

# Response to the SEC Consultation on Climate Change Disclosures and Sustainability Reporting Standards

Contact: [consultations@value-balancing.com](mailto:consultations@value-balancing.com)

## Contents

<b>1. General Comments .....</b>	<b>2</b>
1.1. Key Points .....	2
1.2. The VBA Approach .....	2
<b>2. Specific Comments .....</b>	<b>4</b>
2.1. Question 1.....	4
2.2. Question 2.....	5
2.3. Question 8.....	6
2.4. Question 9.....	7
2.5. Question 15 .....	8
<b>3. References .....</b>	<b>10</b>

The **Value Balancing Alliance** was founded in June 2019 and (as of April 2021) represents 20 large international companies, including Anglo American, BASF, BMW, Bosch, Deutsche Bank, DPDHL, Kering, LafargeHolcim, Mitsubishi Chemical, Otto, Porsche, Michelin, Novartis, Sana Kliniken, SAP, Schaeffler, Shinhan Financial Group, SK, ZF. Some of our VBA membership companies have direct exposure to SEC regulation, while many are operating in the US and dealing with companies listed in a US-based stock exchange. The alliance is supported by the four largest professional services networks - Deloitte, EY, KPMG, PwC - as well as by leading academic institutions, such as the University of Oxford and Harvard University. Furthermore, in partnership with the Capitals Coalition the alliance has received funding from the EU through its LIFE programme for the Environment and Climate Action. Within a short period of time, the alliance has established itself as a pragmatic voice of the real economy in the global accounting policy arena and contributes its expertise to the EU Sustainable Finance Platform and other international fora and working groups.

## 1. General Comments

### 1.1. Key Points

We fundamentally endorse the SEC's initiative on climate change disclosures. Our response is structured around the following points to consider from the perspective of the real economy and the VBA's methodology development towards a global solution:

- 1.1.1 Global standards for market transparency:** The SEC should align their regulatory strategy with global developments in sustainability (climate change) reporting currently underway in the European Union, the G7, and G20. The SEC may use its channels and networks on the global level to create a solution that focuses on market transparency.<sup>1</sup>
- 1.1.2 Enterprise value and impact valuation:** The disclosure framework should ensure comparability based on enterprise value and impact valuation. The VBA endorses the double materiality principle (Figure 1): the impact of business on and its value to society and the environment on the one hand ("Inside-out"), and, on the other hand, the environmental and social impacts on enterprise value ("Outside-In").
- 1.1.3 Independent and evidence-based standard-setting:** Standard-setting should be based on due process and governance that meets general standards of independence, expertise, transparency, public consultation, oversight, and effectiveness currently upheld by organizations such as IASB and SASB.

### 1.2. The VBA Approach

- 1.2.1** The VBA Methodology<sup>2</sup> is grounded in the principle of double materiality. The VBA's two core programs are the Impact Statement and Integrated Accounts. The Impact Statement focuses on the impact on society and aims at developing an applicable methodology for impact valuation and measurement (IMV), meaning that impacts on society, customers, employees, and the environment will be quantified along the value chain and translated into monetary units. This method allows to integrate pre-financial information into financial statements which speaks to the reality of financial markets and the corporate world.
- 1.2.2** The global impact measurement standard is needed to foster long-term thinking and consolidate all the knowledge that has already been created in this field. The Value Balancing Alliance supports and builds on the work of leading universities and expert organizations, such as the Capitals Coalition, the WBCSD, the Impact Management Project, the GRI, the Value Reporting Foundation (including former SASB and IIRC), and the emerging International Sustainability Standards Board of the IFRS (IFRS ISSB). The envisioned transformation requires the collective action of all players in the business ecosystem. The alliance will make its work publicly available and welcomes more companies to join our impact journey.

