data" and did not provide "data on the management control systems and governance structures" that would have been most useful to investors.[83] The examples discussed by Professor Cort indicate that markets need information about governance in addition to information about operations if we expect them to fully price in risk.

IV. Outline of proposed disclosures (RFI Questions 2, 3, 5, 6)

A. The SEC's authority to mandate disclosures

The SEC has the authority to prescribe rules requiring public companies to disclose information as "necessary or appropriate in the public interest or for the

[79] Stefano Giglio, Bryan T. Kelly & Johannes Strobel, *Climate Finance* 15-17 (NBER Working Paper No. 28226).

[80] *Id.* at 24.

[81] IMF, Climate Change: Physical Risk and Equity Prices—Online Boxes 5.1-5.3, at 4 Global Financial Stability Report: Markets In The Time Of Covid-19 (Apr. 2020), https://www.imf.org/-/media/Files/Publications/GFSR/2020/April/English/onlinebox51.ashx.

[82] Todd Cort, *ESG Risk Depends on Management Control Quality*, in Esty & Cort, *supra* note 28, at 35.

[83] *Id.* at 40.

protection of investors."[84] The SEC's authority to require disclosures is not limited to information that is "material."

The materiality construct comes from the anti-fraud rules, and it defines when a party may be liable for omissions or misrepresentations. Several decades ago, in deciding whether there was fraud related to inadequate disclosures surrounding a proxy vote, the Supreme Court expressly held that the SEC had broad authority to require information that would be important to investors in making that voting decision. It then continued by explaining that information "is material if there is a substantial likelihood that a reasonable shareholder would consider it important."[85]

The Supreme Court has never imposed a materiality test on the SEC's authority under the 1933 and 1934 Acts to compel disclosure requirements that it determines are necessary or appropriate in the public interest or for the protection of investors.[86] Nevertheless, the SEC is on extremely solid legal ground if it requires the disclosure of climate-related information that is important to investors and other market participants in making their business decisions. That information is facially material.

The SEC need not conclude that a topic for disclosure is material to every single company subject to the disclosure obligation before making such disclosures mandatory. If that were so, there would be no need for a separate test regarding liability for material misstatements or omissions; *every* misstatement or omission would necessarily be material. The Securities Exchange Act and the Securities Act authorize the SEC to promulgate disclosure requirements for all registrants, without requiring the analytically impossible task of demonstrating that every disclosure is material for every single registrant.[87] Moreover, the purpose of a mandatory disclosure requirement is to allow investors to compare information across companies, and that purpose would be defeated if the SEC first had to demonstrate that the requested information is necessarily material for every

[84] 15 U.S.C. §77g(a)(1); 15 U.S.C. §§ 78l, 78m(a).

[85] *See TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *see also Matrixx Initiatives, Inc. v. Siracusano*, 563 U.S. 27, 38 (2011).

[86] George S. Georgiev, *The Human Capital Management Movement in U.S. Corporate Law*, 95 Tul. L. Rev. 639, 714 n.298 (2021).

[87] The SEC can craft exceptions to its disclosure requirements, but it does so for "any specified class or classes of issuers," not for issuers individually. 15 U.S.C. § 78l(c). Nothing in the design of the Securities Act or Securities Exchange Act demonstrates Congress' intent for the SEC to conduct an issuer-by-issuer materiality analysis before requiring disclosure on any topic.

reporting company. Commissioner Lee thus correctly dismissed a company-by-company analysis of materiality, as being "at odds with modern capital markets which have become increasingly comparative in nature."[88]

The securities laws do not require companies to disclose all material information to investors, however, in the absence of an affirmative disclosure obligation.[89] If investors and other market participants want climate-related information – and as we outlined above, they do – then the way to ensure that they receive accurate, decision-useful information is for the SEC to require that companies disclose it. The importance of the information on its own will not ensure that companies release it.

While materiality is not a prerequisite to disclosure, the SEC does permit companies – in some circumstances – to apply a materiality filter when making certain disclosures. "So, for instance, in describing the legal proceedings facing a company under Item 103, issuers are required to '[d]escribe briefly any material pending legal proceedings, other than ordinary routine litigation incidental to the business . . . .'"[90] This filter ensures that investors are not buried under trivial information. The SEC may, in its discretion, apply a materiality filter to some climate change disclosures. A materiality filter should only be available to companies if it is consistent with the disclosure laws' central purpose of providing investors and the public with decision-useful information on the present and anticipated future conditions of companies. Disclosure laws are not narrowly focused on the immediate financial condition of the company, but rather "disclosure

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[88] Commissioner Allison Herren Lee, *Living in a Material World: Myths and Misconceptions About "Materiality"* (May 24, 2021), *available at*: https://www.sec.gov/news/speech/lee-living-material-world-052421.

