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11 June 2021

Securities and Exchange Commission
100 F St. N.E.
Washington, D.C. 20549-1090

Submitted via email: rule-comments@sec.gov

Ladies and Gentlemen:

Ethic Inc. ("Ethic") appreciates the opportunity to provide input in response to the Securities and Exchange Commission's request for public comment on climate-related disclosures.[1] Ethic is an SEC-registered investment adviser based in New York City. We have a tech-driven asset management platform that powers the construction of individualized investment portfolios. We enable advisors to personalize a given benchmark to correspond with a client's investment values, risk preferences and tax management objectives, while seeking to minimize tracking error to the underlying benchmark.

We believe that specific, standardized disclosure rules for issuers around climate-related information—and environmental, social and governance ("ESG") information more generally—would provide both investors and issuers with long-term benefits. Our comment outlines the current market demand for disclosure, as well as the types of disclosures that we believe would help foster well-functioning capital markets.

Investor Demand for ESG Information

Across the industry, there is growing demand for sustainable investments. Both individual and institutional investors are increasingly seeking to incorporate sustainability issues, including climate change risks, in their investment and risk management decisions. In a 2019 survey, Morgan Stanley found that 85% of individual investors were interested in sustainable investing, and the percentage was even higher

[1] "Public Input Welcome on Climate Change Disclosures," https://www.sec.gov/news/public-statement/lee-climate-change-disclosures

among millennials (95%).[2] According to Ernst & Young's 2020 Global Alternative Fund Survey 72% of investors stated that they usually conduct a structured and formal review of ESG disclosures, which is more than double the amount of investors that formally reviewed ESG disclosures in 2018.[3,4]

Since its creation in 1933, the SEC has revised and expanded disclosure requirements many times in order to respond to investor demand and the evolving needs of the marketplace. The requirements have grown from the brief appendix attached to the original Securities Act of 1933 to Regulations S-K, S-X, industry guides and other measures today. We believe this moment is another inflection point where disclosure requirements need to be revised to incorporate broader and more detailed standards pertaining to sustainability.

As stated by SEC Chair Gensler during an interview by the Wall Street Journal, "...[Investors] are asking for more disclosure for their investment decisions around climate risk, both the physical risk [and] the transitional risk...and the SEC, since the 1930s, has had a real role to help bringing that consistency and comparability, and reliability for investors."[5]

While there is ample evidence of market demand for climate-related disclosures, we recognize that the term "ESG" has many definitions and investors have different views as to what types of ESG disclosures are most relevant. We do not think this is an obstacle to the creation of disclosure rules that address sustainability generally, and would welcome the opportunity to comment on additional ESG-related disclosures in the future.

SEC Requirements Should Emphasize Disclosure of Information, Not Ratings

The primary point we wish to make in our letter is that the SEC should require issuer reporting of information pertaining to climate-related impacts and other ESG issues, rather than score-based ratings or conclusory judgments devised by third party vendors. For example, this might include requiring issuer reporting of individual data points such as carbon emissions scope 1 and 2.[6]

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[2] https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/wealth-and-asset-management/ey-in-times-of-change-does-accelerated-adaptation-present-obstacles-or-opportunities-v2.pdf?download
[3] https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/assurance/assurance-pdfs/ey-global-institutional-investor-survey-2020.pdf
[4] https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/wealth-and-asset-management/ey-in-times-of-change-does-accelerated-adaptation-present-obstacles-or-opportunities-v2.pdf?download
[5] https://www.wsj.com/video/watch-sec-chairman-gary-gensler-at-the-wsj-cfo-network-summit/A4ECE821-5505-47E4-A53C-2FDC4F5EC190.html
[6] https://ghgprotocol.org/corporate-standard

Historically, investors seeking to construct portfolios incorporating ESG considerations have been limited to simple binary criteria (e.g., excluding all companies with any revenue from thermal coal production) or opaque proprietary scores (e.g., assessing companies based on a vendor-defined grading scale for “environmental risk”). Today, advances in data science and analytics have improved investors’ ability to construct portfolios on the basis of a much broader range of ESG information, including estimates of facilities’ physical risk related to particular environmental phenomena (e.g., floods, droughts, wildfires, etc.) and the volume of potential emissions associated with issuers’ fossil fuel holdings.

While this has led some ESG data vendors to create more complex scores by aggregating multiple more specific data points, such scores are nevertheless proprietary to each data vendor. These different methodologies mean that, although several data vendors may offer an “environment score” to inform ESG-driven portfolio construction, each one may yield a dramatically different assessment of companies.[7] Moreover, there is often only general information disclosed as to how a particular score is arrived at, rendering such ratings somewhat opaque to the investor.

