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By Electronic Mail

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Chair Gary Gensler
U.S. Securities and Exchange Commission
100 F St., NE
Washington, D.C. 20549-0609

Dear Chair Gensler:

On behalf of the undersigned law professors, all of whom teach and write on the U.S. securities laws and capital markets regulation, we welcome the opportunity to provide our views on three issues we consider fundamental to the SEC's consideration of the public comments it receives in response to Interim Chair Allison Lee's March 15, 2021, request for public input on climate change disclosure. Those issues are: (1) the authority of the SEC; (2) the role of materiality; and (3) the potential involvement of a third-party standard setter in crafting disclosure standards or metrics.

We note that the arguments as to why the SEC should require more climate-related disclosure have been made extensively by others, and we will not repeat those arguments here. We do not all agree on the policy issues facing the SEC with respect to the optimal scope of environmental, social and governance (ESG) disclosure, including climate change disclosure. Nonetheless, we agree that: (1) Congress has delegated broad authority to the SEC with respect to disclosure and ESG disclosure falls within the SEC's mandate; (2) although we believe a range of ESG disclosures are material to investors, the SEC's authority is not constrained by a requirement of materiality; and (3) while the SEC has several options with respect to formulation of specific ESG disclosure requirements and metrics, the SEC possesses the legal authority either to incorporate metrics developed by a private entity or to develop the expertise to establish the operative standards internally.

I. Authority of the SEC

The SEC's statutory authority over disclosure is broad. Congress, in both the Securities Act of 1933 and the Securities Exchange Act of 1934, "authorize[d] the Commission to promulgate rules for registrant disclosure 'as necessary or appropriate in the public interest or for the protection of investors.'"[1] In 1996, Congress added Section 2(b) to the Securities Act and Section 23(a)(2) to the Exchange Act. These parallel sections provide that:

> Whenever pursuant to this title the Commission is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.[2]

In our view, the SEC's authority to require ESG disclosure stems both from its mandate to protect investors and from its obligation to promote efficiency, competition, and capital formation.

A. Investor Protection

We start by highlighting the advantages to investors of the SEC adopting formal rules to require the incorporation of ESG disclosures into securities filings rather than continuing to rely on voluntary disclosures – disclosures that occasionally are included in an issuer's securities filings but, more commonly, are found in other documents such as sustainability reports. Although, as many commentators have noted, voluntary disclosures continue to increase, a system of voluntary disclosure is inadequate. As with traditional financial disclosure, mandatory disclosure is necessary to ensure that reporting companies disclose at the optimal level necessary to protect investors and ensure efficient capital markets.[3]

The experience over the past decade with ESG disclosure has highlighted the deficiencies of a voluntary framework. Under the existing regime, disclosures by individual reporting

[1] Business and Financial Disclosure Required by Regulation S-K, Release No. 33-10064; 34-77599, April 16, 2016, *available at* https://www.sec.gov/rules/concept/2016/33-10064.pdf at 22-23 & fn. 50 (quoting Sections 7, 10, and 19(a) of the Securities Act; Sections 3(b), 12, 13, 14, 15(d), and 23(a) of the Exchange Act).

[2] Securities Act §2(b); Exchange Act § 23(a)(2).

[3] *See, e.g., Merritt Fox, Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment*, 85 VA. L. REV. 1335, 1339 (1999) (observing that, by the mid-1980s, "even most economics-oriented legal academics . . . [agreed that] mandatory disclosure should be retained").

companies are inconsistent and of varying quality.[4] Although private standard-setters have developed a variety of disclosure frameworks, the resulting requirements frequently conflict, and reporting companies can selectively choose which items to disclose.

The proliferation of standards increases the burden on both investors and issuers. Investors must search and compare multiple documents, standards, and ratings, yet the patchwork of voluntary standards impedes their ability to compare information from different companies.[5] In the absence of standardization, issuers are often overwhelmed with requests for information.[6]

In addition, the failure to incorporate sustainability disclosures into federally-mandated filings means that ESG disclosures are not subjected to the rigorous internal controls associated with traditional financial reporting or external verification, undercutting their reliability. Although voluntary sustainability reports are, in theory, subject to the antifraud provisions of the federal securities laws, unlike a firm's 10-Ks, S-1s and proxy statements, they are not regularly reviewed and evaluated by the SEC staff for accuracy or consistency. This SEC staff review process plays a valuable role in increasing standardization across reporting companies.

At the same time, ESG disclosure, and climate change disclosure in particular, fall within the SEC's core mission of investor protection. An increasing percentage of investors use ESG information in connection with their investment decisions, whether that information is used to evaluate the viability of an issuer's long term business model, its vulnerability to future regulation, or its reputational risk.[7] An issuer that does not adequately incorporate ESG-related considerations

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[4] *See* Petition for Rulemaking on Environmental, Social, and Governance Disclosure, Oct. 1, 2018, https://www.sec.gov/rules/petitions/2018/petn4-730.pdf; Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 GEO. L.J. 923 (2019), cll12-8861700-240098.pdf (sec.gov).

[5] *See e.g.,* U.S. Government Accountability Office, GAO-20-530 Report to Honorable Mark Warner U.S. Senate, *Public Companies Disclosures of Environmental, Social, and Governance Factors and Options to Enhance Them* (2020), https://www.gao.gov/assets/710/707949.pdf (noting the lack of standardization as a significant problem), *cited in* Thomas Lee Hazen, *Social Issues in the Spotlight: The Increasing Need to Improve Publicly-Held Companies' CSR and ESG Disclosures*, 23 U. PA. J. BUS. L. 740, 749 fn. 36 (2021).

