Securities Regulation Daily Wrap Up, TOP STORY—Gensler: SEC action on climate disclosure by end of 2021, (Jul. 28, 2021)

Securities Regulation Daily Wrap Up

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SEC chair says consistent and comparable disclosures, and fund naming, need to be addressed.

Citing investor demand and the need to keep up with the times, SEC Chair Gary Gensler made a call for SEC action to propose standardized climate change disclosures by the end of this year. "When it comes to climate risk disclosures, investors are raising their hands and asking regulators for more," he said. The remarks were made in an event sponsored by institutional investor group Principles for Responsible Investment. The SEC gathered 550 unique comments on climate change disclosures through July 21 after then Acting Chair Allison Herren Lee issued a public statement on the issue in March. Three out of four of these comments supported mandatory climate disclosure rules, Gensler said. Thousands more comments came in on standardized letters.

New disclosures are nothing new. The chair cited the SEC's history of adding new disclosures that are now considered essential information for investors. Initially disclosures were about financial performance, followed by investor demand for information on who runs a company, then information about how they were compensated. He said in 1964 the SEC started to offer guidance about risk factors and in 1980 they added the MD&A section to Form 10-K. These disclosures came with opposition but they have become "integral to our regime," he said. "Investors are looking for consistent, comparable, and decision-useful disclosures so they can put their money in companies that fit their needs."

Chair Gensler referenced one report that found two-thirds of companies in the Russell 1000, and 90 percent of the 500 largest, published sustainability reports in 2019 that used various third-party reporting standards. But comparability is lacking. Using Olympic gymnastics as an example, Gensler noted how fans want to compare the performance of the competitors quantitatively and qualitatively, as well as across countries and generations. "Investors today are asking for that ability to compare companies with each other. Generally, I believe it's with mandatory disclosures that investors can benefit from that consistency and comparability. When disclosures remain voluntary, it can lead to a wide range of inconsistent disclosures."

Form 10-K is being considered as the vehicle for these disclosures, he said, which should contain sufficient detail to be "decision-useful." Qualitative and quantitative answers to questions like how company leaders are managing climate risks and opportunities and adjusting strategy, as well as metrics on greenhouse gas emissions, the financial impact of climate change, and progress toward climate goals, could meet investor demand for more information.

Hinting at the potential complexity of specific new disclosures, the chair used the example of "Scope 3" greenhouse gas emissions. Scope 1 and 2 emissions are related to a company's operations and use of electricity and resources. Scope 3 emissions are a measure of the greenhouse gas emissions of companies in an issuer's value chain. He has asked staff to make recommendations about how Scope 1 and 2 emissions can be disclosed, and whether Scope 3 emissions should be disclosed.

SEC staff is considering the question of whether companies should provide "scenario analyses" on how a business might adapt to the physical, legal, market, and economic changes related to climate change. That could entail disclosure of "transition risks" associated with an issuer's stated commitments or compliance requirements from certain jurisdictions.

The chair also referred to "net zero" commitments and other announcements from companies about their intentions to reduce greenhouse gas emissions by certain dates. Companies can make those claims without providing any information to stand behind it, he said. "For example, do they mean net zero with respect to Scope 1, Scope 2, or Scope 3 emissions?"

The requirements of jurisdictions companies operate in, such as those countries signed on to the Paris Agreement, could mean regulatory or economic changes in those countries. The staff is looking for useful data that companies might use to inform investors about how they are meeting those requirements. The chair said many commenters to Commissioner Lee’s public statement referred to the Task Force on Climate-related Financial Disclosures framework recently endorsed by the Group of Seven. "I’ve asked staff to learn from and be inspired by these external standard-setters. I believe, though, we should move forward to write rules and establish the appropriate climate risk disclosure regime for our markets, as we have in prior generations for other disclosure regimes."

Fund names rule. The SEC requested comment on fund names in March of 2020, and "truth in advertising" in fund names is also on the Commission’s radar in the context of climate change. Investors need objective figures to judge funds calling themselves "green," "sustainable," "low-carbon," and the like, said Gensler. "I think investors should be able to drill down to see what’s under the hood of these funds."

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