June 14, 2021

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

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

Re: Public Input on Climate Change Disclosures

Dear Chair Gensler:

The Healthy Markets Association (HMA) appreciates the opportunity to respond to Acting Chair Allison Herren Lee's public request for information regarding climate change disclosures ("Request for Information" or "RFI").[1] HMA is a not-for-profit member organization of public pension funds, investment advisers, broker-dealers, and market data firms focused on reducing conflicts of interest and improving the transparency, efficiency, and fairness of the capital markets.[2]

Summary

HMA takes no position on the creation and nature of any new climate-related disclosure obligations. Rather, we wish to focus our comments on two areas implicated by the Request for Information: (1) the Commission's potential reliance upon third parties to perform essential government functions, and (2) the impact of new disclosure requirements on the relationship between the public and private markets. In particular, our comments respond to Questions 3, 6 and 14 of the RFI.

In general, HMA urges the Commission to eschew unnecessary reliance upon third parties for the development, implementation, maintenance, or enforcement of any new disclosure requirements. We also recommend that the Commission recognize that new disclosure requirements on public companies only may have the unintended consequence of driving more companies into even less transparent private markets.

[1] *Public Input Welcomed on Climate Change Disclosures*, Hon. Allison Herren Lee, Sec. and Exch. Comm'n, Mar. 15, 2021, *available at* https://www.sec.gov/news/public-statement/lee-climate-change-disclosures.
[2] To learn more about HMA or our members, please see our website at http://healthymarkets.org/about. We strongly support the Commission's mission of protecting investors; maintaining fair, orderly, and efficient markets; and facilitating capital formation.

Further, the Commission should acknowledge that companies' climate-related risks and opportunities directly impact business decisions by investors, lenders, suppliers, workers, customers, and other market participants regardless of the form the companies may have used to raise capital. Accordingly, the Commission should take targeted actions to bring large private companies and offerings into its public disclosure and accountability regulatory regime.

Comments

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.)?

Question 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?

Combined Response to Questions 3 and 6:

The Commission should not delegate its governmental power to one or more third parties to develop, implement, maintain, or enforce climate or ESG-related disclosures. Rather, the Commission should directly establish mandatory disclosures in its rules and guidance, and maintain and enforce them the same way it does with other existing disclosure obligations. Put simply, while the Commission's processes are imperfect, the Commission is nevertheless best equipped to effectively perform these governmental functions.

Proponents of delegating the critical work of development, implementation, oversight, and enforcement of these disclosure requirements often suggest that third parties:

- Have, or could quickly gain, necessary specialized expertise to quickly and effectively design the disclosure requirements;
- Have already developed existing regimes, and so their frameworks would presumably meet with less industry or issuer resistance than a new, different framework;
- Could more quickly and precisely update disclosure requirements;
- Would be relatively insulated from political pressures and better withstand cyclical political changes to policy priorities;
- Would be able to adopt rules more quickly because they may not be subject to the requirements of the Administrative Procedure Act — namely, the time-consuming notice and comment requirements; and
- Might be able to avoid the legal challenges before the United States Court of Appeals for the District of Columbia Circuit, which have resulted in several Commission losses of rules in recent years.

While these arguments may be appealing at first blush, further examination reveals that they have been tested before, and are not likely to hold true. For example, as a review of the entire history of the Public Company Accounting Oversight Board makes clear, even "independent" third parties are often subject to many of the same "political" pressures and swings as the Commission itself. In 2017, the Commission decided to replace the entire PCAOB. And on June 4, 2021, the Commission removed the Chairman of the PCAOB, and announced that it was again looking for candidates to fill all five positions on the Board.[3]

Similarly, if the Commission is to ensure any accountability to a third party for its rules, the Commission would need to have the ability to approve or deny them. Yet, those actions by the Commission would then ultimately be challengeable in court. Simply having the rules be developed, implemented, or maintained by a third party does not isolate them from the fact that the Commission can and must remain responsible for them, and with that responsibility comes judicial accountability and process (including delays).

Of course, third parties may provide valuable inputs and references that the Commission can and should build upon, but the Commission's delegations of governmental functions have generally led to slow, conflicted, costly, and ineffective regulation and enforcement. Unfortunately, these weaknesses have persisted across the different models of delegation to third parties used by the Commission.

Despite perhaps the best of intentions at the start, the Commission has demonstrated that it will ultimately lack the consistent interest, time, or resources to sufficiently oversee a third party in the long run. As a result, third parties imbued with governmental

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[3] *Press Release, SEC Announces Removal of William D. Duhnke III from the Public Company Accounting Oversight Board; Duane M. DesParte to Serve as Acting Chair*, Sec. and Exch. Comm'n, June 4, 2021, *available at* https://www.sec.gov/news/press-release/2021-93.

functions have historically ended up exercising their powers in ways that either directly benefit themselves, or those whom they are intended to most directly regulate.

