Statement

We are Not the Securities and Environment Commission - At Least Not Yet

Commissioner Hester M. Peirce

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Thank you, Chair Gensler. Many people have awaited this day with eager anticipation. I am not one of them. Contrary to the hopes of the eager anticipators, the proposal will not bring consistency, comparability, and reliability to company climate disclosures. The proposal, however, will undermine the existing regulatory framework that for many decades has undergirded consistent, comparable, and reliable company disclosures. We cannot make such fundamental changes to our disclosure regime without harming investors, the economy, and this agency. For that reason, I cannot support the proposal.

The proposal turns the disclosure regime on its head. Current SEC disclosure mandates are intended to provide investors with an accurate picture of the company's present and prospective performance through managers' own eyes. How are they thinking about the company? What opportunities and risks do the board and managers see? What are the material determinants of the company's financial value? The proposal, by contrast, tells corporate managers how *regulators*, doing the bidding of an array of non-investor stakeholders, expect them to run their companies.[1] It identifies a set of risks and opportunities—some perhaps real, others clearly theoretical—that managers *should be* considering and even suggests specific ways to mitigate those risks. It forces investors to view companies through the eyes of a vocal set of stakeholders, for whom a company's climate reputation is of equal or greater importance than a company's financial performance.

As you have already heard, the proposal covers a lot of territory. It

establishes a disclosure framework based, in large part, on the Task Force on Climate-Related Financial Disclosures ("TCFD") Framework and the Greenhouse Gas Protocol. It requires disclosure of: climate-related risks; climate-related effects on strategy, business model, and outlook; board and management oversight of climate-related issues; processes for identifying, assessing, and managing climate risks; plans for transition; financial statement metrics related to climate; greenhouse gas ("GHG") emissions; and climate targets and goals. It establishes a safe harbor for Scope 3 disclosures and an attestation requirement for large companies' Scope 1 and 2 disclosures.

Some elements are missing, however, from this action-packed 534 pages:

- A credible rationale for such a prescriptive framework when our existing disclosure requirements already capture material risks relating to climate change;
- A materiality limitation;
- A compelling explanation of how the proposal will generate comparable, consistent, and reliable disclosures;
- An adequate statutory basis for the proposal;
- A reasonable estimate of costs to companies; and
- An honest reckoning with the consequences to investors, the economy, and this agency.

I will talk about each of these deficiencies in turn. My statement is rather lengthy, so I will turn my video off as I speak; by one estimate, doing so will reduce the carbon footprint of my presentation on this platform by 96 percent.[2]

I. Existing rules already cover material climate risks.

Existing rules require companies to disclose material risks regardless of the source or cause of the risk. These existing requirements, like most of our disclosure mandates, are principles-based and thus elicit tailored information from companies. Rather than simply ticking off a preset checklist based on regulators' prognostication of what should matter, companies have to think about what is financially material in their unique circumstances and disclose those matters to investors. Financial statements and their accompanying disclosure documents are intended to present an objective picture of a company's financial situation.

Even under our current rules, climate-related information could be responsive to a number of existing disclosure requirements. For

example, Item 303 of Regulation S-K, Management's Discussion and Analysis of Financial Conditions and Results of Operations ("MD&A") requires disclosure of "material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be necessarily indicative of future operating results or of future financial condition."[3] Item 101 of Regulation S-K, Description of Business, requires a description of the registrant's business, including each reportable segment.[4] It specifically requires disclosure of the material effects that compliance with environmental regulations may have on capital expenditures.[5] Item 103 of Regulation S-K, Legal Proceedings, requires a description of material pending legal proceedings, as well as administrative or judicial proceedings relating to the environment if certain conditions are met.[6] Item 105 of Regulation S-K, Risk Factors, also could include climate-related risks under its broad requirement to discuss the "material factors that make an investment in the registrant or offering speculative or risky."[7] Securities Act Rule 408 and Exchange Act Rule 12b-20 require companies to disclose, in addition to the information that is subject to specific disclosure mandates, "such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading."[8] Under these existing rules, companies already are disclosing matters such as the risk of wildfires to property, the risk of rising sea levels, the risk of rising temperatures, and the risk of climate-change legislation or regulation, when those risks are material the company's financial situation.[9] Similarly, issues like "[c]hanging demands of business partners" and "changing consumer . . . behavior" are certainly things all companies consider and disclose when they rise to the level of material risks.

In 2010, the Commission issued guidance to help companies think about how to apply existing disclosure rules in the context of climate change.[10] And, last year, the Division of Corporation Finance, in a sample disclosure review comment letter, among other things, underscored the need for companies to apply existing disclosure requirements to climate risks and opportunities, as set forth in the 2010 guidance.[11] Since the 2010 guidance was issued, companies routinely disclose climate-related information in SEC filings under the current rules, and the Division of Corporation Finance has regularly evaluated such disclosures in filing reviews and issued comment letters only sparingly.[12] The Division has taken a more aggressive posture in its review of climate-related disclosures in the past year; it has issued comment letters on the subject at an increased rate; sought enhanced disclosure on a variety of issues, including a number of topics that appear in the proposal; and demanded the underlying materiality analysis. The companies' responses are instructive: they generally have stated that the requested disclosures by

SEC staff were largely immaterial and inappropriate for inclusion in SEC filings. These recent exchanges reveal that for many companies—including large manufacturers, retailers, and even insurance companies—issues like climate-related physical damage, so-called transition risks related to conjectural climate regulation and potential legislation, and expenditures related to climate change are not material.[13] Few of these exchanges resulted in agreements to provide enhanced disclosure, although one company—declaring that it "is providing this additional information not because it believes that such information is material" but out of the altruistic belief that "corporations should be good stewards of the environment"—assented to include more information in its proxy statement.[14]

Instead of being a one-size-fits-all prescriptive framework, the existing rules are rooted in the materiality principle. Depending on a company's own facts and circumstances, existing disclosure requirements may pull in climate-related information. Over the years, however, many companies, responding to calls from various constituencies, have provided substantial amounts of information *outside* of their required SEC filings. For example, a lot of companies prepare sustainability reports and post them on their website. Rather than being geared toward investors, these sustainability reports have a much larger target audience of non-investor stakeholders, whose primary concern is something other than company financial performance. Because these reports are not directed toward investors, the information they contain is not limited to information that is material to the company's financial value. The Commission proposes today to require companies to pull into Commission filings much of this non-investor-oriented information that is either immaterial or keyed to a distended notion of materiality that seems to turn on an embellished guess at how the company affects the environment.

