



June 11, 2021

The Honorable Gary Gensler
Chairman
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-0213

Re: Request for Public Input on Climate Change Disclosures

Dear Chairman Gensler:

My name is Jennifer Schulp, and I am the director of financial regulation studies at the Cato Institute's Center for Monetary and Financial Alternatives. I appreciate the opportunity to provide input to assist the Securities and Exchange Commission (SEC) in its consideration of climate change disclosure. The Cato Institute is a public policy research organization dedicated to the principles of individual liberty, limited government, free markets, and peace, and the Center for Monetary and Financial Alternatives focuses on identifying, studying, and promoting alternatives to centralized, bureaucratic, and discretionary monetary and financial regulatory systems. The opinions I express here are my own.

The March 15, 2021 public statement seeking public input on climate change disclosures by then Acting Chair Allison Herren Lee posed fifteen questions for consideration. I provide specific comments below in response to Questions 3, 4, 5, 6, 9, 14, and 15. Before addressing those questions, though, I write to express skepticism about the need for mandatory minimum disclosures specifically relating to climate change and to urge the SEC to exercise caution in mandating disclosures that extend beyond the SEC's remit to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation.

The public company disclosure regime is based on a principles-based framework, rooted in the concept of materiality. Under this principles-based framework, companies are already required to disclose material climate change-related information.¹ But altering this principles-based framework to require disclosure of specific metrics, such as emissions and power consumption, has the potential to harm both U.S. capital markets and investors.

¹ Securities and Exchange Commission. "Commission Guidance Regarding Disclosure Related to Climate Change." Rel. No. 33-9106 (2010). Available at <https://www.sec.gov/rules/interp/2010/33-9106.pdf>.

I share many of the concerns previously expressed by Commissioners Peirce and Roisman.² In particular, reasonable projections about the impacts of climate change can be subjective and those issues are subject to change as both approaches to understanding climate impacts and the science underlying climate change continue to evolve. As such, prescriptive disclosure requirements in this space are difficult, if not impossible, to craft and, even if one can overcome the subjective elements of potential disclosures, prescriptive disclosure requirements have the potential to quickly become outdated or misleading. When coupled with the high costs of producing such disclosures, it is unclear that a mandatory disclosure regime can provide a net benefit.

I am also concerned that prescriptive disclosures in this area are aimed more at altering company and investor behavior, rather than providing material information to market participants to assist in the efficient pricing of capital. In this sense, prescriptive disclosures begin to look more merit-based and less like the traditional disclosure regime that contributes to the strength of the U.S. markets. Moreover, the SEC is not tasked with environmental regulation, and lacks the requisite expertise, drawing the Commission far from its statutory mandates. This not only raises questions about the scope of the SEC's authority, but also raises questions about the SEC's ability to evaluate prescriptive disclosure frameworks and fairly enforce compliance with them.

Instead, the SEC should consider that market forces are well-equipped to respond to demand for environmental sustainability efforts of companies that are not already subject to disclosure. This is particularly important because demand for such information is not limited to investors, but also comes from consumers, employees, and others. As discussed in more detail below, voluntary disclosure already provides substantial amounts of information about sustainability practices, including from almost all the country's largest publicly traded companies. Such voluntary disclosure, including disclosure made pursuant to private disclosure frameworks, is more capable of flexibly responding both to changing demands and changing science. The fact that, according to some, voluntary disclosures have not yet produced consistent or comparable information about climate change-related issues can be attributed both to evolving methodologies (and the underlying science) and the relatively recent expansion of demand for such information. Government intervention aimed at creating such consistency or comparability may be unnecessary or premature, and risks saddling companies with inflexible and quickly outdated disclosure requirements that may do more harm than good.

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² For example: Elad L. Roisman. "Keynote Speech at the Society for Corporate Governance National Conference." *Securities and Exchange Commission*, July 7, 2020. Available at <https://www.sec.gov/news/speech/roisman-keynote-society-corporate-governance-national-conference-2020>; Hester M. Peirce. "Lucy's Human: Remarks at Virtual Roundtable on The Role of Asset Management in ESG Investing Hosted By Harvard Law School and the Program on International Financial Systems." *Securities and Exchange Commission*, September 17, 2020. Available at <https://www.sec.gov/news/speech/peirce-lucys-human-091720>.

