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Public Policy Letter – SEC Climate Change Disclosures

Dear SEC Chair Gensler,

Re: EOS at Federated Hermes' response to the U.S. Securities Exchange Commission ("SEC or Commission") consultation on climate change disclosures

On behalf of EOS at Federated Hermes we welcome the SEC's efforts to review and update reporting requirements for issuers to include material, decision-useful environmental, social and governance or ESG factors and as part of that review evaluate disclosure rules on climate change. We appreciate the opportunity to provide input to that process, specifically on the disclosure of consistent, comparable and reliable information on climate change, and ESG factors.

About EOS at Federated Hermes

EOS at Federated Hermes ("EOS") is a leading stewardship services provider. Our engagement activities enable long-term institutional investors to be more active owners of their assets, through dialogue with companies on environmental, social and governance issues. We believe this is essential to build a global financial system that delivers improved long-term returns for investors, as well as better, more sustainable outcomes for society. EOS represents $1.5bn of assets under advice as of March 31st 2021. EOS conducts proactive and reactive engagement with the companies in which its clients invest on a regular basis on environmental, social, governance, strategy, risk and communications concerns. Our team engages in active stewardship on behalf of clients, speaking at annual meetings and other shareholder gatherings and recommending proxy votes consistent with engagement objectives to achieve our clients' responsible ownership aims and fulfil their fiduciary duty. EOS is a stewardship services provider and does not carry out registered activity.

EOS[1] is majority owned by Federated Hermes Inc ("FHI") a global leader in active, responsible investing[2]. As of March 31st 2021, Federated Hermes had $625bn in assets under management.

Executive Summary

EOS is very supportive of the SEC requiring companies to report on material climate-related information that may impact the long-term value of companies. To achieve this, we believe that a combination of rules-based and principles-based disclosures is required to allow investors the ability to access timely, accurate, comprehensive, consistent and comparable information.

[1] EOS is a subsidiary of Hermes Fund Managers Limited, which is majority owned by Federated Hermes, Inc. EOS' views and positions are those of EOS and/or its clients, and do not necessarily represent the views or positions of Federated Hermes, Inc., its investment advisory subsidiaries or their clients, due to differences in goals, objectives, time horizons, obligations or other factors among these organizations or their clients.

[2] Federated Hermes Inc is submitting a separate response to this consultation

We recommend that the SEC give guidance to companies on what is deemed to be material information, to mandate that companies report on all material scope 1, 2 and 3 emissions (including all material greenhouse gasses), encourage the use of relevant sector based guidelines for disclosure as well as for companies to provide other bespoke information which is materially relevant. All companies should set targets for reducing their emissions in line with the ambitions of the Paris Agreement and a Net Zero ambition by 2050 at the latest. Governance and risk management should also be covered by the disclosure.

It is critical that guidance provided by the SEC should lead to the publication of useful, materially relevant climate-related information and not encourage 'box-ticking'.

We strongly encourage the SEC to make use of and leverage existing frameworks such as TCFD and SASB in its disclosure requirements and guidelines as well as collaborate with international bodies who may also be developing international climate disclosure standards so that these are aligned as possible.

The disclosure requirements should apply to public and private companies alike. We do recognize however that whilst applicable, due consideration should be given to the extent of the requirements for smaller companies. We believe that climate disclosures should be subject to the same standards as financial information and audited by an independent, suitably qualified third-party provider.

We are confident that relevant and material climate change disclosure by companies will lead to more informed capital allocation and business decisions by companies with material benefits of value creation and risk mitigation for investors.

Our responses to the SEC's specific questions are provided below.

Federated Hermes
EOS

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.*

<u>We are very supportive of the SEC requiring companies to report on material climate-related information that may impact the long-term value of companies.</u> This information is critical for investors to better understand the physical and transitional climate-related risks that exist within their portfolios and to understand the potential systemic impacts from climate change and the responsibility of corporations. This information will also support our engagement process with companies, that seeks to improve the sustainability and quality of long-term returns for our clients. The information about each company's climate strategy will increase the transparency and comparability of this information.

