Essex Investment Management, LLC

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Ms. Vanessa Countryman

Secretary

Securities and Exchange Commission

100 F Street N.E. Washington, D.C. 20549

Re: File No. S7-10-22: The Enhancement and Standardization of Climate-Related Disclosures for Investors

Dear Ms. Countryman,

Essex Investment Management, LLC welcomes the opportunity to respond to File No. S7-10-22: The Enhancement and Standardization of Climate-Related Disclosures for Investors. The standardization of climate-related financial disclosures is long overdue and will help investors efficiently analyze the risks and opportunities of climate change to publicly traded companies. We commend the SEC staff for their tireless work on such a comprehensive and important rule, and for basing the proposed rule off the highly respected frameworks of the Task Force on Climate-Related Financial Disclosures (TCFD) and the Greenhouse Gas Protocol. Climate-related risks are currently mispriced in capital markets and the proposed rule will facilitate more efficient security valuation, strengthen investor protection, and inform proxy voting decisions. The Intergovernmental Panel on Climate Change's (IPCC) Sixth Assessment Report highlights the present and future risks that climate change is posing through physical and transitional risks. Climate risk is material to the investment process and standardized climate-related disclosures are critical to fully understand the scope of risks to companies and portfolios.

Essex Investment Management, LLC is an independent, employee-owned institutional investment firm that utilizes a fundamental investment process to invest in dynamic, global growth equity trends. Founded in 1976, Essex has more than 40 years of experience identifying growth trends and investing in inefficient areas of the capital markets to create long term value for our clients. It is the firm's perspective that environmental, social, and governance (ESG) factors, such as climate change, are material when evaluating a company and its equity shares from both a risk and an investment opportunity perspective. Essex is a signatory of the Principles for Responsible Investment (PRI), and a member of the Interfaith Center on Corporate Responsibility (ICCR) and Confluence Philanthropy.

The proposed climate risk disclosure rule will bring needed clarity and standardization to climate risk disclosures and help inform investment decision-making. The rule will help investors analyze how

companies are managing climate risks in their business strategy operations, including physical and transitional risks. We have already seen physical climate impacts such as flooding, wildfires, and drought affect the financial performance of public companies and we expect this trend will increase in the future. Assessing physical climate risk is currently even more difficult for investors than transitional risk since registrants disclose even less information related to physical risks. The proposed climate disclosures will help us assess physical climate risks so we can incorporate the risks into our security valuation and portfolio management processes. Finally, the proposed rule will provide details outlining how companies are managing the transition to a low carbon economy. We believe the transition to a low carbon economy will reshape the global economy and companies must capitalize on opportunities and minimize transition risk to optimize shareholder value. In aggregate, the disclosure of standardized climate-related financial information will support our analysis of climate-related risks and opportunities to ensure we invest in companies that are best managing the financial impacts of climate change.

Current voluntary reporting of climate-related disclosures makes it difficult to assess the risks and opportunities of climate change to public companies. While some companies disclose certain climate-related information, the reported information is often difficult to compare across companies and excludes material details. Furthermore, larger companies dominate voluntary climate risk disclosures, making it particularly difficult to assess climate risks for smaller reporting companies (SRCs). Given their small size, SRCs are likely less resilient to the financial impacts of climate change, making it imperative for investors to have more access to climate-related financial information.

Most companies that provide climate-related information include the disclosures in voluntary ESG, sustainability, or corporate responsibility reports. Since companies have considerable autonomy over what information to include in voluntary reports versus SEC filings, companies often cherry-pick disclosures and shield investors from the true extent of climate risks they face. Disclosures are frequently based on the TCFD framework, like the proposed rule, but rarely includes full alignment with the TCFD recommendations. The proposed rule will eliminate the inherent bias in climate-related disclosures since companies will no longer be able to choose what climate information to disclose or omit. The rule will also enable greater comparison across companies due to the standardized presentation format and provide more actionable investment information. The mandated climate disclosures will ensure more efficient use of investor resources since all relevant climate-related information will be in SEC filings. The current voluntary reporting of climate-related information forces investors to dedicate significant resources to gain a fragmented understanding of a company's climate-related governance and risks. Examples include dedicating staff time to corporate climate engagement, purchasing estimated climate data from third-party data providers, and analyzing various non-SEC filings that may contain certain climate-related information. While the proposed rule will not eliminate the need for engagement or further due diligence in the investment process, it will streamline climate-related analysis and ensure all investors have the requisite information needed to make investment decisions.

