



June 15, 2021

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

Re: Public Input on Climate Change and ESG Disclosures

Dear Chair Gensler,

On behalf of [Hannon Armstrong](#) (NYSE: HASI), a leading investor in climate solutions, we are pleased to submit comments on climate change and other ESG disclosures as outlined by the U.S. Securities and Exchange Commission request for public comment on March 15, 2021.

Based in Annapolis, Maryland, Hannon Armstrong is the first U.S. public company solely dedicated to investments in climate solutions, providing capital to leading companies in the energy efficiency, renewable energy, and other sustainable infrastructure markets. With more than \$7 billion in managed assets, our core purpose is to make climate positive investments with superior risk-adjusted returns.

At Hannon Armstrong, we have aspired to be a leader in transparent reporting on financially material and comparable ESG metrics. In fact, we were the first U.S. company to report the avoided emissions resulting from our investments (through our propriety [CarbonCount®](#) methodology) – a disclosure most financial service companies are still reluctant to provide – and one of the [first to commit](#) to the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

As many stakeholders, investors, and companies have noted, the current lack of global standardized ESG reporting metrics creates challenges with investment decision making when ESG risks and opportunities are material to the organization. We believe that enhanced requirements regarding environmental disclosures are an essential element to improving the availability of information for investment decision making.

Urgent Need for SEC Action

We applaud the SEC's initiatives to evaluate its disclosure rules to facilitate the disclosure of consistent, comparable, and reliable information on climate change. The U.S. federal securities laws are founded on the enduring principle that regulation of the capital markets is necessary to avoid "national emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry."¹

We believe that the SEC must view climate change through this lens when considering how to improve disclosure and what other steps are needed.

Climate change presents a profound, systemic risk to U.S. capital markets. The effects of climate change are already being observed. According to the U.S. National Oceanic and Atmospheric Administration ("NOAA"), there were 22 natural disaster events in the United States in 2020, with an estimated individual cost of greater than \$1 billion and an aggregate cost of approximately \$95 billion. The NOAA reports that, since 1980, the U.S. has sustained 285 separate billion-dollar weather events and climate disasters with cumulative costs exceeding \$1.9 trillion. In its Weather, Climate & Catastrophe Insight: 2020 Annual

¹ Securities Exchange Act of 1934, Section 2 ("Necessity for Regulation").



Report, Aon reports that there were 416 natural catastrophe events globally in 2020, resulting in economic losses of \$268 billion, which represents increased losses of 8% compared to the century average.

The risks and impacts of the climate crisis are increasing at a dramatic rate. These include physical risks to real assets from climate-fueled weather events and transition risks posed by regulatory, technology, economic and litigation changes during the shift to a net-zero economy. The risks can combine in unexpected ways, with serious, disruptive impacts on asset valuations, global financial markets, and global economic stability. Further, climate change poses a variety of material risks to companies of all sizes in all industries across the nation. The costs of inaction to companies, investors, workers, and savers could be dire in the medium and long term, and many severe impacts, such as those from floods, fires, droughts, and hurricanes, are already being incurred in the short term.

Climate change does not discriminate. Its risks permeate all aspects of capital markets. Much like cybersecurity risks and the coronavirus pandemic, climate change poses grave threats to investors, our capital markets, and our country. Climate change risk does not differentiate based on issuer size or sector. Because climate change already poses material risks to most industries, and as a systemic risk it threatens all industries, our belief is that climate change is material to all companies. While material risks, including those related to climate change, should be included in existing SEC reporting requirements, climate risk is inherently different from the risks typically assessed by issuers, often resulting in inadequate disclosures. More explicit requirements for climate disclosures will help bridge this gap between the spirit of the existing framework and current practices with regard to disclosure of climate risk.

The SEC website states, "For more than 85 years since our founding at the height of the Great Depression, we have stayed true to our mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation." The climate crisis poses one of the greatest threats the SEC has faced to all aspects of this mission. Consistent, comparable climate change disclosure is a key step toward ensuring the SEC can continue to fulfill its vital mission.

