Financial Services Management

Climate-Change Investor Disclosures

Cite

SEC, Public Statement by Acting Chair Allison Herren Lee

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Website

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Impact Assessment

- The SEC has embarked on a new policy that combines social and market value in regulatory, disclosure, and enforcement policy, starting with climate change and moving on to much more.
- A new disclosure regime for climate risk is now officially in the SEC's works, with formal action sure to follow swiftly.
- Sector-specific – e.g., financial services – disclosures are possible, as are those tailored by registrant size and/or other criteria.
- Broader ESG disclosures and, in some cases, rules will proceed in tandem with these climate-change disclosure standards.

Overview

Reflecting views of the Biden Administration and those of its nominee to chair the SEC,[1] Acting Chair Allison Herren Lee is requesting public views ahead of more formal proposals revising the climate-risk disclosures to be required of publicly registered companies. The SEC now has only posed a series of questions, but the questions and an accompanying speech make it clear that the Commission is moving as quickly as possible to craft a climate-risk disclosure regime that relies to the greatest extent possible on comparable, quantifiable data that may vary by industry sector, registrant size, and other factors. A voluntary regime is possible, but questions about attestation requirements to ensure stringency suggest that the SEC would also allow voluntary disclosures only with safeguards. The agency also seeks views on how to transition to new disclosures, perhaps allowing qualitative disclosures along lines now permitted for financial data at least as an interim step. For the

[1] See *Client Report* **INVESTOR14**, January 21, 2021.

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SEC now, climate change is an initial foray into U.S. market rules addressing a broad range of social-welfare issues in cases where the Commission believes investor rights may be adversely affected.

Impact

The Commission last formally addressed climate-risk disclosures in 2010, well before much of the concern about climate risk and its magnitude was widely shared. That statement thus provided only guidance about when climate-risk disclosures might be appropriate, not requiring that they be issued or standardizing the format for doing so. In 2020, an SEC advisory committee recommended additional steps to more mandatory and consistent disclosures, with a CFTC advisory committee subsequently issuing extensive recommendations on how best to do so.[2] Global regulators are also intensely focused on climate-risk disclosures, advancing both cross-border and domestic standards and regulatory initiatives to mandate them along with additional risk safeguards.

As noted, the SEC's action so far is preliminary, doubtless asking now for public engagement to make it easier for a confirmed chair to take binding action as quickly as possible. As is often the case with these open-ended requests for input, the SEC asks only a series of questions that are, when closely examined, still very informative about the possible direction current Commission members and staff think advisable. As detailed below, the Commission seems inclined to move quickly to a final rule that would eventually lead to comparable, quantified disclosures that could vary considerably by registrant but that would hold boards and management accountable.

How this is done and the extent to which SEC standards overlap with those sure to advance at federal banking agencies will affect not only the burden associated with these disclosures, but also the types of information released that could lead to investor, activist, political, or regulatory concerns. As previously noted,[3] the FRB is reluctant at this time to mandate climate-risk stress testing, but it is considering disclosure requirements on at least an interim, qualitative basis to guide examiners and, should these disclosures be made public as seems likely, investors, advocates, and other regulators.

Although the bulk of the request focuses on climate risk, the Commission is also seeking views on how its actions related to the environment affect the broader class of ESG investing. This makes it even clearer that the SEC will move forward not only on climate-risk disclosures, but also on others designed to aid the growing number of investors considering ESG, diversity, political, and other social-welfare factors when making market decisions. As Acting Chair Lee notes in the speech accompanying release of this public statement, investors are increasingly aligning social and market values rather than viewing them as distinct objectives. The more disclosures across the social-welfare field, the greater the pressure on all registrants to address new factors on which there may be considerable uncertainty or even disagreement. The extent to which targeted firms such as fossil-fuel companies and large banks ensure that

[2] See *Client Report* **GREEN4**, September 9, 2020.

[3] FedFin Issue Brief: Going Green: The Future of U.S. Climate Risk Financial Policy, October 26, 2020.

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disclosures address their unique concerns will thus prove a significant market, legal, and reputational risk factor going forward For example, Republicans are strongly opposed to bank decisions to deny services to certain types of entities (e.g., firearms or fossil-fuel companies), reintroducing legislation advanced in the last Congress to impose severe sanctions on large banks that are deemed to do so.[4]

What's Next

The request was issued on March 15; comments are due June 13. The Commission has also established a web portal through which answers to questions and views on matters in addition to those addressed below may be provided.

In her speech, Acting Chair Lee indicated that ESG disclosures will advance both in concert with those related to climate change and on their own. The Commission is particularly focused on disclosures related to workforce and board diversity, with rules also possible with regard to the board. Disclosures related to political spending will advance if Congress provides the authority to the Commission as other social-welfare proposals are released.

Analysis

As noted, comment on issues in addition to those directly addressed by the SEC is invited, with the chair expressly asking that comments be as empirically grounded as possible. Questions include:

- How best to regulate and ensure consistent, comparable climate-change disclosures of most use to investors and other market participants that most accurately reflect registrant risk? The Commission also asks in what form and on what timing these disclosures should be required.
- What climate risks can now be reliably quantified and which information is now being used in the market? Are there metrics that could be standardized and which are the most material to voting and investment decisions?
- Should disclosures be tailored by size of registrant or business activity?
- Should disclosures be phased in over time?
- How are markets evaluating and pricing climate-risk externalities? Does climate change affect the cost of capital?
- How are investors and registrants now evaluating climate change?
- How might robust carbon markets influence climate risk and related disclosures?
- What are the benefits of permitting voluntary standards and how might they work?
- How do existing standards, such as internationally-accepted ones, affect what the SEC should require? Are global standards possible?

[4] See **ESG**, *Financial Services Management*, February 20, 2020.

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- Is attestation to climate-change standards advisable or might annual management reports or other documents suffice? Acting Chair Lee's speech also suggests PCAOB scrutiny for climate change and/or broader ESG actions in a manner akin to accounting standards as one approach. Would a CEO or similar attestation then be of value?
- Is a "comply-or-explain" framework advisable? Would a sustainability analysis akin to current management disclosures be of value in addition to disclosures? How might climate-change standards best be updated – e.g., by the SEC, advisory groups, etc.?
- Are new SEC rules required? How best to disclose internal governance (e.g., re any compensation linked to climate risk)?
- What information is now available on private companies and how should the SEC best address these firms?
- Should climate change be one component of a broader ESG framework or stand on its own?

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