<u>We would encourage the SEC to mandate reporting in line with the TCFD recommendations.</u> There are already several organizations that are providing guidance to companies and investors on climate-related disclosures, including what the relevant metrics and targets are for each sector. The most prominent of these is the Task Force on Climate-related Financial Disclosures (TCFD), which provides guidance on climate-related disclosures which are broken down into four high-level themes: governance, strategy, risk, metrics and targets. The TCFD recommendations do give additional guidance to specific sectors in the supplementary reports as well as pointing to other useful materials in the TCFD Hub. Many of the other organizations that provide guidance to companies on climate-related disclosures use the TCFD guidance as a starting point, and we agree that this is a good foundation from which to build from. Furthermore, we think it would be appropriate and efficient for the SEC to leverage much of the guidance that is already publicly available regarding how and what information to report that is decision-useful for investors.

<u>It is important for material climate-related information to be included within routine financial reporting documents.</u> This should include, but not be limited to, annual reports and accounts, 10-K, proxy statement, quarterly reports and presentations and other reporting channels. We recognize that it may not be appropriate to include the extent of the climate strategy within the 10-K, however, this should at least include a summary of the climate strategy and all material information.

<u>We would recommend that the SEC give guidance to companies on what is deemed to be material information</u> to ensure that this is consistent and takes into account the long-term impacts of climate change and the energy transition. Where

companies disagree that this information is material, they should clearly disclose their reasons and why they have chosen not to provide the information.

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?*

<u>The SEC should ensure that companies report on all material scope 1, 2 and 3 emissions.</u> Similarly, the SEC should give guidance at the sector-level to companies on what are material emissions to companies, particularly as it pertains to scope 3 emissions. We recognize that there are current challenges with the accuracy of scope 3 emissions data, however, we feel that this will only improve if the regulation mandates these disclosures. Furthermore, due to the fact that this data will extend throughout the value chain, the requirement to report on this information will increase transparency at a global level and encourage consistency across multiple jurisdictions.

<u>All companies should set targets for reducing their emissions in line with the ambitions of the Paris Agreement</u>, limiting warming to well-below 2°C with the ambition of achieving 1.5°C. This is consistent with the recent actions taken by the US the rejoin the Paris Agreement and to reach net-zero emissions across the economy by 2050. This will allow the company to demonstrate its resilience to evolving risks, such as policy risk. Emissions data – the most critical element of a climate strategy – can be easily quantified and integrated into financial analysis, with risks modeled by investors using a shadow carbon price[3].

[3] Many investors use a shadow carbon price to understand what the potential impact would be on the financial performance of companies. The relevance of a shadow carbon price extends well beyond the probability of a carbon price being implemented, as it can act as a proxy for shifts in the market towards lower-carbon products and services. Whilst a carbon price is not the only legislation that will be necessary for reaching net-zero

The SEC should ensure that emissions reporting and targets cover all material greenhouse gasses, not just carbon dioxide.

Company disclosure should cover governance and risk management. The TCFD highlights the importance of these factors in their guidance, which require more qualitative information. In fact, it is this disclosure that, in our experience, has been the preference for many companies in beginning to report in line with the TCFD recommendations. One example of this is how companies are disclosing their public policy positions and those of third-party organizations of which they are a member.

This reporting should include information on how public policy inconsistencies are evaluated, what actions are taken to reduce these and what actions are taken when such inconsistencies cannot be resolved. This information is material to investors when reviewing climate strategies, and is integrated in a qualitative manner to engagement and voting decisions. This has been exemplified by the number of shareholder resolutions that have focused on lobbying in the US, where we have seen a growing rate of support for these resolutions. Many of the external benchmarks that are reviewing the adequacy of disclosure around climate strategies are reviewing this qualitative information and informing scoring methodologies[4].