[89] *Matrixx*, 563 U.S. at 44 ("[I]t bears emphasis that § 10(b) and Rule 10b–5(b) do not create an affirmative duty to disclose any and all material information. Disclosure is required under these provisions only when necessary 'to make . . . statements made, in the light of the circumstances under which they were made, not misleading.'" (quoting 17 C.F.R. § 240.10b–5(b)); *In re Time Warner Inc. Sec. Litig.*, 9 F.3d 259, 267 (2d Cir. 1993) ("[A] corporation is not required to disclose a fact merely because a reasonable investor would very much like to know that fact. Rather, an omission is actionable under the securities laws only when the corporation is subject to a duty to disclose the omitted facts."); *Backman v. Polaroid Corp.*, 910 F.2d 10, 12 (1st Cir.1990) (en banc) ("The materiality of the information claimed not to have been disclosed . . . is not enough to make out a sustainable claim of securities fraud. Even if information is material, there is no liability under Rule 10b–5 unless there is a duty to disclose it." (quotation omitted)).

[90] Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 Harv. L. Rev. 1197, 1208 (1999) (quoting Reg. S-K, Item 103, 17 C.F.R. § 229.103 (1998)).

of facts concerning how companies were being managed."[91] Disclosure obligations, in Congress' view, included "'not only . . . the financial condition of the corporation,' but also the 'major questions of policy,' including 'adequate explanation of the management policies [insiders] intend to pursue.'"[92] Those purposes favor detailed disclosures of information on the company's assessment of the risks and opportunities of climate change.

B. Rationale for Mandatory Disclosure

While voluntary frameworks are an encouraging development, they will necessarily fall short of providing investors with the information they need to make informed decisions about the environmental records of public companies, and providing the overall market with the consistent, comparable information it needs to function. They are, after all, voluntary. Many public companies have not adopted them, and those that have adopted them can be selective in what they disclose. The Task Force on Climate-related Financial Disclosures surveyed 1,100 companies that endorsed its disclosure recommendations and found that on average those companies made less than four of the eleven recommended disclosures.[93] And while nothing prevents public companies from discussing environmental risks and opportunities in registration statements and reports filed with the Commission – they could, for example, include a discussion of environmental issues in their management discussion and analysis (MD&A) – it seldom happens. Among companies listed in the Russell 3000 index, only 3 percent discussed climate change as a risk in the MD&A section of their 10-K filings.[94]

There are sound theoretical reasons why voluntary disclosure regimes will lead to less-than-optimal levels of disclosure from public companies. Information on corporate sustainability practices and risks is a public good, which a firm's competitors can make use of just as easily as its shareholders, and for that reason companies are loathe to disclose any information with competitive implications.[95]

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[91] *Id.* at 1245 (summarizing the legislative history of the 1933 and 1934 Acts).

[92] *Id.* (quoting S. Rep. No. 73-792, at 12 (1934) and H.R. Rep. No. 73-1383, at 13-14 (1934)); *see also SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968) (en banc) ("[M]aterial facts include not only information disclosing the earnings and distributions of a company but also those facts which affect the probable future of the company and those which may affect the desire of investors to buy, sell, or hold the company's securities.").

[93] Task Force on Climate-related Financial Disclosures, *2019 Status Report* at 7-8 (June 2019).

[94] Leah Rozin, *ESG Risks Trickle Into Financial Filings*, Nat'l Ass'n of Corp. Directors (Oct. 21, 2019), https://blog.nacdonline.org/posts/esg-risks-trickle-into-financial-filings.

[95] Esty & Karpilow, *supra* note 68, at 663-64.

Voluntary disclosure can also be used as a platform for corporate greenwashing, which "can breed distrust in sustainability reporting mechanisms as a whole."[96] Public mistrust reduces other companies' incentives to be industry leaders on sustainability and to report on their efforts accurately. If the public will regard them as greenwashers no matter what they do, then there is no benefit to making robust disclosures.[97] Finally, voluntary sustainability disclosures will always be subject to selective reporting. Companies can choose which disclosure frameworks to follow, and which disclosures they make under their chosen frameworks.[98] While investors could theoretically draw conclusions based on a company's silence about a particular topic –inferring that the company's record on that disclosure metric must be unflattering – voluntary disclosure is not sufficiently widespread that investors can draw that conclusion. "Instead, investors face the challenging task of determining *which* nonresponses are due to businesses strategically hiding their unsustainable practices and which have more benign causes."[99]

The plain fact is that voluntary disclosure frameworks, useful as they are, will never produce disclosures from all companies, that can be effectively compared across different companies, and that are sufficiently robust in their disclosure of emissions, impacts, risks, and opportunities.