Question 3: What are the advantages and disadvantages of permitting investors, registrants, and other industry participants to develop disclosure standards mutually agreed by them? Should those standards satisfy minimum disclosure requirements established by the Commission? How should such a system work? What minimum disclosure requirements should the Commission establish if it were to allow industry-led disclosure standards? What level of granularity should be used to define industries (e.g., two-digit SIC, four-digit SIC, etc.)?

Question 4: What are the advantages and disadvantages of establishing different climate change reporting standards for different industries, such as the financial sector, oil and gas, transportation, etc.? How should any such industry-focused standards be developed and implemented?

Question 5: What are the advantages and disadvantages of rules that incorporate or draw on existing frameworks, such as, for example, those developed by the Task Force on Climate-Related Financial Disclosures (TCFD), the Sustainability Accounting Standards Board (SASB), and the Climate Disclosure Standards Board (CDSB)? Are there any specific frameworks that the Commission should consider? If so, which frameworks and why?

Question 6: How should any disclosure requirements be updated, improved, augmented or otherwise changed over time? Should the Commission itself carry out these tasks, or should it adopt or identify criteria for identifying other organization(s) to do so? If the latter, what organization(s) should be responsible for doing so, and what role should the Commission play in governance or funding? Should the Commission designate a climate or ESG disclosure standard setter? If so, what should the characteristics of such a standard setter be? Is there an existing climate disclosure standard setter that the Commission should consider?

I address Questions 3, 4, 5, and 6 together to emphasize that government-mandated disclosures are not necessary to disseminate information relevant to climate change and that government intervention has the potential to degrade the quality of information otherwise supplied by the marketplace. Companies already supply a wealth of information voluntarily, and continued evolution, consolidation, and innovation in the marketplace for this information is likely to result in further consistency and comparability of information that some think mandatory disclosures will provide.

As of 2019, 90% of the companies in the S&P 500 were publishing a sustainability report.³ That number continues to grow: our informal analysis shows that for 2020, more than 95% of the companies in the S&P 500 published a sustainability report. This represents consistent and rapid growth from 2011, where only 20% of the companies in the S&P 500 were providing such reporting. While reporting coverage has increased, the information provided also has become

³ “2020 Flash Report S&P 500: Trends on the Sustainability Reporting Practices of S&P 500 Index Companies.” *Governance & Accountability Institute*, July 16, 2020. http://www.ga-institute.com/fileadmin/ga_institute/images/FlashReports/2020/G_A-Flash-Report-2020.pdf. A different survey indicates that 98% of the largest companies in the United States published a sustainability report in 2020. “The KPMG Survey of Sustainability Reporting 2020.” *KPMG*, December 2020. <https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/11/the-time-has-come.pdf>.

“more sophisticated, mature, and decision-useful for investors and other important stakeholders.”⁴

Sustainability reporting has been driven by many factors, including peer pressure, competition, and increasing demand from investors and other stakeholders.⁵ It is important to note that although there is undoubtedly evidence of demand for ESG-investment strategies, both domestically and globally, it is difficult to say, exactly, what investor interest is with respect to climate-change specific information from companies.⁶ Because little rigorous empirical research has explored the question of investor demand, mandatory climate change-related disclosure should not be justified on the grounds that investors are demanding it without understanding more about the nature and magnitude of investor interest.⁷

Climate change disclosures have been occurring, and will likely continue to occur, without any SEC mandate. The SEC should reject calls to intervene in this private ordering, which has proven to provide substantial information and is more likely to flexibly respond to the changing conditions inherent in the climate change space.

First, and perhaps most importantly, whatever disclosure framework the SEC were to mandate, the SEC would be stepping in to pick “winners” and “losers” in an already functioning private marketplace for information. As the question itself makes clear by citing several competing disclosure frameworks (TCFD, SASB, and CDSB), there are multiple options in the space, with each offering different approaches to addressing sustainability disclosure.⁸ There is little consensus among any market participants or other stakeholders—companies, activists, consumers, employees, etc.—as to the superior disclosure framework, in part because superiority itself seems to lack a common definition and is often dependent on the circumstances.

⁴ “2020 Flash Report S&P 500: Trends on the Sustainability Reporting Practices of S&P 500 Index Companies.” *Governance & Accountability Institute*, July 16, 2020. http://www.ga-institute.com/fileadmin/ga_institute/images/FlashReports/2020/G_A-Flash-Report-2020.pdf.

