SEC PUBLIC CONSULTATION ON CLIMATE REGULATION, THE ENHANCEMENT AND STANDARDIZATION OF CLIMATE-RELATED DISCLOSURES FOR INVESTORS (File Number S7-10-22)

RESPONSE FROM THE CITY OF LONDON CORPORATION

Introduction

The City of London Corporation works closely with a wide range of stakeholders to promote UK-based financial and professional services (FPS). These include departments across the UK Government (i.e. the Department for International Trade, HM Treasury, and the Foreign, Commonwealth, and Development Office), financial and professional services firms, and international FPS trade associations. The common goal is to sustain prosperity and stimulate economic growth in London and across the UK through global trade and investment.

We support the SEC's efforts to establish climate-related financial services regulation and are pleased to see the hard work of the Commission included in this proposed rule. By providing a submission to the SEC on their proposed climate rule, we would like to illustrate the importance of international collaboration between the UK and the US in climate-related financial services regulation.

To note, all reports referenced in this comment can be found in the links cited and are included in the appendix to this submission. The City of London Corporation has played an integral role in the writing of these documents and fully supports the findings and recommendations they present. We would also be willing to discuss any of the topics included in this report further with the appropriate individuals, if required.

Regulatory coherence: the case for UK-US bilateral and international collaboration

Compatible regulatory outcomes provide a strong basis for cross-border investment, growth and job creation across the entire economy. Estimates suggest that such regulatory divergence increases business costs by 5-10% of annual turnover on average.[1] This is of particular relevance when considering the global transition to net zero. Climate change is one of the primary global challenges. The green transition will only succeed if properly financed by business operating across borders and regulatory jurisdictions.

The UK and the US can lead the development of international climate-related financial services regulation. UK and US regulators have strong trust-based relationships which underpin collaboration bilaterally and on global regulatory standards. This cooperation should set the baseline for more compatible and consistent regulatory outcomes to support the global net zero challenge.

As global financial centres, UK-US collaboration can help mobilise consensus around standards – particularly on disclosure and data – at the multilateral international level (FSB, IOSCO, G20). This will be key to minimise fragmentation of approaches in jurisdictions.

There is a need for a global set of internationally recognised sustainability reporting standards. However, this will take time and it is crucial for the UK and US to be working towards compatibility on the most urgent aspects.

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[1] https://biac.org/wp-content/uploads/2018/04/IFAC-OECD_Regulatory-Divergence_V9_singles.pdf

Key points:

- International collaboration between like-minded countries is essential to ensure international coherence in climate-related financial services regulation that supports global net zero goals. The UK and the US should look to lead the international discussion through bilateral mechanisms, such as the FRWG, and on the international stage.
- The City of London Corporation is encouraged by the Proposed Rule's reference to utilising pre-existing mechanisms to capture ESG data from issuers, the inclusion of early guidance with regards to data verification, reference to TCFD-based metrics, and guidance on phase in periods.
- The City of London welcome the SEC's initial steps to develop clear principles and priorities for ESG data and ratings through encouraging transparency and development of wider accessible data for market participants. This is crucial for the development of proportionate and principles-based regulation for ESG ratings, but also offers immediate gains through supporting comparable, reliable, and auditable climate-related data.
- As engagement with voluntary carbon markets are likely to increase, the City of London Corporation welcomes the inclusion and consideration of carbon credits in the proposed rule. This will require international collaboration to support a functioning global market and UK and US coordination, as global financial centres will be crucial to developing the necessary frameworks.
- The City of London Corporation believe the financial and professional services sector would benefit from further detail on the SEC's future plans for climate-related regulation and how these regulatory decisions will be reviewed. We also hope that the early guidance which has already been provided in the Proposed Rule, especially with regards to data verification, will continue to be built upon in future regulatory reviews.
- With regards to the process that the SEC has taken to develop this proposed rule, the City of London Corporation welcomes the engagement of the private sector and open consultation periods. We hope this private-public dialogue will continue, and be strengthened, as climate-related regulation develops further.

Conclusion

The City of London Corporation welcomes the consideration of the SEC of the inclusion of climate-related information within its disclosure frameworks. There remain numerous challenges facing the financial and professional services sector in this space including lack of data, comparability of information, and divergent international approaches. The City of London Corporation greatly supports the continued engagement of the SEC and other US policymakers with industry on these issues. Public-private collaboration in the establishment of climate-related financial services regulation is essential to develop an impactful and practical structure which supports our global net zero goals.