[6] *See* Comment Letter from Keir D. Gumbs, Vice President, Deputy General Counsel and Deputy Corporate Secretary, Uber Technologies, Inc., Apr. 27, 2021, https://www.sec.gov/comments/climate-disclosure/cll12-8731000-237041b.pdf (supporting a required climate disclosure framework because the current "ecosystem [of voluntary reporting frameworks]. . .has created a myriad of cumbersome and time-consuming commitments for companies."); Sarah C. Haan, *Shareholder Proposal Settlements and the Private Ordering of Public Elections*, 126 YALE L.J. 262, 267-71 (2016) (questioning the quality of ESG disclosures that result from the settlement of shareholder proposals).

[7] Global assets under management with sustainability screens have risen 34% between 2016 and 2018 to $30.7 trillion in five major markets (the EU, US, Canada, Japan, and Australia/New Zealand). Just under 40% of this total ($12 trillion) is held by U.S. investors and asset managers, comprising 25% of money under professional management in the U.S., with the dominant strategy being integration of environmental, social, and governance (ESG) data into

into its operational decisions is increasingly vulnerable – as evidenced by a Dutch court's recent decision requiring Shell to reduce its carbon emissions by 45% by 2030.[8] This vulnerability can have a substantial impact on an issuer's long term business plan and economic performance.

Investors use ESG information in a variety of ways. Many investors believe that a firm's behavior on ESG issues is correlated with financially important information such as economic returns,[9] the firm's level of innovation, and susceptibility to ligation. A growing number of empirical studies document such relationships.[10]

> <u>On firm performance</u>: One widely-cited study using the Sustainability Accounting Standards Board's framework of material, industry-specific metrics found that firms with good ratings on material sustainability issues, as defined by SASB, significantly outperform firms with poor ratings on the same issue.[11] A comprehensive review in 2015 of 200 "best in class" studies of the relationships between sustainability as a management practice and financial outcomes found as follows: 90% of these studies showed that sound sustainability standards lower firms' cost of capital; 80% showed that companies' stock price is positively influenced by good sustainability practices; and 88% showed that better E, S, or G practices result in better operational performance.[12]

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fundamental value analysis for portfolio selection and management. *See* Global Sustainable Investment Alliance, *The 2018 Global Sustainable Investment Review*. This Review is published bi-annually. The 2020 Global Sustainable Investment Review is expected in mid-2021. *Id.*

[8] *Milieudefensie et al. v. Royal Dutch Shell*, The Hague District Court, C/09/571932 / HA ZA 19-379, May 26, 2021, https://uitspraken.rechtspraak nl/inziendocument?id=ECLI:NL:RBDHA:2021:5339 (English translation). *See* Sarah McFarlane, *Shell Ordered by Dutch Court to Cut Carbon Emissions*, WALL ST. J., May 26, 2021.

[9] *See* Amir Amel-Zadeh & George Serafeim, *Why and How Investors Use ESG Information: Evidence from a Global Survey,* 1 FIN. ANALYST J. 74 (2018) (finding that 82% of their survey respondents use ESG information because they perceive it as financially significant to investment performance).

[10] We note that empirical studies to date have relied on the patchwork of disclosures provided by issuers voluntarily. Standardized disclosure facilitates comparative analysis and enhances the ability of investors to evaluate these relationships.

[11] *See* Mozaffar Khan & George Serafeim, *Corporate Sustainability: First evidence on materiality*, 91(6) THE ACCOUNTING REV. 1697-1724 (2016).

[12] *See* Gordon L. Clark, Andreas Feiner & Michael Viehs, *From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance* (2015), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2508281. This report is an excellent resource because it analyzes the empirical literature on the financial effects of sustainability initiatives by type of initiative (E, S or G) and by various financial measures of interest (cost of debt capital; cost of equity capital; operating performance; and effect on stock prices).

On innovation: Research has shown that companies with a longer-term management focus [13] or a stakeholder orientation [14] promote innovation within the firm and higher levels of trust of the firm among various external stakeholders. Empirical results from Jodi Surroca, Josep Tribó and Sandra Waddock support the theory that intangibles like innovation are a necessary mediating variable that explain the relationship between corporate responsibility and better financial performance. [15] Their study shows that corporate responsibility strategies and operating procedures positively influence intangibles of innovation, human capital improvements, reputation and corporate culture, and that these intangibles are significantly related to corporate financial performance. [16]

On litigation risk: High ESG scores are also associated with lower risks of being sued for securities fraud, while lower scores are associated with more meritorious securities litigation. [17] This latter finding led the authors to surmise that perhaps ESG metrics serve as a proxy for firm culture, particularly integrity.

Investors may also use ESG information to evaluate reporting companies with respect to their nonfinancial preferences. An increasing volume of assets are invested using ESG criteria. [18] Michal Barzuza, Quinn Curtis, and David Webber attribute increasing ESG stewardship and climate activism by large institutional investors, many of whom are passive investors, to a

[13] *See* Caroline Flammer & Pratima Bansal, *Does Long-Term Orientation Create Value? Evidence from a Regression Discontinuity* (2014) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2511507 (showing that firms that adopted longer-term executive compensation plans showed an increase in firm value and operating performance after the adoption of those plans).

[14] *See* Caroline Flammer & Aleksandra Kacperczk, *The Impact of Stakeholder Orientation on Innovation: Evidence from a Natural Experiment*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2353076.

[15] *See* Jordi Surroca, et al., *Corporate Responsibility and Financial Performance: The Role of Intangible Resources*, 31 STRAT. MNGMT. J. 463 (2010).