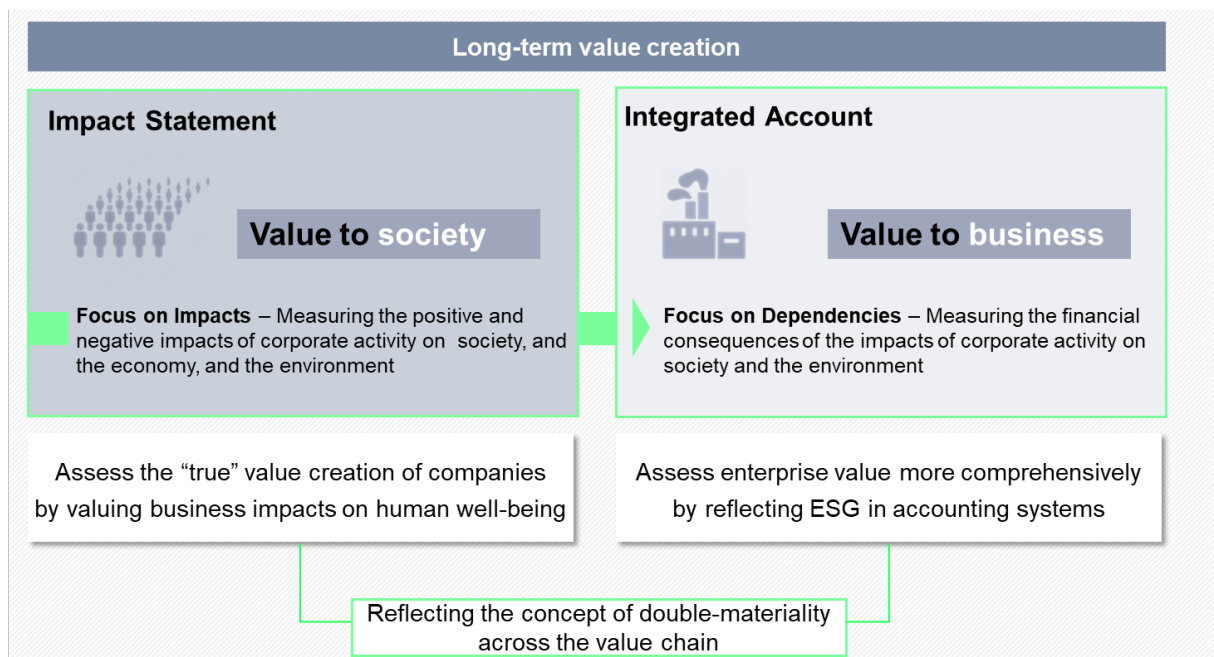
<sup>1</sup> Following the SEC Guidance Release 75 FR 6290 (Feb 8, 2010), section I.A.

<sup>2</sup> Value Balancing Alliance, 2021a.

1.2.3 As a global organization, the VBA develops and pilots<sup>3</sup> its standards and guidance for disclosure and business steering (Figure 1). To ensure its robustness and feasibility, the VBA's IMV Methodology follows four core principles:

- **Decision relevance:** The impact measurement and valuation methodology should support users in their decision-making.
- **Standardization:** The methodology development should standardize approaches as far as possible.
- **Connectivity:** The standards should allow for connectivity with existing frameworks.
- **Scalability:** The methodology and implementation guidance should aim for scalability and practical feasibility.

Figure 1: The VBA Approach: Impact Statement and Integrated Account



Piloted management accounting methodologies to ensure robust and feasible standards and guidance for disclosure and business steering

<sup>3</sup> Value Balancing Alliance (2021e).

## 2. Specific Comments

### 2.1. Question 1

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

- 1.2.4 Comparability through globally recognized standards:** The Commission can comparably regulate climate change disclosures by using the already existing or widely accepted frameworks: The sustainability reporting standards initiatives such as SASB, the IIRC, and CDSB are expected to converge around the IFRS ISSB. The European Commission is also moving forward to establish mandatory standards for corporate sustainability reporting for European and US-based companies operating within the European Union.
- 1.2.5 Focus on market transparency:** To avoid market confusion and enhance market transparency, the SEC needs to focus on enterprise value and impact valuation across the entire value chain (Figure 3). This approach will enable investors to assess climate-related financial performance disclosures across the whole value chain of global companies more accurately.
- 1.2.6 Integrated reporting:** The disclosure should be included in the annual filings to promote the integration of climate change information into financial information. There is an increasing consensus that sustainability data and financial data should be reported with similar levels of assurance and presented in the same report, as promoted in the European Commission's proposal for the Corporate Sustainability Reporting Directive. To inform investors more effectively, companies should report their climate-related data together with financial data in one single report.