C. Proposed Disclosures (RFI Question 2)

We recommend that the SEC require companies to make disclosures aligned with the Task Force on Climate-related Financial Disclosures, supplemented by some additional disclosures on physical and transition risks and climate justice.

First, the SEC should require companies to make disclosures aligned with the Task Force on Climate-related Financial Disclosures on governance related to climate change. Specifically, the SEC should require that companies incorporate into their annual reports disclosures regarding:

1. The board of directors' oversight of climate-related risks and opportunities; and
2. Management's role in assessing and managing climate-related risks and opportunities.

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[96] *Id.* at 664-65.

[97] *Id.* at 664-65.

[98] *Id.* at 666-67.

[99] *Id.* at 667.

To describe the substance of climate-related risks and opportunities, the SEC should require that companies incorporate into their annual reports disclosures regarding:

1. The climate-related risks and opportunities the company has identified over the short, medium, and long term;
2. The impact of climate-related risks and opportunities on the company's businesses, strategy, and financial planning; and
3. The resilience of the company's strategy, taking into consideration different climate-related scenarios, including a two-degree Celsius or lower scenario.

To describe the company's approach to managing climate-related risks, the SEC should require that companies incorporate into their annual reports disclosures regarding:

1. The company's processes for identifying and assessing climate-related risks;
2. The company's processes for managing climate-related risks; and
3. How processes for identifying, assessing, and managing climate-related risks are integrated into the company's overall risk management.

Finally, to provide specific disclosures about metrics and targets used by the company that are relevant to its climate-related risks and opportunities, the SEC should require that companies incorporate into their annual reports disclosures regarding:

1. The metrics used by the company to assess climate-related risks and opportunities in line with its strategy and risk-management process;
2. The targets used by the company to manage climate-related risks and opportunities and performance against targets; and
3. The science-based targets, if any, used by the company to reduce their contribution to climate change, and progress toward those targets.[100]

To verify investments in emissions-reduction targets, we also recommend that the SEC amend Regulation S-X to require companies to disclose current period and planned capital expenditures in a note to their financial statements, disclosing

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[100] The Task Force on Climate-related Financial Disclosures does not define metrics and targets in terms of "science-based targets." *See* Task Force on Climate-related Financial Disclosures, *supra* note 44, at 14. The term refers to an emissions reduction target consistent with keeping overall warming to two degrees Celsius or less. *See* Carbon Disclosure Project, *Science-based Targets*, https://www.cdp.net/en/campaigns/commit-to-action/science-based-targets.

which expenditures address transition risks and adaptation, and which address physical risks.

We recommend aligning the SEC's disclosure rule with the Task Force on Climate-related Financial Disclosures because it already has broad uptake domestically and internationally both by companies and investors.[101] A core purpose of mandatory disclosure is comparability; having disclosure standards in U.S. law align with international disclosure frameworks will enable investors to evaluate disclosures by different issuers even if they are not otherwise subject to the same domestic disclosure rules. Comparability is an important consideration, even if it limits somewhat the SEC's options for disclosure frameworks.

Second, the SEC should require companies to disclose audited, tabular information about their Scope 1, Scope 2, and Scope 3 greenhouse gas emissions.

Third, the SEC should require companies to disclose their internal pricing for greenhouse gas emissions, including details about the methodology used to derive the internal pricing, the extent of its use internally, and the emissions to which it applies (e.g. Scope 1, Scope 2, or Scope 3 emissions).

Fourth, the SEC should require disclosures on water scarcity and land use (including deforestation), aligned with the World Economic Forum's framework. Land use disclosure would require companies to report on their own operations, and estimate for their supply chain's "overall area of land used or affected," the "annual change in an area of land used or affected," and the "number of IUCN Red List[102] species present in areas used or affected."[103] Land use drives climate change, and sustainable land management can mitigate the stress of climate change on ecosystems.[104] The water scarcity disclosure would require companies to report on

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[101] The G-7 recently endorsed the Task Force on Climate-related Financial Disclosures as a framework for corporate disclosure. *See* Reuters, *G7 backs making climate risk disclosure mandatory*, June 5, 2020, https://www.reuters.com/business/environment/g7-backs-making-climate-risk-disclosure-mandatory-2021-06-05/.