Since the SEC issued interpretive guidance on climate change disclosure in 2010, the volume of climate change disclosure has increased, but the quality and usefulness to investors remains insufficient. Investors find disclosures lacking for several reasons. Many registrants are not fully following the SEC's 2010 guidance on climate change disclosure by disclosing material risks in a manner consistent with Item 503 (c) of Regulation S-K, which requires a clear identification of risk and its impacts that are particular to the registrant, or Item 303 of Regulation S-K, which requires that trends or events that are likely to affect the company be reviewed in the Management's Discussion & Analysis (MD&A). Unfortunately, enforcement has historically been limited. Additionally, since the release of the interpretive guidance in 2010, the understanding of the financial impacts of climate change on companies, investment portfolios, and financial markets has significantly evolved. In 10 years, investor expectations of the quality of disclosure have been strengthened due to the work of governments around the world, the Task Force on Climate-related Financial Disclosures (TCFD), voluntary disclosure frameworks, academic contributions, and many other initiatives. We believe the SEC should continue to acknowledge this evolution and mandate "decision-useful," consistent, and comparable climate risk disclosure through its rulemaking authority.

Climate-related disclosure will create significant public benefits by giving investors and companies the tools they need to align their investments and strategies with the transition to a net-zero economy. Investors need access to consistent, comparable, and reliable information at scale, so that they can allocate capital in a manner that reduces risk and navigates the path to a net-zero future with fewer financial shocks or disruptions. The current state of climate change disclosure does not meet these needs and instead undermines the effectiveness of capital market operations. To function effectively, capital markets need comprehensive, decision-useful data from all enterprises facing material climate change risks and opportunities.

Robust climate disclosure is also needed to meet the full measure of the climate crisis by providing transparency as to the impact of market responses to it. This includes impacts on the workforce, communities, human rights implications, and the connection between climate, water, food, and forests and associated impact on commodities markets. Congress and President Roosevelt established the SEC 87 years ago to address just such national emergencies through the power of capital markets

Specific Recommendations

Today's investors and lenders seek to track absolute greenhouse gas (GHG) emissions to measure and hold companies accountable for promised reductions, in order to arrest both specific and systemic collapses in asset values and businesses. They seek clarity as to whether management's capital expenditures are consistent with announced climate strategies, both in substance and magnitude. They want comparable information on how companies plan to contribute to and survive in a net-zero carbon economy as well as integrity on progress towards net-zero commitments. They seek this information both to protect the capital they have invested in (or lent to) individual companies as well as to protect their portfolios from the systemic risks of climate change. It is these common, systemic risks that have motivated formation of coalitions such as Climate Action 100+, the Investor Agenda, the Partnership for Carbon Accounting Financials (PCAF), and many other initiatives, which have developed extensive governance, monitoring, and measurement techniques that can and should be adapted into regulation in the public interest.

The problem is the lack of a mechanism to enforce those voluntary disclosures in a rigorous and reliable way and the concomitant variability in depth, completeness, and accuracy. Quantitative, comparable, company-specific disclosure is imperative for financial markets to judge and price climate risk as well as to hold financial markets and market participants accountable for contributing to achievement of global climate goals. Investors need the SEC to step in to mandate and enforce material climate-related disclosures that are informative, not misleading, rigorous, consistent, and comparable across companies and markets.

As the SEC considers how best to address these issues, we highlight the below recommendations.

1) New required disclosures should be complementary to existing disclosures.

- The SEC has a robust framework already established through Regulation S-K, which we believe is the natural place for registrants to disclose climate-related data. Seeing these disclosures alongside prominent disclosures they already understand, such as the Management's Discussion and Analysis and Quantitative and Qualitative Disclosures about Market Risk, will allow investors to readily incorporate the information offered by such disclosure into their process for making investor decisions. Inclusion of these disclosures within the existing Regulation S-K framework will make such disclosures within the scope of current disclosure controls and procedures as defined in Exchange Act 13a-15(e), further increasing investor confidence in such disclosure.