Figure 2: Impact valuation across the value chain

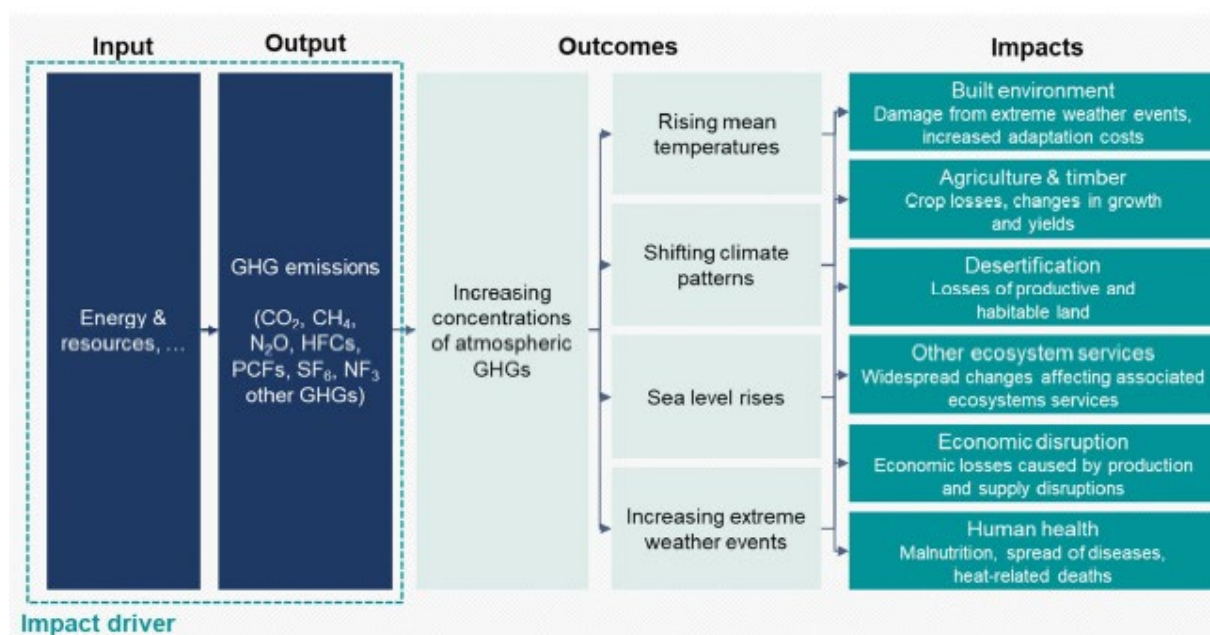
	Upstream	Own operations	Downstream
Value chain			
Description	<b>Cradle-to-gate</b> covering all suppliers and all activities (no matter what is purchased)	<b>Gate-to-gate</b> covering all activities over which the business has direct control (same scope for financial statement)	<b>Gate-to-grave</b> covering all activities linked to direct customers, product use by customers, and product end-of-life
Example	GHG-Protocol: Scope 2 and upstream Scope 3	GHG-Protocol: Scope 1	GHG-Protocol: downstream Scope 3

## 2.2. Question 2

What information related to climate risks can be quantified and measured? How are markets currently using quantified information? Are there specific metrics on which all registrants should report (such as, for example, scopes 1, 2, and 3 greenhouse gas emissions, and greenhouse gas reduction goals)? How have registrants or investors analysed risks and costs associated with climate change?

**2.1.1 Information on climate risks and opportunities:** We support the recommendations developed by the Task Force on Climate-related Financial Disclosures (TCFD) and the standards provided by the Carbon Disclosure Standards Board (CDSB). In addition, we encourage to build disclosure on climate-related risks and opportunities following the impact pathway used in the VBA Methodology (Figure 3). We recommend disclosure of scope 1, 2, and 3 of greenhouse gas emissions<sup>4</sup> and following the guidance provided by the GHG-Protocol and the CDSB.

