Stanford Law School
Law and Policy Lab

June 14, 2021

The Honorable Gary Gensler
Chair
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549

Re: Response to Call for Public Input on Climate Change Disclosures

Dear Chair Gensler:

The Climate Risk Disclosure Law and Policy Lab at Stanford Law School welcomes the opportunity to respond to the Securities and Exchange Commission's request for input on climate-related financial disclosures. We are pleased to submit this comment for consideration.

About the Law and Policy Lab Programs at Stanford Law School

The Law and Policy Lab Programs at Stanford Law School are committed to finding solutions to some of our most pressing issues. Under the guidance of seasoned faculty advisers, Law and Policy Lab students counsel real-world clients in such areas as education, copyright and patent reform, governance and transparency in emerging economies, policing technologies, and energy and the environment. Policy labs address problems for real clients, using analytic approaches that supplement traditional legal analysis. The clients may be local, state, or federal public agencies or officials, or private non-profit entities such as NGOs and foundations. Typically, policy labs assist clients through empirical evidence that scopes a policy problem and assesses options and courses of action. The resulting deliverables reflect the needs of the client grounded in the law school's belief that systematic examination of societal problems, informed by rigorous data analysis, can generate solutions to society's most challenging public problems.

Co-taught by Graham Steele, Alicia Seiger, and Tom Heller, the Climate Risk Disclosure Law and Policy Lab was convened with the goal of helping design climate-related disclosure and reporting processes at the state and federal level. The Stanford graduate students in the policy lab, drawn from the schools of law, business, and engineering, were tasked with (1) researching best-in-class disclosure and reporting processes, data sources and scenarios; and (2) drafting position papers on key questions. This comment letter presents the consolidated findings from empirical research and qualitative analysis relevant to the development of appropriate climate-related risk disclosures.

Summary of Recommendations

Environmental, social, and governance (ESG) considerations and climate-related risks have become a priority for many corporations and investors around the world, as they increasingly recognize the importance of understanding and preparing for material and systemic climate-related risks facing the financial and real economy. Many companies are assessing their own exposure to climate change-related risks and are integrating these factors into their risk management processes and capital budgeting decisions. Large institutional investors are also requiring portfolio companies to disclose climate-related information to understand potential impacts of climate change to their assets and portfolios, and, thereby, aim to get an accurate valuation and efficient allocation of capital.

Even with this newfound commitment however, companies and investors lack much of the necessary information to perform these risk assessments. In most of the world, including in the United States, there are few legal requirements for investors and asset managers to disclose their climate risks. It is critical for the Commission to develop a clear framework for disclosure that will provide investors with detailed information about the growing physical and transition climate-related risks that companies face, the potential impacts of these risks on long term value, and the strategies that companies are developing to manage these risks.

The mandate of Stanford Law and Policy Labs is to conduct impartial, evidence-informed policy analysis through analytical approaches that supplement traditional legal approaches. The students in the Climate Risk Disclosure Law and Policy Lab conducted extensive academic research and interviews with key stakeholders, including asset owners, corporate executives, and policymakers. Based on this work, the Policy Lab proposes the following recommendations for the SEC in its ongoing development of a climate-related risk disclosure framework:

1. The Commission should consider a climate-related risk disclosure framework that requires disclosure of basic mandatory items through a “comply or explain” approach, while providing evolving standards for more complex requirements.

2. The Commission should consider a climate-related risk disclosure framework that facilitates the near-term implementation of mandatory disclosure items but allows for more sophisticated risk assessments to be phased in over time.

3. The Commission should consider a climate-related risk disclosure framework that includes a standardized methodology for forward-looking climate-risk scenario analysis and scope 3 emissions, as well as near-term protection for good faith compliance efforts.

4. The Commission should consider a climate-related risk disclosure framework developed by an independent standard-setting body with SEC oversight to promote a framework that is consistent, transparent, and evidence-based.

Discussion of Recommendations

1. **The Commission should consider a climate-related risk disclosure framework that requires disclosure of basic mandatory items through a "comply or explain" approach, while providing evolving standards for more complex requirements.**

Any proposed framework should require the disclosure of the most basic and essential climate-related risk information in order to facilitate greater standardization across companies and asset managers. The various voluntary disclosure frameworks, such as those created by the Task Force on Climate-Related Financial Disclosures (TCFD) and the Sustainability Accounting Standards Board (SASB), while an important step toward increased disclosure, lack consistency in key concepts that make them insufficient for investors to make meaningful risk assessments. These voluntary frameworks also fail to produce essential information that is comparable between business or across sectors and have historically been used to make climate risk reporting a public relations exercise rather than a critical risk management function.