[102] A list of the global conservation status of species maintained by the International Union for Conservation of Nature.

[103] *Id.*

[104] *See* IPCC, 2019: Summary for Policymakers, in *Climate Change and Land: An IPCC Special Report on climate change, desertification, land degradation, sustainable land management, food security, and greenhouse gas fluxes in terrestrial ecosystems* at 7 [P.R. Shukla, J. Skea, E. Calvo Buendia, V. Masson-Delmotte, H.- O. Pörtner, D. C. Roberts, P. Zhai, R. Slade, S. Connors, R. van Diemen, M. Ferrat, E. Haughey, S. Luz, S. Neogi, M. Pathak, J. Petzold, J. Portugal Pereira, P. Vyas, E. Huntley, K. Kissick, M. Belkacemi, J. Malley, (eds.)]. In press. *See also* Kelly Levin & Sarah Parsons, World Resources Institute, *7 Things to Know About the IPCC's Special Report on Climate*

their own operations, and estimate for their supply chain, "[m]ega-lit[ers] of fresh water consumed (withdrawals minus discharges of equal quality) in water-stressed areas."[105] This disclosure covers one source of physical risk (disruption of operations because of increasing water scarcity) and a climate change-related opportunity, as some companies will manage limited water resources more efficiently than others.[106]

Fourth, recognizing that the effects of climate change are varied and that some communities bear a disproportionate burden from climate change, the SEC should require that companies disclose their strategies concerning climate and environmental justice, including how the company has historically impacted communities through its contribution to climate change, what actions the company has taken to address environmental and climate injustice, and the results of those actions. Companies that disclose targets to reduce their contributions to climate change should also disclose their targets for a just transition, and their progress toward meeting those targets.

D. Should the Commission Tier Disclosures? (RFI Question 2)

We leave the question of whether the SEC should tier some of these disclosures to the Commission's discretion. We note, however, that issuers should be able to disclose much of this information without a significant investment of resources that would justify tiering disclosures based on issuer size. For example, issuers of any size should be able to disclose their governance processes for evaluating climate risk. They should likewise be able to disclose what processes and methodologies they use to identify physical and transition risks and climate change-related opportunities.

If the SEC were to consider implementing tiers, we would suggest it consider relying upon the "accelerated filer" and "large accelerated filer" designations. While we do not think the Commission should rely upon these designations to tier the general company disclosures, such tiering may be appropriate in industry-specific guides, if adopted.

Change and Land (Aug. 8, 2019), https://www.wri.org/insights/7-things-know-about-ipccs-special-report-climate-change-and-land.

[105] World Economic Forum, *supra* note 46. "Water-stressed areas" can be defined with reference to international standards, such as UN-Water's designation of water stressed areas by comparing freshwater resources withdrawn versus freshwater resources available. *See* UN-Water, 2020: Summary Progress Update 2021 – SDG 6 – water and sanitation for all. Version: 1 March 2021. Geneva, Switzerland.

[106] *See* World Economic Forum, *supra* note 46.

E. Should Disclosures be Filed with the SEC or Merely Furnished?

We do not believe it would be appropriate to amend the SEC's regulations and require disclosure about climate change but to also allow those disclosures to be "furnished" rather than "filed." Allowing information to be "furnished" to the SEC is typically a way to "limit potential liability" on the part of the disclosing company.[107] To ensure that investors have confidence in the accuracy and completeness of disclosures, we recommend that they be filed with the company's reports to the SEC.

V. Process for setting disclosure standards (RFI Questions 3, 5, 6 & 9)

As we stated above, we recommend that the Commission establish disclosure requirements based on standards set by the Task Force on Climate-related Financial Disclosures and the World Economic Forum. Going forward, the SEC should update and improve disclosure requirements through notice-and-comment rulemaking. The Commission should also consider how best to incorporate developments in corporate disclosure, possibly with the assistance of the Task Force on Climate-related Financial Disclosure or a similar group.

The SEC might incorporate private standards in any of several ways.[108] The Commission might (1) defer entirely to private standard setters; (2) endorse a standard without mandating compliance; (3) partner with a private standard-setting body to develop mandatory standards; (4) delegate standard-setting authority to a private body; (5) mandate compliance with new standards or existing private standards; or (6) set standards supplanting private standards.[109]

We recommend that the SEC adopt a hybrid approach that combines (5) and (2). That is: the SEC should mandate disclosures modeled on existing voluntary disclosure frameworks, and review and consider endorsing *future, updated* standards.[110]

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[107] Thomas W. White, *SEC Again Adopts Resource Extraction Disclosure Rules*, Bus. L. Today, December 2020, at 3

[108] *See* Virginia Harper Ho & Stephen Kim Park, *ESG Disclosure in Comparative Perspective: Optimizing Private Ordering in Public Reporting*, 41 U. Pa. J. Int'l L. 249, 277-78 & fig.1 (2019).