Figure 3: Impact pathway for GHG emissions in the VBA Methodology version 0.1



**2.1.2 Valuation models based on social cost of carbon (SCC):** To capture the externalities and value of business activities for the wider society, economists have defined a set of approaches that assess how the activities determine the overall wellbeing of society and how those well-being benefits is distributed. Three types of approaches can be applied to estimate the impact of those externalities on

<sup>4</sup> Greenhouse Gas Emissions reported as CO<sub>2</sub>-equivalent is usually quantified as information related to climate risks. Climate change is driven by the total concentration of GHGs in the atmosphere, regardless of where they are emitted or removed. The Intergovernmental Panel on Climate Change (IPCC) lists 18 different GHGs. The seven principal classes of GHGs are carbon dioxide (CO<sub>2</sub>), methane (CH<sub>4</sub>), nitrous oxide (N<sub>2</sub>O), sulphur hexafluoride (SF<sub>6</sub>), various hydrofluorocarbons (HFCs), perfluorocarbons (PFCs) and nitrogen trifluoride (NF<sub>3</sub>). Contributions to climate change depend on the type of gas. These contributions can be normalized by calculating them relative to the effect of carbon dioxide as “CO<sub>2</sub> equivalents” (CO<sub>2</sub>e) using their Global Warming Potential (GWP). As different gases have different lifetimes, a GWP is calculated over a specific time horizon. The GWP most widely used is GWP100.

society: stated preference, revealed preference and cost-based approaches.<sup>5</sup> Following these set of valuation methods, the impact on climate change can also be monetized. Economic damages that would result from emitting one additional tonne of GHGs into the atmosphere can be estimated. For example, Resource for the Future RFF (RFF) has provided Social Cost of Carbon based on research on projections for economic growth, population and emissions as well as expected impact on agriculture, health, energy use and other aspects of the economy. Future damages are converted into present values to determine total damages.<sup>6</sup>

- 2.1.3 Effects of climate change disclosure on the cost of capital:** It is expected that registrants that do not take efforts to reducing their climate impact will face premiums due to the increasing likelihood of a specific pricing that internalizes the externalities. A shift in consumer as well as investor behavior could also lead to increased pressure on the cost of capital through the mechanisms of capital allocation by equity as well as private investors. It is also important to stress the notion of ‘stranded assets’ at this point.<sup>7</sup> Assets can be stranded through the shift in consumer preferences as well policy changes (carbon tax) but also through technology learning curves and decreasing costs of alternative energy sources diminishing the value of assets that depend on carbon-intensive technology in favour of low-carbon technologies.<sup>8</sup>

## 2.3. Question 8

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

- 2.3.1 Internal governance and business steering:** The internal governance is contains important information about the level of leadership commitments to push forward climate goals as well as the robustness of the internal control system to track and manage climate related risks as well as motivate employees to contribute to climate goals in their daily operations.
- 2.3.2 Alignment of US and EU initiatives:** We encourage the SEC and the European Commission to collaborate and align their respective regulatory initiatives in sustainable finance and governance.<sup>9</sup> The European Commission’s legislative proposals aim at reflecting “sustainability preferences in insurance and investment advice and sustainability considerations in product governance and fiduciary duties.”<sup>10</sup> With measurable targets set at the strategic level, registrants can then coordinate their internal teams to focus on the climate goals by embedding them in the compensation scheme of executives and employees.
- 2.3.3 Aligning incentives with long-term value creation:** The advantage of requiring disclosure in connection with compensation issues would be promoting an alignment of executive and employee incentives with the registrant’s long-term

<sup>5</sup> Value Balancing Alliance (2021a), p. 18-26.

<sup>6</sup> Value Balancing Alliance (2021b), p. 6-13.

<sup>7</sup> Caldecott (2018).

<sup>8</sup> Barby et al. (2021).

<sup>9</sup> European Commission, COM/2021/189.

<sup>10</sup> European Commission, COM/2021/188, p. 1.