II. The proposed rule dispenses with materiality in some places and distorts it in others.

Some of the proposed disclosure requirements apply to all companies without a materiality qualifier, and others are governed by an expansive recasting of the materiality standard. Both of these approaches to determining what information should be disclosed are problematic because they depart from the generally applicable,[15] time-tested materiality constraint on required disclosures.

Justice Thurgood Marshall described our existing materiality standard in *TSC Industries v. Northway*:[16] an item is material if there is a

substantial likelihood that a reasonable investor would consider the information important in deciding how to vote or make an investment decision. The "reasonable investor" Justice Marshall referred to in *TSC Industries* is someone whose interest is in a financial return on an investment in the company making the disclosure. Thus, there is a clear link between materiality of information and its relevance to the financial return of an investment.[17]

The Commission proposes to mandate a set of climate disclosures that will be mandatory for all companies without regard for materiality. As I mentioned earlier, the comment letters that the Division of Corporation Finance issued over the past year foreshadowed this development. The staff pressed companies to include in their SEC filings disclosures that they make in their sustainability reports, but many companies responded that the information was immaterial and therefore need not be included.[18] The proposal would sweep in much of this information without any materiality nexus. For example, the proposed rules require all companies to disclose all Scope 1 and 2 greenhouse gas emissions, and the financial metrics do not have a materiality qualifier.

The Commission justifies its disclosure mandates in part as a response to the needs of investors with diversified portfolios, who "do not necessarily consider risk and return of a particular security in isolation but also in terms of the security's effect on the portfolio as a whole, which requires comparable data across registrants."[19] Not only does this justification depart from the Commission's traditional company-specific approach to disclosure, but it suggests that it is appropriate for shareholders of the disclosing company to subsidize other investors' portfolio analysis. How could a company's management possibly be expected to prepare disclosure to satisfy the informational demands of all the company's investors, each with her own idiosyncratic portfolio? The limiting principle of such an approach is unclear.

Even where materiality thresholds exist, the proposal tweaks materiality. The Commission obliquely admits that it is playing a little fast and loose with materiality, but assures us that the "materiality determination that a registrant would be required to make regarding climate-related risks under the proposed rules is ***similar*** to what is required when preparing the MD&A section in a registration statement or annual report."[20] Similarity is in the eye of the beholder, and so is materiality if it is decoupled from its financial context, as the proposal seeks to do—just try asking an investor in the company and a climate activist what each finds material about a company's business. You might not get the same answer. The proposal, unlike a standard MD&A materiality determination, requires short-, medium-, and long-term assessments of materiality to account for "the dynamic nature of climate-related

risks."[21] Moreover, the proposal would seek to get behind these materiality determinations by requiring disclosure of how the company "determines the materiality of climate-related risks, including how it assesses the potential size and scope of any identified climate-related risk."[22] As the proposal acknowledges, assessing the present materiality of potential consequences of ongoing and future climate change will be difficult, but have no fear, "climate consulting firms are available to assist registrants in making this determination."[23] Score one for the climate industrial complex!

With respect to Scope 3 greenhouse gas emission[24] disclosures, the Commission also maintains the fiction that it is not departing from the materiality standard. Under the proposal, a company, unless it is a smaller reporting company, would have to disclose Scope 3 emissions, but only if the company has set an emissions reduction target that includes Scope 3 emissions or if those emissions are material. The materiality limitation is not especially helpful because the Commission suggests that such emissions generally are material[25] and admonishes companies that materiality doubts should "'be resolved in favor of those the statute is designed to protect,' namely investors."[26] That admonition does not work as the Supreme Court intended it when "investors" are redefined to mean "stakeholders," for whom the cost of collecting and disclosing information is irrelevant. The release offers without explicitly endorsing a possible quantitative metric (40% of a company's total GHG emissions) at which Scope 3 emissions might well be material,[27] but then layers on a hazy qualitative test: "where Scope 3 represents a significant risk, is subject to significant regulatory focus, or 'if there is a substantial likelihood that a reasonable [investor] would consider it important.'"[28] The Commission also reminds companies that "[e]ven if the probability of an adverse consequence is relatively low, if the magnitude of loss or liability is high, then the information in question may still be material."[29] Further deterring omission of Scope 3 data, the release says, "it may be useful [for investors of companies that do omit Scope 3 emissions for lack of materiality] to understand the basis for that determination."[30] Likewise, if a company "determines that certain categories of Scope 3 emissions are material, [it] should consider disclosing why other categories are not material."[31] In sum, the Commission seems to presume materiality for Scope 3 emissions.

The Scope 3 materiality confusion stems in part from the fact that Scope 3 emissions reflect not the direct activities of the company making the disclosure, but the actions of the company's suppliers and consumers. As the proposal recognizes, "a registrant's material Scope 3 emissions is a relatively new type of metric, based largely on third-party data, that we have not previously required."[32] A company's Scope 3 emissions are based on what third parties do either in contributing to the company's

creation, processing, or transport of its products or when using and disposing of the company's products.[33] Admittedly, a company's choices about things like what products to produce and which suppliers and distributors to use affect its Scope 3 numbers, but Scope 3 data is really about what other people do. The reporting company's long-term financial value is only tenuously at best connected to such third party emissions. Hence, the Commission's distorted materiality analysis for Scope 3 disclosures departs significantly from the "reasonable investor" contemplated by Justice Marshall.

III. The proposal will not lead to comparable, consistent, and reliable disclosures.

The proposal optimistically posits that mandatory disclosure of reams of climate information will ensure that all companies disclose comparable, consistent, and reliable climate information in their SEC filings. The proposal does not just demand information about the company making the disclosures; it also directs companies to speculate about the habits of their suppliers, customers, and employees; changing climate policies, regulations, and legislation; technological innovations and adaptations; and changing weather patterns. Wanting to bring clarity in an area where there has been a lot of confusion and greenwashing is understandable, but the release mistakenly assumes that quantification can generate clarity even when the required data are, in large part, highly unreliable. Requiring companies to put these faulty quantitative analyses in an official filing will further enhance their apparent reliability, while in fact leaving investors worse off, as Commission-mandated disclosures will lull them into thinking that they understand companies' emissions better than they actually do.

