Mandating Disclosure of Climate-Related Financial Risk

Strengthening Climate Risk Disclosure at the Securities and Exchange Commission

Climate change presents grave risk across the U.S. economy, including to corporations, their investors, the markets in which they operate, and the American public at large. Unlike other financial risks, however, climate risk is not routinely disclosed to the public. Insufficient disclosures have persisted despite the SEC's issuance of regulatory guidance, the emergence of voluntary disclosure frameworks and standards, and growing calls from investors for improved disclosure.

The SEC should act to strengthen climate risk disclosure. In a new report, Environmental Defense Fund and the Institute for Policy Integrity at New York University School of Law conclude that new mandatory disclosure regulations are needed and recommends procedural strategies for developing rules that will elicit comparable, specific, and decision-useful information.

Climate-Related Financial Risk is Increasing and Significant

The consequences of climate change will profoundly affect the institutions that undergird modern society and challenge almost every industry and economic sector. Even incomplete estimates find significant economic effects, with one recent study concluding that 215 of the world's largest companies face nearly $1 trillion in climate-related risk. **This climate risk must be rigorously disclosed in corporate financial reports**.

Existing Rules Are Not Driving Sufficient Disclosure

Neither existing SEC rules nor voluntary disclosure regimes are eliciting climate risk information that is comparable, specific, and decision-useful.

The SEC already requires public corporations to disclose material information regarding the corporation's financial health and exposure to risk. The Commission clarified that these rules apply to climate risk in 2010 guidance but this guidance did not result in the disclosure many expected. In the absence of further SEC action, voluntary frameworks have emerged to fill the gaps and facilitate disclosure. Two of the most adopted efforts include the Taskforce on Climate-Related Financial Disclosure's framework and the Sustainability Accounting Standards Board's standards.

Despite these critical efforts, studies consistently find widespread insufficient climate risk reporting, including through the use of boilerplate disclosure or omission of climate risk information. This problem persists, **even as major investors increasingly call for improved disclosures.**

Benefits of Improved Disclosure

Requiring improved climate risk disclosure will benefit corporations, investors, markets, and society.

The issuance of new SEC disclosure regulations, alongside climate engagement from other financial regulators, will convey significant benefits for financial actors and for society as a whole. Improved disclosure helps corporations engage in careful and systematic risk assessment and can support subsequent risk management efforts. Investors, meanwhile, receive information needed to properly price risk, compare investments, and make decisions. Strengthened disclosure likewise benefits markets by enabling the efficient allocation of capital across industries and corporations, reducing the systemic risk of abrupt climate-related shifts in valuation, which could reverberate across the economy. Finally, improved climate risk disclosure benefits the American public at large, not only by decreasing the likelihood of systemic financial shock, but also by furthering greenhouse gas mitigation efforts, which offers substantial health and welfare benefits for society.

Recommendations

The SEC has authority to promulgate disclosure regulations that are in the public interest or for the protection of investors. It also has authority to conduct its own research on market risks and financial trends.

Using this authority, the SEC should **issue new notice-and-comment rules that expressly require corporations' annual reports to disclose the companies' exposure to climate risk** a form that is comparable, specific, and decision-useful. To aid in this effort, the SEC should:

- **Develop greater institutional expertise on climate risk.** The Commission should consider conducting analysis of climate impacts on financial markets and integrating those findings into its rulemaking and enforcement operations through its Division of Economic and Risk Analysis. The SEC should additionally hire advisors with expertise in climate risk, as institutional expertise will be critical for the agency to make informed, evidence-based decisions as it establishes new policies and rules. Such expertise will also aid the SEC in enforcing its disclosure rules, by enhancing the Commission's ability to detect insufficient or inaccurate disclosures.

- **Develop channels for stakeholder input.** In order to build a regime that produces comparable, specific, and decision-useful climate disclosure, the SEC will need to craft unique metrics and disclosure requirements for different industries. Accomplishing this task will require an intimate understanding of the specific climate risk that these industries face, as well as a grasp of the specific reporting requirements that would most help investors assess a corporation's risk exposure. The SEC should solicit feedback and recommendations from those best positioned to understand how disclosure rules will result in practice through a concept release, advisory committee, or other stakeholder engagement process.

- **Coordinate across agencies**. Climate risk is a critical concern across the federal government. The SEC shares financial oversight authority with a variety of regulators, and other agencies may be better positioned to provide technical expertise on climate science. The SEC could coordinate with these peers through an interagency working group established by executive order or the Financial Oversight Stability Council. In particular, the SEC should consider coordination on requirements related to climate scenario analysis.

- **Draw best practices from existing frameworks and standards**. In crafting its new disclosure rules, the SEC should draw from voluntary frameworks and standards, such as the TCFD and SASB, as well as from disclosure policies in other countries. Such efforts are the product of extensive research and are highly reflective of the needs of both users and preparers of disclosure.

- **Read the full report**
- **Email EDF and Policy Integrity**