One important aspect of the proposed rule we want to highlight is the focus on quantitative disclosure of greenhouse gas emissions. With strong momentum towards global decarbonization, we believe companies that are reducing their own scope 1-3 emissions and helping customers reduce their emissions will be less susceptible to negative climate-related financial impacts. Investors can analyze company scope 1-3 emissions and decarbonization plans to assess transitional climate risk. Analyzing and projecting a company's current and future scope 1-3 emissions is important to understand potential financial impacts

stemming from carbon pricing schemes, higher cost of capital for carbon intensive activities, and declining revenue opportunities. The proposed rule will provide investors the necessary qualitative and quantitative information needed to forecast future company emissions. Given the forward-looking nature of equity valuation, utilizing accurate inputs to forecast future emissions can help eliminate a flaw from current carbon footprint analysis where investors rely on static emissions data.[1] Importantly, the estimates of future company scope 1-3 emissions based on the climate-related information included in registration statements and certain annual filings will be of significantly higher quality than the current estimated emissions data used today.

One important use of quantitative emissions in investment analysis is to assess the extent to which a company is vulnerable to carbon pricing schemes. Carbon markets such as emissions trading schemes and carbon taxes currently cover 22% of global greenhouse gas emissions and are expected to cover a greater share of emissions in the future.[2] Companies with high scope 1-3 emissions will be forced to reduce their operational and supply chain emissions or pay costly fees. Investors can use the data to analyze the potential impact on earnings from compliance with different carbon prices or changes in operating expenditures from actions taken to rapidly decarbonize operational emissions.

Companies with high scope 1-3 emissions may also face a higher cost of capital in the future due to regulatory and market risks. Understanding the need to decarbonize the economy, many financial institutions have pledged to reduce financing to carbon intensive activities in the future. One study found that companies with lower carbon intensity of revenue are rewarded in the capital markets with lower cost of capital, whereas more carbon intensive firms are penalized with a higher cost of capital.[3] If financing for carbon intensive activities decreases or investors demand a higher risk premium, companies may be unable to meet their liquidity and capital needs or be forced to raise capital at unattractive terms. Investors can use the quantitative emissions data to forecast future cost of capital for use in discounted cash flow models and other aspects of company valuation.

Finally, as countries, corporations, and other economic participants seek to decarbonize their economic activities, carbon intensive companies may experience declining financial performance. Countries contributing to more than 88% of greenhouse gas emissions have committed to reach net-zero emissions in the future.[4] While targets vary in ambition, time frame, and feasibility, the evidence is clear that major governments are pledging to drastically slash emissions. The private sector is also pledging to net-zero with more than 1,000 companies committed to net-zero as part of the Science Based Targets Initiative (SBTi).[5] Companies committing to net-zero goals as part of the SBTi must also reduce scope 3 emissions, putting pressure on companies with net-zero targets to contract with suppliers that are decarbonizing their operations as well. Without transparent disclosure of company greenhouse gas emissions, investors are unable to accurately assess climate-related financial impacts to companies from the net-zero

[1] Benedetti et al., *Climate change investment risk: Optimal portfolio construction ahead of the transition to a lower-carbon economy*, 2018. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3281390

[2] Credit Suisse ESG Research, *Carbon Markets: The Beginning of the Big Carbon Age*. Credit Suisse, 2022

[3] Trinks et al., *Carbon Intensity and the Cost of Equity Capital*, 2017. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3035864

[4] Net-Zero Tracker. https://www.zerotracker.net/

[5] Maxine Meixner, #NetZeroActionDay-It’s now or never for net-zero. Science Based Targets Initiative, 2022 https://sciencebasedtargets.org/blog/netzeroactionday-its-now-or-never-for-net-zero

transition. As economic momentum to decarbonize continues, we expect companies that do not reduce their scope 1-3 emissions will be at a competitive disadvantage to peers that reduce their emissions. Therefore, disclosure of quantitative greenhouse gas emissions can be useful for investors to assess company carbon intensity versus competitors, helping investors compare the relative carbon efficiency of different companies.