[109] *See id.*

[110] This hybrid approach is consistent with the Commission's approach to internal-control frameworks.

Federal agencies commonly incorporate by reference privately developed standards into their rules.[111] To ensure that the public is adequately informed of the content of those standards, the Office of the Federal Register (OFR) has procedures that require an agency incorporating a standard by reference to secure formal approval from the OFR. OFR's approval is conditioned on the agency making the incorporated material reasonably available to interested parties.[112]

However, the OFR's regulations specifically prohibit the incorporation by reference of a *dynamic* standard.[113] Although the SEC has previously incorporated dynamic standards, we recommend that the SEC not do so for this disclosure rule.[114] We recommend that, as part of the SEC's initial set of disclosure rules, it specify a baseline set of disclosures that it expects from all companies (our recommendation is summarized above). By establishing the baseline standards for disclosure in a regulation promulgated by the SEC itself after notice and comment, the Commission will avoid any concerns about incorporation of dynamic standards.

To update standards going forward, we recommend that the Commission do three things. First, when the Commission issues its rule setting disclosure requirements, it can also issue guidance explaining which existing voluntary frameworks, in the SEC's view, meet the requirements of the disclosure regulation. The SEC can identify acceptable frameworks as issuing bodies update and revise them, including with subsequent industry-specific reporting guidelines. The Division of Corporation Finance can also assist in this process through comment letters that identify effective disclosure practices. Second, the SEC can charter a

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111 *See Am. Soc'y for Testing & Materials v. Public.Resource.Org, Inc.* (*ASTM*), 896 F.3d 437, 440 (D.C. Cir. 2018); Nina A. Mendelson, *Private Control over Access to Public Law: The Perplexing Federal Regulatory Use of Private Standards*, 112 Mich. L. Rev. 737, 739 (2014) (noting 9,500 rules relying on standards incorporated by reference in the Code of Federal Regulations).

112 1 C.F.R. § 51.5(b); *see* 5 U.S.C. § 552(a). Whatever standard the SEC incorporates, the Commission should endeavor to make the contents of those standards available for free to the public. It may be unconstitutional to incorporate standards that are not freely available. *See ASTM*, 896 F.3d at 447 (court "leav[ing] for another day the question of whether the Constitution permits copyright to persist in works incorporated by reference into law."); *ASTM*, 896 F.3d at 458 (Katsas, J., concurring) ("[A]ccess to the law cannot be conditioned on the consent of a private party . . ."); *cf. Georgia v. Public.Resource.Org*, 140 S. Ct. 1498, 1508 (2020) (holding that annotations to the state code, when commissioned by the state, are government edicts and therefore not copyrightable). Regardless, the Commission should work with copyright holders, to the extent they exist, to ensure public access to the standards.

113 *See* 1 C.F.R. § 51.1(f) ("Incorporation by reference of a publication is limited to the edition of the publication that is approved. Future amendments or revisions of the publication are not included.").

114 *See In Re Commission Statement of Policy Reaffirming Status of FASB*, Release No. 70 (Apr. 25, 2003) (prospectively recognizing as generally accepted the standards to be created by the FASB).

federal advisory committee to assess how companies are responding to a mandatory disclosure regulation and to recommend updates to the SEC's regulation or improvements in how it implements the regulation. Third, the Commission can consider amending its disclosure requirements through further notice-and-comment rulemaking.

This approach will also allow the Commission to harmonize U.S. standards with international standards. The Commission has recognized the importance of coordinating U.S. accounting standards with international standards,[115] and has taken several steps to do so.[116] Nevertheless, the U.S. has maintained its own accounting standards. It should adopt a similar approach for climate-risk disclosure standards (i.e., adopt a disclosure regime that is currently aligned with the

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[115] *See, e.g.*, Chair Mary Jo White, A U.S. Imperative: High-Quality, Globally Accepted Accounting Standards (Jan. 5, 2017), https://www.sec.gov/news/statement/white-2016-01-05.html.