Mandatory disclosure requirements, particularly related to basic climate-related risks, could therefore help to improve and standardize key information available to the market. In particular, a rules-based framework that requires certain material disclosures by sector would enhance transparency and increase comparability between companies within industries. It is clear that climate change-related risks faced by companies are not universal across all sectors, and the materiality of different risks across various industries require disclosures specific to individual industries. To properly help investors understand the physical and transition climate-related risks faced by different industries and the resilience of strategic plans to respond to, and manage, these risks, a framework should have mandatory disclosure standards that identify common material drivers of risk and value unique to a given industry.

To facilitate compliance with this mandatory disclosure framework while providing flexibility for filers, the SEC should consider adopting a "comply or explain" approach, along with a monitoring mechanism for all mandatory climate risk disclosures, in a manner consistent with the U.S. securities laws. This "comply or explain" approach should apply to all mandatory disclosure items – meaning that companies that do not make specific disclosure must provide an explanation to investors as to why they are not in compliance. While there are important differences between the legal regimes in France and the United States that must be considered, under Article 173-VI in France and more generally in the European Corporate governance system, the "comply or explain" approach has been a successful avenue in promoting a high level of compliance. Companies have tended to comply to avoid providing lengthy explanations for why they are not reporting, as well as in order to avoid reputational costs. The flexibility of the "comply or explain" approach also has found support from market participants.

The ultimate decision regarding which material disclosure items should be included as mandatory in an initial framework should reflect careful consultation with experts, incorporate input from key stakeholders in a transparent rulemaking process, and capture the unique transition risks faced by each industry. The resulting framework should provide companies and asset managers with initial flexibility in reporting more complex disclosure items specific to the industry that are not yet mature. Finally, to prevent temporary exemptions from reporting requirements into permanent ones, standards for these more complex requirements should transition from qualitative and general to quantitative and specific as disclosure and assessment capabilities improve.

2. **The Commission should consider a climate-related risk disclosure framework that facilitates the near-term implementation of mandatory disclosure items but allows for more sophisticated risk assessments to be phased in over time.**

Among global financial regulators and thought leaders, there is substantial support for implementing a disclosure regime beginning in 2023. Several factors support near-term adoption of a disclosure regime. First, to the extent that other foreign regulatory regimes begin to adopt 2023 (or earlier) as a mandated start date for various climate-related disclosures, in the absence of a U.S. disclosure regime, U.S. corporations with international operations may instead be subject to overlapping international regulatory requirements. Second, at this point, companies have already had significant exposure to the voluntary disclosure concepts provided by the TCFD and preliminary SEC guidance, and one to two years of additional time is likely sufficient for larger public companies to formally comply with more basic disclosure requirements.

However, it is also important to recognize that certain types of disclosure may initially be particularly difficult to comply with, and the Commission should be flexible in requiring these types of risk disclosure by implementing an evolving standard for more sophisticated requirements. In particular, for scenario analysis related to multi-faceted transition risks and scope 3 emissions, even many of the largest companies are having to outsource from top accounting and consulting firms. While it is likely that larger organizations will eventually be able to develop these capabilities, it may be unduly burdensome for many smaller companies to develop the same in-house capabilities or afford outsourcing for necessary assessments.

As a result, for these more difficult disclosure requirements, the Commission should consider phasing in these requirements by tier, perhaps initially beginning with large accelerated filers in 2023 and following with smaller filers over time. This would allow the SEC to work with most well-resourced organizations (and which include many of the largest greenhouse gas emitters) to develop standardized practices for complex scenario analysis. These initial analyses could set the example for other companies for both governance processes (e.g., the group within an organization tasked with overseeing these assessments) and reportable outcomes of these risk assessments (e.g., the quantitative and qualitative outputs for these assessments). It is important that any disclosure regime does not overwhelm smaller entities that do not immediately have the capabilities to conduct complex risk analysis. Adopting a disclosure framework which accounts for the capabilities of various organizations will ensure that they are able to disclose their climate risks without undue costs, providing for increased acceptance of the framework.

