



via Electronic Mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov)

June 14, 2022

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

**Re: Public Comment on The Enhancement and Standardization of Climate-Related Disclosures for Investors  
Proposed Rule— Release Nos. 33-11042; 34-94478; File No. S7-10-22**

Dear Ms. Countryman,

Thank you for the opportunity to participate in this important discussion on the merits of the corporate reporting of climate-related disclosures for investment decisions.

Acadian Asset Management LLC is a U.S. Securities and Exchange Commission-registered investment adviser and Boston-headquartered investment management firm. Along with our wholly owned investment advisory affiliates in Singapore, Australia, and the UK, we specialize in the active management of systematic investment strategies. As of March 31, 2022, the combined Acadian entities invested \$110 billion on behalf of pension funds, endowments, foundations, governments, and other institutions globally.

We are excited and encouraged by the Commission's extensive work on climate-related disclosures and applaud its thoughtful and comprehensive approach. We fully support efforts that promote disclosure and transparency and endorse the Commission's efforts to enhance investors' abilities to integrate climate considerations into investment analysis.

In this document, we seek to address a subset of the questions raised by the Commission's proposal.



## Carbon reporting and company valuations

Acadian systematically integrates climate change considerations into investment decisions (via a carbon valuation adjustment model). Our goal is to enhance the prediction of risk-adjusted return forecasts for the benefit of all client portfolios. Our approach is motivated by the observation that as investors price stranded asset and transition risks and opportunities, this will be reflected in company valuations. This, in turn, requires investors to model firms' carbon risks where exposures are not publicly reported. For example, as at end May 2022, 78% of companies by market cap weight report Scope 1 and 2 emissions within the Russell 1000 universe (with Energy, Utilities, and Materials amongst the highest-reporting sectors at more than 85% data coverage). This implies that carbon emissions data must be imputed for 22% of the investment universe.

All else equal, one benefit for companies reporting carbon emissions data is a potential reduction in their cost of equity.<sup>1</sup> To provide empirical support for such a relation, we infer the market-implied cost of equity for U.S. companies and statistically test for a relation with companies' reporting of carbon data. That is, given the market-implied cost of equity, we conduct a statistical analysis to test for differences between those companies that report Scope 1 and 2 carbon emissions and those that do not, controlling for company attributes including firm size and peer group.

Whilst acknowledging the challenges associated with inferring the market-implied cost of equity particularly regarding the sensitivity to model assumptions,<sup>2</sup> we find some evidence to suggest that those companies in the Russell 1000 universe that report Scope 1 and 2 carbon emissions are indeed associated with a lower cost of equity.

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<sup>1</sup> Page 333 of the Commission's proposal encourages feedback on methodologies to quantify the impact of climate disclosure on a firm's cost of equity.

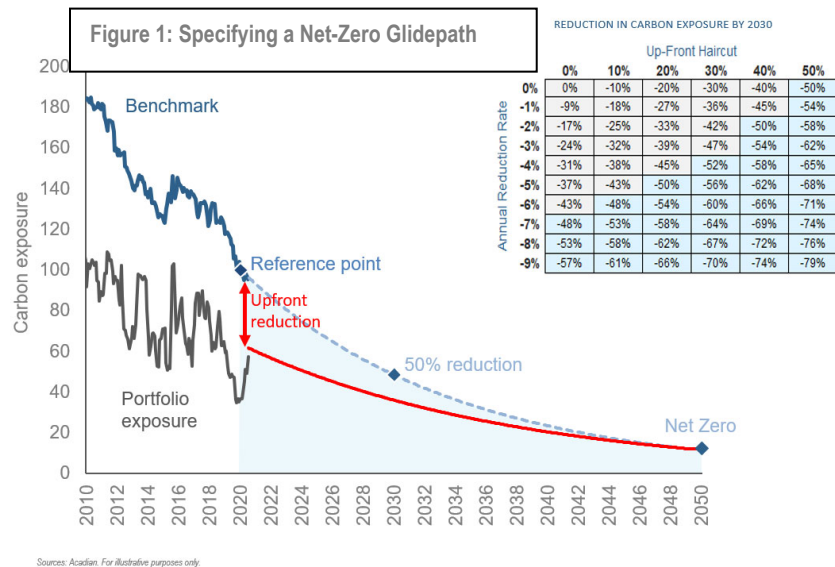
<sup>2</sup> A company's market-implied cost of equity may be inferred from sell-side analyst forecasts via a residual income model. We employ a three-stage model to estimate residual income. In the first stage of the model, sell-side analyst estimates of book value and earnings per share are explicitly integrated between FY1 and FY5. In the second stage of the model, a company's return on equity (ROE) is assumed to mean revert to the median industry ROE. This mean reversion attempts to capture the long-term erosion of abnormal ROE over time. The third stage of the model assumes an equilibrium state where incremental economic profits are zero. That is, any growth in earnings is value-neutral.