[116] *See generally* Concept Release on Allowing U.S. Issuers to Prepare Financial Statements in Accordance with International Financial Reporting Standards, Exchange Act Release Nos. 33-8831, 34-56217, Fed. Sec. L. Rep. (CCH) (Aug. 14, 2007); Acceptance From Foreign Private Issuers of Financial Statements Prepared in Accordance With International Financial Reporting Standards Without Reconciliation to U.S. GAAP, Securities Act Release No. 33-8879, Exchange Act Release No. 34-57026 (Dec. 21, 2007); Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers, Exchange Act Release Nos. 33-8982, 34-58960, Fed. Sec. L. Rep. (CCH) (Nov. 14, 2008); Office of the Chief Accountant, Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers: Final Staff Report (July 13, 2012), *available at* http:// www.sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-final-report.pdf; Office of the Chief Accountant, Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers: A Comparison of U.S. GAAP and IFRS, A Securities and Exchange Commission Staff Paper (Nov. 16, 2011), *available at* https://www.sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-paper-111611-gaap.pdf; Office of the Chief Accountant, Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers: Exploring a Possible Method of Incorporation, A Securities and Exchange Commission Staff Paper (May 26, 2011), *available at* https://www.sec.gov/spotlight/globalaccountingstandards/ifrs-work-plan-paper-052611.pdf; Office of the Chief Accountant, Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers, Progress Report (Oct. 29, 2010), *available at* https://www.sec.gov/spotlight/globalaccountingstandards/workplanprogress102910.pdf; Office of the Chief Accountant, Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers, Appendix to SEC Release No. 33-9109 (Feb. 24, 2010), *available at* https://www.sec.gov/spotlight/globalaccountingstandards/globalaccountingstandards.pdf; IFRS Foundation, Report to the Trustees of the IFRS Foundation, *IFRS Foundation Staff Analysis of the SEC Final Staff Report—Work Plan for the Consideration of Incorporating IFRS Into the Financial Reporting System for US Issuers* (Oct. 22, 2012), available at https://cdn.ifrs.org/content/dam/ifrs/groups/trustees/analysis-of-sec-final-staff-report.pdf?la=en.

emerging international framework, but retain the freedom to proceed independently going forward as the framework evolves).

Coordinating U.S. standards with international standards will be easier in the context of climate disclosure because, as discussed above, the TCFD and World Economic Forum standards are already widely accepted. We expect that this convergence on disclosure standards will enable regulators to align requirements across countries.[117]

VI. Adopting a "comply or explain" option (RFI Question 12)

In general, we recommend that the Commission not adopt a comply-or-explain framework; doing so will enable some issuers to dodge disclosures and reduce the effectiveness of a mandatory reporting regulation. However, such a framework may have a limited use in the disclosure rules. One advantage of a "comply or explain" framework is that it might not "compel" any speech. Given that opponents of climate-risk disclosure intend to challenge such requirements as violating the First Amendment,[118] the Commission should consider ways to reduce that legal exposure. Comply or explain may help insulate the Commission's rule from First Amendment challenge.

We disagree with the contention that climate-related disclosure would be subject to strict scrutiny under the First Amendment.[119] The Supreme Court has never held or even suggested that securities regulations must meet the exacting standards of strict scrutiny.[120] Rather, securities regulation, like much other

[117] *See, e.g.*, The Greenhouse Gas Protocol, *A Corporate Accounting and Reporting Standard*, https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf. As the TCFD has recognized, the Greenhouse Gas Protocol's "methodology is the most widely recognized and used international standard for calculating [greenhouse gas] emissions." Task Force on Climate-related Financial Disclosures, *Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures* 22 n.40 (2017)..

[118] *See, e.g.*, Letter from Patrick Morrisey, Attorney General, West Virginia, to Hon. Allison Herren Lee, Acting Chair, Sec. Exchange Comm'n (Mar. 25, 2021), https://www.sec.gov/comments/climate-disclosure/cll12-8563794-230748.pdf.

[119] *Contra id.* at 2-3.

[120] Justice Breyer has noted that certain of the Court's recent decisions *could* have a destabilizing effect on securities regulation. *See, e.g.*, *Reed v. Town of Gilbert*, 576 U.S. 155, 177 (2015) (Breyer, J., concurring in judgment) (listing regulations that inevitably involve content discrimination, ranging from securities disclosures to signs at petting zoos). But as Justice Breyer has also observed, securities regulation involves "a different balance of concerns" and "calls for different applications of First Amendment principles." *Nike, Inc. v. Kasky*, 539 U.S. 654, 678 (2003) (Breyer, J., dissenting from the dismissal of certiorari as improvidently granted).

commercial regulation, generally falls outside the First Amendment altogether. That is so even though the regulated conduct may involve "speech."[121] The "speech" involved in the marketing of securities, like the exchange of prices among competitors, the coordination of a criminal conspiracy, the sexual harassment of a colleague, or the negligent warning on a consumer product may all be regulated without any role for the First Amendment at all.[122]