We believe that reporting of specific information, rather than scores, is valuable for personalized investor decision-making. As Commissioner Peirce recently stated, “One person’s ecofriendly windmill is another person’s bird killer…Better to let an asset manager describe its approach to funding green energy so that likeminded investors can select that asset manager and differently minded investors can go elsewhere…”[8]

A Data-Focused Approach Will Serve the Diverse Needs of Our Capital Markets

Enhanced issuer disclosures should encourage individual analysis and decision-making, not replace it with conclusory judgments. Commissioner Peirce’s example illustrates the benefits of such an approach: instead of a broad “ecofriendliness score” that only supports certain investors’ interpretations of the ESG issue in question, simple reported measurements of revenues and investments related to wind power (for example) would allow different investors to interpret the same data through their own individual lenses. Investor opinions on materiality and ESG can and will differ, and views will change over time. Standardized reporting of granular data, as opposed to opaque scores, will benefit all investors, as this information can be leveraged in different ways based on individual interpretations of materiality.

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[7] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3438533
[8] https://www.sec.gov/news/speech/peirce-lucys-human-091720

Disclosure requirements that lead to the dissemination of information that investors and analysts can use to form their own analyses will foster the diverse types of analysis that enhance the efficient allocation of capital. Our capital markets are characterized by robust sectors of professional analysts and investment advisors who can make use of such information to provide investors with useful insights and guidance. The SEC's goal should therefore be to facilitate diversity of analysis and transparency for investors, rather than incorporate particular ratings into disclosure regulations.

In our business, we use a more granular, data-focused approach that relies on underlying data points wherever possible to evaluate issuers. We believe such an approach is more reliable and transparent, and well suited to the diverse views of investors. Providing investors with insights into the measured volume of an issuer's direct carbon dioxide emissions, water usage, or hazardous waste effluents, for example, is more meaningful than providing an assessment that that issuer scored a 4.2 out of 10 on its "environment score" according to a proprietary rubric. Many of these more granular data points are already produced by companies for voluntary environmental reporting or in response to ESG data provider questionnaires.

The Importance of Comparability and Consistency

We recognize the value of comparability, consistency, and methodological rigor in issuer-reported information, so ESG reporting requirements should provide enough guidance and specificity to achieve standardization. Commissioner Lee warned in a recent speech that investors "aren't getting the benefits of comparability that would come with standardization. And there are real questions about reliability and level of assurance for the disclosures that do exist."[9]

It may be appropriate, then, to mandate issuer disclosure according to certain measurement standards, including, for example, greenhouse gas emissions data according to the Greenhouse Gas Protocol Corporate Standard's scopes 1 and 2; deforestation data according to the Carbon Disclosure Project; or revenues and R&D expenses associated with renewable energy and related technologies.[10]

The Importance of General Standards and Reasonable Requirements for Issuers

[9] https://www.sec.gov/news/speech/lee-climate-change
[10] https://guidance.cdp.net/en/guidance?cid=19&ctype=theme&idtype=ThemeID&incchild=1&microsite=0&otype=Questionnaire&tags=TAG-646%2CTAG-609%2CTAG-599.

At the same time, we recognize that sustainability disclosure standards cannot be composed entirely of a list of specific data points or standardized measures. The notion of “sustainability” is far too complex and subject to variation for such an approach to be sufficient. One method to address this is to combine some specific metrics and standardized disclosures with broader rules and guidance that address sustainability risks more generally. For example, SEC requirements could incorporate broader standards like those produced by the Sustainability Accounting Standards Board (“SASB”), which identifies the ESG issues most material to 77 different industries, or the Task Force on Climate-Related Financial Disclosures (“TCFD”), which provides recommendations in thematic areas including risk management, strategy and governance. We believe this could be a useful approach, provided that there is sufficient guidance as to what types of disclosure would meet the standards so as to facilitate comparability and consistency. While we understand the benefit of leaving the exact format of climate risk disclosures up to issuers, for example, certain information would benefit particularly from standardization requirements (e.g., requirements that commitments to reduce carbon emissions are supported with science-based targets).[11]

SEC requirements should also be crafted in a way that is beneficial to both issuers and investors in the long term. Over the long term, issuers will benefit from taking into account sustainability information, such as the risk to facilities exposed to climate-related droughts, flooding, and hurricanes. Disclosure standards that combine specific, standardized measures with broad thematic areas will reduce the burden on issuers who today are faced with whether or not to respond voluntarily to multiple ratings systems on issues pertaining to sustainability. As Commissioner Lee noted, “issuers are assailed from all sides by competing and potentially conflicting demands for information. That’s why we have begun to take critical steps toward a comprehensive ESG disclosure framework aimed at producing the consistent, comparable, and reliable data that investors need.”[12]

We appreciate the opportunity to comment on this important topic. We would be happy to provide supplemental comment regarding specific climate-related disclosures or other ESG-related disclosures if it would be helpful to the Commission. Please contact us with any questions.

Sincerely,

Doug Scott, CEO

[11] https://sciencebasedtargets.org/resources/legacy/2017/04/SBTi-manual.pdf
[12] https://www.sec.gov/news/speech/lee-climate-change