2) New required disclosures should be principles-based, varying by industry.

- Disclosures should not be prescriptive, as different industries are exposed to climate and transition risks in different ways. For example, the largest climate risks and impacts a financial institution has will be from the loans and investments they make, rather than from their relatively small operational footprints. Accordingly, an appropriate disclosure framework will be one which shows the extent to which their portfolios are subject to climate risks. Such a framework would not be appropriate for other registrants such as manufacturers. Different disclosure from different industries is already seen in areas such

as non-GAAP operating measures, and tailored disclosure would ultimately be far more useful to investors.

3) The 11 recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) should be incorporated into Regulation S-K.

- These recommendations address companies' climate risk exposure, governance, strategies (including scenario planning), and metrics and targets and have been endorsed by over 2,000 companies and investors globally. In October 2020, the Group of Thirty Working Group on Climate Change and Finance, co-chaired by Janet Yellen, found that climate disclosures "remain far from the scale" necessary for investors to "systematically channel investment to sustainable and resilient technologies and companies" and called on all national securities regulators to make the full set of TCFD disclosures mandatory by 2023. Arguably, the disclosure framework provided by the TCFD is already implicitly required by Regulation S-K Item 303, which mandates discussion of matters that are reasonably likely based on management's assessment to have a material impact on future operations; requiring climate disclosure explicitly will allow investors access to the information they demand to allocate capital in the face of climate and transition risks.

4) Disclosure of progress on announced science-based targets and other corporate climate commitments, in the form of clear, periodic updates on the status of and progress towards meeting those commitments should be required.

- To their credit, many companies have announced climate strategies, including net-zero ambitions for their operations and products, and report on their progress. These announcements may be the basis for investment and/or voting decisions by investors and investment managers. Yet investors lack transparency as to whether and how companies follow through on their announcements. Many companies disclose progress on commitments in voluntary reporting, but it can be unclear what measures the company is using as well as whether the methodology to track the measure is consistent from period to period. Disclosure of voluntary commitments and progress in a supplemental SEC schedule will help make the commitments credible and allow investors to reliably measure progress. Most science-based targets do not count carbon offsets, but companies should disclose the role of carbon offsets in their targets and/or claims of achieving milestones. Inclusion of these disclosures within the existing Regulation S-K framework will ensure such disclosures are within the scope of current disclosure controls and procedures as defined in Exchange Act 13a-15(e).

5) Tabular disclosure of a company's estimated Scope 1, 2 and 3 greenhouse gas (GHG) emissions based on the GHG Protocol's widely-accepted framework for measuring and reporting emissions, which covers direct and indirect emissions and the percentage of carbon, methane, and other gases, should be required.

- Item 303 of Regulation S-K already requires that the MD&A in annual reports address the company's liquidity, capital resources, and results of operations as well as "such other information that the company believes to be necessary to an understanding of its financial condition, changes in the financial condition and results of operations." Emissions reporting is critical to investors' understanding of the quality of a company's earnings in the face of climate change and the energy transition as well as to an understanding of a company's liquidity and capital resources, especially considering the climate commitments of financial institutions to restrict financing of emissions-intensive activities. Many companies voluntarily report some information on emissions, but reporting is often incomplete and disconnected

from securities disclosure. Because investors have signaled how important emissions disclosures are, some companies obtain limited independent verification of their emissions disclosures. But the absence of the discipline of mandatory requirements, backed up by regulatory monitoring and enforcement, has resulted in inconsistent emissions disclosure quality. The SEC should require that GHG emissions are disclosed alongside other Regulation S-K related disclosures, which would result in the inclusion of such disclosures within the scope of current disclosure controls and procedures as defined in Exchange Act 13a-15(e).

