AFR Americans for Financial Reform

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 jurisdictions 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 SEC's mission to protect investors and promote fair and efficient capital markets and capital formation.

Key Points

- **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 SECto 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.*

- **The SEC can make sure Scope 3 emissions reporting does not burden small, independent farmers by instructing companies to calculate GHGs for agricultural products on a per volume basis.**[1]
  - **Volumetric emissions estimates makes sense, is consistent with the rule and GHG Protocol, and should be clearly delineated in the final rule:**[2] Companies can calculate the embedded emissions in a ton of corn, head of cattle, or hundredweight of milk that would estimate their upstream, Scope 3 emissions from agricultural products. This is implied but not specified in the proposed rule and is consistent with the GHG Protocol Scope 3 methods. A recent study of 100 major food companies found that 51 already disclose Scope 3 emissions from suppliers using estimates.[3]
  - The rule only applies to public companies. It does not – and cannot – directly create any disclosure obligations for small private entities. Nevertheless, agribusinesses and food companies have disingenuously told farmers they can force them to accept controlling terms and burdensome recordkeeping in order to sell their products.
  - **The SEC can and should provide clarifying language** around the proper use of emissions estimates that explicitly protects non-registrants, such as instructing the use of volume-based estimates for raw material inputs and for complex supply chains with large numbers of small upstream entities, and requiring that any primary information from suppliers is **"voluntarily delivered"** or already **"publicly available."**
  - The proposal also 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 <u>any</u> Scope 3 emissions that it deems immaterial.
  - *As Antonio Tovar of the National Family Farm Coalition said: "**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.**"*[4]

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[1] 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/
[2] https://www.sec.gov/comments/s7-10-22/s71022-314720-820163.pdf
[3] https://www.frontiersin.org/articles/10.3389/fsufs.2021.789499/full
[4] Notes from Senate Banking Committee Briefing on 3/23/23.

- **In the coming years, at least 75% of Fortune 1000 public companies will need to disclose their Scope 1, 2, and 3 emissions pursuant to a California disclosure bill (SB 253) which was signed into law, and many companies will also need to disclose against the EU Corporate Sustainability Reporting Directive (CSRD), which includes relevant Scope 3 emissions.**[5]
    - The California law will require Scopes 1, 2, and 3 emissions regardless of materiality for all companies with over $1 billion in annual revenue that do business in California, which includes at least 75% of Fortune 1000 companies.
        - This significantly lowers the compliance cost of the SEC rule and will also make it much easier to calculate GHGs before more public data will soon be available from GHG disclosures from other companies in a registrant's value chain.
        - The benefits of the SEC acting largely remain:
            - A standard methodology for all companies will level the playing field
            - Info will be freely available in the same location: SEC's EDGAR system
            - Streamlining of the audit process
            - Ensuring a federal right of action for defrauded investors based on securities law, and improving the disclosure quality and accountability resulting from SEC disclosure review.
    - 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?

- **The International Sustainability Standards Board (ISSB) recently released its baseline climate disclosure standards that will be used by jurisdictions around the world, and it includes 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."*

- **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

[5] "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

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.[6] 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 -0.2% since 2014,[7] compared to 10.0% percent for the overall S&P500,[8] as of January 2024.

- **97% of investors that commented on the GHG provisions in the rule–representing nearly $50 trillion in assets under management–support disclosure of GHGs (Scopes 1, 2, 3).[9]**
    - Blackrock, Vanguard, Wells Fargo, Citigroup, and Bank of America all support maintaining Scope 3 emissions in some form in the final rule.

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

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[6] 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
[7] S&P500 Energy. https://www.spglobal.com/spdji/en/indices/equity/sp-500-energy-sector/#overview
[8] S&P500. https://www.spglobal.com/spdji/en/indices/equity/sp-500/#overview
[9] 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