While greater disclosure of climate-related risks and quantitative emissions is useful for investment analysis at the company level, it is also important for effectively managing portfolio climate risk. Climate risk does not merely affect individual companies, but also affects investment portfolios. With few companies currently disclosing climate-related risks, it is difficult to sufficiently identify and manage portfolio-level climate risk. As part of our annual reporting requirements to the PRI, Essex is required to report on TCFD recommendations, which includes a focus on portfolio climate risk. While portfolio climate risk management is a complex process, calculating portfolio weighted average carbon intensity (WACI) is often a starting point for analyzing transition risk. Investors compare portfolio WACI, or tons of CO2e per $ million in revenue, to the carbon intensity of benchmark indices to gauge relative vulnerability to climate-related transition impacts. This analysis is currently difficult since so few companies publicly disclose their scope 1 and 2 emissions, with even fewer disclosing scope 3 emissions. The proposed rule will help us gain a more nuanced understanding of our portfolio emissions, which we can use in our assessment of portfolio transition risk. To support our analysis currently, we must rely on estimated emissions data.

Other elements of the proposed rule will also inform our portfolio climate risk management. Certain types of portfolio climate risk may only be discernable when aggregating specific climate risks from individual companies. For example, companies in a portfolio may operate in locations with medium level water stress, a form of physical climate risk. At the individual company level, the water risk may be immaterial. However, when the geographic water impacts are aggregated across all companies in the portfolio, water stress may be a significant risk due to competition for water resources. Given the lack of physical climate risk disclosures from companies today, we do not have access to detailed information needed to deeply assess our portfolio vulnerability to physical climate risk. The proposed rule will improve our assessment of physical climate risk, helping us gain a deeper understanding of how our portfolios are vulnerable to the physical impacts of climate change.

Although we support most of the planned disclosures in the proposed rule, Essex sees opportunities for the SEC to strengthen the rule. In particular, the details concerning disclosure of scope 3 emissions is of the utmost importance and requires further examination. In the current draft, large accelerated, accelerated, and non-accelerated filers would be required to report scope 3 emissions if material or if included in a decarbonization goal set by the company. Furthermore, the Commission states, “While we are not proposing a quantitative threshold for determining materiality, we note that some companies rely on, or support reliance on, a quantitative threshold such as 40 percent when assessing the materiality of Scope 3 emissions.” We believe the SEC should re-evaluate the proposed materiality details concerning disclosure of scope 3 emissions. According to research by Bernstein, scope 3 emissions could represent more than 75% of a company’s total emissions in the energy, consumer discretionary, and financials

sectors.[6] Scope 3 emissions are also a substantial portion of the overall average emissions footprint in several other sectors. Due to the significant contribution of scope 3 emissions to the overall emissions footprint for most companies and sectors, and the financial relevance of quantitative emissions analysis, we believe scope 3 emissions are material for all companies and should be disclosed. As such, we urge the Commission to require that all large accelerated, accelerated, and non-accelerated filers disclose scope 3 emissions. This change will ensure investors have sufficient access to scope 3 emissions data when making investment and voting decisions. In the absence of complete scope 3 disclosures, investors will be forced to continue relying on sector estimates that may be inaccurate and fail to consider company specific emissions details. By forcing investors to rely on estimates or sector averages, the proposed rule may contribute to inefficient market activity. In addition, lack of scope 3 disclosures may lead market participants to penalize companies with high scope 1 and 2 emissions simply because they lack complete emissions transparency for all companies. This conflicts with the Commission's stated intention to provide more comprehensive and comparable climate-related disclosures. With mandated disclosure of scope 3 emissions required for the types of filers mentioned, investors will have access to all material information from a climate risk perspective. Our recommendation to the Commission on the proposed rule will also eliminate issuer confusion in determining when scope 3 emissions are material.