Another area where the proposal will mandate disclosure of information that appears useful but that likely will be entirely unreliable involves physical risks tied to climate change. Establishing a causal link between physical phenomena occurring at a particular time and place and climate change is, at best, an exceedingly difficult task. Disclosures on the physical risk side will require companies to select a climate model and adapt it to assess the effects of climate change on the specific physical locations of their operations, as well as on the locations of their suppliers and customers. This undertaking is enormous.[34] It will entail stacking speculation on assumptions. It will require reliance on third-parties and an array of experts who will employ their own assumptions, speculations, and models. How could the results of such an exercise be reliable, let alone comparable across companies or even consistent over time within the same company? Nevertheless they will appear so to investors and stakeholders.

Required disclosures of so-called transition risks also present these challenges. The proposal defines "transition risks" broadly as:

the actual or potential negative impacts on a registrant's consolidated financial statements, business operations, or value chains attributable to regulatory, technological, and market changes to address the mitigation of, or adaptation to, climate-related risks, such as increased costs attributable to changes in law or policy, reduced market demand for carbon-intensive products leading to decreased prices or profits for such products, the devaluation or abandonment of assets, risk of legal liability and litigation defense costs, competitive pressures associated with the adoption of new technologies, reputational impacts (including those stemming from a registrant's customers or business counterparties) that might trigger changes to market behavior, consumer preferences or behavior, and registrant behavior.[35]

Transition risk can derive from potential changes in markets, technology, law, or the more nebulous "policy," which companies will have to analyze across multiple jurisdictions and all across their "value chains." These transition assessments are rooted in prophecies of coming governmental and market action, but experience teaches us that such prophecies often do not come to fruition. Markets and technology are inherently unpredictable. Domestic legislative efforts in this context have failed for decades,[36] and international agreements, like the Paris Accords, have seen the United States in and out and back in again.[37] How could this proposal thus elicit comparable, consistent, and reliable disclosure on these topics?

IV. The Commission lacks authority to propose this rule.

This proposal exceeds the Commission's statutory limits. Congress gave us an important mission—protecting investors, facilitating capital formation, and fostering fair, orderly, and efficient markets—and granted us sufficient regulatory authority to achieve that mission. Effective execution of that mission forms the basis for healthy capital markets and, in turn, a healthy economy. Congress, however, did not give us plenary authority over the economy and did not authorize us to adopt rules that are not consistent with applicable constitutional limitations. This proposal steps outside our statutory limits by using the disclosure framework to achieve objectives that are not ours to pursue and by pursuing those objectives by means of disclosure mandates that may not comport with First Amendment limitations on compelled speech.

All the disclosure mandates we adopt under authority granted to us by Congress are at bottom compelled speech, and this one in particular

prescribes specific content for the speech that it mandates. The Supreme Court has made clear that corporations do enjoy protections under the First Amendment's freedom of speech clause, but also has concluded that the government is subject to lesser scrutiny—and therefore has greater leeway—when requiring companies to disclose "purely factual and uncontroversial information."[38] For this reason, our disclosure mandates are at their strongest when there is a clear and indisputable connection between the factual information to be disclosed and our three-part mission.

Attempting to establish that essential connection, the Commission points to "significant investor demand for information about how climate conditions may impact their investments."[39] Large asset managers—who are paid to invest other people's money[40]—some institutional investors, and some retail investors have been vocal proponents of climate change disclosures. But why are they asking? If they are asking for information to help them assess the financial value of companies in which they are considering investing, this information may be material and is likely covered by existing disclosure rules. But many calls for enhanced climate disclosure are motivated not by an interest in financial returns from an investment in a particular company, but by deep concerns about the climate or, sometimes, superficial concerns expressed to garner goodwill.[41]

The fact that retail and institutional investors and asset managers have myriad motivations when making investing decisions and by extension therefore might want different categories of information necessarily means that we cannot adopt a disclosure regime that provides all information desired by all investors and asset managers. Indeed, we have been cautioned against disclosure requirements so sweeping that they "simply . . . bury the shareholders in an avalanche of trivial information."[42] We have in the past achieved the necessary balance between mandating enough but not too much information by focusing on what information is material to an objectively reasonable investor in her capacity as an investor in the company supplying the information seeking a financial return on her investment in the company.

Focusing on information that is material to a company's value proposition not only serves as a key mechanism to winnow out needless volumes of information, but also keeps us from exceeding the bounds of our statutory authorization. The further afield we are from financial materiality, the more probable it is that we have exceeded our statutory authority. One commentator argues that the rationales relied on by the Commission here—that the "Commission has broad authority to promulgate disclosure requirements that are 'necessary or appropriate in the public interest or for the protection of investors'"[43] or that "promote

efficiency, competition, and capital formation"[44]—cannot justify disclosure mandates that lie outside the "subject-matter boundaries" Congress imposed on it.[45] Indeed, in the rare instances when Congress has wanted us to go beyond those subject-matter boundaries, it has told us to do so.[46] We do not have a clear directive from Congress, and we ought not wade blithely into decisions of such vast economic and political significance as those touched on by today's proposal.

Other scholars similarly have raised serious and fundamental questions regarding our authority to mandate climate-related disclosures in the manner proposed here. A proper understanding and application of our materiality standard is essential. Professor Sean Griffith contends that First Amendment jurisprudence suggests that the SEC cannot compel disclosures of the type proposed today. He proposes that to determine whether a particular mandated disclosure is uncontroversial, one should look to the degree that it is consistent with the language and objectives of the statute authorizing the mandate. If there is a clear and logical connection between disclosing the information and achieving the objectives of the statute, then it likely is uncontroversial; however, if disclosing the information is unrelated, or only tangentially related, to the statutory objectives, then it likely is controversial.[47] The objective of Congress's instruction for us to regulate in the public interest and for the protection of investors is to protect investors in their pursuit of returns on their investments, not in other capacities. For this reason, to qualify as uncontroversial and thereby stay within First Amendment bounds, our disclosure mandates must be limited to information that is material to the prospect of financial returns. In Professor Griffith's view, disclosures of information material to financial returns are uncontroversial because the quest for financial returns is the common goal that unites all investors. Their other individualized goals—whether ameliorating climate change, encouraging better labor relations, pursuing better treatment of animals, protecting abortion rights, or any other number of issues—are material for purposes of our disclosure regime only to the extent they relate to the financial value of the company.