The residual income framework allows us to infer a company's market implied cost of equity. The model is based on the concept that in equilibrium, the implied cost of equity is the internal rate of return that equates the present value of expected residual income to the current share price.

## Benefits of reporting carbon emission data to create investment solutions

In addition to adjusting companies' valuation metrics for carbon risk and opportunities, Acadian offers bespoke decarbonization solutions to those clients with specific Net Zero goals. These custom solutions support Acadian's commitment to the Net Zero Asset Managers Initiative.

Our dedicated climate solutions employ advanced techniques to integrate a decarbonization constraint into portfolio construction by defining a smooth upper bound for a given portfolio's carbon exposure. We define carbon exposure using a combination of weighted Scope 1 & 2 emissions, Weighted Average Carbon Intensity (normalizing by companies' sales) and Carbon Footprint (normalizing by Enterprise Value Including Cash).



The typical starting point is to assume that the benchmark is a proxy for the economy and to require that the benchmark decarbonizes in line with IPCC and IEA guidelines (7% decarbonization a year to ensure a 50% reduction between 2020-2030). This is illustrated in Figure 1 by the benchmark Reference point which is indexed to a value of 100 as at December 2020, declining to 50 by 2030. Given the Reference point, the portfolio then integrates an upfront reduction and ongoing annual reduction in carbon exposure as indicated by the red lines in Figure 1 (that is, a “Net Zero Glidepath”).

*Implication: Scope 1 and 2 carbon emissions data for all companies are required for investors to quantify the carbon exposure of the benchmark. This in turn would enable investors to more easily create Net Zero aligned solutions and to compare the carbon exposures across portfolios and versus the benchmark.<sup>3</sup>*

<sup>3</sup> See page 9 of the SEC's proposal.



## Integration of forward-looking climate metrics into investment processes

One consequence of the proliferation of sustainability standards and frameworks is that ESG metrics are not reported on a consistent basis across regions, industries, or companies. For example, as at end May 2022, 71% of companies within the Russell 1000 universe have announced decarbonization targets (with Energy, Utilities, and Materials amongst the highest-reporting sectors at more than 85% coverage), while 32% of companies have announced science-based approved targets, and a further 13% have committed to science-based targets in the future. Of the 71% of companies that report decarbonization targets, 22% relate to horizons up to 2030, 30% of targets refer to 2030-40, and a further 20.3% refer to post-2040. This lack of standardization hinders investors' abilities to make an "apples-to-apples" comparison of the climate risks and opportunities across investee companies.

To gain greater insight into companies' decarbonization plans, Acadian's Responsible Investing team conducts both direct engagements and participates in collaborative engagements including through Climate Action 100+. Our engagements focus on the need for companies to commit to frameworks shaped by the Taskforce for Climate-related Financial Disclosures (TCFD) and Science Based Targets initiative (SBTi). In our discussions with companies, we advocate disclosure of climate change risks, with board oversight of climate risk and overall climate strategy, adoption of company-wide emissions reduction goals, and the commitment to short-, mid- and long-term carbon emissions reduction targets and scenario analysis, including where global warming is limited to well below 1.5°C.

*Implication: The Commission's proposals would enable the standardization of disclosures allowing investors to identify and compare the risks and opportunities within portfolios.<sup>4</sup>*

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<sup>4</sup> Our view builds upon the Commission's 2010 Guidance recommending that companies may choose to publish climate change disclosures as part of their *Description of Business, Risk Factors, Legal Proceedings, and Management Discussion and Analysis of Financial Conditions and Results of Operations* ("MD&A").