Below, we examine just two examples of failed Commission oversight of third parties: (1) the Commission's struggles to implement a Consolidated Audit Trail (CAT) and (2) the Commission's struggles to improve accounting and auditing standards.

The Tortured History of the CAT

In May 2010, the financial markets experienced an unprecedented "crash" in which the markets collapsed more than 1100 points in just a few minutes, and nearly as quickly recovered.[4] Just a few weeks after that event, the Commission proposed the CAT.[5]

On July 18, 2012, the SEC unanimously approved a rule to create a National Market System Plan ("NMS Plan") for the CAT.[6] The exchanges and FINRA were—pursuant to that plan—directed to propose, create, operate, and use the CAT (with the Commission signing off at different stages of the process).

Unfortunately, this meant that the legal entities that would bear the cost, compliance, and oversight burdens of this new critical regulatory tool were effectively in charge of getting the tool up and running.[7] This facially conflicted governance structure caused countless squabbles among the various market participants, which led to years of implementation delays.

Even after the CAT came partly online, the exchanges refused to begin reporting data into the CAT, in clear violation of the CAT Plan that they had themselves crafted and for which they had received Commission approval.[8] The Commission—which remained dependent upon these third parties to develop, implement, and maintain the CAT—declined to institute enforcement proceedings to compel compliance.

Interestingly, while the exchanges and FINRA were tasked with setting up the CAT, their

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[4] *Findings Regarding the Market Events of May 6, 2010*, Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues, Sept. 30, 3010, *available at* https://www.sec.gov/files/marketevents-report.pdf.

[5] *Consolidated Audit Trail*, Sec. and Exch. Comm'n, 75 Fed. Reg. 32556, June 8, 2010, *available at* https://www.sec.gov/rules/proposed/2010/34-62174fr.pdf.

[6] *See* Consolidated Audit Trail, Release No. 34-67457; File No. S7-11-10 (July 18, 2012), *available* https://www.sec.gov/rules/final/2012/34-67457.pdf.

[7] *See* Tyler Gellasch testimony before the House Financial Services Committee hearing on "Implementation and Cybersecurity Protocols on the Consolidated Audit Trail," (November 30, 2017), *available* at https://financialservices.house.gov/uploadedfiles/11.30.2017_tyler_gellasch_testimony.pdf.

[8] *See* Statement on Status of the Consolidated Audit Trail, Hon. Jay Clayton, Sec. and Exch. Comm'n, Nov. 14, 2017, *available at* https://www.sec.gov/news/public-statement/statement-status-consolidated-audit-trail-chairman-jay-clayton.

choices obviously impact the thousands of brokers who would be required to comply with its reporting requirements. Not surprisingly, these brokers, their trade representatives, and politicians who are sympathetic to their concerns, pressured for more reforms. It is now more than eleven years since the CAT was proposed, and yet regulators still do not have the basic information they need to see the markets in a comprehensive way.

But delays are not the only problem. There are substantive concerns. Again, the Commission's CAT final rule was adopted following the Flash Crash as a tool to enable regulators to have a comprehensive, accurate view of the markets. Amongst other things, that requires the collection of information regarding orders and trades in relevant, related financial products (including who is involved in and benefits from the activities) as well as essential temporal precision. Unfortunately, more than a decade after the rule was proposed, this information is no longer even being sought—much less provided in an operational CAT.[9] Again, this is the result of different industry and political pressures being brought to bear on the third parties tasked with the CAT project, as well as the Commission itself.

There are also funding concerns. The exchanges and FINRA—all members of the CAT's "Operating Committee" that oversees the development, implementation, and operation of the CAT system—were also given wide latitude to determine how the project would be funded. They delayed their initial determination for several years, and finally proposed a funding mechanism in 2017 that would have placed much of the burden on others, namely, broker-dealers. That proposal was suspended by the Commission and ultimately rejected.[10] Today, a full nine years after the CAT rule was finalized, the fight over who will have to pay for the CAT has yet to be fully resolved.

The tortured history of the CAT highlights how failures of governance, funding, and conflicts of interests can lead to delays, lawsuits, and a general lack of effective accountability.

Unfortunately, this experience is not unique. The Commission's delegations to the exchanges and FINRA in the oversight and operations of providing for public market data has been similarly plagued by failures regarding their governance, funding, and conflicts of interest.[11]

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[9] See, e.g., *Hearing on Implementation and Cybersecurity Protocols on the Consolidated Audit Trail Before the House Financial Services Committee, Subcommittee on Capital Markets, Securities and Investment*, 115th Cong. (2017), *available at* https://financialservices.house.gov/uploadedfiles/11.30.2017_tyler_gellasch_testimony.pdf.

