

**ICGN**International Corporate Governance Network
Inspiring good governance & stewardship

Vanessa A. Countryman, Secretary
100 F Street, NE
Securities and Exchange Commission
Washington, DC 20549-1090

Via email : rule-comments@sec.gov

17 June 2022

Dear Secretary Countryman,

**File Number: S7-10-22. The Enhancement and Standardization of
Climate-Related Disclosure for Investors**

The International Corporate Governance Network (ICGN) welcomes the Securities and Exchange Commission's consultation and request for comment on the Enhancement and Standardization of Climate-Related Disclosure for Investors.

Led by investors responsible for assets under management of around \$70 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship. Headquartered in London, our membership is based in more than 45 countries and includes companies, advisors, and other stakeholders. We are proud that leading pension funds and asset managers in the United States support ICGN as highly active and effective members. ICGN offers an important international investor perspective on corporate governance and investor stewardship to help inform public policy development and the encouragement of good practices by capital market participants. For more information on the ICGN, please visit www.icgn.org

ICGN wishes to underscore that in addition to the SEC, regulators in other major markets (notably the European Union) and standards-setters at the International Sustainability Standards Board (ISSB) are also now working towards establishing climate-related disclosure requirements.¹ This presents a unique and historic opportunity for coordination to establish a truly global set of requirements that can meet the needs of both local and international markets. At the same time ICGN and its investor members remain alert to the risk of regulatory fragmentation that could present obstacles in achieving a globally agreed baseline across jurisdictions. We urge the SEC to continue to observe developments outside the US and work constructively with foreign regulators and standards-setters to realize the vision of global alignment.²

ICGN believes that a Globally-aligned regulatory structure with agreed targeted outcomes to address climate-related risk is crucial. Globally-aligned disclosures backed by regulation and enforcement should ensure that investors are in a position to assess climate-related risks and opportunities, measure progress towards reducing company and investor-specific climate risks and advance towards a net zero greenhouse gas (GHG) emissions economy. Given the long-term perspective of our investor members, particularly pension funds and asset managers, promotion of robust disclosure is a fundamental requirement, that builds from their fiduciary duties to their beneficiaries. Global alignment will both facilitate robust comparisons and reduce the regulatory burden for registrants. For these reasons we support the SEC's positioning of the Taskforce on Climate-Related Disclosure (TCFD) as the center of climate disclosure regulation.

In this letter, we affirm the positioning of the TCFD as the center of climate disclosure regulation, and then focus on areas we believe need strengthening. These include governance, transition plans, scenario analysis, greenhouse gas emissions disclosure and financial statements.

¹ [Financial Conduct Authority, *Enhancing Climate-Related Disclosures by Asset Managers, Life Insurers, and FCA-Regulated Pension Providers*](#), June 2021 and [Financial Conduct Authority, *Enhancing Client-Related Disclosures by Standard-Listed Companies*](#), December 2021.

² See the statement issued by the [World Business Council for Sustainable Development, the International Federation of Accountants and the Principles for Responsible Investment](#)

The Challenge

ICGN commends the SEC for taking up the challenge of enhancing requirements for corporate climate-related disclosures. This initiative is timely and crucially important. Climate change presents a systemic risk to capital markets, the world's environment and broader society. For investors, systemic risk is defined as the risk that the financial system, or a major part of it, is in real and immediate danger of collapse or serious damage with the likelihood of material damage to the real economy. The nature of systemic risk is that it builds over time, it is interactive and synergistic and, once in play, is difficult to control.³

There is a global consensus that climate change presents arguably the most severe systemic risk to business, to investors, to the economy and to society. The most recent reports of the Intergovernmental Panel on Climate Change (IPCC) affirm levels of scientific certainty and warn of increasingly complex dynamics and severely adverse impacts.⁴

The 2021 United Nations Climate Change Conference (COP26) in Glasgow served to underscore this global consensus and, with the creation of the Glasgow Financial Alliance for Net Zero (GFANZ), positions the financial sector as critical to efforts to tackle the climate challenge.⁵ Indeed, a new bar has been set as an increasing number of corporations and investors are developing transition plans with near, medium and far term performance benchmarks to reach net zero greenhouse gas emissions by 2050 or sooner.⁶

Capital markets participants around the world are addressing the challenges presented by climate change. In this context, capital markets regulators have a central role to play. Properly designed disclosure requirements will allow investors to assess and price climate risk. This will allow for more efficient allocation of capital towards companies most able to respond to climate change through climate mitigation, adaptation, and the provision of solutions to climate change causes and impacts.

In this demanding context, climate disclosures are currently scattered across media releases, websites, 10-Ks, sustainability reports and annual reports. The state of disclosure is incommensurate with the demands of investors for rigorous, consistent, comparable, verifiable reporting backed by enforcement. ICGN seeks to advance a global disclosure framework that will, above all, ensure capital allocation that underpins sustainable economic growth consistent with a 1.5-degree Celsius target. This needs to be delivered in a way that levels the global playing field, eliminates jurisdiction-shopping, eases comparability of data and minimizes the regulatory burden for registrants.