Information on physical climate risks should also be disclosed so that investors are able to understand how these risks might manifest within their portfolio. For companies and for investors, this type of data is less familiar, and so external advisors are likely to be required to help model these risks and how they may translate through to assets and portfolios. The SEC should give clear guidance to companies on how to report information on physical climate risks, including the metrics and targets used to measure these risks.

The size of the organization should not be a determining factor in whether a company discloses *material* climate-related information. Companies in every sector will increasingly run greater reputational and legal risks if they do not reduce their emissions in line with the goals of the Paris Agreement. As with the example of our voting policy, lack of disclosure will likely be seen negatively as an indicator that

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emissions, it is certainly a useful mechanism and one which companies and investors should be considering. Furthermore, many policies have an implicit carbon price, such as regulations that limit non-greenhouse gas emissions that cause air pollution.

[4] Examples of these methodologies are those produced by the Transition Pathway Initiative (TPI) and the Climate Action 100+ Benchmark. The TPI looks at the quality of disclosure of large companies that are materially exposed to climate-related risks. Both the TPI framework and Climate Action 100+ Net-Zero Benchmark look at a wide range of factors that are material to the climate strategy of each organization. In EOS at Federated Hermes, we integrate benchmarks such as these into our voting recommendations, and recommend voting against directors when disclosure is inadequate or when we deem a company's strategy to be misaligned with the goals of the Paris Agreement. If companies are not willing to engage with us or to disclose more information about their climate strategy, it is likely that we will recommend a vote against an increasing number of directors over time.

these risks are not being managed. However, due consideration should be given to the extent of the requirements to ensure these are not overly burdensome.

The TCFD strikes in our opinion an appropriate balance between mandatory disclosure (eg Scope 1 and Scope 2 GHG emissions and, if appropriate, Scope 3) and recommending that firms disclose metrics on how they *themselves* measure and manage their climate risks and opportunities.

The recommendations of the TCFD were published in 2017, and so companies have had time to understand and integrate these recommendations. As such, we do not feel that there ought to be any delay in implementing regulations around mandatory TCFD disclosure and that the earlier the SEC can signal to companies that this will occur the better it will be for promoting transparency on climate-related risks.

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.)?*

<u>Minimum standards for climate-related disclosures should be set across all sectors. To improve the relevance of disclosures, sector-level guidance should be given to companies, particularly around what the appropriate metrics are to use.</u>

<u>We would encourage the SEC to consider industry led disclosure standards. We are supportive of utilizing both TCFD and SASB frameworks.</u>

Principles based frameworks such as the TCFD while generally industry agnostic have developed sector specific supplements which focus on industry considerations.

SASB's Sustainable Industry Classification System (SICS®) which uses sustainability profiles including environmental factors such as climate to group similar companies within industries and sectors among other industry classification systems. The underlying principle being that not all sustainability topics matter equally to each industry and the same topic, for example climate, can manifest differently across industries. Standard development processes such as those undertaken by SASB that take into account investor financial interest and analytical expertise as well as the operational experience of companies ensure the information and data disclosed is material to investors and decision-useful.

Investors already rely on a range of existing industry focused disclosure standards such as SASB and the emerging Global Reporting Initiative (GRI) sector program[5].

The IFRS are also working on creating consistent disclosure standards, through the formation of the International Sustainability Standards Board (ISSB). It will be important for the SEC to monitor these developments to ensure alignment on disclosure requirements.

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?*

At the *highest* level, there needs to be consistency around what information is being reported.

We consider the TCFD recommendations to bring this high-level architecture.

Where relevant, there should also be consistency of information at the sector level to allow the comparison of company performance within a sector regarding the management of climate-related risks and opportunities.

We would encourage the SEC to use the materials that have been produced already, such as those by SASB which recommend specific industry metrics. It may be the case that not all companies can be categorized into specific sectors easily, although SASB has achieved this with its SICS®. We recognize that this will add an additional layer of complexity in developing standards at the sector level. We would not want this process to slow down the development of climate-related disclosure requirements, and therefore, it may be that sector guidance gets developed and integrated over time.