[10] See, *Suspension of and Order Instituting Proceedings to Determine Whether to Approve or Disapprove Proposed Rule Changes to Establish Fees for Industry Members to Fund the Consolidated Audit Trail*, Sec. and Exch. Comm'n, Exchange Act Rel. No. 34-81067, June 30, 2017, *available at* https://www.sec.gov/rules/sro/batsbyx/2017/34-81067.pdf.

[11] We note that the Commission's statutory delegation to the exchanges and FINRA for the development, implementation, and operation of the CTA/CQ and UTP Plans has led to dramatic increases in complexity

The Failures of the FASB and PCAOB

As the Commission takes a comprehensive and critical review of the self-regulatory and third party standard setters' models, the Commission should also reassess and learn from its and Congressional efforts to improve the accounting and auditing industry after the investor-confidence shattering scandals of the late 1990s and early 2000s, such as Enron and WorldCom.

In the wake of those accounting scandals, Congress and the Commission affirmed their commitment to clean up the auditing and accounting profession to ensure that those responsible for setting accounting standards are free from undue influence of the accounting profession, and those who audit companies are overseen by an independent and capable regulatory body. The bipartisan Sarbanes-Oxley Act of 2002 ("SOX") aimed to improve the governance of the Financial Accounting Standards Board ("FASB") and created a new third-party regulator for auditors, the Public Company Accounting Oversight Board ("PCAOB").[12]

Put simply, SOX was a very heavy bet on the value of third party regulatory powers. It created one third party regulator and reformed a third party standard setter in an effort to improve the performance of accountants and auditors whose roles were, in turn, to serve as independent checks on corporate executives' decisions. Sadly, the regime has ended up looking more like an M.C. Escher painting than an effective regulatory model. [13] While there are many paths intended to promote accountability, none of them seem to work as intended.

FASB, for example, has long faced criticism that it is overly skewed towards large corporations and the auditing industry that dominate its board of directors, leading to slow and inadequate responses to investors' needs.[14] In short, despite good faith efforts to reform and refocus FASB to meet the needs of investors, FASB has not lived up to its promise.

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and costs to the detriment of investors, brokers, and other market participants, and has prompted years of Commission efforts to minimize and reverse some of these negative consequences.

[12] *Sarbanes-Oxley Act of 2002*, Pub. L. 107-204 (2002).

[13] M.C. Escher was a Dutch artist known for his woodcuts and other depictions of impossible physical and mathematical constructions.

[14] *See* Letter from Jane B. Adams, et. al., Alliance of Concerned Investors, to Hon. Jay Clayton et. al., Sec. and Exch. Common, Oct. 26, 2020, *available* at https://www.dropbox.com/s/6ccwdzvcej7sqcx/AOCI%20SEC%20Letter%2010_26_2020.pdf?dl=0 (explaining that "investors have been ignored in the agenda-setting process" of FASB").

Similarly, PCAOB has “drifted away from its core mission of investor protection.”[15] In fact, former members of the agency’s own Investor Advisory Group, which was essentially abandoned and then dissolved earlier this year, have explained that the PCAOB has, contrary to investors’ needs:

- Purged much of the key staff responsible for setting standards, overseeing registration and reporting regime, conducting inspections, and enforcing PCAOB’s rules and standards;
- Slashed its own budget, neutering its inspections programs;
- Adopted a 2018 Strategic Plan that all but omitted its role in investor protection;
- Refused to meet with and receive the guidance from the statutorily created PCAOB Investor Advisory Group (of which they had been members);
- Eliminated the solicitation of public comment on PCAOB rulemaking;
- Declined to adopt its own new standards to replace “interim” auditing standards that had been written by industry before the PCAOB was created almost 20 years ago;
- Elevated the standards adopted by the auditing profession through the International Auditing and Assurance Standards Board, rather than developing its own standards;
- Failed to act on recommendations from investors with respect to significant auditing standards in need of reform, such as standards for disclosure of audit quality metrics, auditing non-compliance with laws and regulations, going concern audit opinions, and the need for auditor involvement with other information in filings with the SEC such as disclosures of the impact of climate change and Non-GAAP measures;
- Declined to hold roundtables and public meetings where proposed concepts could be discussed and debated in a manner that would provide useful feedback from investors and the public;
- Failed to hold regular Board meetings, and when it held meetings, has failed to make public its meeting agendas; and
- Failed to disclose when its senior leadership meets with individuals or groups to discuss potential rule-making projects.[16]

As one group of investors, former regulators, academics, public interest advocates, and audit experts recently summed it up, “today, FASB remains both glacially slow and unresponsive to investor concerns, and the PCAOB seems to have become more focused on protecting audit firms than protecting investors.”[17]

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[15] *See* Letter from Mary M. Bersot, et. al, Former PCAOB Investor Advisory Group Members, to Hon. Gary Gensler, Sec. and Exch. Comm’n, Apr. 19, 2021, *available* at https://consumerfed.org/wp-content/uploads/2021/04/PCAOB-IAG-Letter.pdf.
[16] *See* Letter from Mary M. Bersot, et. al, Former PCAOB Investor Advisory Group Members, to Hon. Gary Gensler, Sec. and Exch. Comm’n, Apr. 19, 2021, *available* at https://consumerfed.org/wp-content/uploads/2021/04/PCAOB-IAG-Letter.pdf.
[17] Letter from Jane B. Adams, et. al. to Hon. Gary Gensler, Sec. and Exch. Comm’n, June 7, 2021.

