Dear Ms. Countryman,

FILE NO. S7-10-22: THE ENHANCEMENT AND STANDARDIZATION OF CLIMATE-RELATED DISCLOSURES FOR INVESTORS

INTRODUCTION
Generation Investment Management LLP is an independent, private, owner-managed partnership dedicated to long-term investing, integrated sustainability research, and client alignment, headquartered in London. It is the parent company to San Francisco based Generation Investment Management US LLP. Collectively both entities are referred to as Generation Investment Management ("Generation"). Founded in 2004, we seek to prove the business case for sustainable capitalism by consistently taking a long-term view and fully integrating sustainability research within a rigorous framework of traditional financial analysis. We invest in both listed and private equity and as at 31 March 2022 Generation was responsible for $37 billion assets under management. While we invest globally, the US is our most significant investment market.

We were very pleased to see the publication of File No. S7-10-22: The Enhancement and Standardization of Climate-Related Disclosures for Investors. We strongly support the SEC proposal.

BACKGROUND
By way of background, Generation operates an investment process that fully integrates sustainability analysis into our decision-making and is focused on companies’ long-term performance. We think about the dynamics that drive and influence the performance of companies and construct portfolios of sustainable companies based on deep research and analysis.

We believe that a sustainable company is one:

i. whose current earnings do not borrow from its future earnings
ii. whose sustainability practices drive performance and competitive positioning
iii. that provides goods and services consistent with a net zero, prosperous, equitable, healthy and safe society and
iv. that focuses its external communication on long-term issues.

We believe a company’s long-term sustainability is further enhanced if its business thrives by directly meeting some of the world’s challenges. We aim to invest in high-quality, sustainable businesses run by management teams that are long-term orientated.

In the 18 years since our inception, Generation has consistently sought to encourage better and more consistent sustainability reporting by companies. We have supported the growth of CDP, the Sustainability Accounting Standards Board (SASB) and the Taskforce on Climate-related Financial Disclosures (TCFD) and have encouraged companies to report in line with the standards that these initiatives have set. Generation’s investment process is best served by the public availability of credible and consistent sustainability reporting.

We have worked to encourage climate-related disclosures by issuers because they are financially material for investors. Climate-related risks and opportunities represent economic risks and opportunities for companies. Importantly, they also create economic impacts on the market as a whole from which investors cannot protect themselves by diversification.

Current voluntary climate-related disclosures materially fail to meet our information needs as investors.

The urgency of improving climate disclosures by companies publicly listed in the US cannot be over-estimated. While we see many companies publicly listed in the US, large and small, taking leadership on climate disclosure and strategy, progress as a whole has not kept pace with investor need and demand.

As a result, procuring the information we need to assess US companies’ management of climate-related risks and opportunities is highly cumbersome and inefficient. We have to search through company disclosures (from web pages to press releases to sustainability reports), CDP disclosures (if the company responds to CDP’s annual questionnaire) and the Science Based Targets initiative website (if the company has a science-based emissions reduction target submitted to SBTi for validation).

Where (in the great majority of cases) there are gaps in disclosure, then the need can arise to engage on a company-by-company basis for those gaps to be closed. This is a time-consuming process, and cost burden, even for an investment manager like Generation that follows a limited number of listed companies (less than 150 in our largest, global equity, strategy). It requires attention, time and sustained effort from our portfolio managers, investment analysts and engagement director.

In order to fill information gaps resulting from lack of disclosure, we also have to contract with ESG research providers who provide estimated Scope 1, 2 and 3 emissions data for companies who do not disclose this data, disclose it partially or may be disclosing it inaccurately. In many instances we therefore have to rely on estimated data to understand the extent to which US registrants’ climate strategy is aligned with the goals of the Paris Agreement, even though the US is a leading party to it.

These processes are being repeated across multiple asset owners and investment managers to overcome market information gaps and inefficiencies for US registrants. 73 asset owners representing $10.6 trillion of AUM¹ have joined the UN-convened Net Zero Asset Owner Alliance. 55 asset owners with $3.3 trillion of AUM have committed to achieve net zero alignment by 2050 or sooner via the Paris Aligned Investment Initiative (PAII). The Net Zero Asset Managers initiative (NZAM), only established in December 2020, has 273 signatories with $61.3 trillion of AUM. Many of our investors are signatories to these initiatives.

We believe that it is the mandate of the SEC to assess and remedy the significant market inefficiencies and costs that the status quo imposes on investors. We are fully satisfied that the Commission has the appropriate authority to require disclosures via a new rule.

¹ All membership and assets under management numbers are as at the time of writing and are taken from the initiatives’ websites.
DETAILED COMMENTS

We very much welcome the fact that the SEC proposal builds effectively on emerging private sector and international standards, in particular the TCFD, the Greenhouse Gas Protocol (GHG Protocol) and the International Sustainability Standards Board (ISSB, which incorporates SASB). That the SEC has approached disclosure requirements in this way is beneficial to investors and registrants alike: global investors and multi-national registrants need consistent global reporting requirements. We already use these international standards to guide the expectations on corporate climate-related disclosure that we communicate to companies. The approach of sector-specific reporting — pioneered by SASB and adopted by ISSB — is very much in line with the informational and organisational structure by which capital markets operate.

We strongly support the integration of specified climate-related information in financial statements as this promotes consistency in information across a company’s reporting.