Proposed Framework: The Taskforce on Climate-Related Financial Disclosures (Section II.A.1)

In this context, the SEC has appropriately based climate-related disclosures on the requirements specified in the Task Force on Climate-Related Financial Disclosures (TCFD). ICGN strongly endorses the TCFD framework.

The direction of travel is clear, rapid, and accelerating. TCFD-aligned reporting is where the world is going, and the speed of regulatory developments will increase in 2022. It is in this context that

³ [ICGN, *Investor Framework for Addressing Systemic Risks*](#), June 2019.

⁴ [Intergovernmental Panel on Climate Change, *Sixth Assessment Report*](#), March 2022

⁵ [Glasgow Financial Alliance for Net Zero](#)

⁶ In recognition of this, ahead of COP 26, ICGN published a [Statement of Shared Climate Change Responsibilities to address climate related priorities for companies, investors, auditors, regulators and standard setters](#). ICGN *Statement of Shared Climate Change Responsibilities to the United Nations Climate Change Conference of the Parties 26 (COP 26)*, 20 October 2022

ICGN offers comments on the SEC modifications to the TCFD recommendations. Our remarks draw from established ICGN positions on climate-related disclosure, our submission to the Canadian Securities Administrators in March 2022 and our 2021 submission to the U.S. Securities and Exchange Commission (SEC) on climate change disclosures.⁷ Our recommendations to the SEC follow the structure of the TCFD framework: governance, strategy, risk management, and metrics and targets. In addition, we set out our support for enhanced financial statement disclosures that follow from – and ensure consistency with – the narrative disclosures under TCFD. As proposed by the SEC, these are a vital part of ensuring economically efficient financial markets and thus capital allocation.

Governance (Item 1501)

ICGN supports the proposed rule's inclusion of governance-related disclosures for boards of directors. A board has the ultimate oversight of climate-related risks, which should be part of a robust business strategy linked to a sustainable, long-term approach and embedded in all required financial and narrative reporting.

The ICGN *Global Governance Principles (GGP)*, sets out the requirements for board members related to climate risk, who are responsible for: overseeing the company's risk assessment and management (including relevant systemic risks such as climate change, ecological degradation, social inequality and digital transformation) that affect sustainable value creation and preservation and reviewing policies annually, or with any significant business change.⁸

More specifically, Principle 7.5 of the Global Governance Principles states:

The board should assess the impact of climate change on the company business model and how it will be adapted to meet the needs of a net zero economy as part of a long-term strategy. This includes setting and disclosing targets to reduce carbon emissions and a period for achievement. Where climate change risks, whether physical or transitional, are identified as material and relevant, reporting should include discussion of the diligence process, strategy, metrics, targets and initiatives used to manage the risks. Disclosure around these actions would help investors understand the resilience of companies facing climate change risks and to assess progress towards achieving net zero targets.⁹

Under the Global Governance Principles, ICGN has also called for the need for directors to consider the wider risks pertaining to current and emerging sustainability risks.¹⁰ We advance the view that directors have a legal duty to act on an informed basis, with good faith, care and loyalty to promote the long-term best interests of the company to preserve and enhance sustainable value creation. Implicit in this concept is the need to generate economic risk-adjusted returns on capital for shareholders, while having regard to relevant stakeholders, and wider societal and environmental interests.¹¹

⁷ [ICGN Letter Canadian CSA Climate Disclosure January 2022](#)
[ICGN Letter to SEC RE: Public Input on Climate Change Disclosure June 2021](#)

⁸ [ICGN Global Governance Principles 2021](#)

⁹ [ICGN Global Governance Principles 2021](#)

¹⁰ Investment institutions and leading governance and stewardship authorities point to the UN Sustainable Development Goals (SDGs) as providing a comprehensive list of emerging systemic risks. See George Dallas & Mike Lubrano, *Governance, Stewardship and Sustainability: Theory, Practice and Evidence*, ICGN 2021.

¹¹ [ICGN Global Governance Principles 2021](#)

Climate Expertise on the Board

The climate-related disclosure, as proposed by the SEC, would encourage boards to enhance board education on the risks inherent to the company due to climate change; select new board candidates that represent diversity and have a background on ESG-related work; seek outside experts and consultants to provide recommendations on how to assess risks that neither management nor the board has considered. Importantly, they should also ensure proper consideration by audit and risk committees of whether and how material climate risks are reflected in company financial statements to ensure a fair representation of entities' economic position. Overall, such measures would enhance the level of confidence that investors and relevant stakeholders have in the company's commitment to address risks in its capital allocation strategy and long-term sustainability plan.