The Commission today proposes to require companies to disclose information that may not be material to them and recasts materiality to encompass information that investors want based on interests other than their financial interest in the company doing the disclosing. We would do well to heed the admonition of the Supreme Court in a case involving the agency Congress charged with regulating the environment:

When an agency claims to discover in a long-extant statute an unheralded power to regulate "a significant portion of the American economy," we typically greet its announcement with a measure of

skepticism. We expect Congress to speak clearly if it wishes to assign to an agency decisions of vast "economic and political significance."[48]

V. The Commission underestimates the costs of the proposal.

Even if it were within our statutory authority, the proposal is expensive. The Commission is sanguine about the costs of this endeavor because some companies are already making climate-related disclosures. I look forward to seeing whether commenters agree with the Commission's cost assessments. Several aspects of the proposal could make implementation costlier than the Commission anticipates.

First, although the proposal is based in part on popular voluntary frameworks, those frameworks are neither universally used nor precisely followed. For example, the proposal looks extensively to the framework developed by the TCFD because its popularity "may facilitate achieving this balance between eliciting better disclosure and limiting compliance costs."[49] Yet, a survey cited in the release suggests that U.S. companies pick and choose elements of the TCFD framework to follow and the majority do not adhere to key parts of the framework.[50] These results suggest that using the TCFD framework as a basis for this rulemaking will not reduce cost substantially. Moreover, for many companies the TCFD-based disclosures will be new. For these reasons, neither the data regarding predicted costs of complying with the TCFD as it was originally designed nor the data regarding costs to companies using bespoke versions of the TCFD are particularly instructive on the potential costs of complying with this proposal.

The Commission also ignores the distinction between voluntary disclosure in a sustainability report of selected items outlined in the TCFD and mandatory disclosure in SEC filings. The former disclosure is subject neither to mandatory assurance[51] nor to the level of liability[52] or scrutiny that attaches to SEC filings. I liken it to cooking. When I "follow" a recipe, I pick and choose which aspects to follow based on how much time I have, how ambitious I am feeling, and which ingredients I have on hand. If I were told that I had to prepare the same recipe in a Michelin-starred restaurant for a table of eminent food critics, my stress level would rise considerably, and I would have to outsource the job to a high-priced chef. A similar rude awakening is in store for companies that have been asking for disclosure mandates, perhaps thinking that these mandates would simply require a little more than what they are already doing voluntarily (and, as importantly, make their competitors do the same): Under these proposals, they are going to be playing an entirely different game, at far higher stakes. It is difficult to sympathize with the

self-inflicted pain they are going to feel, but unfortunately, their shareholders, who, unlike corporate leadership, have not been clamoring for such disclosures, will foot the bill.

Second, as hard as it will be for a company to be confident in its own climate-related information, a company may not even be able to get the information it needs to calculate Scope 3 emissions. The company's customers and suppliers may not track this information. Even if its suppliers disclose their emissions information, a reporting company may not feel sufficiently confident in the information to include it in its SEC filings. Many companies, therefore, will have to turn to third-party consultants to help them determine Scope 3 emissions.[53]

The proposal recognizes the unprecedented nature of the Scope 3 disclosure framework in a couple ways. First, it exempts smaller reporting companies.[54] Second, it provides a safe harbor for Scope 3 disclosures.[55] The efficacy of this safe harbor turns on its terms, which, in the spirit of the rest of the proposal, are nebulous. Specifically, the safe harbor covers Scope 3 statements unless they were "made or reaffirmed without a reasonable basis or [were] disclosed other than in good faith."[56] "Reasonable basis" seems clear enough in most cases, but is it in this case? How is a company to determine which particular climate model or set of estimates constitutes a "reasonable basis" when different models and estimations lead to substantially different results? And what catapults a statement that was made with a reasonable basis into the category of "other than in good faith"? Is it bad faith if a company that gets wildly different numbers from two suppliers that appear to use similar processes for producing and transporting raw materials chooses to use the numbers that produce the lowest Scope 3 emissions? Third, the proposal also recognizes the unreliability of Scope 3 data by excluding those data from the assurance requirement. Realistically, nobody could credibly provide assurance for numbers that are inherently unreliable, and if nobody can credibly provide assurance, no investor is likely to find that these data provide a reasonable basis for making any investment decisions.

Third, the assurance that companies do have to get likely will be expensive. Accelerated filers and large accelerated filers will be required to include an attestation report on their Scope 1 and 2 emissions signed by an independent GHG emissions attestation provider, which will be required to provide limited assurance for the second fiscal year after the Scopes 1 and 2 emissions disclosure compliance date, and reasonable assurance starting for the fourth fiscal year after the relevant compliance date.[57] Audit firms are likely to be the biggest winners, as they already have established assurance infrastructures and are familiar with SEC reporting and the proposed independence framework. The attestation

mandate could be a new sinecure for the biggest audit firms, reminiscent of the one given them by Section 404(b) of the Sarbanes-Oxley Act.[58]

Companies also will incur audit costs in connection with a number of metrics proposed to be included in the notes to the financial statements. The mandated financial statement metrics "would consist of disaggregated climate-related impacts on existing financial statement line items."[59] Requiring all companies[60] to include disaggregated, subject-specific metrics within the financial statements is unusual, fails to accommodate the diversity across companies, and reflects a disproportionate emphasis on climate. Embedding a risk-specific disclosure requirement in the financial statements erodes the important status of financial statements as objective, economically sound representations of a company's financial situation. These numbers and the assumptions that underlie them will be invaluable for stakeholder groups looking to force companies to pour more money into climate-related expenditures, but their value to investors is unclear.

VI. The proposed rule would hurt investors, the economy, and this agency.

Many have called for today's proposal out of a deep concern about a warming climate and its effects on the planet, people, and the financial system. It is important to remember, though, that noble intentions, once baked into complex regulatory plans, often have ignoble results. This risk is considerably heightened when the regulatory complexity is designed to push capital allocation toward politically and socially favored ends,[61] and when the regulators designing the framework have no expertise in capital allocation, political and social insight, or the science used to justify these favored ends. This proposal, developed under these circumstances, will hurt investors, the economy, and this agency.