Even if disclosures under the securities laws were subject to First Amendment scrutiny, such disclosures—like other commercial disclosure requirements—would be subject to the far less demanding standard articulated in *Zauderer v. Office of Disciplinary Counsel of the Supreme Court of Ohio*. Under that standard, the SEC may compel disclosure of commercial speech so long as it is "factual and uncontroversial information."[123] The disclosures we hope the SEC will compel fall comfortably within this framework.[124]

These disclosures would also satisfy more stringent scrutiny. Disclosure of the kind we hope the SEC will require would serve a "substantial" government

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[121] *Dun & Bradstreet, Inc. v. Greenmoss Builders, Inc.*, 472 U.S. 749, 758 n.5 (1985); *Ohralik v. Ohio State Bar Ass'n*, 436 U.S. 447, 456 (1978) ("Numerous examples could be cited of communications that are regulated without offending the First Amendment, such as the exchange of information about securities, corporate proxy statements, the exchange of price and production information among competitors, and employers' threats of retaliation for the labor activities of employees." (citations omitted)). *See also SEC v. Wall St. Pub. Inst., Inc.*, 851 F.2d 365, 373 (D.C. Cir. 1988) ("*Dun & Bradstreet* . . . indicates that securities regulation is a form of regulation distinct from the more general category of commercial speech, and *Ohralik* suggests that the First Amendment protections provided by the commercial speech doctrine do not *detract* from the government's regulatory power over the securities market."). *See generally* Frederick Schauer, *The Boundaries of the First Amendment: A Preliminary Exploration of Constitutional Salience*, 117 Harv. L. Rev. 1765 (2004).

[122] *See Schauer*, *supra* n. 122, at 1770; *see, e.g.*, *Nat'l Soc'y of Pro. Eng'rs v. United States*, 435 U.S. 679, 697-98 (1978) (agreements in restraint of trade); *Giboney v. Empire Storage & Ice Co.*, 336 U.S. 490, 498 (1949) (speech integral to crime); *Harris v. Forklift Sys., Inc.*, 510 U.S. 17, 21-24 (1993) (upholding hostile work environment claim under Title VII without even mention of First Amendment, despite full briefing of First Amendment defense).

[123] *Zauderer v. Off. of Disciplinary Couns. of Sup. Ct. of Ohio*, 471 U.S. 626, 651 (1985). In *National Institute of Family & Life Advocates v. Becerra*, 138 S. Ct. 2361 (2018), the Court affirmed that *Zauderer*'s standard continues to apply to compelled commercial disclosures. *Id.* at 2372.

[124] Note that the Commission's interest in compelling such disclosures need not be combatting deception. *See Am. Meat Inst. v. U.S. Dep't of Agric.*, 760 F.3d 18, 22 (D.C. Cir. 2014) (en banc); *N.Y. State Rest. Ass'n v. N.Y. City Bd. of Health*, 556 F.3d 114, 133 (2d Cir. 2009); *Pharm. Care Mgmt. Ass'n v. Rowe*, 429 F.3d 294, 310 (1st Cir. 2005) (Torruella, J.); *id.* at 316 (Boudin, C.J. & Dyk, J.); *id.* at 297-98 (per curiam) (explaining that the joint concurring opinion of Chief Judge Boudin and Judge Dyk is controlling on the First Amendment issue); *Nat'l Elec. Mfrs. Ass'n v. Sorrell*, 272 F.3d 104, 113-15 (2d Cir. 2001).

interest: ensuring that investors have ready access to the information they need.[125] And mandating disclosure of that information directly advances that goal.[126]

Nevertheless, the Commission might also consider employing a "comply or explain" framework to avoid any question of First Amendment scrutiny. A "comply or explain" framework would allow an issuer to either (1) comply with the disclosures mandated by the Commission; or (2) explain why it will not.[127] Although primarily used in Europe, this framework has been successfully adopted in limited applications in U.S. law.[128]

To the extent the Commission adopts a "comply or explain" framework for climate-risk disclosure, it should apply to select disclosures only. As to many disclosures, there can be no serious dispute that the compelled information is "factual and uncontroversial."[129] Thus, for example, the Commission should not allow issuers to avoid compliance with rules requiring the disclosure of historical greenhouse gas emissions: such disclosures are purely factual.[130] Scenario analysis, however, might be seen as involving expert judgment about which scenarios are realistic. For such scenario analysis, an issuer might object to being compelled to appear to embrace the judgments underlying the scenario's assumptions. A comply-or-explain option would allow the issuer to avoid addressing the scenario at all. Instead, any issuer who objected to the assumptions underlying the scenario analysis could opt to disregard that scenario and, instead, explain why it was doing

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[125] *Edenfield v. Fane*, 507 U.S. 761, 769 (1993) ("[T]here is no question that [the government's] interest in ensuring the accuracy of commercial information in the marketplace is substantial.").