The history of FASB and PCAOB should, again, give the Commission pause as it contemplates delegating the enormously broad, complex, and costly tasks of developing, implementing, maintaining, and enforcing climate or ESG-related disclosures.

Essential Design Elements for Any Third Party Delegation

Should the Commission, nonetheless, decide to propose to delegate some or all the functions necessary to develop, implement, maintain, and enforce climate or ESG-related disclosures to one or more third parties, we believe that such outsourcing should have the following minimum essential elements:

1. Members should be independent and selected by the Commission only, and should reflect the relevant market participants, including that a majority of the members should be investors;
2. The third party should be funded pursuant to express direction and control by the Commission;
3. The third party should be subject to Commission and public transparency and accountability regarding its processes for developing and implementing its work; and
4. The third party should be subject to Commission and public accountability regarding the substance of its work (*i.e.*, its rules or actions be subject to explicit Commission approval or rejection).

We have significant concerns with the Commission's ability to effectively address each of these core elements, and even if so, question whether any responses may introduce other unnecessary risks and costs.

Independent Members

As we detailed above, independent members to a standard setting or self-regulatory body is essential. Simply requiring that members to such standard setting or self-regulatory bodies be independent is insufficient. A case in point is the board composition of the Municipal Securities Rulemaking Board ("MSRB"). Since its founding in 1975, the MSRB's board had majority industry representatives (sometimes, nearly all members of the Board were representatives of different segments of the municipal securities industry). The Dodd-Frank Wall Street Reform and Consumer Protection Act sought to reform the board composition by requiring that the majority of its members be public representatives. Nevertheless, since the passage of the Dodd-Frank Act, many of

MSRB's "independent and public" board members have been individuals who have spent much of, if not their entire careers, in the industry.[18]

And thus, despite the Congressional directive and the Commission's oversight, a genuine independent and public majority board is yet to be achieved at MSRB (much like FASB and the PCAOB). The Commission should scrutinize these failures before delegating to one or more third parties to perform any governmental functions regarding mandatory climate or ESG-related disclosures. Put simply, the Commission would need to propose a governance structure that would represent investors, other market participants, and the public interest in a way that is materially better than what has been done before.

Budgeting and Funding at the Direction of the Commission

The Commission must ensure that any decisions regarding a third party's budgeting and funding are made by the Commission itself—and not delegated to the third party.

First, an inadequately restrained third party may seek to promote or protect a significant funder's interests. Third parties will have preferences upon who they would like to charge more or less. For example, as discussed above, when the Commission delegated the control of funding for the CAT, the exchanges and FINRA devised plans that would shift much of the costs to those who were not involved in making the determinations, namely, the broker-dealers. Similarly, prior to the establishment of the PCAOB, the American Institute of Certified Public Accountants (AICPA) had created and funded a Public Oversight Board that was intended to oversee the auditing profession, but this body was subject to industry control through its funding. This funding challenge was one of the reasons Congress decided to create and independently fund the PCAOB.

In part due to the lesson painfully learned from the Public Oversight Board, when Congress established the PCAOB, Congress explicitly provided for a funding mechanism. For climate-related disclosures, many of the existing third party standard setters are distinctly dependent upon concentrated, industry stakeholders.[19] That is facially inadequate for the Commission's purposes.

Second, a third party's funder may reduce its resources or otherwise use its "power of the purse" to substantively or procedurally influence the third party in its development, implementation, or enforcement of its rules or guidelines.

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[18] *See* Letter from Americans for Financial Reform, et. al., to Ronald W. Smith, Municipal Securities Rulemaking Board, Apri. 29, 2020, *available at* https://consumerfed.org/wp-content/uploads/2020/04/Comment-to-MSRB-Re-Rule-A-3.pdf.

[19] *See* Congressional Research Service, *Accounting and Auditing Regulatory Structure: U.S. and International*, R44894, July 19, 2017, *available* at https://crsreports.congress.gov/product/pdf/R/R44894.