[16] *See id.* at 480

[17] Adam B. Badawi & Frank Partnoy, *Measuring How Corporations Impact Society: The Relationship between ESG Metrics and Securities Litigation* (2020), https://insights.truvaluelabs.com/hubfs/Academic%20Research%20Network/ARN_Partnoy_ESGandLitigation.pdf.

[18] Morningstar reports that the number of ESG-focused index funds and the volume of assets invested in those funds have doubled over the past three years. Pippa Stevens, *ESG index funds hit $250 billion as pandemic accelerates impact investing boom*, CNBC, Sept. 2, 2020, https://www.cnbc.com/2020/09/02/esg-index-funds-hit-250-billion-as-us-investor-role-in-boom-grows.html.

competition to attract millennial investors.[19] Millennials are due to inherit between $27 trillion and $ 47 trillion over the next decades and "place a significant premium on social issues in their economic lives."[20]

Finally, ESG information is relevant not just to buying or selling securities but also to the oversight of management through shareholders' exercise of their voting rights. The broad statutory authorization for the SEC to regulate the proxy process is found in Section 14(a) of the Exchange Act, which makes it unlawful for any party to solicit proxy authorization in contravention of "such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."[21] Giving investors sufficient information about how public companies were being managed, and how insiders were exercising their fiduciary duties, was an important consideration for Congress in 1934.[22]

That investors view ESG information as important, and relevant to their exercise of oversight, is evidenced by the increasing number of shareholder proposals requesting the disclosure of such information, and increasing shareholder support for such proposals. An analysis of shareholder voting trends from 2000 to 2018 by ISS Analytics, the research arm of the major proxy advisor ISS (Institutional Shareholders' Services), concluded that "[t]he most significant change in investors' voting behavior pertains to environmental and social issues, as these proposals are earning record levels of support in recent years. . . ."[23] It stated that ESG proposals are "increasingly focusing on disclosure, risk assessment, and oversight," seeking key indicators of management's approach to matters such as workforce diversity, climate change, or employee health and safety.[24]

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[19] *See* Michal Barzuza et al., *Shareholder Value(s): Index Fund ESG Activism and the New Millennial corporate Governance,* 93 S. CA. L. REV. (2020).

[20] *Id.*

[21] Exchange Act Section 14(a).

[22] *See* Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1238-1245 (1999) (quoting the House and Senate Committee Reports' discussions of proxy voting and goals to be advanced).

[23] Kosmas Papadopoulos, ISS Analytics, *The Long View: U.S. Proxy Voting Trends on E&S Issues from 2000 to 2018*, Jan. 31, 2019, https://corpgov.law harvard.edu/2019/01/31/the-long-view-us-proxy-voting-trends-on-es-issues-from-2000-to-2018/. *See also* Maura Souders, ISS ESG, *Survey Analysis: ESG Investing Pre-and Post-Pandemic*, Oct. 13, 2020, https://www.issgovernance.com/library/survey-analysis-esg-investing-pre-and-post-pandemic/.

[24] *Id.*

The growing support for disclosure proposals is particularly noteworthy. For example, at Exxon's 2017 annual meeting, more than 62% of shares were voted in support of a proposal requesting the company to disclose "the impact on its business of compliance with global climate change guidelines."[25] Shareholder support for ESG disclosure during the current proxy season has increased to unprecedented levels. BlackRock, for example, backed 91% of shareholder proposals on environmental issues in the first half of the year.[26] That backing, with that of other institutional investors, has led to some of the more remarkable outcomes this proxy season. Among those proceeding to vote were resolutions proposing that:

- ConocoPhillips and Chevron set and report on emission reduction targets covering the greenhouse gas emissions of the company's operations as well as their energy products (Scope 1, 2 and 3) (passed with 59.3% and 60.7% of the vote, respectively);[27]
- Chevron report on the implications of the International Energy Agency's October 2020 Net Zero 2050 scenario (failed with 47.8% of the vote);[28]
- Phillips 66 set and report on GHG reductions targets as well as the alignment of its lobbying activities with the objectives of the Paris Agreement (passed with 80.28% of the vote);[29]
- General Electric evaluate and disclose if and how the company has met the criteria of the 'Net Zero Indicator' produced by the Climate Action 100+ (passed with 97.97% of the vote);[30] and
- ExxonMobil evaluate and report on the alignment of its lobbying activities with the objectives of the Paris Agreement, on the basis that "corporate lobbying that is inconsistent with the goals

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[25] Steven Mufson, *Financial firms lead shareholder rebellion against ExxonMobil climate change policies*, WASH. POST, May 31, 2017, https://www.washingtonpost.com/news/energy-environment/wp/2017/05/31/exxonmobil-is-trying-to-fend-off-a-shareholder-rebellion-over-climate-change/.

[26] Dawn Lim, *BlackRock Starts to Use Voting Power More Aggressively*, WALL ST. J., Apr. 30, 2021, https://www.wsj.com/articles/blackrock-takes-aggressive-posture-on-esg-proxy-votes-11619775002.

[27] ConocoPhillips. Form 8-K (filed May 13, 2021). EDGAR. Securities and Exchange Commission, 2021, https://www.sec.gov/ix?doc=/Archives/edgar/data/1163165/000110465921065508/tm2116180d1_8k.htm; Chevron Corporation. Form 8-K (filed 28 May 2021). EDGAR. Securities and Exchange Commission, 2021, https://www.sec.gov/Archives/edgar/data/0000093410/000009341021000020/cvx-20210526.htm.

[28] Chevron Corporation. Form 8-K (filed May 28, 2021). EDGAR. Securities and Exchange Commission, 2021, https://www.sec.gov/Archives/edgar/data/0000093410/000009341021000020/cvx-20210526.htm.