⁵ *Ibid.*

⁶ Simon Jessop and Patturaja Murugaboopathy. “Sustainable Fund Inflows Hit Record High in Q1 - Morningstar.” *Reuters*, April 30, 2021. <https://www.reuters.com/business/sustainable-business/sustainable-fund-inflows-hit-record-high-q1-morningstar-2021-04-30/>.

⁷ For example, while some research points to substantial demand from clients of institutional investors to consider ESG-related issues (see Rick A. Fleming and Alexandra M. Ledbetter. “Making Mandatory Sustainability Disclosure a Reality.” *Envtl. L. Rep.* 50 (2020): 10647. Available at <https://www.sec.gov/files/making-mandatory-sustainability-disclosure-a-reality-white-paper.pdf>), other research suggests that ESG-related factors are not relevant to retail investors’ portfolio allocation decisions (see Austin Moss, James P. Naughton, and Clare Wang. “The Irrelevance of ESG Disclosure to Retail Investors: Evidence from Robinhood.” *SSRN*, June 12, 2020. Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3604847).

⁸ Indeed, the SEC failed to highlight the most-used framework, GRI. “The KPMG Survey of Sustainability Reporting 2020.” *KPMG*, December 2020. <https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/11/the-time-has-come.pdf>.

The SEC's choice of a winner in these debates will have far-reaching consequences by defining the appropriate disclosure framework, affecting the provision of information not required by mandatory disclosures, and by imposing unknown costs on companies to adopt or change their disclosure framework. The uncertainty associated with climate science and its economic effects, and the lack of convergence in existing disclosure frameworks, combined with the SEC's lack of expertise in climate change matters, presents a cause for concern.

Second, a mandated disclosure framework can be inflexible by enshrining required disclosures that are difficult to change without subsequent governmental action. While lack of flexibility sometimes can be seen as a regulatory feature—rather than a bug—in that it provides stability for regulated entities,⁹ the nature of climate change-relevant information demands dynamic and flexible standards that adapt to the constant flow of developments in the scientific, economic, and legal literature. Thus, regulatory ossification is a particularly salient concern where there is little existing consensus on disclosure frameworks—both the methods of disclosure and the aims of that disclosure—and where disclosure frameworks themselves are subject to change based on developments. Evolving understandings of climate change and a broad potential audience make it difficult to create a single, reliable, set of disclosures,¹⁰ and mandating greater levels of disclosure, based on shaky theoretical foundations, could result in less reliable disclosures.¹¹ Moreover, because climate change disclosures, whether mandatory or voluntary, are costly,¹² those costs are less likely to be justified where disclosure frameworks fail to provide useful information.

The difficulty in crafting standards to stand the test of time is multiplied when considering crafting industry-specific disclosure frameworks. (This is one reason that the existing principles-based disclosure framework is attractive because it largely avoids this question altogether.) Industries should be specifically defined to limit the situations where firms may be faced with ambiguous or irrelevant (and costly) requirements. Care must also be taken to minimize the potential distortion that occurs through inevitable advantages of some firms or industries over others through categorization and subsequent requirements. Because some firms may avoid expansion or other business practices to avoid being subjected to different sets of disclosure requirements, industry-specific disclosures have the potential to affect economic efficiency well beyond the question of climate change.

⁹ Aaron L. Nielson. “Sticky Regulations.” *U. Chi. L. Rev.* 85 (2018): 85. Available at <https://lawreview.uchicago.edu/publication/sticky-regulations>.

¹⁰ Hans Bonde Christensen, Luzi Hail, and Christian Leuz. “Economic Analysis of Widespread Adoption of CSR and Sustainability Reporting Standards.” *SSRN*, January 25, 2019. Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3315673.

¹¹ For a similar argument, see Jonathan R. Macey “Efficient Capital Markets, Corporate Disclosure, and Enron.” *Cornell L. Rev.* 89 (2004): 394. Available at <https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=2947&context=clr>.

¹² See Hans Bonde Christensen, Luzi Hail, and Christian Leuz. “Economic Analysis of Widespread Adoption of CSR and Sustainability Reporting Standards.” *SSRN*, January 25, 2019. Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3315673.