Disclosure of Board Processes

ICGN supports the SEC's proposal that registrants should disclose the processes and frequency by which the board and/or board committees discuss climate-related risks, as proposed. Some boards have already adopted an annual review of climate-related risks, while other boards have a more frequent review on an as needed basis. Many boards already disclose details of the board's involvement in the annual proxy statement or SEC filings.¹² Yet, research shows that there are still too many boards that have not adequately placed climate change on the agenda, thereby negating any oversight of the CEO and senior management's plan to address systemic risks like climate change.¹³ The need for boards to retain flexibility in setting their own agendas and handling the business of the board is well respected. However, if the data show that too many boards are not yet involved in climate discussions, it leaves investors exposed to heightened risk.¹⁴

ICGN recognizes that registrants should have their own flexibility in designing the unique C-suite organizational model and responsibilities of senior executive officers that suits their needs. That said, investors would benefit from disclosure specifying whether the board sets climate-related targets or goals and how management fulfils its role in carrying out the plan. ICGN prefers to allow companies to decide which executive officer (or officers) have the primary responsibility to oversee climate-related risks. Some companies may decide to place that responsibility with the Chief Financial Officer or within the realm of General Counsel. Other companies have pursued the creation of new titles, such as Chief Sustainability Officer. ICGN does not have a preference which title is selected. It is the experience and authority behind the title that is essential.¹⁵ Further, ICGN recommends that issuers use a comprehensive approach to the oversight of risk and disclose in basic terms the frequency of reports to the board or board committee that is charged with the responsibility of oversight for climate-related risks.¹⁶

Executive Compensation

¹² Prudential 2020 ESG Report, [Prudential Financial 2020 ESG Report details company transformation | Prudential](#), June 2021.

¹³ Carbon Tracker, [Flying Blind: The Glaring Absence of Climate Risk in Financial Reporting](#), September 2021..

¹⁴ [PwC Annual Director Survey. The Director's New Playbook: Taking on change.](#)

¹⁵ There has been a dramatic increase in the hiring of the chief sustainability officer (CSO) role among Fortune 500 companies, with demand for CSOs growing 228% in corporate America over the last decade, according to the [latest report](#) from CSO recruitment firm the [Weinreb Group. Charting the rise of the chief sustainability officer | Business Chief North America](#), By Kate Birch June 04, 2021. See also [CSO 10 Years Later Rise of ESG 2021 - Weinreb Group | Sustainability Recruiters | ESG Recruiters](#)

¹⁶[Principle 6. Comprehensive approach.](#) The board should adopt a comprehensive approach to the oversight of risk which should be enterprise-wide and include threats to the company's business model, cyber-security, supply chain resilience, performance, solvency, liquidity and reputation. Risk oversight should extend beyond financial capital to include human capital and natural capital and in particular, systemic risks identified in the United Nations Sustainable Development Goals, where these are relevant to the company's business model and strategy. Fundamental to this is the board's agreement on its risk appetite, and the board should seek to publicly communicate this in basic terms. [ICGN Global Governance Principles 2021.pdf](#).

The SEC asks if registrants should be required to disclose a connection between executive compensation and the achievement of climate-related targets and goals. We answer in the affirmative.

ICGN believes that the inclusion of metrics in the consideration of setting executive pay, and any additional compensation should not create perverse incentives. Any achievement reached by an executive with respect to climate-related goals should be evaluated against actions taken that support the long-term sustainability of the company. And, critically, the individual metrics utilized must be financially material, measurable and assurable. ICGN has noted that, “Often a sustainability related omission or controversy hits the reputation of a company before it may impact its bottom line. Compensation clawbacks can be a measure in place that punishes sustainability-related wrongdoing after the fact while malus gives a negative bonus for poor performance – thereby incentivizing focus on meeting and surpassing targets.”¹⁷

For several years, ICGN has also called for companies to link executive compensation to key performance metrics that are financially material, and which relate to sustainability targets. We believe performance measures in incentive-based plans should integrate risk considerations so that there are no incentives for taking inappropriate risks at the expense of the company, shareholders and relevant stakeholders. Metrics should be measured over timescales and with methodologies which help ensure that performance pay is directly correlated with sustained value creation and preservation. In addition to financial performance metrics, quantifiable indicators that are material to the company’s sustainable value creation and preservation, should be considered. Metrics guiding performance grants should be based on audited financial data, and, where possible, assured sustainability indicators.¹⁸

We would also underline the link between ensuring appropriate executive remuneration and delivering audited financial statements that properly reflect material climate risks (covered in Section F of the proposed Rule). For most entities, the majority of incentive plans are tied to financial metrics based on the audited financial statements. Where the accounts leave out, for instance, climate-related losses or liabilities, the numbers will result in inappropriate incentive payments. This, of course, would exacerbate the perverse behaviours and misallocation of capital raised in our discussion on financial statements below.

Climate Strategy and Risk Management: The Need for Transition Plans (Items 1500, 1501, 1502, 1503)

The SEC proposal notes that “Many commenters recommend that we require disclosure regarding a registrant’s transition plan, stating that such disclosure would help investors evaluate whether a registrant has an effective strategy to achieve its short-, medium- or long-term climate-related targets or goals.”¹⁹ ICGN supports such disclosures.