Further detail on relevant City of London Corporation workstreams on climate-related financial services regulation:

'*Data, Direction, Dialogue*': UK-US Collaboration in Climate-related Financial Services Regulation

As previously stated in our comments on Climate Change Disclosures, we welcome continued policymaker engagement with industry regarding potential climate-related financial services regulation. We would also underline the importance of international engagement in this area to ensure compatible standards which support global net-zero goals.

The City of London Corporation published a report on trans-Atlantic cooperation in climate-related financial services regulation on 24 May 2021. This report[2] is based on discussions with firms across the various areas of the financial and professional services sector and forms the basis for our response to this proposed rule and the previous public consultation. This includes discussion of the importance of climate-related data, the establishment of disclosure frameworks, and multilateral collaboration via international fora among other issue areas.

High-quality science-based data is the building block to effective climate regulation. The UK and US should collaborate to ensure that climate data is reliable, comparable, and verifiable. This should include the following:

- UK and US regulators should create a model for collecting reliable and auditable climate-related data. We are encouraged by the SEC's reference to utilising pre-existing mechanisms to capture ESG data from issuers. We would also encourage consideration such as the EDGAR filing mechanisms which provide a valuable starting point for establishing a trustworthy data set.
- The UK and the US should explore effective public-private sector collaboration as a template for future climate-related data management. We are encouraged by the involvement of the private sector in the establishment of the SEC's climate-related regulation. This should be built upon in the day-to-day workings of the regulation. The UK and US should ensure structures allow for companies to own and share their climate-related data as with other financial data. These structures could mimic the ISDA CDS template for collaboration around ownership of critically important data or expand on the structures established by the Carbon Disclosure Product.
- UK and US policymakers should collaborate on the use of alternative data and provide guidance to firms. As climate-related data is limited, firms would benefit from regulator guidance on the acceptable use of alternative proxy data. This should include which proxy data sets are verified and deemed comparable. We are encouraged by the inclusion of early guidance towards which firms can provide data verification in the SECs proposed rule and hope this continues to be built upon in future regulatory reviews.
- UK and US regulators should collaborate to provide similar climate-related reporting standards which produce comparable data. Such collaboration will help firms incorporate climate-related data into their operations. We are encouraged by the Proposed Rule's reference to TCFD-based metrics and other pre-established structures. We would also welcome collaboration on further development of TCFD and these metrics and disclosures being underpinned through an MoU establishing mutual recognition of climate-related reporting
- Alongside this, financial and professional services firms would greatly benefit from clarity on political and regulatory direction. The importance of clear and long-term guidance from the public policy and regulatory community for firms cannot be understated. This should include

[2] *Data, Direction Dialogue: opportunities for UK-US collaboration in climate-related financial services regulation* (May 2022) found here: https://www.cityoflondon.gov.uk/supporting-businesses/economic-research/research-publications/data-direction-dialogue

regulatory policy and approaches to disclosure frameworks, climate metrics, and risk assessments. The SEC has ensured an open dialogue with the private sector during the process. We strongly hope that this dialogue will not stop once the rule has been finalised, but rather continue to develop and grow as it is rolled out.

With regards to disclosure, the UK and US collaboration to develop standardised climate-related FPS disclosure frameworks should include the following:

- We are encouraged by the inclusion and incorporation of TCFD reporting requirements into the proposed rule. This should be viewed as a starting point to developing standard disclosure models rather than a final aspect, however. The UK and the US should work together to limit divergence in TCFD reporting requirements and providing clarity around what firms are required to disclose through TCFD.
- UK and US policymakers should collaborate on the exploration and establishment of appropriate potential independent verification for climate-related reports. This could be achieved by the regulators themselves or through approved independent institutions such as the IFRS Foundation or Sustainable Accounting Standards Board. We are encouraged by reference to the inclusion of expert review of disclosure submissions in the proposed rule, however there is a distinct need for international collaboration to ensure cross-border comparability.
- UK and US regulators should provide coordinated structured guidance on disclosure. UK and US policymakers and regulators can provide markets with certainty about the direction of travel and the milestones through guidance which enables firms to start to make strategic choices. This guidance should specify the acceptable climate-related metrics and reporting framework.
- Guidance should also identify the relevant regulatory bodies and their respective authority. This should be supplemented with guidance around legal liability and materiality. The proposed rule provides an admirable start to this process and outlines various phase in periods, however it would benefit from more detail on future plans for climate-related regulation and how these regulatory decisions will be reviewed.

