ISS

Filed Electronically

June 14, 2021

Ms. Vanessa A. Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1090

Re: Request for Comment on Climate Change Disclosures

Dear Ms. Countryman:

Institutional Shareholder Services Inc. (ISS) is pleased to submit these comments in response to the Securities and Exchange Commission's (SEC's) request for public input on climate-related financial disclosure issued by Acting Chair Allison Herren Lee on March 15, 2021.[1] Given the increasing importance of integrating environmental, social and corporate governance ("ESG") factors into a prudent investment management strategy, ISS applauds the Commission's decision to seek input on this important topic.

ISS ESG, ISS' responsible investment arm, is the world's leading provider of environmental, social, and governance solutions for over 1100 global clients spanning asset owners, asset managers, hedge funds, and asset servicing providers. ISS ESG delivers differentiated sustainability services and a suite of solutions to its investor clients. Our team of over 460 global professionals with thematic and sector expertise underpin our commitment to sustainable finance. With more than 35 years of corporate governance expertise and 25 years of providing in-depth responsible investment research and analytics including a dedicated global climate research team, ISS ESG has a unique understanding of the requirements of institutional investors. With its comprehensive offering of solutions, ISS ESG enables investors to develop and integrate responsible investing policies and practices, engage on responsible investment issues, and monitor portfolio company practices through screening solutions. We also provide climate data, analytics, and advisory services to help financial market participants understand, measure, and act on climate-related risks across all asset classes. In addition, ISS ESG delivers corporate and country ESG research and ratings, enabling its clients to identify material social and environmental risks and opportunities. As such, ISS ESG extensively uses public company reporting (including sustainability reporting) as one of the main sources of information.

The purpose of the SEC's public company disclosure regime is to foster fair and orderly markets by affording investors access to material information about public companies. "Material" information is that which a reasonable investor would think is an important part of the mix of information needed to make an investment decision. Judged by this standard, ISS observes that investors today believe that climate-related information is material.

[1] US Securities and Exchange Commission (SEC), "Public Input Welcomed on Climate Change Disclosures," Public Statement (March 15, 2021).

In a recent report on public companies' disclosure of ESG factors, the U.S. Government Accountability Office ("GAO") found that the institutional investors they interviewed generally agreed that ESG considerations can substantially influence a company's long-term financial performance.[2] Among other things, "factors like climate change impacts . . . .may affect a company's expected financial performance and thereby its value to shareholders."[3] Likewise, the SEC's Investor Advisory Committee last year observed that "ESG is no longer a fringe concept. It is an integral part of the larger investment ecosystem of our modern, global, interconnected world Many investors view material ESG factors as critical drivers of risk and returns in their investment making decisions, both in the short and long term."[4] The SEC itself has recognized that ESG factors may be material to investors. For example, in 2019, the SEC proposed to modernize its public company disclosure requirements to include information about human capital management, which the agency observed "may represent an important resource and driver of performance for certain companies."[5]

While company reporting has developed and improved over the last several years, there are significant regional differences in terms of comprehensiveness. As our clients are global investors, comparability is of high importance to them (and to us). We therefore welcome regulatory initiatives that seek to improve company ESG reporting as well as any efforts on the international level to harmonize and standardize reporting.

We very much welcome the opportunity to provide feedback to the SEC on climate change disclosures. ISS ESG provides responses as an ESG provider and thought leader. Our answers do not necessarily represent the views of our clients.

Question 1. *How can the Commission best regulate, monitor, review, and guide climate change disclosures in order to provide more consistent, comparable, and reliable information for investors while also providing greater clarity to registrants as to what is expected of them? Where and how should such disclosures be provided? Should any such disclosures be included in annual reports, other periodic filings, or otherwise be furnished*?

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[2] U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-20-530, PUBLIC COMPANIES: DISCLOSURE OF ENVIRONMENTAL, SOCIAL, AND GOVERNANCE FACTORS AND OPTIONS TO ENHANCE THEM 9 (2020) ("GAO ESG Report"), available at https://www.gao.gov/assets/710/707949.pdf.

[3] *Id.* at 5.

[4] INVESTOR-AS-OWNER SUBCOMM., INVESTOR ADVISORY COMM., RECOMMENDATION FROM THE INVESTOR-AS- OWNER SUBCOMMITTEE OF THE SEC INVESTOR ADVISORY COMMITTEE RELATING TO ESG DISCLOSURE 7-8, 9 (as of May 14, 2020), available at https://www.sec.gov/spotlight/investor-advisory-committee- 2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf. *See also* INT'L MONETARY FUND, *Sustainable Finance: Looking Farther, in* GLOBAL FINANCIAL STABILITY REPORT: LOWER FOR LONGER 83 (2019) ("IMF Sustainability Report") ("ESG issues can have a material impact on firms' corporate performance and risk profile, and on the stability of the financial system").