Companies should be encouraged to report information beyond what is recommended in the sector-level guidance where material and relevant to do so. Sector-level analysis and sector-level pathways to net-zero are an area where more action may be required over time to increase the comparability of company's climate transition plans. This will clarify more of the quantitative and qualitative information that is required within these disclosures. The sector-level information should build upon the broader guidance to companies to give additional detail to companies on what is material information that ought to be disclosed.

[5] GRI Sector Program (globalreporting.org)

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?*

We are in favor of rules that incorporate or draw on existing climate disclosure standards and frameworks. There are many disadvantages in permitting the use of multiple climate disclosure standards and accounting methods including fragmentation, loss of comparability and reliability of the information. High variability in the disclosure of climate information also erodes its decision usefulness and makes it less actionable for shareholders and other stakeholders.

Existing disclosure frameworks and standards commonly used by S&P 500 companies to communicate climate and sustainability data and information to investors include SASB/IIRC, the Global Reporting Initiative (GRI), TCFD, CDP, and the Climate Disclosure Standards Board (CDSB). We are encouraged by the collaborative joint venture with these standard setters in September 2020 – even more so with the merger of the IIRC and SASB announced last year. These standard setters have produced a paper "Reporting on enterprise value", illustrated with a prototype climate related financial standard[6].

We would prefer if these standard setters continue to self-organize a streamlined approach to consistent and coherent global climate reporting as a priority and for the SEC to engage closely with them to determine how this work can inform its climate disclosure requirements. We think that this approach will help to ensure alignment between the SEC requirements on mandatory climate disclosures with that of third-party standards. This will be important to minimize the competing demands of companies as it relates to climate-related disclosures and streamline these disclosures to the most material, decision-useful information.

We would also ask the SEC to collaborate with international bodies who may also be developing international climate disclosure standards, for example the London-based International Financial Reporting Standards Foundation (IFRS) and the International Sustainability Standards Board (ISSB). The IFRS is writing standards on how listed companies should disclose risks from climate change on their operations. We understand the IFRS is intending to have developed an initial batch of standards by mid-2022 on climate adapted from existing norms set by global regulators from the TCFD.

[6] CDP, CDSB, GRI, IIRC and SASB "Reporting on enterprise value, illustrated with a prototype climate-related financial disclosure standard" (December 2020). Progress towards a comprehensive corporate reporting system from leading sustainability and integrated reporting organizations, facilitated by the Impact Management Project, World Economic Forum and Deloitte. Link to the source: here

There are accounting areas that may need further development and consideration by the SEC. Accounting treatments for intangible "carbon" assets, such as offsets, including those from sequestration activities and facilities that generate performance credits, are currently inconsistent. These intangible assets underpin public climate commitments and strategies as are often necessary to help achieve these climate goals. This is an area we feel warrants more scrutiny and guidance as does carbon liabilities, where material.

International frameworks that may provide additional guidance to the SEC include, but are not limited to, the following:

- European Union (EU) Non-financial reporting directive (NFRD - Directive 2014/95/EU, October 22, 2014, amending Directive 2013/34/EU) as regards to disclosure of non-financial and diversity information by certain large undertakings and groups
- The proposal for a corporate sustainability reporting directive (CSRD) (adopted by the European Commission on April 21, 2021) revises and extends the scope of the sustainability reporting requirements introduced by the NFRD
- The UK TCFD Roadmap Rules
- France's law on energy transition for green growth (Article 173)
- Japan's mandatory greenhouse gas (GHG) accounting and reporting system, established in 2006.
- In April 2021 New Zealand introduced legislation to make climate-related financial disclosures in line with TCFD recommendations mandatory for some organizations[7].
- The Australian Securities and Investment Commission (ASIC) has previously recommended the TCFD framework to listed companies for disclosing climate risks[8].