These disclosure frameworks should be further supported through the incorporation of appropriate climate metrics, risks, assessments, and classification. The UK and the US must work to ensure comparable metrics are established for and included within climate-related financial services regulation. This should include the following:

- UK and US regulators must ensure open communication about climate-related financial services regulation metrics, scenario building, and classification. Communication should be encouraged at all levels, from formal regulator meetings to working-level discussions. This open flow of information will ensure effective solutions and that issues are dealt with before they create market access barriers. We are encouraged by the inclusion of climate-related topics in meetings of the Financial Regulatory Working Group (FRWG). These discussions should continue and expand as the UK and the US further develop their climate-related regulatory regimes.
- The UK and the US should support development of a common global language around sustainable investing. Common understanding and structures around product naming support global regulatory coherence in climate-related financial regulation. Existing frameworks such as the IIF framework, the UK IA Responsible Investment Framework, and Scope 3 provide a baseline which should be expanded and enhanced. We are encouraged to see the consideration of Scope

3 in the proposed rule, however we would welcome an expansion to include other internationally agreed frameworks as the building blocks for disclosures.

- The UK and US should ensure that regulators develop comparability and support evolution of metrics through including the metrics, scenarios, and frameworks in required disclosures. Policymakers and regulators are still in the early stages of establishing climate-related metrics, scenarios, and frameworks. Once they are created, they should be appropriately linked to disclosures through incorporating them into the requirements placed on firms. By doing this, regulators can provide a baseline for disclosures, increase comparability between disclosures, and support data gathering.
- When considering risk assessments, the UK and US should collaborate to establish risk assessments and incorporate this into financial regulation. The goal should be establishment of a single simplified assessment for both jurisdictions as the baseline for multilateral agreement.

Domestic advances in climate-related financial services regulation must be paired with international collaboration in order to tackle climate change. The UK and US should advocate urgently for the maximum collaboration in the development of globally consistent standards which leverage existing structures. There are numerous possible routes to achieving such coherence.

- The UK and the US should utilise their leadership roles within the G7, G20, and at COP26 to further integrate wider application and reach of climate-related financial services regulation.
- The UK and US should collaborate through pre-existing structures to advance climate-related regulation. At the international level, the UK and US should use existing fora and structures available to lead collaboration in climate-related financial services regulation. The Financial Stability Board (FSB) would be well-placed to identify leadership. The UK and the US should drive coordinated adoption of international standards and recommendations including IFRS sustainability reporting recommendations, ICI sustainable finance product descriptors, the IIF product naming framework, the Network of Central Banks and Supervisors for Greening the Financial System (NGFS), and the IOSCO Sustainable Task Force initiatives. The UK and US should learn from past experience, for example, in the development benchmarking and accounting standards to avoid divergences.
- Though not directly cited in the report, the Glasgow Financial Alliance for Net Zero (GFANZ) is another forum where the City of London Corporation believes UK-US collaboration in both supporting the initiative and driving the group's agenda will be important. The City of London Corporation has welcomed the synchronicity between UK and GFANZ work so far, including on the Transition Plan Taskforce. To further this work, we also hosted the Net Zero Delivery Summit in May 2022 to evaluate the progress made so far, set new milestones, and accelerate on delivery of global net zero goals. Alignment between the US and UK approach to GFANZ's workstreams, including surrounding gold standard transition plans, would only bring about positive results and could further bolster momentum behind private finance's role in delivering net zero.
- The UK continues to promote the merits of further US engagement and potential membership of the International Financial Reporting Standards (IFRS) Foundation. An important aspect of long-term international collaboration would be US membership of the IFRS Foundation. In the

meantime, the UK welcomes SEC engagement with IFRS on sustainability reporting as it develops its own structures such as this rule.

- The UK and US should coordinate these efforts bilaterally through the US-UK Financial Regulatory Working Group (FRWG). We are encouraged to see sustainable finance included as a recurring topic of discussions for these meetings and welcome it becoming an established topic of discussion for all FRWG meetings. Through these discussions, the UK and US could issue a joint statement outlining the urgency of ensuring cooperation in climate-related financial services regulation. As this work progresses, industry would see value in expanding initial statements and singular agreements on climate into a dedicated climate-related FRWG workstream.
- UK and US policymakers should ensure there is continual industry engagement when developing climate-related financial services regulation. Successful regulatory cooperation will require substantive engagement with industry to identify cross-border issues in a timely fashion. Policymakers should make use of the British American Finance Alliance and other existing industry engagement tools.