[29] Phillips 66. Form 8-K (filed May 12, 2021). EDGAR, Security and Exchange Commission, 2021, https://www.sec.gov/ix?doc=/Archives/edgar/data/1534701/000153470121000116/psx-20210512.htm.

[30] General Electric Company. Form 8-K (filed May 4, 2021). EDGAR. Securities and Exchange Commission, 2021, https://www.sec.gov/ix?doc=/Archives/edgar/data/40545/000004054521000030/ge-20210504.htm.

of the Paris Agreement presents regulatory, reputational and legal risks to investors" (passed with 63.8 % of the vote).[31]

Notably, the disclosure requests extend beyond climate change to other ESG issues. As of April 2021, shareholders filed 69 proposals seeking disclosure of information on the diversity of corporate workforces and statistics on retentions and promotions.[32] At IBM's 2021 annual meeting, 94% of shares were voted in favor of a proposal seeking an annual report on "'the board's process for addressing the effectiveness of its [DEI] programs and the board's assessment of program effectiveness, as reflected in any goals, metrics and trends related to its promotion, recruitment and retention of protected classes of employees."[33] Yum Brands agreed, in response to a shareholder proposal, to provide a report on the use of antibiotics in their supply chain.[34] These data points are just illustrative of the general trend: shareholders are seeking more and better disclosure on a range of ESG topics, including climate.

B. Promoting Competition

In a number of international policy venues, frameworks for climate risk recognition, measurement, and disclosure are being developed and deployed, a trend that is accelerating. The SEC's failure to regulate in this area could therefore put the U.S. capital markets and U.S. firms at a competitive disadvantage.

Disclosure according to the standards of the Task Force on Climate-related Financial Disclosures (TCFD)[35] has rapidly become a global norm for disclosure of companies' and

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[31] ExxonMobil Corporation. Form 8-K (filed June 2, 2021). EDGAR, Securities and Exchange Commission, 2021, https://www.sec.gov/ix?doc=/Archives/edgar/data/34088/000003408821000031/xom-20210526.htm.

[32] Lorraine Woellert, Catherine Boudreau & Kellie Meidrich, *Shareholders target 'white man's world' with record demands for diversity data*, POLITICO, Apr. 6, 2021, https://www.politico.com/news/2021/04/06/shareholders-diversity-data-479159.

[33] Ben Maiden, *IBM investors and board back DEI report*, CORPORATE SECRETARY, May 12, 2021, https://www.corporatesecretary.com/articles/shareholders/32575/ibm-investors-and-board-back-dei-report.

[34] The Shareholder Commons Announces Withdrawal of Shareholder Proposal after Yum! Brands Commits to Disclose Systemic Costs of Antibiotic Use, PRNEWSWIRE, Mar. 3, 2021, https://www.prnewswire.com/news-releases/the-shareholder-commons-announces-withdrawal-of-shareholder-proposal-after-yum-brands-commits-to-disclose-systemic-costs-of-antibiotic-use-301239878 html.

[35] Taskforce on Climate-related Financial Disclosures, *Final Report, Recommendations of the Task Force on Climate-related Financial Disclosures* (2017), https://www.fsb-tcfd.org/publications/ (hereafter TCFD *Final Report*). The TCFD is a project of the Financial Stability Board of the G-20, led by Michael Bloomberg, CEO, and with special assistance from former SEC Chair Mary Schapiro. It was established in 2015, and its standards for disclosure were developed by a global consortium of companies, accounting firms, and investors after a global consultation. *Id.*

investment funds' climate governance, strategies, risk management, and targets and metrics for tracking improvement. The TCFD 2020 Status Report issued in October 2020 states that TCFD has been endorsed by "over 1,500 organizations globally, including over 1,340 companies with a market capitalization of US$12.6 trillion and financial institutions responsible for assets of $150 trillion."[36] The TCFD reports, however, that while disclosure of climate-related financial information has increased since the TCFD framework was published in 2017, the quality of that disclosure is poor. It concludes that there is "a continuing need for progress in improving levels of TCFD-aligned disclosures given the urgent demand for consistency and comparability in reporting."[37]

The TCFD Status Report further states that 110 regulators and governmental entities from around the world now support the TCFD, with governments embedding its recommendations in policy and guidance and moving to require TCFD disclosures through legislation and regulation.[38] TCFD supporters include "the governments of Belgium, Canada, Chile, France, Japan, New Zealand, Sweden, and the United Kingdom."[39] First mover jurisdictions such as the UK are mandating climate-risk disclosures in line with the TCFD recommendations by 2025 at the latest.[40]

Accounting bodies outside the U.S. are also working to incorporate climate change risks into financial accounting. The International Financial Reporting Standards (IFRS) Foundation is conducting a consultation on its potential role in developing sustainability reporting standards, responding to investor demand and global consolidation efforts to align sustainability standards being developed amongst private standard setters.[41] In its consultation document, the IFRS

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[36] TCFD, *2020 Status Report: Taskforce on Climate-related Financial Disclosures*, Oct. 29, 2020, at 2, https://www.fsb.org/2020/10/2020-status-report-task-force-on-climate-related-financial-disclosures/(hereafter TCFD 2020 Status Report).

[37] TCFD, Press Release, *Third TCFD Status Report Shows Progress & Highlights Need for Greater Climate-Related Disclosures and Transparency*, 29 October 2020, at 1, https://assets.bbhub.io/company/sites/60/2020/10/TCFD-2020-Status-Report-Press-Release_FINAL.pdf.

[38] TCFD 2020 Status Report, *supra* note 36 at 71.