Third, a third party may seek to apply any new fees or costs in ways that may negatively impact market participants or the markets overall. As we detailed below, pursuant to the Securities Exchange Act of 1934, exchange and FINRA rules need to provide for “an equitable allocation of reasonable dues, fees, and other charges,” “not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers,” and not unduly burdensome on competition.[20]

If the Commission were to grant a third party the ability to essentially lay and collect taxes to fund the third party’s work on climate-related and other ESG disclosures, then the Commission should take steps to ensure that the third party is generating revenues in ways that are, at a minimum, consistent with the burdens Congress has imposed upon the exchanges and FINRA under the Exchange Act.

The burdens of a new climate or ESG-related disclosure regime are unlikely to fall evenly on disclosing parties of different sizes, orientations, and businesses. The Commission should be extremely cognizant of potential risks associated with potentially unnecessarily high, anti-competitive, or discriminatory fee structures. Again, the Commission need only look to the pricing of equities market data for concrete examples of how third parties that have been empowered to establish and maintain governmental duties may exploit their positions for their own benefits or to those of particular favored market participants.

Further, in the absence of a statutory directive, it is unclear whether and how the Commission may legally and effectively establish and oversee such budgeting and funding. Some may even question the authority the Commission may have to establish a funding mechanism. The CAT saga we detailed above is a prime example of how a critically important regulatory tool may suffer years of implementation delays and not be properly upgraded, all due to inadequate or unfair funding mechanisms. It is unclear whether or how these disputes may be resolved, but it seems likely that the dispute will ultimately involve litigation before the Federal Court of Appeals for the District of Columbia Circuit. If such litigation is pursued, it could have direct and profound impacts on the Commission’s ability to essentially levy a fee upon market participants upon its own discretion.

Process Accountability

In order to develop, implement, maintain, and enforce a climate-related disclosure regime, the Commission must design mechanisms that ensure that any third party standard setter would take into full consideration and address the concerns of investors and other market participants who would be the consumers of the ensuing disclosures. As detailed above, the current models as practiced by FASB and PCAOB fall far short of investors’ needs. Any standard setter should be obligated to give fulsome notice of the

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[20] 15 U.S.C.§ 78f(b).

standards it proposes to adopt, receive the feedback of interested parties, and be obligated to incorporate and address their feedback before approval or submission to Commission's approval.

The Commission should also recognize that any standard setter cannot be held accountable when its actions are not public. Several laws, such as the Administrative Procedures Act, Sunshine Act, and Freedom of Information Act, are intended to provide very basic accountability for governmental actions. Yet, a third party standard setter designated by the Commission would unlikely be deemed a governmental entity that would be subject to those requirements. This could allow for undisclosed, undue influence to be exerted on the third party without any knowledge or accountability. Accordingly, the Commission would need to establish clear expectations regarding public disclosure of communications regarding third party actions, public meetings, public votes, and other transparency measures necessary for good governance and accountability.

It is worth cautioning that, currently, self-regulators' rule proposals that are approved or disapproved by the Commission are often challenged before and sometimes invalidated by the DC Circuit.[21] In fact, the Commission is currently facing litigation regarding its recent approval of a stock exchange order type,[22] its review of NYSE's market data products,[23] and its approval of a new FINRA database for corporate bonds. Given the growing use of legal challenges to its actions to approve third party actions, should the Commission decide to delegate its work to a third party standard setter, the Commission will likely not avoid a review by the DC Circuit for any controversial action. Rather, it will simply add another layer of proposal, review, and appeals. This will likely slow the standard setting process considerably.

Substantive Accountability

Should the Commission decide to delegate to one or more third parties some or all of the functions regarding the development, implementation, oversight or enforcement of climate-related disclosures, the Commission must design mechanisms to ensure that the standard setter is performing its functions in a way that furthers the Commission's mission and its stated purposes. Put simply, the Commission needs to establish substantive boundaries for any delegation.

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[21] *See Susquehanna Int'l Grp., LLP v . SEC*, 866 F.3d 442 (D.C. Cir. 2017) (where the court rejected the Commission's approval of a third-party's rulemaking).

[22] See Alexander Osipovich, *Citadel Securities Sues SEC for Approving New Stock-Order Type*, Wall St. J., Oct. 16, 2020, *available* at https://www.wsj.com/articles/citadel-securities-sues-sec-for-approving-new-stock-order-type-11602889484.

[23] *See* Jody Godoy, *D.C. Circuit Scrutinizes Exchanges' Challenge to Market Data Overhaul*, Reuters, May 12, 2021, *available* at https://www.reuters.com/business/legal/dc-circuit-scrutinizes-exchanges-challenge-market-data-overhaul-2021-05-11/.