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*

[7] The regulation would yield qualitative information about governance, strategy and risk management and would allow for flexible implementation of quantitative information as the TCFD does not provide specific metrics for companies. The requirement will apply to publicly listed companies and large insurers, banks, non-bank deposit takers and investment managers (New Zealand Ministry for the Environment (April 2021) Mandatory climate related disclosures Source: here)

[8] After conducting a period of market surveillance, ASIC recently released a statement on expectations for listed companies disclosing and management climate change risks, stating "the voluntary disclosure recommendations issued by the TCFD are specifically designed to help companies produce information useful to investors". (ASIC Managing climate risk for directors. Source: here)

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?

We recommend that the SEC set disclosure requirements that are initially stretching of companies, recognizing the importance of climate-related disclosures for better appraising climate-related risks and opportunities. We recognize however that there may be impracticalities with setting standards which are overly demanding of companies, such as in the instance where it may take more than one year to acquire the right data, relationships and expertise to report this information. Therefore, whilst we think that it is correct for the SEC to be proactive in setting a high threshold for companies, there may need to be a period of implementation to allow companies to establish practices and meet these expectations.

As more information is disclosed, and there is a greater harmonization around approaches and metrics, it will likely be necessary for the SEC to update the disclosure requirements over time to reflect these external changes. We would expect that the SEC would issue an updated consultation for material changes to the disclosure requirements. As with comments in previous questions, we would encourage the SEC to keep abreast with updates by third parties and integrate this information into any future disclosure requirements.

If a standard-setter at the global level is agreed upon, then it would be reasonable for the SEC to pass these responsibilities over to the standard-setter. The work by the IFRS and ISSB, which has been promoted by the G7 and G20, is best placed to do this, though there may be challenges around adopting this standard in the US, where the majority of companies do not report in line with IFRS regulations.

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

In 2019 the SEC sought comments on proposed amendments to modernize the description of risk factor disclosures, among other matters, required pursuant to Regulation S-K (final rule). We concurred with Commissioner Lee, then acting SEC Chair, comments on the final rule adopted in August 2020, specifically that this was a missed opportunity to address climate and diversity risk disclosures[9].

The reliance on a principles-based regime alone has demonstrated that not all companies consistently approach what is material in S-K provisions 101 and 103 when it comes to disclosing climate change information. This years' proxy season has provided numerous case studies where companies have refused to disclose climate information shareholders are requesting.[10].

We are supportive of a combination of rules-based and principles-based disclosures, including specific line item disclosures for climate that allow investors the ability to access timely, accurate, comprehensive, consistent and comparable information. Mandatory disclosure of climate related risks is critical and evidence presented by Ceres in response to the consultation period on regulation S-K showed few companies were disclosing on climate related risks under the current regime[11]. Given the SEC's prior consideration to include ESG information in regulation S-K, from a practical standpoint, we are supportive of climate disclosures being incorporated into the existing rules.

In relation to the regulation S-X, in addition to providing climate risk-related disclosures in the S-K, companies will also need to ensure that the impacts of climate change, where material, are reflected in the financial statements and given context. For example, this may include disclosures on the impact of climate-related risks and opportunities on cash-flow forecasts, revenue and operating costs, asset valuation, assumptions used in impairment testing, depreciation rates and carbon related taxes or levies. Some UK companies for example have begun to do this, for example oil majors such as BP have revised long-term commodity price assumptions downwards in recognition of the energy transition.

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*

[9] SEC.gov | Regulation S-K and ESG Disclosures: An Unsustainable Silence
[10] Source: Yahoo Finance Live recording at hour/minute 2.07pm
[11] Ceres response to the request for comments on file no S7-04-20 s71119-7239602-217099.pdf (sec.gov)

disclosure concerning the connection between executive or employee compensation and climate change risks and impacts?

It is essential for all companies to be able to clearly disclose the governance processes that have been implemented for managing climate-related risks and opportunities. Whilst this information may be more difficult to quantitatively integrate into investment decisions, it is critical for investors when engaging with companies to understand that each company is giving the appropriate level of prioritization to climate-related risks, and not trying to meet expectations of investors through optimizing certain metrics at the expense of a considered climate strategy.