[5] Modernization of Regulation S-K Items 101, 103 and 105, SEC Rel. Nos. 33-10668 and 34-86614 (August 8, 2019) 48, 84 Fed. Reg. 44358, 443 (August 23, 2019).

There are various formats for company ESG disclosures. ESG information can be published in annual reports, sustainability reports or integrated reports. What is most vital from our perspective is that information is clear, easy to find, well-structured, timely and comparable across reporting years.

To allow investors to use ESG information in their investment activities, especially with respect to proxy voting, ESG information should be published at the same time as financial information or at least in advance of the annual general meeting. It would be useful if reference to relevant ESG information is also made in meeting materials.

We believe that any regulation in this area should not only require reporting but that such reporting should be subject to the same standards that the SEC applies to the current disclosure framework.

Question 2. *What information related to climate risks can be quantified and measured? How are markets currently using quantified information? Are there specific metrics on which all registrants should report (such as, for example, scopes 1, 2, and 3 greenhouse gas emissions, and greenhouse gas reduction goals)? What quantified and measured information or metrics should be disclosed because it may be material to an investment or voting decision? Should disclosures be tiered or scaled based on the size and/or type of registrant)? If so, how? Should disclosures be phased in over time? If so, how? How are markets evaluating and pricing externalities of contributions to climate change? Do climate change related impacts affect the cost of capital, and if so, how and in what ways? How have registrants or investors analyzed risks and costs associated with climate change? What are registrants doing internally to evaluate or project climate scenarios, and what information from or about such internal evaluations should be disclosed to investors to inform investment and voting decisions? How does the absence or presence of robust carbon markets impact firms' analysis of the risks and costs associated with climate change?*

ISS ESG supports investors with a wide range of analyses on their investments, including Transition Risk, Physical Risk, Scenario Analysis and GHG emissions. In doing this work, ISS ESG observes that both investors and regulators often use different metrics interchangeably, indifferent to which questions the data should address. Risk reporting (what does climate change mean for the company/ investment) and impact reporting (what does the business/ investment do to the climate), for example, require different sets of metrics.

Likewise, in setting reporting standards, it is important to differentiate between:

- cross-sectoral measurable indicators (such as GHG emissions) and sector specific ones (such as energy produced, reserves *etc*);

- current (*e.g.* GHG emissions) and future (*e.g.* targets) quantifiable indicators. The latter helps to analyze a company's climate change preparedness. Desirable disclosure includes not only Net Zero and Science Based Targets, but also CapEx regarding climate transition as well as on investment in carbon removal technologies to contribute to Net Zero;

- the TCFD categories of Governance, Risk Management, Strategy and Metrics & Targets; and

- transition risks (where carbon markets come into play) and physical risks (that might be brought on by a lack of sufficient transition).

A key guiding thought for any reporting regulation should be the understanding that the ultimate goal is clarity and transparency so that investors can properly integrate material information into their investment activities.

Question 3. *What are the advantages and disadvantages of permitting investors, registrants, and other industry participants to develop disclosure standards mutually agreed by them? Should those standards satisfy minimum disclosure requirements established by the Commission? How should such a system work? What minimum disclosure requirements should the Commission establish if it were to allow industry-led disclosure standards? What level of granularity should be used to define industries (e.g., two-digit SIC, four-digit SIC, etc.)?*

Including relevant stakeholders, especially those to which the standards/requirements will apply, in the development of disclosure frameworks is vital for success, acceptance and relevance. However, to make sure the results meet the requirements of the investors for whom the disclosures will be used and relied upon, we recommend that the SEC should either lead such efforts or define a range of clear parameters and minimum expectations.

Given that we are still in the infancy of assessing climate risk from a financial materiality/risk standpoint, it is our view that the SEC should avoid a rigid standardization of the status quo and make sure to also foster innovation for better analysis and to also allow for the evolution in what investors consider to be material and what investors will require in the future to properly integrate this information into their investment processes.

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

Since ESG risks and key issues are to a large extent sector-specific, it would be beneficial to develop reporting standards that take this into account. At the same time, comparability across sectors is very important. To ensure comparability as well as relevance, one part of a reporting standard could be general and cross-sectoral, while for the sector-specific aspects there could be different standards for different industries. As mentioned in response to question 3, such standards should be developed in cooperation with respective industries and stakeholders.