For reference, when Congress statutorily authorized the Commission to oversee rules of the exchanges and FINRA, it also directed the Commission to ensure that new rules of these third parties met a basic set of minimum standards. For example, Congress has directed the Commission to ensure that exchanges' rules:

- "provide for the equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities;"[24]
- "are not designed to permit unfair discrimination between customers, issuers, brokers or dealers;"[25] and
- do not "impose any burden on competition not necessary or appropriate in furtherance of the purposes" of the Exchange Act."[26]

The Commission has similar requirements for its review of FINRA rules.[27]

Yet, as the implementation of the CAT, as well as the FASB and PCAOB experiences demonstrate, it may be difficult—if not impossible—for the Commission to ensure that a third party actually adopts rules and guidance that are consistent with its purposes and mission. In particular, it would be paramount for the Commission to build safeguards to protect the policymaking work against undue influence of issuers, but also to avoid excessive costs, discrimination, or other impacts that would undermine investor protection, fair, orderly and efficient markets, and capital formation.

Lastly, irrespective of the Commission's determinations on whether to outsource the development, implementation, and oversight to one or more third parties, the Commission should not even consider delegating its enforcement powers to a third party. Setting aside the additional legal authority risks and "state action" concerns, there are extremely significant substantive risks. Will third parties seek to enforce their rules against favored market participants? Will they expend the appropriate resources to identify, investigate, and bring actions? What are their incentives for bringing sufficiently strong cases to encourage compliance? What role will whistleblowers have in ensuring compliance? The less-than-inspiring enforcement records of existing quasi-governmental authorities under the Commission's jurisdiction suggest strongly that the Commission must take ownership of this critical element of any regulatory regime.

Alternatives to Delegated Outsourcing

One alternative to outsourcing the Commission's obligations might be to establish specific requirements, and then explicitly acknowledge that compliance with a particular

[24] 15 U.S. Code § 78f(b)(4).
[25] 15 U.S. Code § 78f(b)(5).
[26] 15 U.S. Code § 78f(b)(8).
[27] *See, e.g.*, Exchange Act Section 15A(b)(5), (6), and (9).

third party's interpretation of those requirements would fulfill the obligations established by the Commission. Some have suggested that the Commission may want to adopt a model similar to how the standards of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) is used.

Importantly, if the Commission were to take this approach, it would need to ensure that the third party would not be developing, implementing, maintaining, or enforcing the standards. Those can and should remain with the Commission. Rather, the third party would be essentially providing guidance. However, one concern with this approach is that there may be alternatives developed. If multiple third parties develop acceptable standards, then the Commission has not necessarily materially advanced the objective of having reliable or comparable disclosures. Further, we question why the Commission could not offer the same guidance itself.

Rather than outsourcing the standard-setting functions to one or more outside organizations, the Commission should consider establishing a standing Advisory Committee and commit to addressing any recommendations that may come from it.

This Advisory Committee—which should include representatives from investors, issuers, asset managers, labor unions, lenders, non-governmental standard setters, and other stakeholders—could help the Commission maintain ESG disclosure standards that remain relevant, given investors' and other market participants' needs. The Advisory Committee should be modeled after the now-defunct SEC and CFTC Joint Advisory Committee on Emerging Regulatory Issues that examined the "Flash Crash." The Advisory Committee (and the Commission separately) should consult with and learn from other substantive experts in government, including the Environmental Protection Agency and the Board of Governors of the Federal Reserve System.

Question 14:

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?

Response to Question 14:

We strongly support the market for public securities. While additional public disclosures about climate-related and other ESG information may enhance the quantity, quality, and utility of information available to investors and other market participants (thus making the markets more "fair, orderly, and efficient'), we are nevertheless concerned that if the Commission does not properly address its offering exemption framework, a new climate-related disclosure regime could negatively impact both the public and private markets.

When compared to private securities, public securities typically offer significant advantages for investors, including:

- Public securities typically are accompanied by more robust accounting and business disclosure practices;
- Information about public companies, including third-party research, is much more readily available and fairly distributed (as required by Commission rules, such as Regulation FD);
- Public securities are far more easily and reliably valued;
- Public securities markets generally offer a transparent and efficient method to liquidate holdings;
- Liquidity risks and trading costs for public securities are often significantly lower than for similarly-situated private securities;
- Public securities are much more easily benchmarked, such as against the S&P 500; and
- Actual net performance tends to be at least as good, if not better.

In general, the Commission's disclosure requirements and investor rights protections apply only to "public" companies. As a result, the Commission must be extremely cognizant of the limitations of a climate-related disclosure regime that would apply to only "public" companies.