The proposal, if adopted, will have substantive effects on companies' activities. We are not only asking companies to tell us what they do, but suggesting how they might do it. The proposal uses disclosure mandates to direct board and managerial attention to climate issues.[62] Other parts of the proposal offer even more direct substantive suggestions to companies about how they should run their businesses. For example, the Commission suggests that a company could "mitigate the challenges of collecting the data required for Scope 3 disclosure" by "choosing to purchase from more GHG efficient producers," or "producing products that are more energy efficient or involve less GHG emissions when consumers use them, or by contracting with distributors that use shorter transportation routes."[63] And the proposal suggests options for companies pursuing climate-related opportunities as part of a transition

plan, including low emission modes of transportation, renewable power, producing or using recycled products, setting goals to help reduce greenhouse gas emissions, and providing services related to the transition to a lower carbon economy.[64] Similarly, the proposal suggests ways companies can meet climate-related targets, including "a strategy to increase energy efficiency, transition to lower carbon products, purchase carbon offsets or [renewable energy credits], or engage in carbon removal and carbon storage."[65] With all due respect to my colleagues, society is in big trouble if we are looking to SEC lawyers, accountants, and economists to dictate how companies should address climate change.

Executives, for their part, might not mind the new regime that elevates squishy climate metrics. After all, how wonderful it will be for an executive who has failed to produce solid financial returns to be able to counter critics with a glowing report on climate transition—"Dear Shareholders, we fell far short of our earnings target this year, but you will be pleased to know that all in all it was a fantastic year since we made great progress on our climate transition plan." If the CEO's compensation is tied to lower greenhouse gas emissions, she can forgo the focus on company financial value—so 20th century!—and spend her time following the proposal's urging to convince suppliers to shift to electric transport fleets and customers to freeze their jeans instead of washing them.[66]

Who then might mind? Investors. And by investors, I mean real people who are saving for retirement and need to earn real financial—not psychic—returns on their money. When executives focus less on financial metrics and more on other things, the financial performance of companies is likely to suffer. Moreover, the proposal does not grapple with the potential that retail investors, who are essentially confined to the public markets, should expect to see lower returns over the long term. The logical result of using the financial system as a tool in combatting climate change is to drive down returns on green investments.[67] Companies that cannot get funding in the public markets will retreat to the private markets, where they will have to pay investors more for capital. Higher returns will be reserved for the wealthy, who the Commission has granted access to private markets.[68]

Investors will not be the only ones to suffer from the diversion of attention from financial to climate objectives. The whole economy, and all of the consumers and producers it sustains, could also be hurt. First, the proposal is likely counterproductive to the important concerns around climate change. Attempting to drive long-term capital flows to the right companies ex ante is a fool's errand because we simply do not know what effective climate solutions will emerge or from where. Markets, if

we let them work, are remarkably deft at solving problems of all sorts, even big problems like climate change,[69] but they do so in incremental and surprising ways that are driven by a combination of chance, opportunity, necessity, and human ingenuity. The climate-change mitigating invention which right now may be rattling around in the head of a young girl in Cleveland, Ohio—the intellectual descendant of great Cleveland inventors like Garrett Morgan and Rollin Henry White[70]—is something of which we regulators cannot even dream. Our limited job as securities regulators is to make sure that enterprising young woman can get matched up with the funds necessary to bring her idea to life. We make that match less likely if we write rules that implicitly prefer the technology we have identified as promising today over the technology of the future germinating in our young inventor's dreams. Second, the diversion of capital also will make the economy less effective at serving people's other needs. Insufficient capital will go to solving other important problems. Third, contrary to the Commission's reasoning,[71] driving more capital toward green investments as defined uniformly by financial regulators could fuel an asset bubble that could make the financial system more vulnerable rather than more resilient.

Finally, our meddling with the incentives for capital allocation will harm this agency, which plays such an important role in the capital markets. As discussed above, the proposal takes us outside of our statutory jurisdiction and expertise, which harms the agency's integrity. In addition, filling SEC filings with information that is inherently unreliable undercuts the credibility of the rest of the information in these important filings.[72] Moreover, while the existence of anthropogenic climate change itself is not particularly contentious, how best to measure and solve the problem remains in dispute. The Commission, which is not expert in these matters, will be drawn into these disputes as it reviews, for example, the climate models and assumptions underlying companies' metrics and disclosures about progress toward meeting climate targets. This proposal could inspire future more socially and politically contentious disclosures, which would undermine the SEC's reputation as an independent regulator.[73] Meanwhile, we have other important work to do, and the climate initiative distracts us from it.[74]

VII. Conclusion

We are here laying the cornerstone of a new disclosure framework that will eventually rival our existing securities disclosure framework in magnitude and cost and probably outpace it in complexity. The building project upon which we are embarking will consume our attention and enrich many, as any massive building project does. The placard at the door of this hulking green structure will trumpet our revised mission:

"protection of stakeholders, facilitating the growth of the climate-industrial complex, and fostering unfair, disorderly, and inefficient markets." This new edifice will cast a long shadow on investors, the economy, and this agency. Accordingly, I will vote no on laying the cornerstone.

If I were voting based on how hard the staff has worked to get this proposal out the door, however, I would support it. I appreciate the long hours, extensive thought, and intense work that staff from all over the Commission—the Division of Corporation Finance, the Division of Economic and Risk Analysis, the Office of General Counsel, and the Office of Chief Accountant, among others—poured into this rulemaking. I also am grateful to the many commenters who responded to Commissioner Lee's request for comment and for the even greater number of comments I expect we will receive in response to this proposal. Your comments will inform my thinking about whether we should adopt climate disclosure rules and, if so, what they should look like. In particular, I am interested in hearing if there are types of universally material climate information that are not being disclosed under our existing rules.

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[1] For example, the proposal requires companies to explain how they "[d]etermine[] the relative significance of climate-related risks compared to other risks." Proposed Rule 17 CFR § 229.1503(a)(1)(i). A company might disclose that climate-related risks are much more significant than other risks given the weight the Commission places on such risks, as evidenced by this proposal.