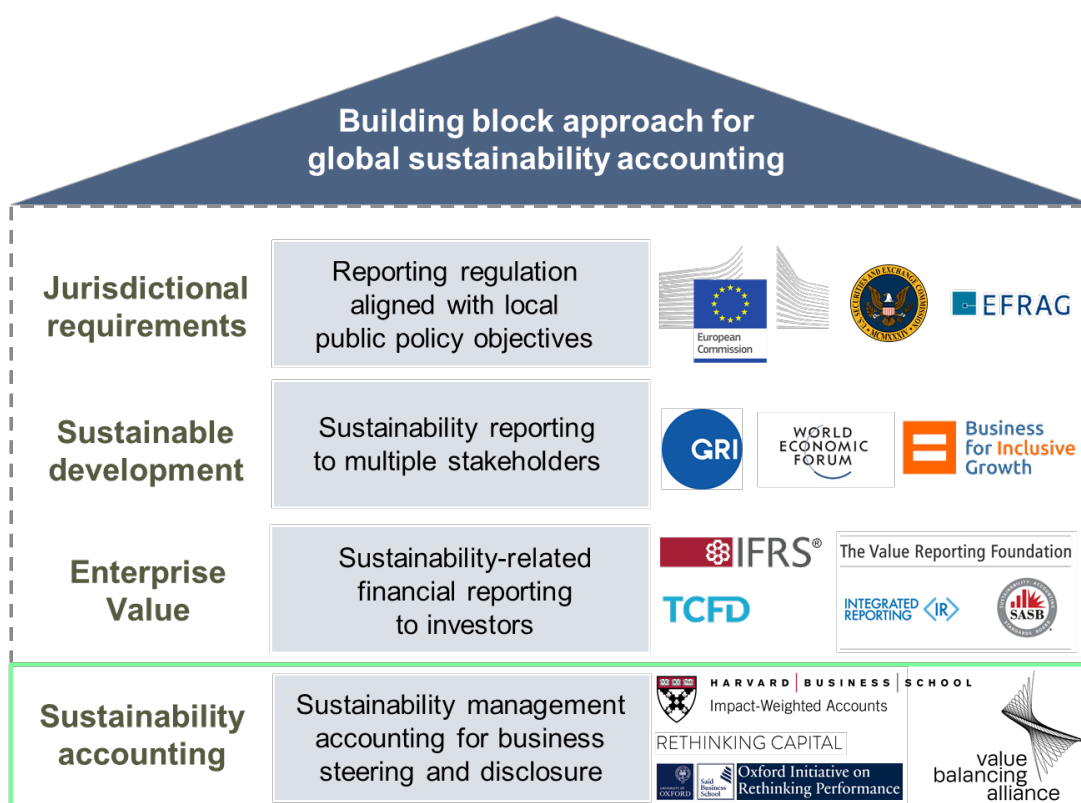
goals on climate change. Registrants face challenges when targets are not clear, or employees' activities are not directly related to climate change issues. It would, therefore, be appropriate to provide some basic principles for disclosing internal governance and oversight.

## 2.4. Question 9

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

**2.4.1 Creating a level-playing field:** the advantage of a single minimum set of global standards applicable to companies worldwide would create a level playing field. Comparability of climate change disclosure is important for financial market players to compare the strengths and weaknesses of investee companies and to help them to draw meaningful conclusions and facilitate better decisions.

Figure 4: The 'Building block approach' for global sustainability accounting



**2.4.2** With a single standard in place, it is possible to consistently measure the performance of various activities and at multiple levels (e.g., company level, project level, product level) can be possible. This set of global standards can, in turn, reduce transaction costs for registrants. In the absence of a single standard, registrants are confused about what to report to meet uncoordinated needs from stakeholders.