Our position is based on the observation that as multiple threats posed by climate change have become more clear and impacts directly experienced, climate ambition has risen. The IPCC *Special Report on Global Warming of 1.5 Degrees Celsius* concludes that greenhouse gas emissions need to decline by about 45% by 2030 to reach net zero around 2050, in order to achieve a 1.5-degree Celsius decline in global temperatures and avoid catastrophic climate impacts.²⁰ In response, several investor initiatives have emerged to compel corporations to establish and achieve net zero transition plans. In addition to GFANZ, mentioned above, these

¹⁷ [ICGN Global Governance Principles 2021](#).

¹⁸ [ICGN Global Governance Principles 2021](#).

¹⁹ [Securities and Exchange Commission, Consultation Draft, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*](#), March 2022.

²⁰ [Intergovernmental Panel on Climate Change, *Guidance on Metrics, Targets and Transition Plans*](#), October 2021.

include Climate Action 100+, Transition Pathway Initiative, UNFCCC Race to Zero, SBTi, UN Net Zero Alliance, Institutional Investor Group on Climate Change, and Investor Agenda.²¹

In this context, the TCFD has updated its framework to provide specific guidance on transition plans: an aspect of an organization's overall business strategy that lays out targets and actions supporting its transition to a low carbon economy. The guidance includes specific aspects and concrete examples detailing how companies can ensure that transition plans are aligned with strategy, anchored in quantitative climate-related metrics and targets, subject to effective governance processes, actionable and include specific initiatives, credible (describing capabilities, technologies, transition pathways and financial plans), periodically reviewed and reported annually.

The ISSB exposure draft also advances disclosure of transition plans, noting that "Disclosing an entity's transition plan towards a lower-carbon economy is important for enabling users of general-purpose financial reporting to assess the entity's current and planned responses to the decarbonization-related risks and opportunities that can reasonably be expected to affect its enterprise value."²²

ICGN recommends that the SEC align climate-related disclosures as it relates to transition plans with emerging international best practice and investor demand to make such plans mandatory. We recommend that such disclosures be phased in over time, starting with companies operating in the sectors subject to Scope 3 disclosure as recommended below. Other sectors should be phased in to ensure that all registrants disclose transition plans by 2027.

Scenario Analysis

The SEC proposed rule requires registrants to disclose both physical and transition climate-related risks that are reasonably likely to have a material impact on the business or consolidated financial statements. ICGN is supportive of the general rule as proposed. The proposed rule would also require companies to describe the resilience of its business strategy and any analytical tools deployed, such as scenario analysis. At the same time, the SEC proposal will not require the use of scenario analysis primarily because of the challenges this may pose for some companies.

ICGN holds the view that scenario analysis provides a useful if not critical tool to assess business strategy resilience and, indeed, may be integral to establishing an over-arching framework for addressing the risks of climate change and setting plans for reducing emissions to net zero over time.

Climate change will impact company strategy, operations, reputations, and finances along the entire value chain, wherever they operate and for decades to come. Although the precise shape and pace of change is uncertain, physical, transition and regulatory risks have already emerged. To plan, survive and thrive under these conditions, scenario analysis will be useful, if not critical, to any company's ability to make strategic and risk management decisions in a structured, systematic, and analytical way.

Following on the recommendations of the TCFD, ICGN believes companies should disclose, at minimum, basic qualitative information regarding the scenario analysis, including how it has informed strategy, operations, capital allocation and other related financial implications (including in financial statements). The disclosure should describe the resilience of the business taking into account different climate scenarios.

The SEC reports that companies have expressed concern about the inherent uncertainties and costs of conducting climate scenario planning. Yet for many companies, scenario planning is a well-established tool, and are already disclosing scenario analysis reports. The extractives sector is particularly strong in this regard. Indeed, some extractives companies provide leading examples

²¹ <https://www.climateaction100.org>, <https://www.transitionpathwayinitiative.org>, <https://unfccc.int/climate-action/race-to-zero-campaign>, <https://www.iigcc.org>, <https://theinvestoragenda.org>.

²² [International Sustainability Standards Board, Exposure Draft IFRS 2 Climate-Related Disclosures](#), March 2022.

of how scenario analysis can be conducted and how this approach can benefit strategy, risk management and capital allocation while helping investors understand impacts on business outlook and the adequacy of the registrant's response.²³ While there is room for improvement in these disclosures, reporting of this nature represents a significant advance. This is the kind of information investors seek.²⁴

In terms of resourcing, the TCFD reports that, depending on size and complexity, companies will need to assign a scenario team of 4 to 20 individuals for a duration of 2 to 6 months. These may be individuals currently serving in sustainability or similar roles. We also note the existence of publicly available scenarios published by the Intergovernmental Panel on Climate Change (IPCC) and the International Energy Agency (IEA) among others. The TCFD provides extensive publicly available guidance on scenario planning and offers free on-line training programs.²⁵ The consulting industry is also making available climate scenario planning services with forecasting capabilities across a range of potential risks and impacts. In ICGN's view, the gravity of climate risks combined with the widespread availability of tools and services places an emphasis on action, rather than inaction. Companies should begin developing skill sets immediately in anticipation of adoption of new climate disclosure rules at the SEC.