[2] Renee Obringer, et. al, *The Overlooked Environmental Footprint of Increasing Internet Use*, 167 Resources, Conservation & Recycling 105389 (2021) (explaining that the monthly carbon footprint of 15 1-hour meetings a week on a standard videoconferencing service would be reduced from 9.4 kg CO2e to 377 g CO2e by simply turning off the video), *available at* https://impact-festival.earth/wp-content/uploads/2021/06/Overlooked-Environmental-Footprint-of-Increasing-Internet-Use_2021_compressed.pdf. *See also The Simpsons: Homer to the Max* (Fox television broadcast Feb. 7, 1999), *available at* https://www.youtube.com/watch?v=LvUItaradGE.

[3] 17 CFR § 229.303(a).

[4] 17 CFR § 229.101(c)(1).

[5] 17 CFR § 229.101(c)(1)(xii).

[6] 17 CFR § 229.103(c)(3).

[7] 17 CFR § 229.101(c)(5).

[8] 17 CFR § 230.408 and 17 CFR § 240.12b-20.

[9] *See, e.g.*, PG&E Corp., Annual Report (Form 10-K) (Feb. 10, 2022), *available at* https://www.sec.gov/ix?doc=/Archives/edgar/data/1004980/000100498022000009/pcg-20211231.htm (discussing risk and effect of material wildfires in Business, Risk Factors, MD&A, and Notes to Financial Statements sections); Boston Properties, Inc., Annual Report (Form 10-K) (Feb. 25, 2022), *available at* https://www.sec.gov/ix?doc=/Archives/edgar/data/1037540/000165642322000013/bxp-20211231.htm#i527431e87b6e4875ab237c2209d9a08f_19 (discussing climate risk in Business and Risk Factors sections); American Int'l. Group Inc., Annual Report (Form 10-K) (Feb. 17, 2022), *available at* https://www.sec.gov/ix?doc=/Archives/edgar/data/5272/000110465922024701/aig-20211231.htm (discussing material risks relating to sea level rise, warming atmosphere and ocean, and climate change regulations in Risk Factors section).

[10] Commission Guidance Regarding Disclosure Related to Climate Change, Rel. No. 33-9106, 75 Fed. Reg. 6290 (Feb. 8, 2010); *available at* https://www.sec.gov/rules/interp/2010/33-9106.pdf.

[11] Div. of Corp. Fin., Sec's & Exch. Comm'n, Sample Letter to Companies Regarding Climate Change Disclosures (modified Sept. 22, 2021), https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures.

[12] *See* U.S. Government Accountability Office, Climate-Related Risks: SEC Has Taken Steps to Clarify Disclosure Requirements (Feb. 2018) at 14-15, https://www.gao.gov/assets/gao-18-188.pdf.

[13] *See* Nicola M. White, *SEC Drops Hints About ESG Rule in Retorts to Vague Disclosures*, Bloomberg Law (Mar. 18, 2022), https://news.bloomberglaw.com/securities-law/sec-scrutiny-of-big-companies-sheds-light-on-climate-priorities.

[14] *See* Palo Alto Networks, Correspondence re Form 10-K for Fiscal Year Ended July 31, 2021 (Oct. 6, 2021), https://www.sec.gov/Archives/edgar/data/0001327567/000119312521293496/filename1.htm.

[15] In 2003, for example, the Commission explained that principle in the context of MD&A this way: "In deciding on the content of MD&A, companies should focus on material information and eliminate immaterial information that does not promote understanding of companies' financial condition, liquidity and capital resources, changes in financial condition and results of operations." Interpretation: Commission Guidance

Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations, Rel. No. 33-8350, 68 Fed. Reg. 75056, 75057 (Dec. 29, 2003); *available at* https://www.sec.gov/rules/interp/33-8350.htm. We have mandated immaterial disclosures in several other areas. The non-statutory immaterial disclosure mandates regarding executive compensation, related party transactions, and environmental litigation, might well merit recalibration with a materiality threshold, but that discussion is beyond the scope of this proposal.

[16] *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

[17] Former Commissioner Elad Roisman succinctly explains the concept of materiality in the federal securities laws in Section II.B of *Can the SEC Make ESG Rules that are Sustainable?* (June 22, 2021), https://www.sec.gov/news/speech/can-the-sec-make-esg-rules-that-are-sustainable.

[18] *See, e.g.*, Sample Letter *supra* note 11 (Question 1 reads: "We note that you provided more expansive disclosure in your corporate social responsibility report (CSR report) than you provided in your SEC filings. Please advise us what consideration you gave to providing the same type of climate-related disclosure in your SEC filings as you provided in your CSR report.").

[19] Proposing Release at 10.

[20] *Id*. at 74 (emphasis added).

[21] *Id*. at 75.

[22] Proposed rule 17 CFR § 229.1503(a)(1).

[23] Proposing Release at 75.

[24] "Scope 3 emissions are all indirect GHG emissions not otherwise included in a registrant's Scope 2 emissions, which occur in the upstream and downstream activities of a registrant's value chain." Proposed rule 17 CFR § 229.1500(r).

[25] *Id*. at 181 ("Given their relative magnitude, we agree that, for many registrants, Scope 3 emissions may be material to help investors assess the registrants' exposure to climate-related risks, particularly transition risks, and whether they have developed a strategy to reduce their carbon footprint in the face of regulatory, policy, and market constraints.") (footnotes omitted).

[26] *Id.* (citing *TSC Industries, Inc. v Northway, Inc.*, 426 U.S. 438, 448 (1976)).

[27] *Id*. 184. Presumably, every company subject to the new requirement

will need at least to estimate Scope 3 emissions as the necessary first step to determining whether they might be material. This exercise will be very expensive.

[28] *Id.* at 184-85 (citing *TSC Industries*, 426 U.S. at 449).

[29] *Id*. at 185.

[30] *Id.*

[31] *Id*.

[32] *Id.* at 192.

