POLICY WORKING GROUP

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The Honorable Gary Gensler
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chairman Gensler,

We thank you for this opportunity to provide input regarding the Securities and Exchange Commission's (SEC) disclosure standards, particularly as they relate to climate change. The mere fact that the SEC is considering these questions is an exciting step towards greater corporate transparency and accountability, though we hope this is only the beginning of the conversation. In light of that, please find our comments below regarding what we believe are critical changes to corporate disclosure processes.

Currently, the SEC's guidance to publicly traded corporations regarding disclosure hinges on materiality, a standard that creates confusion and prioritizes accountability towards the corporation's shareholders over its various stakeholders. As it relates to the question at hand, we believe that climate data should be considered material, and that the SEC should mandate corporate disclosure of emissions data and other key ESG metrics. In a broader sense, however, we believe materiality is a poor standard for corporate disclosure and should be reconsidered. To that end, our comments cover three main categories: 1) the materiality of climate information, 2) a recommendation of which types of disclosure categories would measure a corporation's climate impact, and 3) the need to reconsider a disclosure regime centered around materiality.

Climate information is material

In light of the systemic risk posed by climate change, investors have already begun demanding climate information when making investment decisions, understanding that a corporation's preparation for climate change (or lack thereof) will have a significant bearing on their profitability in the decades to come. As more investors expect and demand climate information (see the next section for what that information entails), it is increasingly clear that this information is material to the reasonable investor, and thus should be a standard disclosure for publicly traded companies.

Over the last decade, it has become clearer that climate change poses a massive systemic economic risk. In an April 2020 letter to the SEC, Senator Elizabeth Warren noted that “the current value of direct private investor losses globally due to the physical risks of climate change is between $4.2 trillion and $13.8 trillion, depending on the warming scenario,” an amount of “permanent damage that would far eclipse the scale of the 2007-2008 financial crisis.” [1] Furthermore, that figure does not include transition risks (the economic costs associated with transitioning to more sustainable operations) like eliminating carbon emissions.

It is rare to have the foresight we have here: a once-in-a-generation economic revolution is on our doorstep, a revolution that will come for every corporation across the planet in some way. Some companies will need to relocate coastal facilities, some will change how they power their offices. Others will need to entirely reinvent themselves or go out of business. But we know that every corporation will have to navigate the risks posed by climate change in the coming decades, which presents serious challenges and opportunities for investors. In other words, the extent to which a corporation has (or hasn’t) planned for climate change will be a big determinant of its profitability in the decades to come.

Accordingly, investors increasingly weighed climate change in their investment decisions. In 2020, Ceres and 40 signatories (with over $1 trillion under management) sent a letter to the Federal Reserve demanding regulation to address the systemic financial risk posed by climate change.[2] In the last decade, Principles for Responsible Investing, a UN-supported network of investors working to implement ESG-conscious investment strategies, has grown from 63 signatories to 1900 with $80 trillion under management.[3] [4] One year ago, Larry Fink, the CEO of the world’s largest asset manager, wrote in his annual letter to CEOs that climate change was “A fundamental reshaping of finance,” and that “Given...the growing investment risks surrounding sustainability, we will be increasingly disposed to vote against management and board directors when companies are not making sufficient progress on sustainability-related disclosures and the business practices and plans underlying them.” [5]

Just the last month, a series of news stories has demonstrated the increasing materiality of climate information:

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[1] “Letter from Senator Warren to SEC Chairman Jay Clayton.” 28 Apr. 2020, www.warren.senate.gov/imo/media/doc/File%20Number%20S7-01-20%20-%2004.28.2020%20Letter%20from%20Senator%20Warren%20to%20SEC%20Chairman%20Jay%20Clayton.pdf.

[2] Ceres. “40 Investors with Nearly $1 Trillion Join Other Leaders to Urge U.S. Financial Regulators to Act on Climate Change as a Systemic Financial Risk.” Received by Honorable Jerome H. "Jay" Powell, 21 July 2020. https://www.ceres.org/news-center/press-releases/40-investors-nearly-1-trillion-join-other-leaders-urge-us-financial.

[3] “About the PRI.” www.unpri.org/pri/about-the-pri.

[4] Vizcarra, Hana. “The Reasonable Investor and Climate-Related Information: Changing Expectations for Financial Disclosures.” *Environmental Law Reporter*, vol. 50, no. 2, 2 Nov. 2020.

[5] Fink, Larry. “Larry Fink's Letter to CEOs.” *BlackRock*, Jan. 2020, www.blackrock.com/corporate/investor-relations/2020-larry-fink-ceo-letter.