Disclosure of Greenhouse Gas Emissions Metrics and Targets (Items 1504, 1506)

The proposed rules contemplate mandatory disclosure of Scope 1 and Scope 2 greenhouse gas (GHG) emissions. Disclosure of Scope 3 emissions would be required if material or if the registrant has set GHG emissions reductions goals that include Scope 3. ICGN believes that the best case is for the SEC to make Scope 3 disclosure (along with transition plan and scenario analysis) mandatory for companies operating in sectors exposed to high levels of physical, transition and regulatory climate risk and those who have announced publicly a net zero strategy.²⁶ The rule should be revisited in three years' time (2025) to evaluate progress and consider a pathway for mandatory Scope 3 disclosure for all registrants.²⁷ We advance several arguments to support this position.

First, the SEC proposal, while noting the progress towards increased Scope 3 disclosures, refrains from mandatory disclosure because collecting the data would be potentially more difficult. ICGN believes that in light of our climate crisis and the threat it poses to capital markets participants and their beneficiaries, it is critical that companies disclose, and investors have access to the most complete possible picture of current emissions and be able to encourage and track progress towards emissions reductions. We are running out of time. The window of opportunity to secure a livable and sustainable future is closing rapidly.²⁸

Second, as reported by the Carbon Trust, Scope 3 emissions can represent as much as 90% of all company emissions — information critical for managing climate risks and setting strategy. As noted earlier, the Sustainability Accounting Standards Board (SASB) has indicated that there are very few sectors that will not be as seriously impacted as others, with "68 of 77 industries significantly affected in some way by climate risk." According to the analysis, the impact covers "89 percent of

²³ See for example the scenario analysis disclosed by ConocoPhillips at <https://www.conocophillips.com/sustainability/managing-climate-related-risks/strategy/scenario-planning/>.

²⁴ [Financial Reporting Council, Climate Scenario Analysis](#), October 2021.

²⁵ See <https://www.tcfdhub.org/scenario-analysis/>

²⁶ [SASB Standards, Climate Risk Technical Bulletin](#), Updated May 2022.

²⁷ [The UK government seeks to implement mandatory TCFD disclosure across the economy by 2025. TCFD disclosure for asset managers are now in effect.](#)

²⁸ A strong academic case calling for mandatory climate disclosures is made in the following working paper by Oxford University law scholars: [Armour, John and Enriques, Luca and Wetzer, Thom and Wetzer, Thom, Mandatory Corporate Climate Disclosures: Now, but How? \(November 1, 2021\), European Corporate Governance Institute - Law Working Paper No. 614/2021, Columbia Business Law Review, Forthcoming.](#)

the market capitalization of the S&P Global 1200.”²⁹ In addition, TCFD analysis shows that of the 2,500 companies in the MSCI All Country World Index, from 2017-2019 disclosure of Scope 3 emissions increased from 28% to 34%.³⁰

Third, the Scope 3 GHG Protocol was first published in 2011.³¹ Since this time, companies and consultants have built considerable expertise in measuring Scope 3 emissions. Data and methodologies have matured sufficiently such that disclosure of relevant, material categories of Scope 3 emissions is now possible if not appropriate for all sectors.³²

The consultation document includes reference to potential mandatory disclosure for large, accelerated filers or, in keeping with the Scope 3 GHG protocol and the Paris Agreement, mandatory when Scope 3 emissions attain the threshold of 40% of total emissions for the registrant. ICGN could support this rule but have a preference for mandatory disclosure for SASB-identified sectors and then phasing in other sectors over time. This graduated and phased-in approach would allow investors to begin to assess portfolio and company-specific emissions and respond appropriately.³³

Assurance (Item 1505)

The SEC proposes that filers include an attestation report for its Scope 1 and 2 emissions and to provide certain related disclosures about the service providers. It also proposes that assurance providers may provide limited assurance meaning that the practitioner need collect less evidence than for reasonable assurance but sufficient for a negative form of expression of the practitioner’s conclusion. The SEC also proposes that the provider need not be from a registered public accounting firm.

ICGN supports this approach but, consistent with our position on GHG disclosures proposes that the phase-in also specify the point at which Scope 3 emissions are also assured.

We agree that the existing capacity to provide GHG assurance is limited. During the early stages the SEC should require limited assurance progressing to reasonable assurance over time. The phase-in period will give time to the audit and assurance industry to build capacity and expertise. Ultimately, the goal is to provide investors and other stakeholders with ever greater degrees of confidence in the accuracy and completeness of the information provided by filers. ICGN is hopeful that in the near future investors will receive reasonable assurance whereby there is only a remote likelihood that material misstatements will not be prevented or detected on a timely basis.