Third, and relatedly, there is limited evidence that private ordering is not a sufficient solution for the perceived gaps in climate change-related disclosures. Chairman Gensler, in particular, opined during his confirmation hearing about the SEC's role in "help[ing] to bring some consistency and comparability" to climate risk disclosures. But there is little evidence that the SEC is needed to fill this role or that the SEC would do a better job than existing market-based solutions.

Corporate environmental sustainability disclosures—and ESG-disclosures more generally—have come to fruition as a result of exogenous demand for such information, and an industry has grown up around the provision of such information. This industry is comparatively new and continues to rapidly change. As the industry matures, it is likely to see some convergence in terms of standard setting bodies; indeed, on June 9, 2021, SASB and IIRC announced a merger to form the Value Reporting Forum. The SEC should allow for further evolution and innovation through private ordering, particularly given the substantial conflict between reporting frameworks and standards. If the concern is with consistency in reporting, there is no reason that consistency achieved through private ordering should be less desirable than government-imposed consistency; in fact, such consistency and comparability would be more desirable because voluntary disclosures are more able to adapt to changing circumstances.

Finally, it is worth noting that the voluntary disclosure of climate change-related information itself can provide valuable signals to the market. Sustainability disclosures and sustainability activities can be used to signal firm health,¹³ and investors can receive important information about a company through its voluntary disclosure, which may be dampened if there is mandatory disclosure for all companies.

Question 9: What are the advantages and disadvantages of developing a single set of global standards applicable to companies around the world, including registrants under the Commission's rules, versus multiple standard setters and standards? If there were to be a single standard setter and set of standards, which one should it be? What are the advantages and disadvantages of establishing a minimum global set of standards as a baseline that individual jurisdictions could build on versus a comprehensive set of standards? If there are multiple standard setters, how can standards be aligned to enhance comparability and reliability? What should be the interaction between any global standard and Commission requirements? If the Commission were to endorse or incorporate a global standard, what are the advantages and disadvantages of having mandatory compliance?

While a single set of global standards would ease compliance burdens for companies subject to disclosure requirements, global standards are not a necessary, or desirable goal, for climate change disclosures.

¹³ See Ali Fatemi, Martin Glaum, and Stefanie Kaiser. "ESG Performance and Firm Value: The Moderating Role of Disclosure." *Global Finance Journal* 38 (2018): 45-64; Steven F Cahan, Chen Chen, Li Chen, and Nhut H. Nguyen. "Corporate Social Responsibility and Media Coverage." *Journal of Banking & Finance* 59 (2015): 409-422.

Aiming for a global standard—particularly when considering compromises to make one happen—discounts the importance of variation in international legal structures and best practices based on domestic economic conditions and the demand for disclosures. To state the obvious, the U.S. disclosure regime itself is not congruent with other disclosure regimes, including European disclosure requirements.¹⁴ Attempting to find a disclosure compromise that works well worldwide may be a fool’s errand, and the U.S. should not compromise its own disclosure regime, which has resulted in the best capital markets in the world, to fit a global standard.

Global standards themselves also amplify the risks of ossified regulation, because changing such standards would depend on world-wide assent, which is even more difficult to achieve than a single country’s modification to its own rules. Again, this is a particularly acute challenge given the fast-changing nature of climate change science and public opinion in this space.

While it may be easy to compare the benefits of globally harmonized climate change disclosure standards with the benefits of international accounting standards, there’s reason for caution in making such a comparison. Putting aside the difficulty in achieving international accounting standards—and putting aside the fact that achieving harmonization on accounting standards is likely an easier task than harmonization on climate change (or other social) standards—the ultimate benefits of harmonization that proponents point to may not have resulted from a global standard. Some studies have found that harmonization of international accounting standards coincided with higher quality of disclosures, and as a result, improved analyst forecasts of company earnings.¹⁵ But other studies attributed much of the improvement in disclosure quality to factors outside of harmonization, such as improvements in investor relations and new rules for measuring relevant variables.¹⁶ It is also tempting to overlook the role that non-governmental forces played in harmonization,¹⁷ again, lending support to the idea that market forces may support convergence of climate change disclosures in the absence of governmental mandates, better preserving flexibility and responsiveness to changing situations.