While a company generally becomes a "public" company after it engages in an initial public offering (IPO), it may also be pulled into the public markets if it hits certain thresholds, such as having a sufficient number of "holders of record."[28]

Congress and the SEC have expanded the exemptions from the securities laws so much in recent years that companies may effectively raise an unlimited amount of capital from an unlimited number of investors without having to ever become a "public" company.[29]

The result has been a rapid increase in the number and size of "private" companies, as well as corresponding reduction in the number of public companies.[30] As Duke Law Professor Elisabeth de Fontenay has explained, "[p]ublic companies benefit significantly

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[28] 15 U.S.C. § 78l.
[29] Letter from Tyler Gellasch, Healthy Markets Association, to Secretary, Sec. and Exch. Comm'n, at 9-10, Sept. 30, 2019, *available at* https://healthymarkets.wpengine.com/wp-content/uploads/2019/09/SEC-Concept-Release-9-30-19-1.pdf(citing to *Concept Release on Harmonization of Securities Offerings*, Sec. and Exch. Comm'n, Sec. Act Rel. No. 33-10649, at 33, Jun. 18, 2019, *available at* https://www.sec.gov/rules/concept/2019/33-10649.pdf).
[30] Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 Hastings Law J. 445 (2017).

less from mandatory disclosure than they did just three decades ago, because raising large amounts of capital no longer requires going and remaining public."[31]

At the same time, private companies enjoy a regulatory advantage over their public markets competitors that may far exceed avoiding the costs associated with identifying and making disclosures. They may also avoid making disclosures that may be viewed negatively by investors or other market participants.

Perhaps the greatest evidence of these effects occurs when companies decide to enter the public markets. Often, years of speculation and incomplete and inaccurate information are rectified by a single filing. Sometimes, the effects of this transparency and market discipline may be profound for the company, its executives, its shareholders, its staff, and others.[32]

Put simply, the ability to raise unlimited sums from investors without required disclosures can conceal a company's actions from public scrutiny, as well as scrutiny from creditors (including suppliers), investors, and consumers. Private companies—especially those pursuing commercial endeavors that have a negative impact on climate change—can also selectively disclose self-serving information while omitting the type of information that could allow shareholders, lenders, suppliers, customers, or even governments to hold the company accountable.

[31] De Fontenay, at 445; see also, *Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment, before the U.S. House of Representatives Cmte on Fin. Svcs Subcmte on Investor Protection, Entrepreneurship, and Capital Markets*, 116th Cong. (2019) (Statement of Renee Jones, at 13)("The most effective way for Congress to shore up shrinking public equity markets is to reverse the JOBS Act amendments to Section 12(g). As it now stands Section 12(g) allows unicorns to delay an IPO indefinitely, allowing these important companies to operate in secrecy, shrouded from public scrutiny and accountability. The growth of private trading markets like SharesPost and Nasdaq Private Market means unicorn shares can trade for years with little public information available to investors about these companies and their financial performance. At the very least, Congress should impose minimum disclosure obligations for companies of a certain size with dispersed ownership patterns. Such a reform would increase pressure for an IPO or sale, and provide needed information for investors considering purchasing shares."), *available at* https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-jonesr-20190911.pdf.

[32] Letter from Tyler Gellasch, Healthy Markets Association, to Secretary, Sec. and Exch. Comm'n, Sept. 30, 2019, *available at* https://healthymarkets.wpengine.com/wp-content/uploads/2019/09/SEC-Concept-Release-9-30-19-1.pdf.

Not surprisingly, law professors,[33] state securities regulators,[34] and many capital market experts have urged Congress and the Commission to ensure that companies with a large number of investors are pulled into the public markets. The Commission has an opportunity and obligation to do it.

The Commission should recognize that climate or ESG-related disclosures for public companies would not exist in a vacuum. By expanding its disclosure requirements and accountability apparatus for public companies to reflect such information that is important to investors and other market participants, the SEC would potentially be widening the gap in burdens between public and private companies. There is likely to be tremendous pressure to "go dark" or stay "private."[35] In fact, some are already seizing on this reality to argue against any new mandatory climate-related disclosures.[36] Further, many companies, and particularly those with the most significant climate-related risks, such as fossil fuels, heavy industry, real estate, and financial services, may seek to avoid the new disclosures.[37]

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[33] *See, e.g., Examining Private Market Exemptions as a Barrier to IPOs and Retail Investment, before the U.S. House of Representatives Cmte on Fin. Svcs Subcmte on Investor Protection, Entrepreneurship, and Capital Markets*, 116th Cong. (2019) (Statement of Renee Jones, at 13)("The most effective way for Congress to shore up shrinking public equity markets is to reverse the JOBS Act amendments to Section 12(g). As it now stands Section 12(g) allows unicorns to delay an IPO indefinitely, allowing these important companies to operate in secrecy, shrouded from public scrutiny and accountability. … ***At the very least, Congress should impose minimum disclosure obligations for companies of a certain size with dispersed ownership patterns. Such a reform would increase pressure for an IPO or sale, and provide needed information for investors considering purchasing shares***.") (emphasis added), *available at* https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-jonesr-20190911.pdf.