Safe Harbor Provisions (Sections II.C.3-4, II.E.2, II.G.3, and II.I)

Concerns have also been raised that the disclosure of transition plans and climate scenarios raises potential legal consequences related to forward-looking statements. In addition, there are concerns about the reliability of Scope 3 GHG emissions data and methodologies. In recognition of these challenges, ICGN supports the inclusion of safe harbor provisions for these three elements of climate-related disclosures. These provisions would recognize the challenges and support the learning process that must occur, while protecting company officers and directors from legal or regulatory liability over reported information, contingent on proof of adequate processes and controls for reporting rigor. Over time, as practices, methodologies and disclosures become better

²⁹ <https://www.corporatesecretary.com/articles/esg/32555/sixty-eight-77-industries-significantly-affected-climate-risk-sasb-says>, SASB Technical Bulletin, April 2021.

³⁰ [TCFD, *Guidance on Metrics, Targets and Transition Plans, October 2021*](#), p.55.

³¹ [Greenhouse Gas Protocol, *Corporate Value Chain \(Scope 3\) Accounting and Reporting Standard*](#).

³² [TCFD, *Proposed Guidance on Climate-Related Metrics, Targets and Action Plans*](#), p.17

³³ MSCI, Brendan Baker, [Scope 3 Carbon Emissions: Seeing the Full Picture](#), 17 September 2020. Powerful arguments for mandatory Scope 3 disclosure for strategically important carbon emitters is provided in John Armour, Luca Enriques, Thom Wetzler, [“Mandatory Corporate Climate Disclosures: Now but How? Columbia Business Law Review, Vol 21, No.3, 1085](#), 14 November 2021.

established, the safe provision could be removed or be subject to sunseting over a period of years. Regulation must find room for the learning process to occur. Perfection should not be the enemy of the good.

Financial Statement Disclosures (Regulation S-X, Items 1502 d of Regulation S-K)

ICGN is supportive of the SEC's proposal to require that registrants include disclosures on how material climate factors have been incorporated into the audited financial statements in the Notes to those Statements. We also support proposed guidance from the SEC that material climate factors should be embedded within critical accounting assumptions and judgements where appropriate, such that the relevant line items in the financial statements are adjusted where needed. Not only would this address potential misstatements where these factors are omitted but it would ensure greater consistency and comparability. A failure to ensure the inclusion of material climate risks (both physical and transition-related) increases the likelihood of capital misallocation and over time raises the risks of market wide disruption.

Institutional investor desire for improved financial statement reliability and disclosures relating to climate change has been made clear through several public statements as well as their ongoing engagements with companies and audit firms, several of which are noted in the SEC's draft proposal.

In September 2020, for example, investor associations from the US, Europe and Asia came together behind a statement calling for companies to ensure their financial statements properly reflected material climate risks associated with the global transition to a 1.5C pathway in line with the Paris Climate Agreement.³⁴ Later that year, the Institutional Investor Group on Climate Change (IIGC) published detailed Investor Expectations for Paris-aligned accounts.³⁵

Building on these expectations, in 2022 the CA100+ initiative, representing over \$60 trillion in AUM, added metrics on accounting and audit to their benchmark for assessing company performance on climate change.³⁶ This is increasingly a basis for company engagement and proxy voting. In May 2022, 52% of Exxon's shareholders supported a resolution at their Annual General Meeting asking the Board to publish an audited account of how its financial position would be impacted by a 1.5C pathway.³⁷

As the SEC highlights in its proposals, US and international standard setters and regulators have released guidance underscoring the importance of disclosures on material climate risks under existing requirements. In November 2020 the International Accounting Standards Board (IASB) published guidance for including climate considerations in financial statements, in line with existing standards.³⁸ They highlighted that the materiality of this information, and thus requirement to cover it under existing rules, was determined by investor demand rather than the opinion of management. The Federal Accounting Standards Board published its own Staff Paper covering climate in March 2021,³⁹ and the International Audit and Assurance Standards Board (IAASB) issued guidance reminding auditors of their responsibilities to cover material climate risks, just as they would other material factors.⁴⁰

³⁴ [Investor groups call on companies to reflect climate-related risks in financial reporting | PRI Web Page | PRI \(unpri.org\)](#)

³⁵ [Investor Expectations for Paris-aligned Accounts – IIGCC](#)

³⁶ [Net Zero Company Benchmark | Climate Action 100+](#)

³⁷ [ExxonMobil investors back push for fossil fuel transition audit | Financial Times \(ft.com\)](#)

³⁸ [IFRS - Educational material: the effects of climate-related matters on financial statements prepared applying IFRS Standards](#)

³⁹ [FASB Staff Educational Paper-Intersection of Environmental](#)

⁴⁰ [IAASB Issues Staff Audit Practice Alert on Climate-Related Risks | IFAC](#)

Accounting regulators in the UK and Europe have reinforced the message to both preparers and auditors that they must, under existing rules, ensure they cover material climate risks. Both the UK's Financial Reporting Council and the European Securities Market Authority issued statements in 2021 to warn of their increasing scrutiny of company accounts on this matter.⁴¹

The rationale that underpins these efforts is captured in the SEC proposed rule. Efficient markets depend on reliable information. Where there are gaps in information, the markets will provide the wrong signals, resulting in a misallocation of capital. In the case of climate change, markets have failed to reflect the true economic costs to society, which means these are being mispriced, and consequently, ignored in decision-making. The result will tend to be an excessive flow of capital towards activities that harm the climate; and an inadequate flow of capital to climate-friendly activities, with negative implications for societal welfare.