- Three climate activists were elected to ExxonMobil's board, in large part because Exxon's largest shareholders including Blackrock and Vanguard were dissatisfied with the company's inaction on climate change.[6]
- Chevron investors successfully passed a shareholder resolution (over the objections of management) demanding cuts in the company's Scope 3 emissions. Two other resolutions--one requiring the company to report the business impact of net-zero emissions by 2050 and the other requiring disclosure of lobbying activity--narrowly failed, but still garnered 48% support from shareholders.
- A Dutch court ruled that Dutch Royal Shell wasn't doing enough to address climate change, and that it needs to cut its carbon emissions by 45% below 2019 levels by the end of 2030.

These trends will only continue. Obviously, climate change will continue to worsen, as we have fallen behind the pace needed to limit warming to 1.5º C. But also, an increasing proportion of voting shares are held by large funds like Blackrock and Vanguard (as of 2020, Blackrock, Vanguard, and State Street own 22% of the typical S&P 500 company[7]), who focus greater attention on systemic, portfolio-level risk relative to smaller retail investors.[8] As these companies, which are beginning to give greater weight to climate change in their investment decisions, control progressively larger swaths of the market, it can be expected to further drive investor demand for climate information in the coming years.

These trends--the increasing severity of climate change, greater interest in climate on the part of investors, and the increased concentration of voting shares in the hands of large asset managers--demonstrate that the definition of "the reasonable investor" has shifted dramatically, and will continue to do so. All of this points to the need for a reconsideration of materiality in light of climate change: it is clear that information relating to climate risks is now material to reasonable investors.

What should companies disclose?

This begs the question--what does a climate-focused disclosure standard entail? The most critical metric for any new disclosure regime is emissions data. Emissions data signifies not only a corporation's contribution to the climate crisis, but also its transition risk; essentially, how much will the business model need to change in the coming decade? As governments around the world begin implementing policy to reduce and eventually eliminate GHG emissions, carbon intensity will become a liability, and companies with large footprints will need to dramatically alter their practices. The aforementioned Dutch court decision is an excellent example of this liability: every company with a carbon footprint--especially those in carbon-intensive industries

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[6] "Vote Bulletin: ExxonMobil Corporation ." *BlackRock*, 26 May 2021, www.blackrock.com/corporate/literature/press-release/blk-vote-bulletin-exxon-may-2021.pdf.

[7] McLaughlin, David, and Annie Massa. "The Hidden Dangers of the Great Index Fund Takeover." *Bloomberg.com*, 9 Jan. 2020, www.bloomberg.com/news/features/2020-01-09/the-hidden-dangers-of-the-great-index-fund-takeover.

[8] Vizcarra, Hana. "The Reasonable Investor and Climate-Related Information: Changing Expectations for Financial Disclosures."

like fossil fuels--will have a day of reckoning, as our world transitions to net-zero, where they will be called to account for the carbon they emit. Investors have every right to know how sizable a corporation's risk is in the face of that potential legislation or litigation. Thus, emissions data should be a nonnegotiable part of the reformed Regulation S-K.

As to the specifics of the emissions data, we live in an increasingly interconnected and globalized world, with sprawling global supply chains that often exist largely in the developing world. It is easy to envision a world in which companies "hide" emissions overseas to obscure the true extent of their global emissions. To avoid this, the SEC should mandate complete disclosure of supply chain emissions--Scopes 1, 2, and 3 emissions--to ensure total transparency of a corporation's climate impact, and allow calculation of the company's carbon intensity. Furthermore, in recognition of the fact that geographically, pollution is often heavily weighted towards communities of color and working class communities, corporations should be required to disclose their five most impacted locations, and total emissions across scopes in those locations, so that investors and stakeholders can understand a company's impact on front-line communities.

While emissions data should be the most essential part of any new disclosure regime, there are other types of disclosure that are worth implementing. For one, companies should have to disclose the physical risk posed to its operations by climate change. They should also disclose any other changes (in addition to emissions reductions) that they would need to make to adhere to the Paris Accords. We also believe higher standards of disclosure are necessary for particularly carbon intensive industries, like fossil fuel companies. Finally, as an organization that believes in climate change's intersectionality, particularly its intersection with issues of racial justice, gender-based justice and economic justice, we also recommend further disclosure in other ESG categories:

- Employee diversity and inclusion across gender, racial/ethnic group, and other representations at each level of management.
- Monetary losses due to legal proceedings and specific employee activities that include customer complaints and counts of arbitration.
- Echoing a letter recently submitted to the SEC by Public Citizen, companies should be compelled to disclose their spending on elections and lobbying. Just as investors are entitled to transparency on business practices and spending, they are entitled to know what political activity their investment is supporting.