[33] For a helpful illustration of Scope 1, 2, and 3 emissions, *see* World Resources Institute & World Business Council for Sustainable Development, Greenhouse Gas Protocol: Technical Guidance for Calculating Scope 3 Emissions (version 1.0) (2013), at 6, https://ghgprotocol.org/sites/default/files/standards/Scope3_Calculation_Guidance_0.pdf

[34] *See, e.g.*, Letter from Benjamin Zycher, Resident Scholar, American Enterprise Institute, (June 10, 2021), https://www.sec.gov/comments/climate-disclosure/cll12-8904262-243681.pdf at

11-12 ("The reality is that a 'climate risk' disclosure requirement would be deeply speculative, and the level of detail and the scientific sophistication that would be needed to satisfy such a requirement is staggering. Such ' 'disclosures' and supporting analysis and documentation would take up thousands of pages, with references to thousands more, and the premise that this 'disclosure' requirement would facilitate improved decision making by investors in public companies is difficult to take seriously.").

[35] Proposed rule 17 CFR § 229.1500(c)(4).

[36] *See generally* John M. Broder, *'Cap and Trade' Loses Its Standing as Energy Policy of Choice*, N.Y. Times (Mar 25, 2010), https://www.nytimes.com/2010/03/26/science/earth/26climate.html; Lauren Sommer, *What Losing Build Back Better Means for Climate Change*, NPR (Dec. 20, 2021), https://www.npr.org/2021/12/20/1065695953/build-back-better-climate-change. Holding companies accountable for material pledges they have made on transition from carbon may make sense, but requiring companies to disclose based on models that incorporate a future regulatory status despite that status not yet being decided seems designed to front-run the legislative process. *See, e.g.*, Proposing Release at 62 (explaining that transition "risks may arise from potential adoption of climate-related regulatory policies including those that may be necessary to achieve the national climate goals").

[37] If we are mandate this type of disclosure, the demand for widespread access to prediction markets in the United States is likely to rise.

[38] *Nat'l Inst. of Family and Life Advocates v. Becerra*, 138 S. Ct. 2361, 2372 (2018). Whether the lesser scrutiny applies when, as here, the government seeks to regulate speech that involves something other than "voluntary commercial advertising" or "point of sale disclosures" is a matter of debate. *See, e.g., Nat'l Ass'n of Mfrs. v. SEC*, 800 F.3d 518, 522-24 (D.C. Cir. 2015).

[39] Proposing Release at 27.

[40] Some of these asset managers already try to gather the information the disclosure of which they would like to see the SEC mandate. Presumably much of the premium they get for investing based on this information they now go to great lengths to collect will be eroded by a mandate which will make the information readily available to all managers.

[41] *See, e.g.*, Letter from Julia Mahoney and Paul Mahoney, University of Virginia School of Law (June 1, 2021), https://www.sec.gov/comments/climate-disclosure/cll12-8855236-238441.pdf (arguing that, in advocating for additional ESG disclosures, some large institutional investors and asset managers, rather than operating from financial motives, may be striving to achieve political and social change through the capital markets).

[42] *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 448-49 (1976).

[43] Proposing Release at 7.

[44] Proposing Release at 8.

[45] Andrew N. Vollmer, *Does the SEC Have Legal Authority to Adopt Climate-Change Disclosure Rules?* (Aug. 2021) at 10, https://www.mercatus.org/system/files/vollmer_-_policy_brief_-_does_the_sec_have_legal_authority_to_adopt_corporate_disclosure_rules_on_climate_change_-_v1.pdf. Vollmer argues that adopting extensive climate change disclosures "would be misusing general rulemaking powers that Congress provided decades ago for different purposes and possibly usurping or preempting decisions Congress would have made." *Id.* at 14.

[46] *Id.* at 9 (citing as examples, conflict minerals disclosure, executive compensation disclosure, and resource extraction disclosure).

[47] Professor Griffith related this argument to me in advance of publication. *See also* Letter from Ryan Morrison, Attorney, Institute for Free Speech (June 10, 2021) at 3, https://www.sec.gov/comments/climate-disclosure/cll12-8904255-

243679.pdf ("Companies may not disclose at a rate that the SEC prefers, but that frustration does not allow the Commission to circumvent the First Amendment. Any legitimate SEC interest in protecting investors and promoting efficiency, competition, and capital formation is addressed by current existing requirements to disclose material information, and thus includes companies where climate change has a material impact on their business.").

[48] *Util. Air Regulatory Grp. v. EPA*, 573 U.S. 302, 324 (2014) (citations omitted).

[49] Proposing Release at 39.

[50] Proposing Release at 346-47 (Table 4).

[51] The proposal cites an estimate that just over one third of Russell 1000 companies, mostly large ones, get assurance of some kind. *See* Proposing Release at 349 (citing G & A Inc., Sustainability Reporting in Focus (2021), *available at* https://www.ga-institute.com/research/ga-research-collection/sustainability-reporting-trends/2021-sustainability-reporting-in-focus.html).

[52] As Professor Amanda Rose points out, "heighten[ing] the private liability risk faced by companies and directors and officers" is an important consequence of mandating that companies file information that previously appeared only in sustainability reports. Letter from Amanda Rose, Professor of Law, Vanderbilt University Law School (May 11, 2021), at 29-30, https://www.sec.gov/comments/climate-disclosure/cll12-8785693-237729.pdf.

[53] *See, e.g.*, Jean Eaglesham, *Startups Rush to Count Company Carbon Emissions*, Wall St. J. (Mar. 18, 2022) (explaining the growth of carbon counting companies: "Supply chains often count for a large part of a company's emissions. Calculating that figure has been hard because it requires detailed information from dozens or hundreds of companies that could be spread across the world."), *available* at https://www.wsj.com/articles/startups-rush-to-count-company-carbon-emissions-11647608401?mod=markets_lead_pos7.

[54] Proposed rule 17 CFR § 229.1504(c)(3).

[55] Proposed rule 17 CFR § 229.1504(f).

[56] *Id*.

[57] Mandating reasonable assurance at a specific date in the future seems premature because we do not know whether that level of assurance will be possible by then. It is not possible now.

[58] 15 U.S.C. § 7262(b).

[59] Proposing Release at 46.

[60] Companies generally must include these metrics unless the aggregate number is less than one percent of the line item under the proposal. The Commission explains that this threshold is set at a level that allows firms to avoid costs "for instances where the impact is likely to be quite small, while providing assurance to investors that more significant impacts are reflected in line item reporting." *See* Proposing Release at 382. A materiality qualifier would have been a better way to strike the balance.