The longer these risks are mis-priced in the market, the greater the risk of system-wide disruption. This is clearly recognized by the US Financial Stability Oversight Council and the Federal Reserve in their efforts to track climate risks embedded in the financial sector.⁴² These risks also need to be properly captured in company accounts.

The problem is the above guidance seems to be rarely applied in company accounting today. Research undertaken by Carbon Tracker and the Climate Accounting Project in 2021 reviewing 107 listed carbon-intensive companies' financial statements (where we would expect a material impact from decarbonization) demonstrated that hardly any provided disclosures as to how they were integrating these considerations into their financial statements.⁴³

Given this backdrop, we agree with the SEC's contention that there is inadequate consistency in how registrants are integrating material climate factors into their financial statements, and therefore a rule by the SEC on this matter is important to ensure implementation. The SEC is also the appropriate body to be setting these rules.

As proposed in the draft rule, we would also welcome further guidance from the Public Company Accounting Oversight Board (PCAOB) for auditors to ensure they are checking that material climate risks are being properly considered in their audit processes. Likewise, Audit Committees need to provide additional disclosures as to how they are considering embedding these factors in the accounting processes. We note that US registrants are providing less disclosure on these processes than their European peers.

Finally, while there is widespread acceptance that material climate risks should be factored into financial reporting under existing rules and regulations, there remains a need for regulator guidance on whether companies should be required to disclose their exposure to a 1.5 or well-below 2C scenario. Here, investors have made clear they wish to have this visibility given the global commitment to achieve this target.

The guidance issued by the IASB and IAASB remains silent on this question. The IASB, however, expressly reminds preparers that materiality is determined by what could be reasonably expected to impact investor decision making. As noted, a large and growing group of institutional investors have stated their expectations for a Paris-aligned pathway. In ICGN's view, therefore, this would make this information material under the standards. Nonetheless, this remains a point of contention, and the ICGN would therefore welcome explicit guidance by the SEC that these disclosures are needed to meet the materiality requirements.

With this as background we provide further comments linked to specific questions posed in the SEC's proposed Rule below. Please note:

⁴¹ [European enforcers target COVID-19 and climate-related disclosures \(europa.eu\); FRC CRR Year End Key Matters_October 2021](#)

⁴² [Financial Stability Oversight Council Identifies Climate Change as an Emerging and Increasing Threat to Financial Stability | U.S. Department of the Treasury; Speech by Governor Brainard -- Building Climate Scenario Analysis on the Foundations of Economic Research \(federalreserve.gov\)](#)

⁴³ [Flying blind: The glaring absence of climate risks in financial reporting - Carbon Tracker Initiative](#)

- ICGN is supportive of all the core elements of the proposals in Section F regarding financial statement disclosures put forward by the SEC, including the need to ensure existing financial statements incorporate material climate risks in accordance with existing principles. Investor desire to have these disclosures provided was made clear in the IIGCC paper “Investor expectations for Paris-aligned accounting”. We support the explicit requirements for both contextual and specific information that disclose how climate-related impacts are accounted for within the financial statements (assumptions, estimates, policies as well as key line items), including the physical and transition impacts. It is important that registrants disclose specific information relating to how key assumptions have been changed (which is already required under FASB ASC Topic 250- 10-50-4, including if a change in estimate does not have a material effect in the period of change, but is reasonably certain to have a material effect in later periods). We view the SEC’s guidance in Sections II.F.2 and II.F.3 as helpful but non-exhaustive. We would also welcome disclosures at segment level and geographic areas for the latest reported time periods. All disclosures in the financial statements should be consistent with other climate-related disclosures in statutory filings, including any climate commitments and targets [Q52-58, 71, 81, 86].
- We are supportive of separate and specific, rather than aggregated, disclosure of the physical and transition impacts (whether expenditure related or otherwise) to facilitate interpretation of the information in investment and voting decisions, and enable a better understanding of cross-cutting portfolio risks by ensuring these are not hidden. Where a registrant cannot disaggregate these impacts, it would be useful to understand why. If possible, it would also be helpful to have a reasonable estimate, with disclosure of associated assumptions to facilitate interpretation. We would welcome explicit disclosure for how the cost of capital estimates have reflected climate risks and opportunities. [Q59-61, 65, 68-69, 73, 83]
- We agree that while risk/negative impact disclosure should be required, disclosure of opportunities should be optional but consistently applied. This approach would be consistent with a prudent accounting mindset that seeks to prevent executives from presenting an over-optimistic view of their financial position. Future potential opportunities should be highlighted in narrative disclosures but not incorporated into the financial statements until they are relatively certain. Also, where a registrant is identifying expected climate-related opportunities as part of their narrative disclosures, then the associated costs should be considered in the forward-looking elements of the financial statements to ensure consistency. For example, where a carbon-intensive company expects to make use of Carbon Capture and Storage to fulfil their net zero commitment, then the costs of delivering this should be explicitly incorporated into the financial statements. [Q62, 75, 85]
- While we agree with the proposed threshold of 1% of the total line item (including for expenditure items), where the aggregate impact is less than this, but investors have expressed a clear interest in understanding this impact (thus making it material), registrants should be required to offer commentary on how the impact was assessed. We are not in favor of netting positive and negative impacts due to the dangers that this hides large and material absolute impacts. We also believe it will be important to both ensure individual impacts are disclosed separately, but the rules should prevent disparate reporting of the climate impacts which could result in each impact falling below the disclosure threshold, such that the understanding of climate impacts is hidden (e.g., separate disclosure of capitalized costs and expenses linked to climate impacts). Given the estimation risks inherent in these forward-looking exercises, it is better to break out the impacts to permit investors to evaluate the underlying impacts. [Q52,66-67, 68, 73-79].
- We would also welcome an explicit requirement for the registrants in high-impact companies to provide sensitivity analysis for reasonable alternative assumptions associated with a 1.5C and well below 2C pathways envisaged under the Paris Climate Agreement. These sensitivity analyses should be provided in the Notes to the Financial Statements to provide investors with visibility of how the registrants’ financial position would be impacted. This is material for a large and growing number of investors that are