[126] *Cf. Spirit Airlines, Inc. v. U.S. Dep't of Transp.*, 687 F.3d 403, 415 (D.C. Cir. 2012) (rule mandating disclosure of airline prices "reasonably tailored" to ensure accuracy of commercial information in marketplace); *see also Am. Meat Inst.*, 760 F.3d at 26 (inquiry whether disclosure directly advances government interest "is hardly necessary when the government uses a disclosure mandate to achieve a goal of informing consumers about a particular product trait, assuming of course that the reason for informing consumers qualifies as an adequate interest"); *id.* at 33-34 (Kavanaugh, J., concurring in the judgment) (similar).

[127] *See generally* Report of the Committee on the Financial Aspects of Corporate Governance (Dec. 1992), http://www.ecgi.org/codes/documents/cadbury.pdf.

[128] *See, e.g.*, 15 U.S.C. § 7264(a) (requiring SEC to issue rules requiring issuers "to disclose whether or not, and if not, the reason therefor, such issuer has adopted a code of ethics for senior financial officers").

[129] *Zauderer*, 471 U.S. at 651

[130] Further, as noted above (*see supra* Answer to Question 3), a substantial number of issuers already disclose this (or similar) information to federal and state regulators.

so. The Commission should consider adopting a comply-or-explain approach in this limited fashion.

VII. Regulation of Private Market Sales (RFI Question 14)

In general, the SEC's disclosure requirements and investor rights protections apply only to public companies. As a result, the SEC must be extremely cognizant of the limitations of a climate-related disclosure regime that would apply to only public companies. While a company generally becomes a public company after it engages in an initial public offering (IPO), it may also be pulled into the public markets if hits certain thresholds, such as having a sufficient number of shareholders of record.[131]

However, over the years the exemptions from the securities laws have dramatically expanded, and companies can remain "private" and still raise all the capital they need.[132] "Private" companies are exempt from the public disclosure requirements that public companies must follow. While this problem is not specific to climate change disclosures, if the SEC does not tackle the problem of private market sales, the disclosure regime will be substantially less effective. The comments from the Healthy Markets Association explain the market distortions of this information asymmetry in greater detail.

We recommend that the SEC consider addressing these concerns by (1) limiting reliance upon securities offering exemptions to only offerings under $100 million, (2) conditioning registration exemptions upon the public disclosure of a limited set of information, including climate-related information, (3) revising its interpretation of the shareholder of record to ensure that companies with a large number of investors are pulled into the public disclosure and accountability regime, and (4) requiring all large private funds to provide details of their climate-related practices and holdings, including risks.[133] These disclosures should mirror, to the extent possible, requirements imposed on public funds, and complement disclosures required of registered investment advisers.

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[131] 15 U.S.C. § 78l.

[132] Letter from Tyler Gellasch, Exec. Dir., Healthy Markets Association, to Secretary, Sec. and Exch. Comm'n, at 9-10, Sept. 30, 2019, *available at* https://healthymarkets.wpengine.com/wp-content/uploads/2019/09/SEC-Concept-Release-9-30-19-1.pdf (citing to *Concept Release on Harmonization of Securities Offerings*, Sec. and Exch. Comm'n, Sec. Act Rel. No. 33-10649, at 33, Jun. 18, 2019, *available at* https://www.sec.gov/rules/concept/2019/33-10649.pdf).

[133] *See* Americans for Financial Reform and Public Citizen, *Climate Roadmap for U.S. Financial Regulation*, 28-30, 2021, *available at* https://mkus3lurbh3lbztg254fzode-wpengine.netdna-ssl.com/wp-content/uploads/Climate-Financial-Reg-Report.pdf.

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Thank you for considering the information in this response. We appreciate the SEC's leadership in responding to the risks that climate change presents to capital markets. If you would like to discuss any aspect of our response or if we can be of further assistance, please contact Sarah Dougherty, [redacted]; Gabe Daly, [redacted]; or Tom Zimpleman, [redacted].

Regards,

Sarah Dougherty
Gabe Daly
Roger Baneman
Douglass Sims
Tom Zimpleman
Natural Resources Defense Council