## Identification of boilerplate climate disclosures

Acadian's Natural Language Processing (NLP) analysis of 10-K disclosures<sup>5</sup> finds 579 companies in the Russell 1000 universe that currently mention climate-related terms (58% by market cap weight). In total, we identify 471 companies within the Russell 1000 universe that mention physical climate risk (51% by weight). Of the 471 companies, 269 companies (57% by count) appear to publish boilerplate climate disclosures. We define a boilerplate statement as a company disclosure that discusses a 'laundry list' of topics that lack numeric information. For instance, we find those companies that mention climate change typically also mention the risk of unrelated exogenous shocks in the same sentence. We include the following extract from one company's 10-K filing as an example:

*"...our supply chain and operations could be subject to events beyond our control, such as earthquakes, wildfires, flooding, hurricanes, tsunamis, typhoons, volcanic eruptions, droughts, tornadoes, the effects of climate change and related extreme weather, public health issues and pandemics, war, terrorism, government restrictions or limitations on trade, and geo-political unrest and uncertainties."*

*Implication: Our findings point to a substantial number of companies adding boilerplate climate disclosures to their 10-K filings.<sup>6</sup> Consequently, we believe that the Commission's proposal to mandate and standardize climate reporting would better address investors' needs to monitor and manage climate-related risks.*

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<sup>5</sup> Our analysis is designed to complement the Commission's own work in this area (see page 302 of the proposal).

<sup>6</sup> See page 331 of the Commission's proposal.

We outline two further examples below where we believe that mandated disclosures would aid investment analysis and mitigate concerns over the current use of boilerplate statements:

### ***Physical climate risk***

Our analysis of the physical climate risk scores procured from ESG vendors highlights substantial disagreement between datasets (0.10 correlation). Measurement error results both from differences in definitions across the dimensions of physical climate risk and from the weighting schemes applied to firms' geolocations/Points of Interest. One data vendor, for example, defines physical climate risks associated with water, floods, coastal floods, heat, cold, hurricanes, and wildfires, and identifies 3 million geolocational points of interest for its universe of companies. A second data vendor defines physical climate risks associated with floods, heat, rain, snow, wind, and cyclones, and identifies 350,000 points of interest for a broadly similar universe of companies. The first data vendor equally-weights Points of Interest to estimate each company's physical climate risk while the second data vendor weights Points of Interest by revenue.

*Implication: In our view, by providing a definition of physical climate risk and asking companies to report the geolocations of their operations would alleviate some of the current measurement error<sup>7</sup>.*

### **Reporting of Scope 3 emissions**

We identify companies that discuss supply chain concerns in conjunction with physical climate risk by employing text analysis to 10-K filings. The following extract is an example of such a sentence:

*"increased frequency or duration of extreme weather conditions, whether due to global climate change or otherwise, could also impair production capabilities, disrupt our supply chain or adversely affect demand for our products."*

We find that around 50% of companies (by market cap weight) discuss such risks within the Consumer Durables & Apparel, Food & Staples Retailing, Food, Beverage & Tobacco, and Semiconductors & Semiconductor Equipment industry groups without providing any quantitative information to augment their concerns.

*Implication: We support the Commission's proposal to consider the reporting of Scope 3 emissions data where they are deemed material and suggest that companies' mentions of supply chain risks offers one way to identify materiality.*

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<sup>7</sup> On page 68 of the Commission's proposal, question 9 asks whether physical climate risk should be defined. Question 61 on page 129 asks if severe weather events and other natural conditions should be specified, while Question 12 on page 68 asks whether companies should provide the geolocation of their operations.



## Conclusion

Thank you for the opportunity to submit feedback on the investment case for the corporate reporting of climate disclosures. We are encouraged by and appreciative of the Commission's thoughtful approach to climate considerations. We view this as a long-awaited and significant step forward for the U.S. market and an opportunity to continue to provide significant benefits of transparency and comparability for market participants.

We look forward to seeing the finalization of this process and welcome further discussions and collaboration with the Commission on this topic.

Kind regards,

Acadian Asset Management LLC

cc. The Honorable Gary Gensler, Chair  
The Honorable Hester M. Peirce, Commissioner  
The Honorable Allison Herren Lee, Commissioner  
The Honorable Caroline A. Crenshaw, Commissioner