Question 5. *What are the advantages and disadvantages of rules that incorporate or draw on existing frameworks, such as, for example, those developed by the Task Force on Climate-Related Financial Disclosures (TCFD), the Sustainability Accounting Standards Board (SASB), and the Climate Disclosure Standards Board (CDSB)? Are there any specific frameworks that the Commission should consider? If so, which frameworks and why?*

The work undertaken by existing market initiatives on company reporting, such as the TCFD, SASB, CDSB, the Global Reporting Initiative, the International Integrated Reporting Council and the CDP (previously the Carbon Disclosure Project), have resulted in established and respected market standards in terms of both reporting topics and reporting quality. For climate reporting in particular, the TCFD recommendations are a widely acknowledged best practice framework. It would therefore be useful to reference them. It should be noted, however, that the TCFD framework does not contain specific standards.

6. *How should any disclosure requirements be updated, improved, augmented, or otherwise changed over time? Should the Commission itself carry out these tasks, or should it adopt or identify criteria for identifying other organization(s) to do so? If the latter, what organization(s) should be responsible for doing so, and what role should the Commission play in governance or funding? Should the Commission designate a climate or ESG disclosure standard setter? If so, what should the characteristics of such a standard setter be? Is there an existing climate disclosure standard setter that the Commission should consider?*

Standards should not be static, as this could be detrimental to innovation. They need to evolve and adapt over time. We believe the SEC should take the lead and be responsible for modifying and improving disclosure requirements. Just as with the initial development of requirements, for modifications it can equally take into consideration changes in the above-mentioned internationally acknowledged reporting standards as well as any future initiatives, especially on the international level, such as work under way by the International Financial Reporting Standards (IFRS).

Question 8. *How, if at all, should registrants disclose their internal governance and oversight of climate-related issues? For example, what are the advantages and disadvantages of requiring disclosure concerning the connection between executive or employee compensation and climate change risks and impacts?*

Internal governance and oversight of climate-related issues is fundamental to an investor's understanding of a company's climate strategy and the financial implications and risks of that strategy. Linking executive remuneration to the successful implementation of the strategy constitutes a key incentive. Such information is thus material for investors.

Question 9. *What are the advantages and disadvantages of developing a single set of global standards applicable to companies around the world, including registrants under the Commission's rules, versus multiple standard setters and standards? If there were to be a single standard setter and set of standards, which one should it be? What are the advantages and disadvantages of establishing a minimum global set of standards as a baseline that individual jurisdictions could build on versus a comprehensive set of standards? If there are multiple standard setters, how can standards be aligned to enhance comparability and reliability? What should be the interaction between any global standard and Commission requirements? If the Commission were to endorse or incorporate a global standard, what are the advantages and disadvantages of having mandatory compliance?*

Company reporting on ESG matters forms the basis of integration of those matters into the investment process. Without such information, investors cannot evaluate the sustainability risks and performance of portfolio companies and properly integrate this information into their investment decisions. To enable comparison between company performance across jurisdictions, reported information must be comparable globally, which necessitates internationally acknowledged standards.

The work initiated by the IFRS to develop a global reporting standard seems promising and could be a viable solution. ISS respectfully recommends that the SEC continue to monitor this effort and assess whether to incorporate it into reporting requirements for U.S. companies.

Question 10. *How should disclosures under any such standards be enforced or assessed? For example, what are the advantages and disadvantages of making disclosures subject to audit or another form of assurance? If there is an audit or assurance process or requirement, what organization(s) should perform such tasks? What relationship should the Commission or other existing bodies have to such tasks? What assurance framework should the Commission consider requiring or permitting*?

In order to increase the credibility and acceptance of ESG-related data, it would be beneficial to subject it to external assurance. An assurance framework for ESG information would also help place it at par with the information contained in a company's financial statements. Third-party assurance of ESG data could be part of general auditing.

Question 11. *Should the Commission consider other measures to ensure the reliability of climate-related disclosures? Should the Commission, for example, consider whether management's annual report on internal control over financial reporting and related requirements should be updated to ensure sufficient analysis of controls around climate reporting? Should the Commission consider requiring a certification by the CEO, CFO, or other corporate officer relating to climate disclosures*?

Climate reporting should not be a marketing or box-ticking exercise. We believe that there should be appropriate accountability with respect to the accuracy and reliability of the information disclosed.

Question 12. *What are the advantages and disadvantages of a "comply or explain" framework for climate change that would permit registrants to either comply with, or if they do not comply, explain why they have not complied with the disclosure rules? How should this work? Should "comply or explain" apply to all climate change disclosures or just select ones, and why*?

To ensure broad uptake, a level playing field and adequate disclosures, it is our view that climate reporting should not be on a "comply or explain" basis but mandatory. Having said that, individual aspects of disclosure requirements could be "comply or explain" for certain lower impact/lower risk sectors or for companies below a certain size (SMEs).

