July 22, 2019

Improving Climate Risk Disclosures from within the SEC: Moving Forward Absent the Climate Risk Disclosure Act of 2018

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While the recently introduced Climate Risk Disclosure Act of 2018 (2018 Act) by Senator Warren momentarily brought the issue of climate change's effects on public companies' financial predictions to the top of the newsreel, this topic is not new, and neither is the regulation it builds off of—an almost decade-old interpretation by the Securities Exchange Commission (SEC) that current securities laws require material risks posed by climate change to be disclosed. While the 2018 Act promises to add to this foundation by requiring uniform disclosure metrics, the bill introduced by eight democratic senators (four of whom are now presidential candidates) first must pass through both chambers of Congress, and then would have to survive a potential presidential veto. This article points to the forgotten path of SEC rulemaking. In light of the SEC's 2016 Concept Release seeking stakeholders' input on climate risk disclosure and two petitions for rulemaking filed with the SEC on the topic just since the 2018 Act was introduced, SEC rulemaking might be the most viable option for improving climate risk disclosure processes moving forward.

The SEC protects the interests and confidence of investors by, among other things, promoting increased transparency through required company disclosures and subsequent agency review of particular investment risks. U.S. Gov't Accountability Office, GAO-18-188, Climate-Related Risks 2 (2018). Generally, the SEC requires public companies to disclose known trends, events, and uncertainties that are reasonably likely to have a material effect on the company's financial condition or operating performance. Material information is defined as information a reasonable investor would likely consider important in making an investment decision. *Id.* at 2. Thus, to the extent that climate change will have a material effect on a public company, these effects must be

reported as part of regular disclosure processes. These processes involve reviewing the required financial disclosures (review of nonfinancial disclosures like climate risks is mostly optional) at least once every three years, publishing comments on companies' disclosures, and if the reviewers find a disclosure inadequate, referring the case to the SEC's Division of Enforcement for further proceedings. *Id.* at 10–12.

Besides reviewing individual disclosures, the SEC can issue interpretations of federal securities regulations. *Id.* at 7. In response to multiple petitions from stakeholders, the SEC issued its Commission Guidance Regarding Disclosure Related to Climate Change (Guidance) in February 2010, interpreting the already-existing disclosure requirements under the SEC as they pertain to climate change issues. 2010 SEC Guidance Regarding Disclosure Related to Climate Change Commission Guidance Regarding Disclosure Related to Climate Change, 75 Fed. Reg. 6290 (Feb. 8, 2010) (to be codified at 17 C.F.R. pts. 211, 231, and 241) (6290). At the most basic level, the Guidance lays out that public companies are required under SEC regulations to disclose any material risks climate change poses to its performance, covering climate change's direct effects on a company's operations and indirect effects through supply chains, regardless of whether these risks stem from climate change itself or regulatory systems and market shifts in response to climate change. *Id.* at 6291.

What the Guidance does not cover, however, is the form in which such climate-related risks should be reported, leading to incomparable and inconsistent reporting and frustrating the overarching goal of improving transparency and investor confidence. These shortcomings of inconsistency and incomparability are highlighted in responses to the SEC's 2016 Concept Release requesting comments on the adequacy of the SEC's current climate risk disclosure processes. U.S. Gov't Accountability Office, *supra* at 25. Similarly, the Government Accountability Office's (GAO's) report of its review of implementation of the Guidance (GAO Report) underlines the limitations of the current SEC climate risk disclosure program first drawn out by the 2016 Concept Release. *Id.* at 14. The GAO Report notes that climate-risk disclosures vary both in where they appear in companies' disclosures (if disclosed at all) and the level of specificity with which the company describes them. *Id.* at 16–19. For example, some disclosures simply mention a general industry-wide vulnerability to climate change without applying it within the context of the reporting company. Other companies might use quantitative mechanisms to disclose climate risks, though these are not necessarily uniform even within the same industry. *Id.* at 18–19. The inconsistencies in the disclosures impact the reviewers' ability to properly identify missing disclosures, as reviewers usually compare the reports of different companies in the same industry to identify potentially omitted disclosures. *Id.* at 19.

In light of these shortcomings, the GAO Report mentions briefly the potential for solidifying rules for climate risk disclosures under the directive of either Congress or the SEC itself. U.S. Gov't Accountability Office, *supra* at 16. Less than a year after the GAO Report came out, Senator Warren introduced the 2018 Act. Climate Risk Disclosure Act of 2018, S. 3481, 115th Cong. (2018). This Act amends the 1934 Securities Exchange Act to explicitly require climate risk disclosures using specified disclosure metrics in order to facilitate intra- and inter-industry comparisons of climate-related risk. *Id.* at § 4(a)(2)(B)(ii) (2018). Notably, the 2018 Act details what should be measured and reported, even going so far as requiring the SEC to set a social cost of carbon that public companies will then include in calculating and reporting greenhouse gas emissions costs. *Id.* at § 4(a)(2)(B)(i)(IV). This uniform climate risk disclosure scheme addresses the issue identified by the GAO Report, namely, the inconsistent climate risk reporting that has frustrated the ultimate purpose of the SEC to facilitate investment through informing investors.