There is not going to be a 'one-size-fits-all' approach to governance and, depending on the materiality of various climate-related risks, each company may have a different approach to governance, including sub-issues such as employee compensation. As it stands, there is an ongoing debate as to what factors should be considered under the governance pillar of a climate strategy. In addition to the governance structure, including board and management accountability structures, we often see that compensation, oversight of a Just Transition strategy, lobbying, succession planning, board training and other issues are covered within the governance pillar. For companies which are newer to climate-related disclosures, it may be useful to give guidance on the minimum expectations for disclosures within the governance segment.

We do not believe climate-related targets should necessarily be linked to compensation, however, disclosure on whether or not this has been carried out would be valuable. This is because, whilst there may be evidence around climate-related metrics driving better performance, such a structure may not be appropriate for every company. Furthermore, with regard to executive pay, we have noted the tendency for climate-related metrics to be unambitious and allow for higher payouts despite weak financial performance. We are concerned that companies may be expecting investors not to challenge them on these metrics, either because they lack the information to scrutinize the targets, or because they have achieved a halo effect from setting a climate-related target.

Related to this will be ensuring companies have the processes, procedures and internal controls in place not only for climate but ESG disclosures more broadly. This will have a bearing on the role of the audit committee, corporate finance and internal audit particularly with respect to risk and metrics. This may merit consideration of broadening existing regulations such as Sarbanes-Oxley to ensure.

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?

<u>Ideally there would be a single set of internationally recognized climate reporting standards applicable to companies worldwide.</u> For existing issuers this would reduce the cost and complexity associated with current reporting requirements. For those new to climate reporting, it would reduce barriers to reporting through removing the need to research which is the most appropriate regime or regimes to report again. The development of such a global standard may take time and there is an urgency for public companies, particularly those who have yet to do so, to disclose in a more uniform way on climate.

We do not have a definitive position on who would be the single standard setter for a set of international standards. We welcome recent moves by the IFRS on climate change to be considered in financial reporting for example. Such a regulatory body would need to demonstrate it has sufficient expertise in climate accounting and reporting. This expertise would have to be developed or acquired in order to ensure credibility and quality in climate-related disclosure requirements.

The question of whether to establish a single independent standard setter or "sustainability standards board" was discussed by the IFRS, which are forming the ISSB. <u>While there is some logic in the establishment of an independent body, it would need to have the credibility to attract the right talent to collaborate quickly on a global scale</u> especially given the joint efforts being made by the standard setters and the four accounting firms more recently on ESG reporting. We think given the urgency and current developments it makes sense for the SEC to explore a dialogue with relevant organizations on how best to cooperate and collaborate with some urgency on climate disclosures.

As mentioned previously in our response to question seven, the rate of adoption of the SEC's climate disclosure guidance by U.S companies demonstrates that trusting companies to voluntarily report is not sufficient even if climate is a material risk. <u>Mandatory compliance ensures the transparency and integrity of climate reporting information.</u>

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?*

We believe that climate disclosures should be subject to the same standards as financial information and audited by an independent, suitably qualified third-party provider. The level of third-party assurance remains low in the U.S. however it is expected to increase[12]. For those that do have their climate data audited, it is more often limited (review) assurance versus an examination or reasonable assurance. Often as not the scope of the audit is limited to a handful of metrics, with no indication of whether these metrics are material or not, for example scope three metrics are rarely audited. Assurance also helps increase the relevancy and reliability of corporate reporting.