¹⁴ For example, European disclosure regimes depart from the U.S. disclosure regime in their conception of “materiality.” See David Katz and Laura McIntosh. “Corporate Governance Update: ‘Materiality’ in America and Abroad.” *The Harvard Law School Forum on Corporate Governance*, May 1, 2021. Available at <https://corpgov.law.harvard.edu/2021/05/01/corporate-governance-update-materiality-in-america-and-abroad/#more-137820>.

¹⁵ Hollis Ashbaugh and Morton Pincus. “Domestic Accounting Standards, International Accounting Standards, and the Predictability of Earnings.” *Journal of Accounting Research* 39, no. 3 (2001): 417-434.

¹⁶ Martin Glaum, Jörg Baetge, Alexander Grothe, and Tatjana Oberdörster. “Introduction of International Accounting Standards, Disclosure Quality and Accuracy of Analysts’ Earnings Forecasts.” *European Accounting Review* 22, no. 1 (2013): 79-116.

¹⁷ Ann B. Murphy. “The Impact of Adopting International Accounting Standards on the Harmonization of Accounting Practices.” *The International Journal of Accounting* 35, no. 4 (2000): 471-493.

Question 14: What climate-related information is available with respect to private companies, and how should the Commission’s rules address private companies’ climate disclosures, such as through exempt offerings, or its oversight of certain investment advisers and funds?

The SEC should not extend any climate change-related disclosure requirements to private companies. Private companies generally are not subject to disclosure requirements, including on such fundamental information as their financial status. Requiring climate change disclosures from private companies would be a substantial change to the regulatory regime. There seems to be little justification for considering climate risk to be a uniquely important factor, justifying disclosure even where a company may maintain private financial information. Indeed, the lack of disclosure from private companies is premised on the sophistication of the market participants, who are assumed to be capable of negotiating for information important to their investment decisions. The same should be assumed of their sophistication to negotiate regarding relevant climate change information. Given this structure, the only justification for requiring climate change-only disclosure from private companies seems to be to encourage behavior changes—a “name and shame”-type of strategy—which is inconsistent with the disclosure-based system of U.S. securities laws and outside the remit of the SEC.

It is important to note that the cost of disclosures is even more important when imposed on private companies than when imposed on public companies. If disclosure were to be required of private companies, that disclosure should be scaled (like it should be for public companies) and ideally not required of the smallest companies. However, to the extent that disclosure is scaled, friction will exist at each disclosure step-up point, distorting company growth and affecting companies’ decisions to grow or seek capital that would require them to engage in higher levels of expensive disclosure.

With respect to investment advisers or funds who represent to their investors that they are following a sustainable—or other ESG—strategy, their statements about their strategy should be evaluated in the same manner that other representations to investors are evaluated. Following a strategy dedicated to environmental impact analysis should not subject an adviser or fund to a higher standard of diligence or care than any other strategy.

Question 15: In addition to climate-related disclosure, the staff is evaluating a range of disclosure issues under the heading of environmental, social, and governance, or ESG, matters. Should climate-related requirements be one component of a broader ESG disclosure framework? How should the Commission craft climate-related disclosure requirements that would complement a broader ESG disclosure standard? How do climate-related disclosure issues relate to the broader spectrum of ESG disclosure issues?

To the extent that the Commission adopts mandatory climate change disclosures, it should not create a broader ESG disclosure framework. Because “ESG” is often shorthand for a broad, and diverse, array of potential disclosure topics, it is difficult to speak with any specificity in response to this question. But to the extent that investors, consumers, or others are interested in certain information from companies, the same voluntary disclosures and private ordering can continue to provide that information. But the case for government intervention in requiring mandatory

disclosures on some unknown subset of social issues or other environmental issues is even weaker than for climate change-related disclosures. Not only are these issues more politically charged and more subject to change based on popular sentiment, but they are also inherently less suitable for meaningful qualification and standardization. The SEC similarly lacks meaningful expertise to determine an appropriate disclosure framework in these politically controversial areas.

* * *

Thank you for the opportunity to share my perspective regarding the drawbacks to mandating climate change-related disclosure when voluntary disclosures are better positioned to provide a broad audience with information that can adapt to uncertain and changing conditions.

Sincerely,

A handwritten signature in black ink, appearing to read 'J. Schulp', written in a cursive style.

Jennifer J. Schulp
Director of Financial Regulation Studies
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