[39] *Id.*

[40] HM Treasury, UK Joint Regulator and Government TCFD Taskforce: Interim Report and Roadmap (Nov. 9, 2020). *See also* Janis Sarra, *Following the Footpath to Mandatory TCFD Disclosure in the United Kingdom: Lessons for Canadian and Other Regulators,* May 2021, https://ccli.ubc.ca/wp-content/uploads/2021/06/Following-the-Footpath-to-Mandatory-TCFD-Disclosure-in-the-UK.pdf.

[41] IFRS Foundation, *Consultation Paper on Sustainability Reporting*, (Sept. 2020), ¶ 33, https://cdn.ifrs.org/-/media/project/sustainability-reporting/consultation-paper-on-sustainability-reporting.pdf?la=en.

Foundation states that climate-related disclosure should likely be first on the agenda of a possible new Sustainability Standards Board operating alongside the International Accounting Standards Board.[42]

The Basel Committee on Banking Supervision, which sets the global standards for capital adequacy, has recognized that climate change potentially affects the safety and soundness of individual financial institutions and has broader financial stability implications for the banking system.[43] In 2020, it created a Task Force on Climate-related Financial Risks (TFCR) to undertake analytical work related to transmission channels of climate-related financial risks to the banking sector and measurement methodologies of such risks, in order to guide prudential oversight.[44] The TFCR has noted that there are currently different metrics and methodologies being used to identify, assess, and monitor climate-related financial risks across financial institutions, making comparability of results challenging; and while prudential supervisors are working with financial institutions using scenario analysis and models quantifying transition and physical risks, there is still considerable uncertainty surrounding the scale and speed at which climate change will occur, requiring supervisory guidance where possible.[45] It plans to make recommendations in 2021 as to how climate risks should be factored into the prudential capital framework.[46]

The International Association of Insurance Supervisors (IAIS) has issued a paper identifying effective practices of prudential supervisors to encourage and/or require insurers to utilize TCFD disclosures, recognizing that "climate change may pose material risks to insurers."[47] It suggests that the TCFD recommendations, TCFD supplemental guidance for insurers, and

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[42] *Id.*, at 1.

[43] Basel Committee on Banking Supervision, *The Basel Committee's initiatives on climate-related financial ris*ks, (Oct. 14, 2020), https://www.bis.org/speeches/sp201014 htm.

[44] *Id.*

[45] The Basel Committee, High-level summary: *BCBS TFCR industry workshop on climate-related financial risks* (Oct. 13, 2020), https://www.bis.org/bcbs/events/201012_tcfr_workshop.htm.

[46] BCBS, *supra* note 43.

[47] International Association of Insurance Supervisors, *Issues Paper on the Implementation of the Recommendations of the Task Force on Climate-related Financial Disclosures* (2020), at 20, https://www.iaisweb.org/file/88991/issues-paper-on-the-implementation-of-the-tcfd-recommendations.

supporting material on scenario analysis can assist in designing best practices or in setting supervisory objectives.[48]

The International Organization of Securities Commissions (IOSCO) has created a Sustainable Finance Task Force that in December 2020 is considering adoption of global securities law guidance on climate-related disclosures.[49] In addition, the Sustainable Stock Exchanges Initiative's (SSEI) sustainable stock exchange guidance document, *How Stock Exchanges Can Grow Green Finance,* tracks TCFD-aligned disclosure requirements in stock exchanges globally, and to date, twenty-nine stock exchanges that regulate entry into capital markets trading have adopted TCFD-aligned disclosure requirements.[50]

C. Facilitating Capital Formation

Promulgating a regulatory framework for the disclosure of ESG information would also promote capital formation. By providing more information to investors, giving better information about risks and opportunities, and standardizing what is currently an uncoordinated universe of ESG disclosures, the SEC would increase confidence in the capital markets. This confidence may well mobilize sources of capital from investors who are currently unwilling to invest given knowledge gaps or information asymmetries. Particularly retail investors, who are important as long-term investors and investors in small and medium enterprises, may be emboldened by a clearer sense of the social and environmental aspects of companies' activities as a guide to companies' longer-term risks and opportunities.[51]

ESG disclosure also promotes the efficient allocation of capital. The Biden Administration's pledge to cut US emissions in half by 2030 announcement will profoundly impact the operation of a variety of businesses.[52] The UK and the EU have already announced even more

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[48] *Id.*, at 13.

[49] International Organization of Securities Commissions, *Sustainable Finance and the Role of Securities Regulators and IOSCO*, (April 2020), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD652.pdf.

[50] Sustainable Stock Exchanges Initiative, *ESG Disclosure Guidance Database*, https://sseinitiative.org/esg-guidance-database/.

[51] *See* Alicia J. Davis, *A Requiem for the Retail Investor?*, 95 VA. L. REV. 1105, 1116-1120 (2009)(discussing evidence showing the importance of retail investors to small and medium enterprises, versus institutional investors which predominantly invest in large-capitalization companies; and for evidence of retail investors' generally longer holding periods for shares of stock).

[52] Brady Dennis & Juliet Eilperin, *Biden Plans to Cut Emissions at Least in Half by 2030*, WASH. POST, Apr. 20, 2021, https://www.washingtonpost.com/climate-environment/2021/04/20/biden-climate-change/.

aggressive emission-cutting targets.[53] These targets make it critical for investors to be able to evaluate which companies are best-positioned to meet these targets and to allocate their capital to those that can operate productively consistent with these mandates.

