SEC Climate Disclosure Rule

The Securities and Exchange Commission (SEC) will soon finalize a rule that will require public companies to make annual disclosures about their climate-related financial risks and how these will affect companies' long-term resilience and profitability. Similar risk disclosure rules are being developed in markets around the world in recognition of the fact that climate change poses material financial risks to investors, industries, governments, and economies.

Climate risks can include companies' vulnerability to climate-related weather disasters, supply chain disruptions, as well as failures to capture financial benefits of emissions reductions (like those created by the Inflation Reduction Act). Climate risk disclosures will include critical details on how companies are managing these risks, including annual GHG emissions and how their transition strategies and actions align with their public statements and promises.

Investors large and small–including retirement savers like teachers, nurses, and firefighters with pensions, as well as those with individual retirement plans—have made it clear: they need more standardized, reliable info about how companies' handling of these risks could impact their savings. Unfortunately, the current practice of relying on companies' *voluntary* climate disclosures is inconsistent, inefficient, and costly. Investors spend significant time and money on shareholder initiatives to fill info gaps and to assess the reliability of claims of progress on climate change. Smaller investors especially lack access to decision-useful information that is free of greenwashing.

The SEC's proposal would provide much-needed transparency to investors and other market participants, a central feature of U.S. capital markets that has made them the most trusted in the world since disclosure requirements for public companies were first instituted in the 1930s. Strengthening disclosures about significant risks facing public companies is squarely in line with the SECs mission to protect investors and promote fair and efficient capital markets and capital formation.

Key Points

- **Climate risk is financial risk.**
    - This is a conclusion reached by banks, asset managers, insurers, investors, companies, and regulators around the world.
    - In 2021, a bipartisan report from the Treasury's Financial Stability Oversight Council identified climate change not only as a financial risk, but as an *"emerging threat to financial stability."*
    - The most recent report from the IPCC warns that physical risks from climate change already threaten banks' assets and operations, while transition risks are predicted to create losses exceeding $1 trillion. The SVB banking collapse highlights how hidden risks can emerge suddenly, fueling panic that quickly infects the entire sector and requires significant federal intervention.

- Real estate in the U.S. is estimated to be overvalued by $121-237 billion due to unpriced flood risk driven by climate change, with low-income households facing the greatest risk of losing home equity, as was the case in the housing crisis of 2007-08 that led to the financial crisis.
- Low-carbon investment strategies were associated with better investment returns 65 percent of the time in a set of over 1000 studies published from 2015 to 2020.[1] Even accounting for recent positive performance of oil and gas stocks driven by supply shocks due the war in Ukraine, the S&P500 energy index has a 10-year annualized return of 1.5% since 2013,[2] compared to 10.2% percent for the overall S&P500,[3] as of April 2023.

- **The SEC has clear authority to require these disclosures**.
  - The rule is clearly in line with frequently-exercised core agency disclosure authority and does not run afoul of the novel Major Questions Doctrine.
  - Securities law experts write: *"In short, the entire statutory structure of federal securities regulation is based on mandating the provision of standardized and comparable information about publicly traded companies to the capital markets, and the original securities laws explicitly establish the authority of the SEC to enact disclosure requirements to protect those markets and market participants.* ***Such policy determinations clearly involved "major questions," but those questions were asked and answered by Congress in the 1930s.*** *The SEC, in turn, has exercised its disclosure authority consistently—and without legislative override—in the nearly ninety years that followed. The SEC has now done so once more with the Proposal on climate-related disclosure."*

- **97% of investors that commented on the proposed rule–representing nearly $50 trillion in assets under management–support disclosure of greenhouse gas emissions (Scopes 1, 2, and 3).**[4]
  - 100% of investors that commented support qualitative disclosures in line with those of the Task Force on Climate-Related Financial Disclosures (TCFD).[5]

- **It's not just about risk, but also opportunity. Investors need info about companies' transition plans and readiness to capture climate opportunities.**

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[1] Whelan *et al.*, "ESG and Financial Performance: Uncovering the Relationship by Aggregating Evidence from 1,000 Plus Studies Published between 2015-2020," NYU Stern Center for Sustainable Business and Rockefeller Asset Management. 2021. https://www.stern.nyu.edu/sites/default/files/assets/documents/NYU-RAM_ESG-Paper_2021%20Rev_0.pdf

[2] S&P500 Energy. https://www.spglobal.com/spdji/en/indices/equity/sp-500-energy-sector/#overview

[3] S&P500. https://www.spglobal.com/spdji/en/indices/equity/sp-500/#overview

[4] Ceres, "Analysis Show that investors strongly support the SEC's proposed climate disclosure rule." 11 Oct. 2022. https://www.ceres.org/news-center/blog/analysis-shows-investors-strongly-support-secs-proposed-climate-disclosure-rule

[5] *Ibid*.

- The IRA created powerful financial incentives to lower emissions that are already factoring into forecasts and recommendations of financial analysts, investors, asset managers, credit rating agencies, and banks.