We also strongly support the SEC’s inclusion of a GHG emissions reporting requirement in the proposal. The proposal correctly identifies Scope 1 and 2 emissions as readily reportable and financially material, primarily as a proxy for transition risk. We support the view that Scope 1 and 2 emissions disclosures are high quality, concrete and auditable reporting requirements and welcome the provisions for requiring assurance of them. Assurance is needed to ensure that investors receive carbon accounting that is accurate and consistent, and that they can trust, and the same requirements should also be phased in for registrants other than accelerated filers and large accelerated filers (Questions 135 and 138).

With respect to broader climate disclosure requirements in line with those of the TFCD, we attach particular importance to disclosure of the following information (for all registrants, with safe harbour provisions, and without, at this stage, undue prescription of detail):

a) at least basic climate-related scenario analysis against a reputable 1.5C warming scenario consistent with the Paris Agreement (Questions 30-31);

b) the registrant’s emissions targets, and any other climate-related targets (Questions 168-174);

c) the registrant’s transition plan setting out how it plans to realise its targets and goals and/or adapt to relevant intergovernmental agreements and public policy on climate change (Questions 46-51).

Making these disclosures requirements for all registrants would avoid the risk inherent in the current proposal that registrants at the leading edge of responding to climate change would be required to make disclosures that registrants behind the curve would not. The SEC’s current proposed approach risks creating incentives for registrants not to advance their approach to the management of climate-related risk and opportunity because of the extra disclosure requirements it would bring (as acknowledged in Question 46).

At the same time, we see scope for some of the current proposals to be simplified. In contrast with Scope 1 and 2 emissions, where the prescription of disclosure needs to be tight, the substance of narrative disclosure can be subjective and largely entity-specific, making too much prescription sometimes unhelpful and unrealistic, and inviting boilerplate disclosure. Similarly, for quantitative disclosures, if well-defined metrics do not exist, there aren’t the foundations for concrete, comparable reporting.

An example on over-prescription is the requirement for “disclosure of material impacts” by registrants (Questions 19-21), where the proposal specifies reporting on material climate-related impacts on: “business operations, including the types and locations of its operations; products or services; suppliers and other parties in its value chain; activities to mitigate or adapt to climate-related risks, including adoption of new technologies or processes; expenditure for research and development; any other significant changes or impacts”. The proposal goes on further to prescribe that “A registrant would also be required to disclose the time horizon for each described impact (i.e., as manifested in the short, medium, or long term, as defined by the registrant when determining its material climate-related risks)”. Our concern is that prescribing specific and detailed requirements in this way will not be appropriate for all registrants, will go beyond investors’ typical needs and will likely lead to formulaic reporting that is not additive to investors.
We wish to emphasise that there is one key respect in which we consider the proposal does not go far enough at present: Scope 3 emissions. The requirement to disclose Scope 3 emissions where they are material is open to too much interpretation. Scope 3 emissions typically represent the largest proportion of the overall emissions of the companies in which we invest and are absolutely material to our investment and stewardship decisions.

Our experience is that companies who have analysed their Scope 3 emissions for public disclosure, following our investor engagement, have found that it delivers useful insight into where the most significant emissions are in their value chain and into potential measures that they should incorporate into their climate strategy. We do not find that companies experience Scope 3 disclosure as unduly onerous. We typically see companies engage some consultancy support for the process and there are now useful software tools available for smaller companies. We therefore think it would be cleaner, and clearer, to phase in requirements for Scope 3 disclosure by all registrants, with as much of a safe harbour as possible (Questions 98 and 100).

The current framing of the proposal’s Scope 3 requirements could have serious unintended consequences – if the requirement to disclose Scope 3 emissions depends in part on whether a company has targets to reduce Scope 3 emissions, the Commission’s proposal could inadvertently disincentivise companies from setting targets that include Scope 3 emissions. This would be highly undesirable and could impede companies from reducing climate risk and taking advantage of climate-related opportunities (Question 99).

Finally, it is worth noting that emissions associated with land use change and deforestation fall within Scope 3 and this disclosure is vital to us. Alongside other financial institutions, collectively with over $8.7 trillion in AUM, Generation committed at COP26 in November 2021 to seek to eliminate agricultural commodity-driven deforestation from our portfolios by 2025.

CONCLUSION

In sum, we believe that, overall, the SEC’s proposed rule would result in the disclosure by registrants of decision-useful, comparable climate risk information to investors and represent a vast improvement on the patchwork of voluntary initiatives and disclosures that companies and investors currently face. Clear requirements mandated by the SEC will lead to reporting that is reliable, comparable and available in an efficient way.

Subject to our comments above, the proposed requirements are aligned with our expectations, and our experience is that companies are well down the road to meeting them. We are keen to see the rule come into place and to see the final rule sustain the full breadth of disclosure in the draft. The rule will be a significant contribution to the efficiency of capital markets and practice of investment in the US.

On foreign issuers, we strongly encourage coverage of foreign issuers whose climate impact is large if this requirement is not covered by their foreign regulator. This will promote comparability of disclosure.

We believe that best practice in reporting in line with the proposed rule should be allowed to evolve and it should be encouraged to do so quickly. In general, it would be sensible for the SEC to focus on education rather than enforcement initially.

We very much appreciate the SEC’s ongoing work on this critical issue and continued consideration of our comments, which we hope are helpful. We would be glad to discuss any of the feedback we have given above.

Yours sincerely,

David Blood
Senior Partner, Generation Investment Management LLP