3. **The Commission should consider a climate-related risk disclosure framework that includes a standardized methodology for forward-looking climate-risk scenario analysis and scope 3 emissions, as well as near-term protection for good faith compliance efforts.**

The SEC should consider proposing specific measurement methodologies and best practices for reporting forward-looking and externally-facing climate risks and provide some protection for filers who comply with these requirements. A comprehensive climate risk regime must explore both physical and transition risks, including forward-looking scenario analysis and scope 3 emissions. However, current future climate risk analyses remain heterogeneous, limited, and based on incomplete assumptions. Few organizations are evaluating scope 3 emissions, or using scenario-based analysis, even though doing so is essential to analyze climate risks. Transition risks are analyzed with regard to the price of carbon without considering the risks of changes in companies' business models. Physical risks are also often limited to exposure to extreme weather events, without considering chronic events such as rising sea levels, desertification etc. For those entities that are attempting to evaluate these risks, it is neither clear nor consistent how these climate risk modeling assessments fit into the broader risk management framework of companies or asset managers, as climate risk management functions vary substantially between organizations.

Any forward-looking climate risk analysis requires a myriad of assumptions, inputs and modeling choices which ultimately result in a great diversity of methodologies, metrics, and tools available to corporations and asset managers. Several corporate leaders expressed their struggle in choosing between the multitude of competing methodologies for modeling their climate risks, as well as confusion of who within the organization would be most appropriate to oversee these analyses. To address this, a proposed guidance framework could establish a standard set of scenario modeling methodologies, assumptions, and best practices. This approach would provide further guidance and clarity to companies on how to develop and sensitize these models and where within an organization these risk assessments should be taking place. Having a guidance framework would also enhance the comparability and standardization of the results of these scenario analyses for investors and asset managers.

Additional concerns were expressed about facing potential liability for forward-looking scenario analysis and external emissions considerations, particularly without specific guidance from the SEC. These liability and regulatory concerns could be addressed through temporary measures limiting civil and enforcement actions related to good faith climate risk disclosures, changing the liability standard of forward-looking climate projection scenarios, or creating a statutory safe harbor as corporations are developing their reporting capabilities. Implementing such protections would give companies the opportunity and incentive to develop more sophisticated climate-related risk reporting functions and improve on these capabilities without fear of litigation or regulatory sanction.

4. **The Commission should consider a climate-related risk disclosure framework developed by an independent standard-setting body with SEC oversight to promote a framework that is consistent, transparent, and evidence-based.**

As companies and investors look to the Commission to standardize relevant climate-related risk disclosures, having an independent body under SEC oversight could provide greater credibility with the market and increased flexibility to respond to unforeseen challenges. Just as the Financial Accounting Standards Board (FASB) serves as an independent third-party standard setter used by the SEC in the financial accounting context to provide legitimacy, transparency, and expertise in rulemaking, an analogous standard setter could be established for climate-related risk disclosures. Like FASB, this organization should be structured to incorporate ongoing input and expertise from policymakers, companies, and investors, and in doing so building institutional legitimacy, promoting transparency in the rulemaking process, and insulating future frameworks from arbitrary changes resulting from political pressures.

Additionally, developing a comprehensive climate-related risk framework across all relevant industries will require substantial resources and expertise. While these activities could potentially be done by the SEC itself, using a standard setting body while providing oversight capacity would free up the Commission's limited resources toward other activities. A third-party standard setter with an ongoing future commitment to climate-risk standard setting might also be better suited to address which requirements should initially be mandatory, as well as come to conclusions on questions of industry specificity, tiering, and phasing discussed above.

Finally, an independent standard setting body could provide ongoing review and revision of the proposed framework well into the future. This independent standard setting body would allow for ongoing monitoring of compliance with the disclosure framework after its implementation, which will be critical in providing a better understanding of the quality of the reporting, assessing whether the disclosure regime is accomplishing its envisioned goals, and making information more easily accessible to companies and investors. An entity that is able to provide ongoing review of the existing framework for companies and investors will improve the quality of the disclosure framework and allow it to continue to evolve in response to new climate-related risks that continue to emerge in the future.

Conclusion

We greatly appreciate the Commission's time in reviewing our input and look forward to further engagement on these recommendations.

Respectfully,

The Climate Risk Disclosure Law and Policy Lab at Stanford Law School

Cc: The Honorable Allison Herren Lee
The Honorable Caroline Crenshaw
The Honorable Hester Peirce
The Honorable Elad Roisman