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Toward a Dynamic Climate Disclosure Framework

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The SEC's sharper focus on climate disclosure is a welcome development, but the Commission's work in this space is only just beginning.

The G7 countries recently announced their support for "moving towards mandatory climate-related financial disclosures that provide consistent and decision-useful information for market participants." This announcement marks a major milestone in international efforts to meet the goals of the Paris Climate Agreement and achieve net zero greenhouse gas emissions by 2050. Clearer and more useful information about public companies' climate-related activities will help investors direct their investment capital to companies that are pursuing projects consistent with the transition to a lower-carbon economy.

But pledging support is one thing, and taking action is quite another. Enhancing climate-related financial disclosure means developing, refining, and implementing a wide range of policymaking initiatives—not just in international fora, but at the national level as well.

The Securities and Exchange Commission (SEC) is responsible for setting the requirements for public company disclosure in the United States, and SEC staff are working right now to establish these requirements, with the goal of facilitating the disclosure of consistent, comparable, and reliable information on climate risk.

How should the SEC approach this endeavor? In a detailed letter, we at the Investment Company Institute called on the Commission to design a new, dynamic framework for public company disclosure of climate-related information, drawing on the views of investors, issuers, standard-setting organizations, and other stakeholders. Such a framework would seek to enhance the quality and volume of information available about how climate-related risks could affect companies' long-term value.

At the heart of this framework, the SEC should require public companies to disclose data on the greenhouse gases they emit, in line with widely accepted reporting standards. The data should include emissions from sources that a company owns or operates (such as factories or vehicles) and from sources generating energy that a company acquires or consumes (such as heating or air conditioning).

This would be a win-win requirement. It would reveal information about companies that are further along in their efforts to reduce emissions as the world transitions to a lower-carbon economy, while giving investors insight into how a company's carbon emissions might affect its future profitability and earnings.

Important though it is, mandatory corporate disclosure is only one part of the equation. A dynamic regulatory framework must also recognize that the knowledge base in this area is still evolving and be flexible enough to account for this continuing evolution.

For example, there currently is no common methodology for calculating upstream emissions associated with a company's supply chain and downstream emissions associated with a company's products and services—at least not one that would produce sufficiently comparable and reliable data across companies in many industries. Therefore, the SEC should promote the development of reporting practices, including appropriate assumptions, models, and methodologies, before beginning to consider a requirement for all companies to disclose this information.

A dynamic framework also must build on the success of initiatives that have come before it. In this regard, the SEC should leverage private-sector initiatives—such as the work of the Sustainability Accounting Standards Board—that have developed standards for companies to use in creating climate-related disclosure for investors. Doing so should promote more consistent, comparable, and useful information—saving companies the time and expense of responding to disparate investor requests for information and enabling investors to better assess a company's enterprise value.

The SEC could go even further and rely on a standard-setting body going forward—one that would maintain existing standards and create new ones. If the Commission takes this path, it should ensure that the standard setter has certain key characteristics—including a balanced funding model and a robust governance structure to protect against conflicts of interest—and that any new standards are grounded in financial materiality.

Any rulemakings to come out of the SEC's work in this area could have implications far beyond the United States, impacting the ongoing multilateral effort to establish a global baseline for the climate-related information that companies must disclose. Establishing a global baseline is critical to ensuring that investors can meaningfully compare this information across jurisdictions.

The SEC has an important opportunity here. If the Commission can craft a successful corporate disclosure framework for the United States—one that produces more useful climate-related information from public companies, promotes the organic evolution of disclosure practices, and builds on the many strengths of voluntary initiatives developed in the private sector—it will be better positioned to advocate for incorporating these features in the emerging global baseline. Accomplishing this will greatly enhance investors' understanding of the climate-related risks and opportunities facing public companies, wherever such companies are located.

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