**2.4.3** The VBA recommends establishing a technical dialogue with the IFRS ISSB and strive for convergence in one global standard-setter for climate-related corporate reporting. Key ESG initiatives should into a set of compatible frameworks (e.g., SASB and IIRC merged into the Value Reporting Foundation): <sup>11</sup>

In the near term, it may be unlikely that there is a single standard-setter because many players are currently contributing to the new ecosystem of ESG disclosure. Information preparers should adopt multiple standards. However, it is desirable and achievable to coordinate the activities of global regulatory players (e.g., FSB-TCFD, IOSCO, IFC), standard-setting organizations (e.g., IFRS, SASB, IIRC, CDSB, GRI), and national or supranational agencies (e.g., US SEC and EU Commission). An effort to harmonize these already existing disclosure initiatives is urgently needed. To ensure comparability and reliability among these different standards, impact valuation is a fundamental tool to fill the gap.

**2.4.4** Climate change disclosures and, more broadly, social-environmental reporting standards should be led by the IFRS ISSB and expert organizations such as the Value Reporting Foundation. The Value Balancing Alliance can complement these efforts through a standardized methodology for impact measurement and valuation.

## 2.5. Question 15

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

**2.5.1 Climate change is a key part of broader social-environmental reporting:** Companies should disclose all positive and negative impacts, including natural and human capital.<sup>12</sup> Investors require a comprehensive set of ESG information to better understand the investee companies, combining a more diverse lens on financial performance. The core metrics should include economic (Gross Value Added), social (occupational health and safety, training), and environmental (air emissions, water consumption, water pollution, land use, and waste) dimensions (Figure 5). The topic areas should be aligned with the WEF IBC's Statement on Common Metrics.<sup>13</sup>

<sup>11</sup> Value Balancing Alliance (2020).

<sup>12</sup> SEC, Revisions to Item 101(c)(2)(ii) of the requirements of the S-K Regulation.

<sup>13</sup> World Economic Forum (2020).



### 2.5.2 Standard-setting based on SEC reference criteria for third-party standards:

We believe that any standard-setting should meet the SEC's criteria for reference<sup>14</sup> to third-party standards and should be aligned with international approaches to enhance market transparency. We believe those third-party standards should be informed by the work of the following organizations and initiatives:

- International Sustainability Standards Board of the IFRS Foundation<sup>15</sup>
- Value Reporting Foundation (SASB and IIRC)<sup>16</sup>
- Harvard Business School's Impact-Weighted Accounts Initiative<sup>17</sup>
- Value Balancing Alliance's Impact Statement and Integrated Accounts

**2.5.3 Standardizing impact measurement and valuation:** An effective way to relate climate-related disclosure to the broader spectrum of ESG disclosure would be monetizing positive and negative impacts: The formats of each element of ESG information are different and hard to compare. Monetization converts these impact metrics into the financial values, translating them into the language of financial markets. This approach enables companies to integrate ESG into business strategy and decision-making.

**2.5.4 The VBA's contribution to a global solution:** The VBA aims to develop a standardized methodology on impact valuation by 2023.<sup>18</sup> As far as possible, the positive and negative impact of corporate activity should be measured analogously to and presented as an integral part of the financial report and regulatory filings. The VBA is also involved in the Project Transparent with the Capitals Coalition and the World Business Council for Sustainable Development to develop standards for natural capital accounting as part of the Corporate Sustainability Reporting Directive (CSRD) proposed by the European Commission. We encourage the SEC and European Commission to establish a regulator dialogue on climate change disclosures and broader social-environmental reporting.

**Figure 5: ESG Dimensions of the VBA Methodology version 0.1 piloted in 2020**

<b>Economic</b>	Gross Value Added (GDP contribution): taxes, wages, profits etc.
<b>Human and social</b>	Occupational health and safety
	Training
<b>Environmental</b>	GHG/climate change
	Air emissions
	Water consumption
	Water pollution
	Land use (biodiversity)
	Waste

<sup>14</sup> SEC Rule 33-8238, section, II. B 3a; Accounting Release No. 150.

<sup>15</sup> IFRS Foundation (2020).

<sup>16</sup> Value Reporting Foundation (2021).

<sup>17</sup> Serafeim G., Zochowski R., Downing, J. (2020).

<sup>18</sup> Including socio-economic topics (Value Balancing Alliance, 2021c).