It is critical that climate related disclosure be provided in a form that auditors are required to read and consider alongside the financial statements[13]. Auditing is a key activity for ensuring reliable information is communicated to investors. Auditors and other verifiers of climate information and data have an important role in assessing the rigor of the disclosure. It is important that audit and assurance considerations are incorporated into the development of the SEC's reporting requirements for climate disclosure. In this regard the following may be useful inputs:

- the AICPA Auditing Standards Board (ASB) 2017 guidance for attestation engagements on sustainability information including GHG emissions.
- The International Accounting Standards Board (IASB) paper detailing how climate change and mitigation strategies could be reflected in company financial statements[14].
- Australian Accounting Standards Board and Auditing and Australian Assurance Standards Board joint bulletin specifying how existing accounting and auditing standards require companies and auditors to take climate risks into account[15].
- Institutional Investor Group on Climate Change report on Investor Expectations for Paris-aligned Accounts

We recognize that by the SEC requiring climate disclosures to be audited there may be cost implications for companies. We feel, on balance, those costs compared with the cost of a financial audit for most companies would not be material. We would

[12] Journal of Accountancy (2019) Demand for sustainability assurance is growing (journalofaccountancy.com)
[13] The Role of Accounting and Auditing in Addressing Climate Change - Center for American Progress
[14] in brief climate change Nick Anderson (ifrs.org)
[15] AASB_AUASB_Joint_Bulletin_Finished.pdf

expect climate risk for most companies and sectors to be considered a critical audit matter (CAM)[16]. In this case it may be there are no additional costs associated with the audit as the matter would be treated in a consistent manner as the current audit process. It is clear more guidance is needed for audit firms to provide shareholders with the necessary consistency and comparability. An assurance requirement will most likely also require audit firms to upskill themselves on how to effectively and efficiently audit material climate-related information.

We also recognize that a high percentage of climate-related verification is currently provided by non-accounting (big four) entities and in some respects the big four oligopoly has only recently demonstrated a newfound enthusiasm for ESG and climate[17]. How the SEC requires assurance of climate disclosures will require consideration of the current competitive landscape for verification and assurance services, the need for independence and subject matter expertise as well as a transparent dialogue on whether an oligopolistic approach to climate assurance is in the best interests of shareholders.

[16] A CAM is a matter arising from the financial statement audit that has been or is required to be communicated to the audit committee, and that relates to accounts or disclosures that are material to the financial statements and involves especially challenging, subjective, or complex auditor judgements. Source: PCAOB Implementation-of-Critical-Audit-Matters-The-Basics.pdf (pcaobus.org)

[17] World Economic Forum and Big Four propose new sustainability reporting framework – Cooley PubCo

11) *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?*

We would recommend that the disclosure requirements be divided into 'core' disclosure requirements and 'supplementary' disclosure requirements, with the latter allowing for a comply or explain approach. We are supportive of a comply or explain approach as it allows for some flexibility within the system when the disclosure requirements are not quite suitable to a particular company. This may come about from imperfect classification systems at the sectoral level which may prescribe details around disclosure which may not suit every company. Nevertheless, this will only occur for certain disclosure requirements which include a higher-level of specificity. Therefore, the comply or explain approach should only be permitted for certain aspects of the disclosure requirements[18].

12) *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?*

Consistent with our responses above, our preference would be for the SEC to leverage the work of existing, voluntary framework providers and standard setters in drafting its rules on climate risk and opportunity disclosures.

In terms of the disclosure location, we echo SASB's views regarding the potential legal risks to US companies and litigation costs that may be associated with any voluntary disclosure in the 10-K particularly if materially misleading or false[19]. One example of this is climate scenario analysis as no scenario will be precisely correct in forecasting the future impacts, but investors may rely on the information including the thinking behind why some scenarios and certain assumptions are used. These risks would be

[18] It is worth noting that as the financial community continues to invest in climate data analytics, companies which fail to disclose the appropriate information are likely to be perceived negatively, demonstrating a lack of awareness and preparedness for managing climate-related risks. If the comply or explain approach were to work, it may address some of these risks, if companies were able to sufficiently substantiate their position around why certain disclosures should be excluded.

[19] SASB comment letter to the SEC May 21, 2021 Source: cll12-8819945-238161.pdf (sec.gov)

largely mitigated should the SEC mandate climate or ESG disclosures. Furthermore, legal research shows that the litigation risks associated with not disclosing material climate-related risks and opportunities to be greater than disclosing information that may turn out to be incorrect[20].