- **The International Sustainability Standards Board (ISSB) is developing a set of baseline climate disclosure standards that will be used by jurisdictions around the world, and it will include Scope 3 emissions when material.**
  - If the SEC finalizes a substantially weaker rule, the U.S. will cede a seat at the negotiating table and global investors may reallocate to markets with more rigorous, uniform disclosure.
  - ISSB made the decision to include Scope 3 emissions after consultation with many large investors, who told them that they *"cannot fully understand a company's transition risk without information about its absolute gross Scope 1, 2, and 3 emissions."*

- **Over 3,000 U.S. companies (about 70% of total public companies) raise money in the EU capital markets and they will need to disclose against the new Corporate Sustainability Reporting Directive (CSRD), which includes relevant Scope 3 emissions, with the first requirements coming in 2024.[6]**
  - The EU disclosure rule is significantly more stringent than the SEC's proposal. Nevertheless, 70% of all U.S. public companies will be subject to it.
  - Over 1,000 U.S. companies already voluntarily reported Scope 3 in 2021, and that number has surely grown for 2022.
  - Columbia Law School: Global Consensus is Emerging on Corporate Scope 3 Disclosures. Will the SEC Lead or Lag?

- **This rule will not burden small farmers or private businesses.[7]**
  - The rule only applies to public companies. It does not–and cannot–create any disclosure obligations for small private entities. Nevertheless, a concern that small farmers will be unduly burdened by Scope 3 requirements – passed on to them from downstream corporate clients seeking to meet their own disclosure obligations – has emerged as a hot button issue. The concern is unfounded.
  - The rule allows issuers substantial flexibility with respect to how they calculate Scope 3 emissions. If reported emissions data are not available for a particular node on an issuer's value chain, the issuer is free to use proxy data, including industry averages to make a reasonable estimate. The rule further provides a strong safe harbor against liability for unintentional errors, and a delayed timeline for Scope 3 emissions. Further, no issuer is required to disclose any Scope 3 emissions that it deems immaterial.

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[6] "At Least 10,000 Foreign Companies to Be Hit by EU Sustainability Rules," Wall Street Journal, 5 Apr. 2023. https://www.wsj.com/articles/at-least-10-000-foreign-companies-to-be-hit-by-eu-sustainability-rules-307a1406

[7] Alex Thornton, "The SEC's Proposed Scope 3 Emissions Disclosure Will Not Affect Farms and Ranches," Center for American Progress, 6 June 2022. https://www.americanprogress.org/article/the-secs-proposed-scope-3-emissions-disclosure-will-not-affect-farms-and-ranches/

- The Institute for Agriculture and Trade Policy puts it bluntly: ***"Agribusinesses are wrongly fighting the wrong battle by enlisting farmers and ranchers to falsely claim that the SEC climate disclosure rule applies to them."***[8]
- *Antonio Tovar of the National Family Farm Coalition said recently: "****Agribusiness corporations who are listed, argue falsely that they represent the interest of all farmers and claim to protect consumers as well. In reality, these corporations represent the greatest threat to farmers, not the provisions in question. Family farmers and ranchers have been decimated by consolidated agribusiness that receives the lion's share of agricultural revenues while leaving a much larger environmental footprint. Local and small producers are not affected by the proposed rule.***"[9]
- Organizations that represent the interests of small farmers wrote the SEC in March 2023 in support of finalizing the rule inclusive of Scope 1, 2, and 3 emissions.[10] They write: ***"Some food and agriculture companies and trade associations are claiming that the proposed rule would result in new burdens for farmers. This outcome is highly unlikely to play out in practice given the nature of how GHG accounting from small, distributed sources like small agricultural producers works today. The USDA, the EPA, state agriculture agencies and private data service providers develop GHG data, estimates, and tools to help large companies estimate GHG emissions from basic information they already receive from suppliers in the course of ordinary business. Measuring GHG emissions on a field-by-field or small farm-by-farm basis across a company's entire supply chain is indeed impractical, not part of the ordinary method deployed for corporate GHG accounting, not required by the proposed rule, and there is no evidence that this practice would be adopted upon finalization of the rule."***
- If concerns persist that the small farmers could be vulnerable under the rule, the solution is clarifying language that more explicitly protects non-registrants – not elimination of Scope 3, which would deeply curtail the benefits of the rule.
- A recent study of 100 major food companies found that 51 already disclose Scope 3 emissions from suppliers using estimates,[11] and 70 percent of public companies in the U.S. will soon need to report relevant Scope 3 emissions because they have listed securities in capital markets in the EU.[12]

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[8] Dr. Steven Suppan, "Agribusiness opposition to the proposed SEC climate-related financial disclosure rule," IATP, August 12, 2022. https://www.iatp.org/agribusiness-opposition-proposed-sec-rule

[9] Notes from Senate Banking Committee Briefing on 3/23/23.

[10] Letter to the SEC, March 2023. https://www.sec.gov/comments/s7-10-22/s71022-20159767-327935.pdf

[11] *Ibid*.

[12] "At Least 10,000 Foreign Companies to Be Hit by EU Sustainability Rules," Wall Street Journal, 5 Apr. 2023. https://www.wsj.com/articles/at-least-10-000-foreign-companies-to-be-hit-by-eu-sustainability-rules-307a1406