International Regulatory Strategy Group (IRSG) engagement on ESG Ratings and Data

ESG and sustainability are becoming increasingly central to investment decisions around the world. COP26 in particular provided a big boost to sustainable finance and the shift in capital toward sustainable activities.

Access to data and data quality remain key barriers to the reliability and comparability of disclosures. A single set of comprehensive disclosure standards — applying to both financial and non-financial firms — are critical in building the necessary data sets to facilitate better investment and financing decisions by all stakeholders.

ESG ratings are another vital component of this capital re-allocation so both demand for and reliance on these products is only expected to grow. It is therefore crucial that market users and investors have confidence in ESG ratings when making investment decisions.

However, with the ESG Ratings market still in its infancy and demand increasing at a rapid rate, it is unsurprising that significant challenges are emerging. These include transparency of methodology, ratings varying widely between different providers, clarity of purpose behind different products, availability of data disclosure, and potential conduct risks. As demand is set only to accelerate, it is paramount that these challenges are addressed to ensure the market is fit for purpose and can properly support market practitioners in assessing the risks and opportunities of potential ESG investments.

It is in response to this need that the IRSG, in partnership with Accenture, published *ESG Ratings and ESG Data in Financial Services – A view from practitioners*.[3] This report explores the challenges the market faces in its present state and offers recommendations of steps industry, regulators and policymakers can take to futureproof the integrity and efficiency of the ESG Ratings Market.

[3] *ESG Ratings and ESG Data in Financial Services – a view from practitioners* (February 2022), found here: https://www.irsg.co.uk/assets/Reports/IRSG-Accenture-report-on-ESG-Ratings-and-ESG-Data-in-Financial-Services-FINAL-2.pdf

At its core, the report recommends clear principles and priorities for proportionate and principles-based regulation for ESG Ratings to provide more transparency and mitigate against potential conduct risks. The report identifies various challenge and recommends how to address these.

The first challenge is the lack of transparency on the process of developing ESG ratings. This makes it difficult for users to understand and interpret providers' outputs. The IRSG recommends establishing clear and transparent methodologies; and for industry to develop clear marketing practices for ESG Ratings, potentially requiring future regulatory supervision

The second challenge faced by ESG rating providers is that of gaps in data coverage, due to insufficient corporate data disclosure. Our recommendation is for industry to improve data disclosure and gathering, and also to have greater alignment in standards by policymakers.

The third challenge is the global fragmentation of rules regarding ESG ratings which does not reflect the global nature of this market. We support the work of global standard setters to develop global standards which ensure, as far as possible, that we develop consistent regulatory approaches across the key jurisdictions.

The fourth challenge is around investor protection. Regulators need to pay greater attention to how ESG ratings products are promoted, particularly in retail markets where end-users will be less aware of what the ratings are measuring or how those ratings should be applied to investment decisions.

Another area of focus for the IRSG are the International Sustainability Standards Board's exposure drafts. The IRSG welcomes the ISSB exposure drafts for working toward a global standard which will provide structure and comparability across jurisdictions and firms worldwide. Like the SEC's proposed transition periods, the IRSG recognize the establishment of an ISSB standard may be a multi-year process. This further underlines the importance of policy continuity, both domestically and internationally, on this matter.

The IRSG ESG workstream is continuing to expand engagement with industry, policymakers, and regulators and undertake further research on these topic areas. The City of London Corporation and the IRSG would be more than willing to discuss the report and its findings in more detail should you believe this would be of benefit when considering any potential changes to the proposed rule.

City of London Corporation Engagement on Voluntary Carbon Markets (VCMs)

Another area of focus for the City of London Corporation is Voluntary Carbon Markets. Global demand for voluntary carbon offsetting is set to grow. Carbon offsetting is a complex subject and yet global demand for voluntary carbon offsetting is highly likely to continue to grow in the coming years.

Globally agreed governance principles and clear standards will be fundamental to the proper supply and use of credits that align to the ambition of the Paris Agreement and can accelerate the delivery of its promise. Investments in carbon offsets offer huge potential for tackling the immense and inequitable challenge of climate change. They can facilitate a just transition. Voluntary carbon markets will allow capital to flow to projects that reduce/avoid or remove/sequester carbon and to propel new carbon capture technologies. The growing demand for a supply of quality carbon offsets provides a catalyst to the innovation and behavioural shift needed from a broad range of private, corporate and government actors.