II. ESG Disclosure and Materiality

The role of materiality has received considerable attention in the debate over ESG disclosure. Some commentators have argued that specific ESG disclosure mandates are unnecessary because, to the extent that ESG disclosures are material, reporting companies are already obligated to disclose all material information. This argument misconceives the disclosure obligations of the federal securities laws. Unlike some jurisdictions, U.S. law does not require reporting companies to disclose all material information.[54] Instead, such companies need only disclose the information explicitly required by the SEC to be set out in the Registration Statement, periodic reporting documents, and proxy statements, based on the requirements of Regulation S-K.[55] Other than situations in which the SEC has mandated disclosure, a failure to disclose material information is only actionable when an issuer has made an incomplete disclosure or half-truth, or in the case of some other disclosure duty, such as in the context of insider trading.

Others have argued that ESG disclosures are not material, and that, as a result, the SEC lacks the power to mandate such disclosures. This argument is based on two mistaken premises. In arguing that ESG disclosures are not material, commentators typically draw upon the definition of materiality articulated by the Supreme Court in *TSC v. Northway* and *Basic v. Levinson*.[56] This

[53] *Id*.

[54] *See Gallagher v. Abbott Laboratories*, 269 F.3d 806 (7th Cir. 2001) (Easterbrook, J) ("Much of plaintiffs' argument reads as if firms have an absolute duty to disclose all information material to stock prices as soon as news comes into their possession. Yet that is not the way the securities laws work. We do not have a system of continuous disclosure. Instead, firms are entitled to keep silent (about good news as well as bad news) unless positive law creates a duty to disclose."). In contrast, the EU's Market Abuse Regulation requires issuers (with certain exceptions) to disclose all information of a "precise" nature, including information about unfolding events. *See generally* Ido Baum & Dov Solomon, *More Jomo Less Fomo: The Case for Voluntary Disclosure of Uncertain Information in Securities Regulation,* 14 VA. L. & BUS. REV. 171, 190-96 (2020).

[55] *See* Staff Report on Review of Disclosure Requirements in Regulation S-K, U.S. Securities and Exchange Commission, Dec. 2013, https://www.sec.gov/files/reg-sk-disclosure-requirements-review.pdf.

[56] *See TSC v. Northway*, 426 U.S. 438 (1976); *Basic v. Levinson*, 485 U.S. 224 (1988). In *TSC v. Northway*, the Court defined material facts in the proxy context as facts for which there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." 426 U.S. at 449. In *Basic v. Levinson*, the Court adopted the *TSC v. Northway* definition of materiality in the § 10(b) and Rule 10b-5 context, 485 U.S. at 232. The Court recognized that determining the

definition was developed in the context of private federal securities fraud litigation, however, as a limitation on the extent to which issuers and others can be held liable for misleading statements. Nothing in those decisions purports to apply to the scope of the SEC's authority to compel disclosure. Indeed, several lower court cases have recognized that a violation of an SEC reporting requirement does not automatically constitute a material omission for purposes of Rule 10b-5.[57]

Nothing in the federal securities laws purports to limit the SEC's authority to require line-item disclosures to those that are individually material. There is no such limit in the SEC's broad statutory authority to require disclosure "as necessary or appropriate in the public interest or for the protection of investors."[58] The definition of materiality that the SEC has promulgated to structure disclosure according to Regulation S-K, Rule 12b-2, applies to the scope of issuer disclosure obligations pursuant to Regulation S-K, not the authority of the SEC itself, and in any case does not apply to proxy disclosure that might be required pursuant to Section 14(a) of the Exchange Act.[59]

Indeed, a variety of disclosure requirements do not appear to meet *Basic*'s legal standard for materiality. Thus, for example, Item 402 requires disclosure of any individual perquisite greater than $25,000 that constitutes part of an executive's compensation. That disclosure may well be relevant to investors' oversight of directors' fiduciary duties and loyalty to shareholder interests, but it is certainly not financially material to any public company.[60] Numerous other items of

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materiality of information "is something to be determined on the basis of the particular facts of each case." *Basic*, 485 U.S. at 238, citing *SEC v. Geon Industries, Inc*., 531 F. 2d 39, 47-48 (2nd Cir. 1976).

[57] *See, e.g., Oran v. Stafford*, 226 F.3d 275, 287 (3d Cir. 2000); *In re Galena Biopharma, Inc. Sec. Litig*., 336 F. Supp. 3d 378 (D.N.J. 2018). We note that this distinction also offers a limiting principle with respect to potential liability concerns associated with mandated ESG disclosure. Similarly, private lawsuits under Rule 10b-5 would need to establish loss causation – proof that the violation impacted stock price. *See* Fisch, *supra* note 4, at 965 (observing that "only the most economically significant of sustainability disclosure-related failures could trigger private litigation"),

[58] *See* notes 1 and 21, *supra*.

[59] Rule 12b-2, 17 C.F.R. § 240.12b–2 "Definitions. Unless the context otherwise requires, the following terms, when used in the rules contained in this regulation or in Regulation 13A or 15D or in the forms for statements and reports filed pursuant to sections 12, 13 or 15(d) of the act, shall have the respective meanings indicated in this rule . . . Materiality: The term ''material,'' when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to buy or sell the securities registered."