[34] *See, e.g.*, Letter from Jack Herstein, North American Securities Administrators Association, to Sen. Jack Reed, Mar. 22, 2012, *available at* https://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Letter-of-Support-for-Reed-Amendment-1931-03-22-20122.pdf.

[35] See, e.g., *Climate Change and Social Responsibility: Helping Corporate Boards and Investors Make Decisions for a Sustainable World before the U.S. House Cmte on Fin. Services, Subcmte on Investor Protection, Entrepreneurship, and Capital Markets*, 117th Cong. (2021) (Remarks of Rep. Bill Huizenga), *available at* https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=407109#LiveStream.

[36] See, e.g., *Climate Change and Social Responsibility: Helping Corporate Boards and Investors Make Decisions for a Sustainable World before the U.S. House Cmte on Fin. Services, Subcmte on Investor Protection, Entrepreneurship, and Capital Markets*, 117th Cong. (2021) (Remarks of Rep. Bill Huizenga), *available at* https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=407109#LiveStream (asserting that mandatory ESG disclosures "only increases costs, and yet add another hurdle for companies who look to go public, while discouraging other companies from doing so.").

[37] See, e.g., Kiel Porter, *Apollo Global to Buy Gas Transportation Firm Total Operations*, Bloomberg, June 8, 2021, *available at* https://www.bloomberg.com/news/articles/2021-06-08/apollo-global-to-buy-gas-transportation-firm-total-operations?sref=f7rH2jWS (reporting the private equity firm acquisition of a large gas transportation firm). It was reported that JP Morgan Chase provided an "upsized credit facility" to support the deal, but the details of any specific climate-related information are not public, and are not generally available to market participants or the public.

Put another way, the Commission should be very careful to not dramatically and unfairly increase the advantages of exempt offerings at the expense of public markets.

Lastly, we understand that under the Paris Agreement, financial firms are expected to assess their climate-related risks. US and foreign financial regulators are increasingly expecting their regulated entities to assess their climate-related exposures. However, for those assessments to be accurate, financial firms must first have detailed information that is generally only in the possession of the issuers of the securities they hold. Further, to the extent that banking regulators and other governmental entities are focused on potential systemic risks related to climate change, they must also rely on information that is mostly—if not entirely—within the possession of the issuers of the securities held by financial firms.

The Commission's disclosure rules that determine what, if anything, these financial institutions are likely to receive. As of now, because the Commission does not mandate any specific information (climate-related or otherwise) from Rule 506 offerings and its Rule 144A offering exemption allow for non-disclosure of information that investors, index providers, credit rating agencies, and other market participants may view as important for making their business decisions.

If a large fossil fuel company were to sell debt securities that do not come due for a dozen years or more, what are the climate-related risks associated with those securities?[38] How would an investment fund assess those risks, if they are not provided with basic information from the issuer first? How would a fund be able to disclose its risks? How would a regulator ensure that the fund's disclosures are accurate?

If the Commission is to ensure that banks and asset managers are able to meaningfully assess their climate-related risks, it must first ensure that they have the information from issuers with which to make those assessments—whether that information comes from a public issuer or not.

Conclusion

If the Commission moves forward with developing, implementing, maintaining, and enforcing a disclosure regime for climate-related and other ESG information, we recommend that it adopt such disclosures directly, and avoid unnecessary and risky delegations to third parties for these essential governmental functions. Further, we urge

[38] See, e.g., Exxon Mobil Corporation, 2020 10K, at 90, *available at* https://corporate.exxonmobil.com/-/media/Global/Files/investor-relations/annual-meeting-materials/annual-report-summaries/2020-Annual-Report.pdf (reflecting billions of debt outstanding at interest rates below 7% that would not be due until 2038 and later); see also Khalid Al Ansary and Kevin Crowley, *Exxon Puts Iraq Field Up for Sale With Debt Mountain Looming*, Bloomberg, Apr. 15, 2021, *available at* https://www.bloomberg.com/news/articles/2021-04-15/exxon-puts-iraq-field-up-for-sale-with-debt-mountain-looming (explaining how the company may be selling assets to pay off its large corporate debts).

the Commission to recognize that its imposition of disclosure obligations on public companies and offerings only will be inadequate to fulfill its obligation to protect investors, promote fair, orderly and efficient markets, promote capital formation, and protect the public interest.

Further, the Commission should recognize that its new disclosure framework will impact the balance between public and private capital raises, and may perversely result in less information about large and otherwise significant companies. To address these concerns, the Commission should review its private offering exemptions and consider either dialing back those exemptions from large offerings and companies, or conditioning such exemptions on additional disclosures.

Sincerely,

Tyler Gellasch
Executive Director

Cc: Hon. Allison Herren Lee, Commissioner
Hon. Hester Peirce, Commissioner
Hon. Elad Roisman, Commissioner
Hon. Caroline Crenshaw, Commissioner