Climate Change Alert

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Chair Gensler Makes Renewed Case for Mandatory Climate Risk Rules

August 5, 2021

In a speech last week before the Principles for Responsible Investment's "Climate and Global Financial Markets" Webinar, the Securities and Exchange Commission's (SEC) Chair Gary Gensler made another case for mandatory climate risk disclosure rules.

Drawing parallels between the Olympics and public disclosure, Gensler noted that the Olympics' standardized scoring system allows for comparability in evaluating athletes across performances or across generations, much like a standardized disclosure system allows for comparability across companies and industries. He also stated that changes in fans' tastes allowed for Olympics to evolve with new events and additional participants, much like investors' desire for additional and new types of information led to the advent of risk factor disclosure and Management's Discussion and Analysis.

Gensler asserted that investors increasingly want to understand public companies' climate risks and are looking for consistent, comparable and decision-useful disclosures to help them invest in companies that fit their needs. Supporting this claim, he cited the more than 550 unique comment letters that have been submitted in response to SEC Commissioner Allison Herren Lee's request for public comment on climate change disclosures, of which three out of every four letters support mandatory climate risk disclosure rules. Gensler remarked that companies are trying to meet the demand for climate information, citing a report that nearly two-thirds of companies in the Russell 1000 Index, and 90% of the 500 largest companies in that index, published sustainability reports in 2019 using various third-party standards. Contending that companies and investors alike would benefit from clear rules of the road and that the SEC should step in when there is a heightened level of demand for information relevant to investor decisionmaking, Gensler noted that he has asked SEC staff (Staff) to develop a mandatory climate risk disclosure rule proposal for the Commission's consideration by the end of the year.

After offering his views on why mandatory climate risk disclosure rules are needed, Gensler addressed some of the specific attributes he asked the Staff to consider in drafting the rule proposal:

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Consistency and Comparability – Gensler noted that the new rules should be consistent and comparable, arguing that information consistency leads to comparability between companies, today and over time.

Mandatory, not Voluntary – Gensler argued that mandatory disclosures allow for consistency and comparability, while voluntary disclosures allow for a wide range of inconsistent disclosures.

Disclosure Vehicle – Gensler did not state any preference, but noted that he asked the Staff to consider whether these disclosures should be filed in the Form 10-K, alongside other information that investors use to make their investment decisions.

Decision Useful – Gensler asserted that the new disclosures must provide sufficient detail so that investors can gain helpful information, adding that in appropriate circumstances, he believes prescribed disclosure strengthens comparability.

Qualitative Disclosures – Addressing the more subjective aspects of the proposed disclosure, Gensler stated that qualitative disclosures could answer key questions, such as how a company's leadership manages climate-related risks and opportunities and how these factors feed into the company's strategy.

Quantitative Disclosures – Addressing the more objective aspects of the proposed disclosure, Gensler stated that quantitative disclosures could include metrics related to greenhouse gas emissions, financial impacts of climate change, and progress towards climate-related goals. He also stated that the disclosures could include metrics for specific industries, such as banking, insurance, or transportation.

Greenhouse Gas Emissions – Noting that some companies currently provide voluntary disclosures related to Scope 1 emissions (those from a company's operations) and Scope 2 emissions (those from use of electricity and similar resources), Gensler added that many investors have been seeking information on Scope 3 emissions (those of other companies in the reporting company's value chain). He revealed that he had asked the Staff to make recommendations about how companies might disclose their Scope 1 and Scope 2 emissions, along with whether to disclose Scope 3 emissions and, if so, how and under what circumstances.

Scenario Analyses – Gensler commented that the new rules might address how a business might adapt to the range of possible physical, legal, market and economic changes that it might contend with in the future. Such analyses might cover the physical risks associated with climate change or the transition risks associated with stated commitments or requirements from jurisdictions in which the companies operate.

Independent Standard– While acknowledging the benefit of external standard-setters, such as the Task Force on Climate-related Financial Disclosures (TCFD) framework, and imploring the Staff to learn from and be inspired by such groups, Gensler resolved that the SEC should independently move forward to write rules and establish the appropriate climate risk disclosure regime for its markets, as it has done in prior generations for other disclosure regimes.

Before closing, Gensler turned to address investment funds, what he termed as the other side of the equation, noting that although many market themselves as "green," "sustainable," or "low-carbon," there is currently little objective information available for an investor to validate such claims. To address this problem, Gensler remarked that he had directed the Staff to consider recommendations about whether fund managers should disclose the criteria and underlying data they use and to consider whether the SEC might take a holistic look at the Names Rule, which, for instance, stipulates that if a fund's name suggests a particular investment type, the fund must invest at least 80% of the value of its assets in that investment type.

Chair Gensler closed by commenting that investors have expressed the climate risk disclosures they want to see from public companies and investment funds. It is now time, as he remarked, for the Commission to take the baton.

To stay abreast of the latest developments, be sure to monitor our Speaking Sustainability blog and Twitter account, both of which we update regularly with input from our cross-disciplinary securities and climate experts.

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