If the Commission believes that mandated disclosure of scope 3 emissions for all large accelerated, accelerated, and non-accelerated filers is not prudent or falls outside the Commission's stated mandate, we believe the Commission should provide further guidance concerning how companies should determine scope 3 materiality. In the current form of the proposed rule, there is likely to be significant market uncertainty from companies and investors about when scope 3 emissions are material. By providing further guidance, the Commission will reduce market confusion and ensure a smooth transition for market participants. Essex proposes that the Commission provides further guidance by establishing a quantitative threshold for determining materiality. As the Commission notes in the proposed rule, some market participants rely on the 40% materiality rule recommended by the SBTi. If adopted by the Commission, a company would be required to disclose scope 3 emissions if they represent 40% or more of their total scope 1-3 emissions footprint. While the SBTi is a highly respected organization, we believe 40% is too lenient and we recommend the Commission adopts a stricter threshold. Lacking access to information concerning 40% of a company's total emissions footprint obscures the true extent of climate risk the company faces. This uncertainty will reduce the accuracy of investment analysis that leverages quantitative emissions data. The Commission should adopt a stricter materiality threshold, such as 20%, which will reduce costs of determining scope 3 materiality and ensure investors have access to the necessary information needed in the investment decision making process.

Essex also urges the Commission to reconsider the indefinite exemption for SRCs from scope 3 reporting. We acknowledge and support that the proposed rule aims to limit the compliance burden for SRCs since scope 3 emissions are not as readily calculable as scope 1 or 2 emissions. However, the indefinite exemption for SRCs from scope 3 disclosures is not prudent. As stated in the text to the proposed rule, SRCs make up approximately half of domestic filers in terms of numbers. By exempting SRCs from scope 3 reporting indefinitely, it will impair investors' ability to fully analyze the extent of the climate-related risks that SRCs face. As mentioned earlier, SRCs are likely less resilient to climate-related risks than large

[6] Zhihan Ma, CFA, *Global ESG Research: The state of scope 3 reporting-time to move beyond measuring business travel emissions*. Bernstein, 2021

or accelerated filers due to their limited financial resources. Essex proposes that SRCs should not be required to disclose scope 3 emissions as quickly as large and accelerated filers, but the Commission adopts a phase-in period for SRCs to report scope 3 emissions that converges with the final standard for large accelerated, accelerated, and non-accelerated filers. SRCs could be subject to the final scope 3 disclosure rule two years after the current disclosure compliance date of accelerated and non-accelerated filers (filed in 2026). Based on this proposed change, SRCs would disclose scope 3 emissions for Fiscal Year 2027 in the 2028 filing period. Since the main impediment to cost-effective scope 3 disclosures is the calculation methodologies, exempting SRCs from scope 3 reporting until the methodologies are refined and standardized should adequately reduce compliance costs. If the rule is structured in this manner, SRCs should not face a disproportionate compliance burden since the data gathering, measurement, and scope 3 reporting process will be well defined. For investors, the proposed change to the SRC scope 3 exemption will provide access to material scope 3 information that is urgently needed for the investment decision-making process.

Overall, we believe the proposed rule on climate-related disclosures fulfills an immense need in the capital markets. As investors, we are already integrating climate-related considerations in our investment decisions since we believe climate change is a material risk to individual companies and portfolios. The current voluntary disclosure regime does not provide clear, comprehensive, and comparable climate-related information, making it difficult to assess and forecast the future climate-related financial impacts. In the current form, the proposed rule is a step forward in providing investors with decision useful climate-related financial information needed to inform investment analysis and voting decisions. With changes included to reflect the importance of comprehensive scope 3 reporting, the proposed rule will finally provide investors with the climate-related disclosures that the market has been lacking.

Sincerely,

On behalf of Essex Investment Management, LLC:

Nancy Prial, Co-Chief Executive Officer and Senior Portfolio Manager

William Page, Senior Vice President and Senior Portfolio Manager

Jack Lloyd, Impact Analyst