[61] Let us be honest about what this proposal is really trying to do. Although styled as a disclosure rule, the goal of this proposal—as with other climate disclosure efforts—is to direct capital to favored businesses and to advance favored political and social goals. The TCFD acknowledges that its framework, on which much of the proposal is based, is designed to "empower[] the markets to channel investment to sustainable and resilient solutions, opportunities, and business models." *See* Task Force on Climate-Related Financial Disclosures, https://www.fsb-tcfd.org/about/ (last visited Mar. 20, 2022).

[62] A couple weeks ago, I argued that similar requirements for cybersecurity were inappropriate. *See* Commissioner Hester M. Peirce, *Dissenting Statement on Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure Proposal* (Mar. 9, 2022), *available at* https://www.sec.gov/news/statement/peirce-statement-cybersecurity-030922. I distinguished the Sarbanes-Oxley mandate for financial expertise on boards because it related to financial statements, which are at the heart of our disclosures, and because Congress expressly directed us to do this. For the cybersecurity rules and this proposal, no similar congressional directive exists. As the cybersecurity proposal did, this proposal would dig deep into how companies make climate risk assessments and probe board materiality determinations. These requirements seem designed to cultivate board discussions of climate, rather than merely elicit whether such discussions are happening.

[63] Proposing Release at 179-80. Suggesting that companies avoid the burden that our disclosure rules impose by producing different products or changing suppliers looks like an admission that these disclosure rules will be costly.

[64] Proposed rule 17 CFR § 229.1503(c)(3).

[65] Proposed rule 17 CFR § 229.1506(b)(6).

[66] Sadly, it seems this method is a poor way to clean jeans. *See Will Freezing Your Jeans Kill the Germs and Keep the Fit?,* Cleveland Clinic HealthEssentials, (Mar. 14, 2019), https://health.clevelandclinic.org/will-

freezing-your-jeans-kill-the-germs-and-keep-the-fit/. But for a CEO focused on lowering Scope 3 emissions, green jeans matter more than clean jeans, and throwing jeans in a freezer running on renewables might be better from a GHG emissions standpoint than throwing them in the washer and dryer.

[67] *See, e.g.*, Robert Armstrong, *ESG's Lower (Expected) Returns*, Financial Times, (June 25, 2021), https://www.ft.com/content/1c229b87-3694-4cff-ad83-d6044d16b1c8.

[68] While a counterargument might be that these returns will come at high risk because of the push away from non-green companies, many companies that do not score well on climate metrics are essential to our lives and so, for the foreseeable future, seem unlikely go away.

[69] Mechanisms to ensure that producers internalize costs can help this system to function properly, but those mechanisms are not within the SEC's power to impose. The Commission's focus is on disclosures for investors to understand what affects the disclosing company, not on disclosures for society to understand how the company affects the climate. Civil society organizations, Congress, and other agencies may have a role to play in addressing that issue. We do not aid their efforts by supplanting them with our own.

[70] *See, e.g.*, Garrett A. Morgan, Ohio History Central, https://ohiohistorycentral.org/w/Garrett_A._Morgan (last visited March 19, 2022); Sophie Giffin, Cleveland Inventions: The Steam Generator Set the Groundwork for the Auto Industry, CLEVELAND MAG. (Dec. 1, 2021), https://clevelandmagazine.com/in-the-cle/articles/cleveland-inventions-the-steam-generator-set-the-groundwork-for-the-auto-industry.

[71] *See* Proposing Release at 10-11 (pointing to "the impact of climate-related risks on both individual businesses and the financial system" and concluding that "climate-related risks and their financial impact could negatively affect the economy as a whole and create systemic risk for the financial system"). For a discussion of why climate risk is inappropriately categorized as a systemic risk, see *21st Century Economy: Protecting the Financial System from Risks Associated with Climate Change, Before the S. Comm. On Banking, Housing, and Urban Affairs*, 117th Cong. (Mar. 18 2021) (statement of John Cochrane, Senior Fellow, Hoover Institution, Stanford University), https://www.banking.senate.gov/imo/media/doc/Cochrane%20Testimony%203-18-21.pdf.

[72] See, e.g., Letter from Benjamin Zycher, Resident Scholar, American Enterprise Institute, (June 10, 2021), https://www.sec.gov/comments/climate-disclosure/cll12-8904262-

243681.pdf at 12 ("When 'risk' analysis becomes an arbitrary function of choices among assumptions complex, opaque, and far from obvious, the traditional materiality standard inexorably will be diluted and rendered far less useful for the investment and financial markets, an outcome diametrically at odds with the ostensible objectives of those advocating the evaluation of climate "risks.").

[73] I have similar concerns about the effect of the proposal on the Public Company Accounting Oversight Board ("PCAOB"), particularly because of the numerous places in which the proposal implicates financial statements and auditors. As I have warned elsewhere, the PCAOB's important mission of overseeing public company financial statement audits could be compromised by being drawn into overseeing auditors' climate work. *See* Commissioner Hester M. Peirce, *Audit Regulators and Cliff Hangers: Remarks before the Stanford Law School Federalist Society* (Feb. 15, 2022), *available at* https://www.sec.gov/news/speech/peirce-audit-regulators-cliff-hangars-20220215. The release raises other troubling possible intersections between accounting and climate standards. In addition to mandating disaggregated climate-related information in the notes to the financial statements and establishing an attestation requirement for greenhouse gas emissions, the proposal suggests that TCFD guidance could replace GAAP for certain disclosure items. *See* Proposing Release at Question 58 ("Are there instances where it would be preferable to require an approach based on TCFD guidance or some other framework, rather than requiring the application of existing GAAP?"). The proposal also asks about whether greenhouse gas emission disclosures should be moved to the financial statements. *See* Proposing Release at Question 142. These questions portend trouble for the future of GAAP and the audit profession. I welcome commenter's views on these questions.

[74] *See, e.g.*, Letter from David Burton, Senior Fellow in Economic Policy, The Heritage Foundation (June 13, 2021), https://www.sec.gov/comments/climate-disclosure/cll12-8914466-244728.pdf (raising investor protection issues, such as disclosure overload and reduced returns; capital formation issues, such as unnecessary burdens on small public companies; and market efficiency concerns, such as inaccurate information driving capital flows and diversion of Commission resources to climate disclosure review).