Question 13. *How should the Commission craft rules that elicit meaningful discussion of the registrant's views on its climate-related risks and opportunities? What are the advantages and disadvantages of requiring disclosed metrics to be accompanied with a sustainability disclosure and analysis section similar to the current Management's Discussion and Analysis of Financial Condition and Results of Operations*?

Disclosure should include targets and a clear action plan to reach them, as well as a discussion on risks and opportunities and how the registrant addresses these. Thus, quantitative metrics need to be accompanied with a qualitative assessment to help provide investors with context for the information presented. For example, in presenting emissions data according to the different Scopes (1-3), it would be important for investors to understand whether a decline in emissions resulted from a company implementing more efficient processes versus the company outsourcing carbon intensive operations.

Question 15. *In addition to climate-related disclosure, the staff is evaluating a range of disclosure issues under the heading of environmental, social, and governance, or ESG, matters. Should climate-related requirements be one component of a broader ESG disclosure framework? How should the Commission craft climate-related disclosure requirements that would complement a broader ESG disclosure standard? How do climate-related disclosure issues relate to the broader spectrum of ESG disclosure issues?*

While climate change has been and continues to be the most widely considered sustainability risk, other topics have come to prominence and should be considered with similar urgency. With regard to environmental risks, such topics include biodiversity and water. Evidence of this growing concern is the upcoming creation of a Task Force on Nature-related Financial Disclosures (TNFD), which aims to mirror the success of the TCFD, to develop an international reporting standard for biodiversity and natural capital risk. An Informal Working Group under the auspices of the United Nations Development Programme has been set up to prepare the launch of the TNFD.

At the same time, the current Covid-19 pandemic as well as movements such as Black Lives Matter, #MeToo and attention to the issue of modern slavery/forced labor have highlighted the significance of social issues, and their relevance and materiality as ESG investment risks.

We therefore suggest developing a broader disclosure framework covering a wider range of ESG elements that investors view as material. More specifically, we recommend that a broader framework might provide for disclosure of both quantitative metrics (e.g. resource consumption, emissions, accident rates, diversity ratios), as well as qualitative data (e.g. human rights policies and due diligence, environmental management systems, climate change strategies, biodiversity management). Further, the framework should address both backward-looking information (historical data to assess trends) as well as forward-looking data (targets and objectives, action plans, strategies).

Existing market initiatives on company reporting, such as the Global Reporting Initiative (GRI) and the Sustainability Accounting Standards Board (SASB) have developed globally acknowledged standards in terms of both reporting topics and reporting quality.

As noted at the outset of this letter, materiality is a key point here. On the one hand, there is the principle of 'financial materiality'. The financial materiality definition is one that typically focuses on direct impacts to a company's balance sheet. On the other hand, there is the concept of 'sustainability or stakeholder materiality' which takes into account risks related to all relevant stakeholder groups along the value chain, including employees, suppliers, customers, communities, and ecosystems.

There is a strong link between stakeholder and financial materiality, as ESG risks and impacts are not a separate category in and of themselves. Both ultimately translate into financial risks such as:

- Market risks and opportunities, relating to shifting consumer behavior towards more sustainable products and services, as well as regulation targeting unsustainable products;

- Operational risks and opportunities, such as those relating to physical risk, including flooding or water scarcity, protection of IT systems against cyberattacks, as well as difficulties in attracting and retaining top talent; as well as

- Reputational risks relating to controversial business activities, which may be decisive for maintaining a license to operate.

ESG risks and impacts are thus highly relevant for the competitiveness, business continuity and the financial success of a company and therefore correspondingly important to investors. There is growing evidence of the financial outperformance of companies with good ESG management – and not only in the long run. The vast majority of studies confirm that the financial performance of companies with high ESG performance is above benchmark.[6]

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We would be happy to supply the Commission or the staff with additional information regarding any of the matters discussed herein. Please direct questions about these comments to the undersigned, to our General Counsel, Steven Friedman, who can be reached at [redacted], or to our outside counsel, Mari-Anne Pisarri, who can be reached at [redacted].

Respectfully submitted,

Gary Retelny
President and CEO

cc: *The Honorable Gary Gensler, Chairman*
The Honorable Hester M. Peirce
The Honorable Elad L. Roisman

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6 *See e.g.,* Clark, Feiner and Vhies, "From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance," 2015; Deutsche Asset and Wealth Management, "ESG and Corporate Financial Performance: Mapping the global landscape," 2015; NN Investment Partners and ECCE, "The materiality of ESG factors for equity investment decisions: academic evidence," 2016; Deutsche Performancemessungs-Gesellschaft (DPG) and ISS ESG, "Outperformance through use of the ISS ESG prime standard," 2020

The Honorable Allison H. Lee
The Honorable Caroline A. Crenshaw
John Coates, Acting Director, Division of Corporation Finance