committed to investing in alignment with these goals. Finally, to support market efficiency, investors need to understand what their exposures are to climate risks whether or not they are themselves committed to a 2050 net zero goal. [Q90]

- While we can support a separate climate report that brings together all the material climate-related financial impacts, this should not replace the disclosures within the financial statements (including in the Notes) that appropriately reflect the financial consequences of these climate factors. This will ensure that investment decisions, as well as other corporate decisions based on financial statements, will be able to incorporate climate impacts. A separate climate statement could send a perverse message that climate impacts are not financial or material for corporate earnings and financial condition. In our view this would be misleading. All these disclosures, of course, should be audited in keeping with existing requirements for financial statements. [Q87-89]
- We believe that auditors have an important role to play in ensuring the reliability of the climate-related financial disclosures. As investors, we look to auditors to provide robust independent challenges to ensure the assumptions and estimates are sound, and the statements themselves provide a fair representation of the entity's economic health. Recent guidance by the IAASB affirms that material climate risks need to be considered in the same manner as any other material factor in the audit process. We believe, however, that it is the regulator – the PCAOB – that should provide explicit guidance to auditors on what is expected, and then undertake reviews to ensure proper implementation. Further, we note a gap between European auditor disclosures relating to climate factors versus their US counterparts, which offer no or little commentary. [Q91]
- We have also noted that Audit and Risk Committees provide little commentary on how they have considered climate risks in their US filings versus their peers in Europe. We would welcome guidance from the PCAOB/SEC to Audit Committees to ensure they offer greater visibility of how they have considered climate risks, the entity's climate commitments and the global commitment to achieve a 1.5C outcome in their oversight of financial reporting. [Q91]
- We would underline that these disclosures are sought by investors as part of investment and stewardship decision-making, including proxy voting. These disclosures are foundational to market efficiency and capital allocation. Without these disclosures, we would anticipate rising levels of uncertainty over hidden climate risks. This could result in system-wide inefficiencies and potentially severe economic dislocation.

Materiality

In driving towards global disclosure standards, ICGN encourages the SEC to observe developments in concepts of materiality. Historically, materiality considerations have focused on the impact of sustainability risks on the company itself. The European Union is building a regulatory structure requiring the identification of a second materiality dimension: that is, the environmental and social impacts of the business on its stakeholders and society more broadly. This 'double materiality' standard represents a significant shift in our conception of materiality where companies will likely be required to report internal impacts of sustainability issues on the company's financial performance as well as the company's external impacts on society and the environment. We appreciate that the immediate interests of the SEC are with regard to protection of investors and the related focus on financial materiality. However, we encourage the SEC to give due consideration to concept of dual materiality to guide companies when making impairment assessments, assessing financial risks, setting strategy, and allocating capital. ICGN members invest for the long-term and want companies to adopt strategies and operations that focus on the long-term as well.

Conclusion

ICGN again thanks the SEC for undertaking this consultation. We are hopeful that our recommendations can help establish a disclosure regime that is robust, yields globally comparable

information for investors, is effective for addressing climate risks and positively incentivizes ambition. Should you wish to discuss our comments further please contact Robert Walker, ICGN's Sustainability Policy Manager (rwalker@icgn.org) or Carol Nolan Drake, ICGN's Governance and Stewardship Policy Manager (carol.nolandrake@icgn.org).

Yours faithfully,



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