Carbon Emission Disclosures Make Little Sense in Financial Statements

I am writing to express my concerns about a new rule being considered by the Securities and Exchange Commission (SEC): The Enhancement and Standardization of Climate-Related Disclosures for Investors (Rule number: S7-10-22; Release Nos. 33-11042, 34-94478). In my opinion, this proposed rule exceeds the SEC’s mandate, risks burdening businesses with new and unnecessary costs, and would hurt individual investors by further complicating investment decisions.

As argued by others in comments submitted to the SEC, the focus of the SEC was intended to be the protection of investors following the Wall Street Crash of 1929. Congress never intended the SEC to venture into broad public policy areas such as climate change or to act as a de facto climate regulator by requiring disclosures of public companies unrelated to basic issues of finance. This is what has compelled twenty-three law professors to comment in substantive detail how the proposal “exceeds the SEC’s authority” and what led sixteen governors to write that the “unprecedented level of federal overreach makes your proposed rule an especially dangerous step.”

As a number of Republican senators expressed in their own comment letter, “The SEC is not tasked with environmental regulation, nor has Congress amended the SEC’s regulatory authority to pursue the proposed climate disclosures. Further, there are serious questions about whether the SEC has the technical expertise to assess climate models and underlying assumptions used in companies’ metrics and disclosures.”

The proposed rule’s problems are manifold. First, if implemented, the SEC’s new rule would require a number of new disclosures from public companies both large and small. These companies would be forced to not only report the greenhouse gas emissions resulting from their own direct operations--as well as the emissions resulting from their use of electricity, steam, heat or cooling--but also to evaluate and disclose indirect greenhouse gas emissions from any companies that supply them or transport their goods.

Many have identified multiple flaws in these requirements, including the most basic points that the SEC is not well equipped with the requisite technical expertise to handle the type of data and modeling upon which disclosures would be based. Furthermore, Dr. Wayne Winegarden of the Pacific Research Institute has pointed to the well documented difficulties in carbon accounting. For example, it is extremely difficult for companies to estimate and report greenhouse-gas output of both their supply chains and consumers (Scope 3 emissions). The inaccuracies likely to be contained in any disclosure of greenhouse gas emissions significantly degrades any value the SEC might hope to pass along to investors.
Second, the proposal imposes tremendous costs on public companies at a time when investors have already lost more than $5 trillion in stock value. The SEC itself estimates that the new proposal could cost businesses between $3.9 billion and $10.2 billion, with costs to individual businesses ranging from $420,000 annually for smaller public companies to $530,000 annually for larger companies. Companies that have never evaluated or reported climate data will face even higher costs, since such reporting would likely require new systems, personnel, and independent audits. As David Lynn, a partner at law firm Morrison & Foerster and a former senior SEC official, has explained, the SEC is “standing up a whole new disclosure regime.” 92% of Fortune 500 companies are already reporting emissions. Given this level of voluntary disclosure from firms, the need for mandatory rules is even less.

Third, the actual value to investors of the proposal remains unclear. In fact, the proposal could even hurt them. As my own research that builds upon a body of literature shows, complex disclosures impose costs on firms as well as investors. The SEC has seemed relatively unconcerned about individual investors throughout this process, a point made previously by the group of twenty-three law professors commenting on the proposal. They point out that the SEC’s proposal, in 508 pages, mentions individual investors only once. The SEC’s proposal fails to identify the specific benefits of the proposal for individual investors or quantify whether the benefits the SEC expects will outweigh the tremendous costs being imposed on public companies.

Rather than helping individual investors, it seems more likely that the SEC’s proposal would hurt them. That’s because the proposed rule could make it more difficult to evaluate a company’s business and profits, adding a new layer of climate-related information that has little to do with a company’s financial outlook. Winegarden explains in his comments that “Reports that provide questionable value but certain costs are more likely to harm investors’ interest, not promote them.”

It seems obvious that creating a new regulatory regime for greenhouse gas emissions will impact the American economy in ways both expected and unexpected. This includes real impacts on our domestic energy, labor, transportation and housing markets, creating some new jobs and destroying others in ways that no one can fully anticipate. The impact could be particularly harsh on America’s energy sector at a time when consumers already face high and rising gas prices and when energy investors are already uncertain about the future, creating reluctance to invest in the kind of new energy production the U.S. desperately needs.

The SEC lacks the authority and mandate to act as a climate regulator, has been notably vague about the benefits to investors or even the Commission’s ability to manage or normalize emissions disclosures, and has itself admitted the high costs imposed by its proposal. Those points combine to make the proposed rule a bad bargain for the American economy and an unsound path for public policy. I join with others in encouraging the SEC to withdraw this rule and focus on other, more fruitful areas of regulation.