Alternatively, just a week after the 2018 Act was introduced, several law professors and investors submitted a petition for rulemaking (Petition) to the SEC on environmental, social, and governance disclosure, notably including climate-related risks. Cynthia A. Williams & Jill E. Fisch, Petition to SEC for Rulemaking on Environmental, Social, and Governance (ESG) Disclosure (Oct. 1, 2018), https://www.sec.gov/rules/petitions/2018/petn4-730.pdf. The Petition differs from the 2018 Act in that it is less prescriptive as to the specific details of the uniform climate disclosure mechanism for which it calls, perhaps due to the nature of a petition *requesting* an agency to act as compared to an act *requiring* such action. Nevertheless, the Petition does point to international voluntary reporting mechanisms that have picked up traction since the 2010 Guidance, both as potential resources for disclosure metrics as well as examples of the increasing materiality of climate-related risks. *Id.* at 11. The Petition especially highlights the G20's Financial Stability Board's Task Force on Climate-related Financial Disclosures' (TCFD) industry-developed (operating companies, investors, insurance companies, and accounting) 2017 Recommendations for climate risk disclosures, which center around metrics and targets. Task Force on Climate-related Financial Disclosures, Final Report: Recommendations of the Task Force on Climate-Related Financial Disclosures 6 (June 2017). Most basically, the TCFD recommends all organizations provide Scope 1, 2, and 3 greenhouse gas emissions according to the GHG Protocol methodology, as this is the most widely recognized international standard, thereby facilitating comparison between reports. *Id.* at 22. Were the SEC to adopt this more basic metric standard as the Petition recommends, it could still address the issue of incomparability between disclosures in current climate risk disclosure practices. Thus, even though the Petition itself does not require a specific reporting mechanism as does the 2018 Act, it provides viable recommendations from which the SEC can work.

Another way to compare the congressional and SEC pathways to standard climate risk disclosures is their viability in actually moving forward through their respective political processes. The benefit of going through an amendment to the Securities Exchange Act is that it gives the SEC a congressional mandate to improve climate risk disclosure processes through an already-outlined uniform reporting system. Absent this, the SEC could be hesitant to instill such specific requirements as an unnecessary stretch of its resources. U.S. Gov't Accountability Office, *supra* at 25. On the other hand, the downside to attempting the congressional route is that the measure may never actually make it through Congress. With climate change being a highly partisan issue in an era of extreme political gridlock, it is hard to imagine how the 2018 Act will survive. In fact, while the 2018 Act moves to broaden the scope of the 2010 SEC Guidance, Republican Representative Bill Posey has attempted to nullify the 2010 Guidance multiple times over the past nine years, with one attempt making it all the way through the House before failing in the Senate. Alex Kotch & David Sirota, *Despite Irma, Florida Congressman Aims to Let Companies Hide Climate-Change Risks*, International Business Times (Sept. 11, 2017), https://www.ibtimes.com/political-capital/despite-irma-florida-congressman-aims-let-companies-hide-climate-change-risks.

Conversely, the Petition aims to enhance the disclosure requirements from within the rulemaking and enforcement tools already at the SEC's disposal. It argues that not only is requiring general climate risk disclosure within the SEC's purview as recognized through its 2010 Guidance, but so is requiring standards for such disclosures so as to make these already-communicated disclosures meaningful to the investors the SEC is mandated to serve. Petition, *supra* at 2. While it is true that this is a petition that the SEC does not have to follow, such petitions are often the first step in its rulemaking procedure. U.S. Gov't Accountability Office, *supra* at 10. To this end, a late-February 2019 petition for rulemaking on biomass and climate disclosures specifically requesting uniform climate impact and greenhouse gas emissions accounting standards further pressures the SEC to move forward with a climate risk disclosure rulemaking process. Partnership for Policy Integrity et al., Rulemaking Petition on Biomass and Climate Disclosures (Feb. 27, 2019), https://www.sec.gov/rules/petitions/2019/petn4-741.pdf.

Perhaps it is most promising to look at these two petitions as following in the footsteps of the environmental disclosure SEC rulemaking process of the 1970s, where the SEC released interpretive guidelines at the beginning of the decade, spent the rest of the decade determining if there was a need for further specific rules on environmental disclosures, before ultimately coming out with the specific environmental risk disclosure rules in the early 1980s. Guidance, *supra* at 6292. Thus, in light of the SEC's pattern of environmental disclosure rulemaking and the increasing movement toward climate change disclosures across industries, these two recent petitions will

allow for uniform climate risk disclosure rules to come out of the SEC even absent the passing of the 2018 Act.

Authors