In considering the need for safe harbor provisions for forward looking climate statements to encourage companies to provide prospective information such as scenario analysis we refer to guidance issued by the then SEC Chair of April 8, 2020, which encourages such disclosures and identifies safe harbors[21]. .

Another consideration for location is the quantity of information that companies may disclose. Again, climate disclosures under TCFD and even SASB with supporting narrative are often lengthy and detailed supporting the need for a separate section.

It may be helpful for the SEC to look at how the IFRS has approached climate disclosures. The IFRS requests the disclosure of management commentary or a narrative report that provides information outside of financial statements and which "*assists the interpretation of a complete set of financial statements or improves users' ability to make economic decisions*". The IFRS conceptual framework may provide a useful guide, particularly as it details three characteristics needed for qualitative information – "relevance, materiality and faithful representation", and four characteristics for qualitative information – "comparability, verifiability, timeliness and understandability". The IFRS defines the management commentary follow five reporting elements: "historical financials, other subject matter disclosures including climate disclosure, business description, management information and market data and management perspective".

13) *What climate-related information is available with respect to private companies, and how should the Commission's rules address private companies' climate disclosures, such as through exempt offerings, or its oversight of certain investment advisers and funds?*

In principle, climate-related disclosures should be mandated at all companies, whether public or private. If climate-related disclosures were only to be mandated for publicly listed companies, this may mean that there is an underestimation of risks within the private sector. Furthermore, the interlinkages between private and public companies must not be underestimated, and other public companies may be exposed to climate-related risks through insufficient disclosure by private companies. An increased burden on publicly listed companies and not private companies may

[20] Commonwealth Climate and Law Initiative, Concerns Misplaced: Will Compliance with the TCFD Recommendations Really Expose Companies and Directors to Liability Risk, Source: https://www.smithschool.ox.ac.uk/research/sustainable-finance/publications/CCLI-TCFD-Concerns-Misplaced-Report-Final-Briefing.pdf

[21] SEC.gov | The Importance of Disclosure – For Investors, Markets and Our Fight Against COVID-19

encourage assets which are more exposed to climate-related risks to migrate towards private organizations, lowering the perceived risks related to these assets.

A lower threshold for disclosure requirements may be required based on the size of the organization as we recognize that it may be more challenging for smaller companies to disclose as much information, particularly as it relates to broader macroeconomic trends. Disclosure requirements for investors must be made sufficiently stringent to drive material climate-related disclosures from private organizations.

14) *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?*

<u>Yes, while we view climate as the most pressing disclosure priority for the SEC, we view it as one component in a broader requirement of ESG reporting by public companies.</u> We encourage the use of existing frameworks (TCFD) and standards (SASB) as the basis of guiding the crafting of broader ESG disclosure standards. Leveraging these frameworks and standards will promote consistency in climate-related disclosure requirements, and minimize the disclosure burden and costs for companies. There has been a harmonization within the investment community in calling for more consistent disclosures and references from large asset managers , promoting the recommendations of the TCFD and SASB.

SASB has taken a broader approach to material ESG issues. However, the approach for determining materiality is backwards-looking and may overlook externalities which are not fully priced into financial markets. As with climate, there are many other material ESG issues that need to be addressed, including the development of disclosure requirements. Whilst we are supportive of the SEC prioritizing climate-related disclosures and creating a model that could be applied to other ESG factors, we hope that this process will not be drawn out so that the SEC is able to move to addressing other material issues and developing guidance for disclosures.

In summary using existing standards such as SASB and TCFD for ESG disclosures is likely to be more cost effective for issuers and investors in the short term leading to less conflicting standards and enhanced comparability than there is at present for investors. In addition, the merger of the International Integrated Reporting Council with SASB paves the way for more mainstream adoption of integrated reporting by

US companies. There is already a significant body of thinking available on this that the SEC could draw from.