### 3. References

Barby, C., Barker, R., Cohen, R., Eccles, R. G., Heller, C., Mayer, C.,... & Zochowski, T. (2021). Measuring Purpose: An Integrated Framework, available at: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3771892](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3771892).

European Commission, COM/2021/188: COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS EU Taxonomy, Corporate Sustainability Reporting, Sustainability Preferences and Fiduciary Duties: Directing finance towards the European Green Deal.

European Commission, COM/2021/189: Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting.

Heller, C., Engels M., Lee J.-S., West, D. (2021). Connecting narrative and numbers, in: Global Solutions Journal, Vol 7, pp. 104-112.

IFRS Foundation (2020). Consultation Paper on Sustainability Reporting, available at: <https://www.ifrs.org/content/dam/ifrs/project/sustainability-reporting/consultation-paper-on-sustainability-reporting.pdf>.

Securities and Exchange Commission (1973), Accounting Series Release No. 150, 5 Fed. Sec. L. Rep. (CCH) 172,172 (Dec. 20, 1973).

Securities and Exchange Commission (2003), Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports, 17 CFR PARTS 210, 228, 229, 240, 249, 270 and 274 [Aug 14, 2003], Release No. 33-8238; File No. S7-40-02; S7-06-03

Securities and Exchange Commission (2010), Guidance Regarding Disclosure Related to Climate Change, Release No. 33-9106 (Feb. 2, 2010) [75 FR 6290 (Feb 8, 2010)] (2010 Climate Change Guidance)

Securities and Exchange Commission (2020), Modernization of Regulation S-K Items 101, 103, and 105, 17 CFR 229, 239, and 240 [Nov 9, 2020], Release Nos. 33-10825; 34-89670; File No. S7-11-19.

Serafeim G., Zochowski R., Downing, J. (2020). Impact-Weighted Financial Accounts: The Missing Piece for an Impact, Harvard Business School, available at: [https://www.hbs.edu/impact-weighted-accounts/Documents/Impact-Weighted-Accounts-Report-2019\\_preview.pdf](https://www.hbs.edu/impact-weighted-accounts/Documents/Impact-Weighted-Accounts-Report-2019_preview.pdf)

Caldecott, B. (Ed.). (2018). Stranded assets and the environment: Risk, resilience and opportunity. Routledge.

Value Balancing Alliance (2020), Response to the Cogito Paper: "Interconnected standard setting for corporate reporting", available at: <https://www.accountancyeurope.eu/wp-content/uploads/200430-VBA-comment-letter.pdf>.

Value Balancing Alliance (2021a), Methodology, Impact Statement, General Paper (Version 0.1), February 2021, available at: <https://www.value-balancing.com/en/downloads.html>.

Value Balancing Alliance (2021b), Methodology, Impact Statement, Focus: Environment, (Version 0.1), February 2021, available at: <https://www.value-balancing.com/en/downloads.html>.

Value Balancing Alliance (2021c), Methodology, Impact Statement, Focus: Socio-Economic, (Version 0.1), February 2021, available at: <https://www.value-balancing.com/en/downloads.html>.

Value Balancing Alliance (2021d), Position Paper on the Standardization of Disclosure Requirements, April 2021, available at: <https://www.value-balancing.com/en/downloads.html>.

Value Balancing Alliance (2021e), VBA First Pilot Study, available at: <https://www.value-balancing.com/en/downloads.html>.

Value Reporting Foundation (2021). Press Release of June 9<sup>th</sup> 2021, available at: <https://www.valuereportingfoundation.org/news/iirc-and-sasb-form-the-value-reportingfoundation-providing-comprehensive-suite-of-tools-to-assess-manage-and-communicate-value/>.

World Economic Forum (2020). Toward Common Metrics and Consistent Reporting of Sustainable Value Creation, WEF International Business Council prepared in collaboration with Deloitte, EY, KPMG and PwC, available at: [http://www3.weforum.org/docs/WEF\\_IBC\\_ESG\\_Metrics\\_Discussion\\_Paper.pdf](http://www3.weforum.org/docs/WEF_IBC_ESG_Metrics_Discussion_Paper.pdf).