[60] Professor Amanda Rose argues that it would inappropriately blur the line between federal securities regulation and state corporate law for the SEC to "federalize" corporate governance by adopting "disclosure rules to influence corporate behavior." Amanda Rose, *A Response to Calls for SEC-Mandated ESG Disclosure* at 26-27, https://www.sec.gov/comments/climate-disclosure/cll12-8785693-237729.pdf. But in his authoritative legal history of the Securities and Exchange Commission and federal securities regulation, Professor Joel Seligman observes that

required disclosure are similarly not likely to be financially material according to the definitions of materiality for purposes of limiting securities fraud causes of action.[61]

III. Potential Involvement of One or More Private-Sector Standard Setters

The debate over ESG disclosure also has raised issues concerning the SEC's legal authority to rely on standards and principles developed by private-sector entities. Recent commentary includes a far-flung claim that the SEC cannot designate a standard setter for ESG disclosure absent congressional authorization.[62] To be sure, only Congress can require reporting companies to pay "support fees" to fund the budget of a private standard setter, as it did in Section 109 of the Sarbanes-Oxley Act of 2002 (the "SOX") in connection with the Financial Accounting Standards Board (FASB). But in formulating specific ESG disclosure requirements, the SEC indisputably possesses the legal authority either to incorporate in rules and regulations standards developed by private entities or to develop its own expertise to establish the operative standards internally. Indeed, Section 19(a) of the Securities Act and Section 23(a) of the Exchange Act accord the SEC broad rulemaking authority, and the agency has for many decades relied on private entities to establish the standards and principles that SEC rules, in turn, impose on reporting companies. The SEC thus has available multiple models for a public-private partnership involving ESG disclosure, each with advantages and disadvantages.

A public-private partnership for ESG disclosure could, for example, involve the SEC's designation of a single private-sector entity's standards as "authoritative," with such standards imposed on reporting companies through formal SEC rulemaking. As far back as 1938, the SEC

"a primary enduring mission of the SEC has been to compel disclosure of data by firms involved in the securities markets, indirectly inducing these firms to avoid illegal or embarrassing activities." JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 39-40 (Aspen 3d ed. 2003).

[61] Other examples include Item 407(b)(i) of Regulation S-K, which requires disclosing the name of each director who has attended fewer than 75% of board and committee meetings during the prior year; or Item 404(a), which requires the disclosure of any transaction greater than $120,000 between the company and a related party, where that amount is material to the related party. Although material to the related party, $120,000 is not an amount of money financially material to the company whose disclosure is being required.

[62] *See, e.g.,* Andrew Ramonas et al., *SEC's Next Difficult Task for ESG is Finding a Standard Setter*, BLOOMBERG FINANCIAL ACCOUNTING, April 13, 2021 (reporting suggestions that the SEC cannot endorse a standard setter without congressional authorization), available at https://news.bloombergtax.com/financial-accounting/bidens-sec-faces-uphill-battle-to-form-esg-reporting-body.

began relying on standards and principles set by the accounting industry's principal trade association, the Association of Accountants, which later became the American Institute of Certified Public Accountants (AICPA).[63] The AICPA's initial standard setting responsibilities included the formation of "generally accepted accounting principles" (GAAP), but, in 1973, the AICPA designated an independent body – the FASB – as the entity that would continue to establish and improve the authoritative principles and standards. As the SEC emphasized when it announced its reasons for continuing to look "to the private sector for leadership," FASB's standard-setting process provides "prompt and responsible actions flowing from research and consideration of varying viewpoints," and the "collective experience and expertise of the members of FASB and the individuals and professional organizations supporting it are substantial."[64] But a single private-sector standard setter operating under SEC oversight with essential due process safeguards for public participation is costly, and one lesson from FASB's experience, prior to the SOX, was that private funding caused FASB to be "less than optimally independent or objective" because it continually placed FASB "in the role of a hat-in-hand supplicant soliciting the industry for charity."[65] Public funding of a single private-sector standard setter for ESG disclosure would make that entity more independent, objective, and accountable.[66] But, as referenced above, not only would that funding mechanism require legislative action, but also governmental creation of an entirely new standard setter for ESG disclosure could render that entity "part of the federal government," as least for purposes of constitutional law.[67]

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[63] *See Administrative Policy on Financial Statements*, Accounting Series Release No. 4 (April 25, 1938).

[64] Statement of Policy on the Establishment and Improvement of Accounting Principles and Standards, Accounting Series Release No. 150 (Dec. 20, 1973).

[65] *The Financial Accounting Standards Board Act*: Hearing Before the House Subcomm. on Commerce, Trade and Consumer Protection of the House Energy & Commerce Comm., 107th Cong. 52 (2002) (prepared statement of John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia Univ. Law Sch.).

[66] Section 19(b) of the Securities Act, enacted as Section 108 of the SOX, explicitly authorizes the SEC to recognize "any accounting principles established by a standard setting body" that satisfies the section's criteria. But there is no doubt that the "standard setting body" was FASB, and that the criteria were prerequisites for FASB's receipt of what was, in effect, a congressionally imposed tax on reporting companies. *See* S. REP. NO. 107-205, at 13 (2002) (stating that "[t]he bill seeks to formalize the SEC's reliance on the FASB"). Section 19(b) does not preclude the SEC from looking to a privately funded entity to assist with establishing the standards and principles that it seeks to incorporate into new disclosure rules and regulations.

[67] *Free Enter. Fund v. Pub. Co. Acct. Oversight Bd.,* 561 U.S. 477, 485–86 (2010) (observing that "[d]espite the [SOX] provisions specifying that [PCAOB] members are not Government officials for statutory purposes, the parties agree that the Board is 'part of the Government' for constitutional purposes" quoting *Lebron v. National Railroad Passenger Corporation*, 513 U.S. 374, 397 (1995)).