In order to examine this area in more detail, the City of London Corporation, alongside BCG, KPMG and Oliver Wyman, published "The Future of Voluntary Carbon Markets"[4] in November 2021. This report outlines the essential components of a well governed and efficient market that can transform the transition to Net Zero. The report references key developments and initiatives in the field, including:

- How VCMs can be a force for good in the journey to Net Zero
- Background to recent developments in VCMs
- What the future of the VCM ecosystem may look like
- Examples of how UK expertise is helping to deliver VCMs for high-quality credits.

The report outlines the vision of the UK Voluntary Carbon Markets Initiative to support a market with the necessary financial architecture and the green credentials to ensure that a scaled-up market is liquid, transparent, and is underpinned by high standards of environmental integrity.

To continue to build upon the findings of this report and action the recommendations, the City of London Corporation is serving as the secretariat to the UK Voluntary Carbon Markets Forum. This is a private sector initiative chaired by Dame Clara Furse. The Forum will build on the principles and recommendations set forth by the global Taskforce for Scaling Voluntary Carbon Markets and drive commitments and momentum to scale UK-based trade. Members of the Forum include senior leadership from across the VCM value chain, including the LSEG, ICE, BP, Climate Care, Fidelity, Standard Chartered, Tata Steel, and independent experts such as Lord Stern.

The City of London Corporation has also been selected to be a founding sponsor of a new governance body for VCMs, The Integrity Council for Voluntary Carbon Markets (Integrity Council or IC-VCM). The Integrity Council launch marks a significant step towards high-quality and scaled VCMs. This new body will now work to finalise the Core Carbon Principles (CCPs), set the threshold standards for the VCMs, provide oversight over standard setting organizations on adherence to the CCPs and coordinate the work between individual bodies within the carbon markets. In addition to this, as a Founding Sponsor, the City of London Corporation has a seat on the Distinguished Advisory Council and will offer office space in central London to the Integrity Council.

The City of London Corporation is encouraged by the inclusion and discussion of carbon credits in the proposed rule. This is an area which will require international collaboration and coordination to support a functioning global market. We welcome further discussions with the SEC on VCMs and how the UK and US, as global financial centres, can support each other to develop the necessary frameworks for the market.

Emissions and Carbon Border Adjustment Mechanisms

Though Carbon Border Adjustment Mechanisms (CBAMs) are not directly included in the proposed rule, they remain a topic worth consideration in the wider ecosystem of climate-related financial services regulation.

As a global problem, climate change needs international collaboration and a global solution. Carbon pricing mechanisms are one way in which jurisdictions can reduce carbon emissions and establish a consensus for a principle-based approach to its regulation.

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[4] *The Future of Voluntary Carbon Markets* (November 2021) https://www.cityoflondon.gov.uk/supporting-businesses/economic-research/research-publications/the-future-of-voluntary-carbon-markets

The City of London Corporation and Norton Rose Fulbright produced a discussion paper, which investigates global climate ambitions and carbon pricing instruments.[5] The report not only describes the global landscape of carbon policies, but also the role of financial services and markets in this.

With the European Union's CBAM set to start in 2026 exemptions to comply will only be applicable to countries participating in the EU Emissions Trading Scheme (ETS) and those having linked their own ETS to the EU's. The UK remains quite ambitious in its plans to reduce carbon footprint and has also expressed interest in a CBAM of its own. In order to improve the understanding of CBAM before the actual start of the legislation, we believe it is vital for the UK and EU to work with non-EU countries and explore the opportunities that come with co-existing CBAM regimes.

The proposal to set up a European Carbon Border Adjustment Mechanism was published on 14 July 2021. The European Commission proposes to start with five sectors (electricity, cement, steel, aluminium and fertilisers) and phase in the CBAM over a period of 10 years, in which it will gradually replace the free allocation of allowances under the EU Emissions Trading System (EU ETS) which is based on product benchmarks. While the Council adopted a general approach on 15 March 2022, the European Parliament is currently working on a position.

The City of London Corporation would encourage the SEC to bear in mind the EU and other countries movements in this space when moving forward with their own considerations and examination of potential CBAMs. To be truly effective in effecting change towards net zero, CBAMs must be internationally cohesive and avoid unnecessary divergence. This is not only important to reach net zero, but also to ensure the widest engagement from across the various sectors of the economy. Divergent regulation can create an increased administrative burden and costs for SMEs meaning they will struggle to meet and engage with the regulation requirements more than larger sector incumbents.

[5] *Discussing EU and UK approaches to carbon pricing as a tool towards net-zero emission targets: implications for financial markets* (October 2021) found here: https://www.cityoflondon.gov.uk/supporting-businesses/economic-research/research-publications/eu-and-uk-approaches-to-carbon-pricing