The SEC should treat violations of these new disclosure standards as any other securities fraud by assessing fines and making the climate disclosures subject to audit, which both enables the SEC to enforce the standards and signals broadly that climate impacts are being taken seriously. The SEC should issue orders and administer judgements ordering climate-related violators to, among other things, pay civil monetary penalties. Additionally, the SEC should extend its Whistleblower Program to climate disclosures, whereby the SEC would issue awards to whistleblowers who provide original information that leads to successful SEC enforcement actions.

Beyond materiality

Currently, Regulation S-K, which provides standards and guidance on corporate disclosures, states that a corporation's main disclosure responsibility is disclosing any information that is material to a reasonable investor. The regulation does not define materiality in greater detail, meaning that the determination of materiality is largely made at the corporation's discretion, unless an action is brought against them, in which case the SEC or courts rule narrowly on the meaning of materiality in that specific case.

This system leaves a lot to be desired. For one, it is an incredibly vague standard that leaves a great deal of room for confusion or omission of important information. Would it not be optimal for the public and companies alike to have a clearer standard for what information must be disclosed, rather than trying to subjectively interpret the ruling? Indeed, according to Amanda Rose, a Professor of Law at Vanderbilt Law School: "The 'reasonable investor' is at best a shadowy figure, described only generically in judicial opinions and—in doctrine if not in practice—someone for the fact-finder to identify case-by-case. Public companies have long bemoaned the reasonable investor test, arguing that materiality should be judged instead by reference to quantitative or other bright-line measures, so as to simplify companies' disclosure choices and provide a basis for dismissal of securities litigation at the pleadings or summary judgment phase." [9]

Furthermore, we should reconsider Regulation S-K's assertion that the corporation's sole disclosure responsibility is to its shareholders. We have arrived at this point in time, with catastrophic planetary destruction on our doorstep, in large part due to an economic system that has prioritized the interests of a relatively small group of wealthy investors over the interests of our broader society. For example, if Exxon were truly accountable to our broader society, it would have been held to account for suppressing information regarding the greenhouse effects of its fossil fuel products, information that is clearly material to our broader society. Yet they have been able to completely evade accountability for suppressing that research, funding misinformation, and causing immeasurable damage to the fight for climate action, because that information has not been found to be material to its investors.

The Exxon case illustrates how in a system where the corporation's fiduciary responsibility reigns supreme, environmental degradation, worker exploitation, and ethical misconduct may be overlooked so long as a company delivers quarterly profits to its shareholders. Ironically, at the same time corporations have been absolved from any broader responsibilities to society, we have granted them political personhood in legislatures and courts, granting them the right to shape the society they bear no responsibility towards, a right which they have used to fight climate action at every turn. This system of shareholder capitalism is untenable and inextricably

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[9] Rose, Amanda. "The 'Reasonable Investor' of Federal Securities Law." *The Harvard Law School Forum on Corporate Governance*, 13 Oct. 2016, corpgov.law.harvard.edu/2016/10/13/the-reasonable-investor-of-federal-securities-law/.

linked to the rise of climate change, and we cannot seriously claim to be fighting climate change if we don't examine critically the lack of corporate accountability in our country.

A corporation must be responsible to the society it operates within. Sunrise Bay Area and its members may not be shareholders in ExxonMobil, but we will inherit the world they are polluting; we have a right to know the extent to which that pollution will affect our future. And it is not only young people that should be considered shareholders in this system; workers, frontline communities, society more broadly--anyone who will be impacted by a company's business practices--have a right to know the scale of pollution caused by these companies. In light of this right to know, we view the materiality standard for disclosure to be far too narrow, and favor an expanded standard that considers the full range of people and communities that hold a stake in a company's actions.

We understand that the SEC is not considering the question at hand so broadly, and that defining the fundamental relationship of the corporation to its society is not within the SEC's jurisdiction. However, in addition to submitting comments on the questions at hand, we believe it is important to consider these larger questions, at the very least because it provides a reason for why action is so urgently needed, but also because we hope this conversation continues beyond this rulemaking process and beyond the SEC's jurisdiction. Amending Regulation S-K is a good first step towards addressing climate change and inequality, but will not succeed without addressing the deeper roots of those crises.

We look forward to seeing a new disclosure standard.

Signed,

Sunrise Bay Area