A public-private partnership for ESG disclosure could instead involve SEC rulemaking that incorporates or draws upon multiple "suitable" frameworks, and the SEC could specify the due process procedures and independence safeguards that would be necessary for a framework's recognition as suitable. The SEC followed this route nearly twenty years ago when it contemplated that multiple private-sector entities would assist with implementing the internal control reporting requirements mandated by Section 404 of the SOX. Rules 13a-15(c) and 15d-15(c) of the Exchange Act require a reporting company to evaluate the effectiveness of its internal control over financial reporting under "a *suitable, recognized control framework* that is established by a body or group that has followed due-process procedures, including the broad distribution of the framework for public comment."[68] In its release adopting these rules, the SEC identified the Committee of Sponsoring Organizations of the Treadway Commission (COSO) as a framework that satisfied the regulatory criteria, but the release was also explicit in recognizing that "other evaluation standards exist outside of the United States, and that frameworks other than COSO may be developed within the United States in the future, that satisfy the intent of the statute without diminishing the benefits to investors."[69] The development of multiple suitable frameworks for ESG disclosure could draw upon funding from a range of public and private sources both inside and outside the United States, thus ensuring that the standard setters were not beholden to a single constituency. Multiple frameworks that are designated as suitable would also benefit multinational companies because some of those frameworks could facilitate compliance with U.S. disclosure requirements as well as requirements imposed by regulators abroad. But multiple frameworks could mean a proliferation of standards from an "alphabet soup" of private entities, which might impede the ability of investors to compare ESG disclosures from different companies.

Any choice by the SEC to rely on one or more private-party standard setters in its ESG disclosure rulemaking would squarely align with not only long-standing SEC practices and traditions but also those at dozens of other federal administrative agencies. And the constitutional permissibility of such public-private partnerships is not in doubt, provided the private entities

[68] 17 C.F.R. § 240.13a-15(c); 17 C.F.R. § 240.15d-15(c) (emphasis added).

[69] Final Rule: *Mgmt.'s Rep. on Internal Control over Fin. Reporting & Certification of Disclosure in Exch. Act Periodic Reps*., Sec. Act Rel. No. 8238; Exch. Act Rel. No. 47986 (June 5, 2003).

"function subordinately" to the federal agencies, with the agencies having "authority and surveillance over [their] activities."[70]

But while the SEC possesses the clear legal authority to rely upon one or more private-sector entities to establish ESG disclosure standards for reporting companies, there may be compelling prudential reasons for the SEC to instead recruit new experienced staff members who could build on the important work already being done by the U.S. based Sustainability Accounting Standards Board ("SASB"), the Global Reporting Initiative ("GRI"), TCFD, IFRS, and others to craft the agency's own ESG disclosure standards. A successful public-private partnership with constitutionally adequate SEC oversight would require both the agency and private-sector standard setters to expend significant resources, and the SEC's resources might be better spent developing ESG expertise internally.[71] Moreover, private-sector adherence to due process procedures for public notice and opportunity for comment would subject ESG disclosure standards to two layers of commentary—one provided by the private entities and the other at the SEC stage when the agency incorporates those standards into new rules and regulations—which could substantially delay the timeline for meaningful disclosures in SEC reports. For this reason and others, public-private partnerships can sometimes constitute the "worst of both worlds rather than the best."[72] These potential drawbacks could be reduced if the SEC opts to promulgate some of its own rules specifying the requisite disclosures on specific topics, but if the SEC develops the expertise to

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[70] *Sunshine Anthracite Coal Co. v. Adkins*, 310 U.S. 381, 399 (1940) (upholding a post-*Carter Coal* version of the Bituminous Coal Act that allowed private coal boards to set rules governing the sale of coal, with the board's rulemaking subject to approval, disapproval, or modification by the government's Bituminous Coal Commission). *See* Jody Freeman, *The Private Role in Public Governance*, 75 NYU L. REV. 543, 639-40 (2003) (discussing the "long tradition of agency incorporation of privately established health, safety, and product standards" and observing that "Congress not only recognizes but endorses this practice"). As an example, Professor Freeman cites the National Technology Transfer and Advancement Act of 1995, Pub. L. No. 104-113, 110 Stat. 775, which "requires federal agencies to use voluntary consensus standards in certain activities as a means of carrying out policy objectives unless the use of those standards would be inconsistent with applicable law or otherwise impractical." *Id.* at 640.

[71] *See* Sidney A. Shapiro, *Outsourcing Government Regulation*, 53 DUKE L. J. 389, 404, 411 (2003) (observing that "an agency's reliance on private parties creates several important transaction costs for the agency" because it often "lacks [ ] the expertise to oversee the standards-writing process in an effective manner" and, "to the extent that a politically powerful industry supports private standard setting, the agency may find it politically difficult to engage in extensive rewriting").

[72] *See* *Accounting Reform and Investor Protection Issues Raised by Enron and Other Public Companies*: Hearings Before the Senate Comm. on Banking, Hous., and Urban Affairs, 107th Cong. 532 at 1027-28 (2002) (testimony of Sarah Teslik, Executive Director, Council of Institutional Investors, referencing the NYSE and NASD and commenting that "[b]y and large, we get better responses, more quickly in the sunshine, with better regulation from government bodies").

promulgate some standards on some topics, it may ultimately be more efficient for the SEC to retain responsibility for both the disclosure standards and the disclosure rules and regulations. The SEC's recent appointment of Satyam Khanna as senior policy advisor for climate and ESG could constitute an important first step, and further steps could follow the 2018 launch of the SEC's Strategic Hub for Innovation and Financial Technology (FinHub). Although now a stand-alone SEC Office, FinHub was initially a unit in the Division of Corporation Finance headed by an Associate Director and staffed by officials who had expertise and involvement in FinTech-related issues.

Conclusion

We welcome the opportunity to discuss these comments with the Commission or the Commission's Staff.

Respectfully,

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