- **Provide credit for avoided emissions.**
 - The investments of banks and capital providers extend beyond the operational carbon footprint of the investing company and contribute to GHG reductions in other sectors of the economy. The downstream impacts of their investment activity could provide tremendous future GHG savings in the form of avoided carbon emissions. Most investors and companies do not receive credit for their investments. The absence of an avoided carbon emissions metric creates a fundamental problem in the way companies are evaluated.
 - While some stakeholders question the precision of Scope 3 emissions, one solution is to revise and appropriately weight an organization's Scope 3 emissions to reflect the carbon impact of their downstream activities. The Greenhouse Gas Protocol, which is the most widely accepted GHG accounting framework, defines Scope 3 emissions as all indirect emissions (not included in Scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions. Scope 3 Technical Guidance Reporting, Category 15 describes the relationship between avoided emissions and investments. Under the current Scope 3 framework, GHG accounting is categorized into four types: equity investments, debt investments, project finance and managed investments, and client services. Some investors currently disclose the avoided carbon emissions of their investments by accounting for the proportional value of Scope 1 and 2 emissions within their Scope 3 reporting. However, investors are currently unable to account for negative Scope 3 emissions. Allowing for a negative Scope 3 category would enable investors and other rated companies to claim full credit for the avoided emissions of their downstream activities and appropriately value climate-friendly companies.
 - CarbonCount promotes transparency in low-carbon project finance by creating comparable metrics for renewable energy and energy efficiency projects. CarbonCount scores help investors determine the expected CO₂ emissions reductions per \$1,000 of investment and appropriately give credit to projects that are displacing the most GHG emissions. For example, a project in the Midwest would likely receive a higher CarbonCount score than a project in California because the grid's avoided emissions factor would be higher in the Midwest. Additionally, CarbonCount incorporates the forward-looking emissions and power generation forecasts used by credit rating agencies. Investors and portfolio managers can leverage an avoided carbon emissions metric to evaluate the downstream impacts of their investments.
 - Allowing for a negative metric in scope 3 emissions reporting would allow investors and rated companies to claim credit for avoided emissions.



- 6) **The SEC should establish an external Climate and ESG Advisory Group to advise the Commission on the materiality of and investor interest in a range of sustainability issues.**
- Regarding climate change, the group should be tasked with developing recommendations for keeping the SEC's disclosure regime up-to-date in light of the fast-evolving understanding of climate change impacts, progress and challenges on the path to a net-zero economy, and capital market responses to climate risks and disclosures. SEC rules should be updated regularly in response to these developments, and they should include the development or adoption of new metrics where investor needs dictate this.
- 7) **The SEC should consider the interaction of human capital and environmental disclosures in developing a framework for disclosure. For example, given TCFD's value in guiding environmental disclosures, it could – if expanded – also serve as a framework for human capital.**
- Investors need more informative data about companies' management of human capital and community impacts. In August 2020, the SEC amended Item 101 of Regulation S-K to provide that companies' description of the business include a description of the company's human capital resources. The SEC should strengthen this provision to include more robust human capital disclosures, including disclosures that evidence companies' resilience to the physical effects of climate change on their employees and the communities from which they draw employees as well as preparedness for the energy transition, diversity, and inclusion.

We commend the SEC's new "whole of the SEC" approach to regulating the capital markets in a way that reduces climate change risk, including through its filings reviews and its hiring decisions. Our recommendations for climate disclosure and related rulemaking build on this approach to ensure that investors receive the information they require and issuers face clear disclosure expectations. We believe that implementing these recommendations will pay off with dramatically improved disclosure and financial reporting and aligns with the SEC's "mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation."

Respectfully,

A handwritten signature in blue ink, appearing to be "JEFF ECKEL", written over a light blue horizontal line.

Jeffrey W. Eckel
Chairman and CEO
Hannon Armstrong