Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549

RE: File No. S7-10-22

Dear Ms. Countryman:

This letter contains my comments on the Securities and Exchange Commission's ("SEC") proposed rule, "The Enhancement and Standardization of Climate-Related Disclosures for Investors" (the "Proposal"). I write this letter as a private citizen, taxpayer, and an accredited investor who manages my family's investment portfolio of equities, bonds and mutual funds. I leverage my observations and recommendations from my professional background as an alumnus of the Big 4 (audit manager) and in my current capacity managing an SEC registrant's reporting (both internal and external), SOX 404 and accounting policy departments in the extractive energy industry.

I begin with a summary of the more significant areas of feedback:

- Never once did I ever review a registrant's greenhouse gas ("GHG") emissions program, quantity of emissions, or effect on the entity either before or subsequent to my investment decision (unless it was disclosed within the 10-K due to it having a material effect on operations, capital spend, etc.). If the GHG data is not within an issuer's Form 10-K, then it's not material enough for me to review.
- The SEC should remove all Regulation S-X requirements in the Proposal
    - The SEC's existing rules already address and require disclosure of material climate risks
    - The Proposal usurps and/or redefines materiality
- The SEC failed to adequately consider the economic consequences of the Proposal
- The SEC is not the appropriate entity to establish standardized climate reporting
- The SEC's proposed rules are an extreme overreach of executive agency authority. I found the Proposal offensive to the Supreme Court's January 2022 decision in National Federation v OSHA in that the Proposal:
    - Would operate as a blunt instrument
    - Is not an everyday exercise of federal power
    - Raises separation-of-powers concerns in the absence of a clear delegation from Congress

<u>Relevancy of registrants' GHG data</u>
Our personal investment portfolio currently contains about 30 individual equity securities and six mutual funds or exchange traded funds. I actively track another 40-50 individual registrants at any given point in time for a potential equity or bond investment. Prior to an initial investment in an equity or bond security, and certainly while holding a position, I read every registrant's most recently filed Form 10-K and Form 10-Q. I also read the prospectus (and related

supplements) for mutual funds + their annual shareholder letters. I provide this for context of my next statement.

To be as clear as possible, unless an issuer includes its GHG data set (emissions, costs, etc.) into its Forms 10-K, 10-Q, prospectus or other documents filed with the SEC, I consider such information wholly irrelevant. Irrespective of what goals, targets, or ambitions a registrant professes outside of these filings, I do not believe such information is useful to my decision framework.

<u>The SEC should remove all Regulation S-X requirements in the Proposal</u>

Existing rules require disclosure of material climate risks
The materiality standard has rightly been described as the "cornerstone" of the securities disclosure system (TSC Industries, Inc v Northway 1976). Thus, companies routinely apply it when making financial disclosures. Information is material if there is a substantial likelihood that a reasonable investor would consider it important or significant when deciding whether to buy or sell a security or how to vote as a shareholder. In explaining the concept of materiality, the Supreme Court has been mindful "not to set too low a standard" (*i.e.*, an overly expansive standard) to avoid "bring[ing] an overabundance of information . . . and lead[ing] management simply to bury the shareholders in an avalanche of trivial information." (Basic Inc v Levinson 1988) This information overload, the Court recognized, is "hardly conducive to informed decision making" by investors.

In recognition of the securities laws' focus on information that is material to the reasonable investor, the Commission has long required that issuers "focus specifically on material events and uncertainties known to management," including only "description and amounts of matters that have a material impact on reported operations, as well as matters that are reasonably likely based on management's assessment to have a material impact on future operations." Further, management discussion is best focused on "financial statements and other statistical data that the registrant believes will enhance a reader's understanding of the registrant's financial condition, cash flows, and other changes in financial condition and results of operations."

Unfortunately, the Proposal disregards the intentional limits on the type of information filed under Regulations S-X and S-K and instead supplants management judgment with that of an unelected group of Commissioners. This will result in filings that overwhelm investors with information that is counterproductive in detail, not material, and likely confusing to an investors' overall understanding of the registrant.

The Proposal usurps and/or redefines materiality
The Proposal would force companies to report minute levels of detail that cannot be considered material to most investment decisions and contravenes the materiality standard that protects investors from being overloaded with unnecessary information. Issuers would be required to disclose, for each line item, the financial impacts of weather events and other natural conditions, as well as costs related to efforts to reduce emissions and mitigate climate-risks, without any meaningful materiality threshold…the only limitation is that disclosure would not be required if the sum of the absolute value of all the impacts is less than 1% of a particular line item. This

effectively provides no limit, however, because the value is absolute, meaning that disclosure is required even without any net effect.

Further, the Proposal's description of the types of "climate-related risk" for which registrants must report financial data is far too broad. It would require vast and granular reporting on all "actual or potential" impacts of "climate-related conditions and events" on financial statements, business operations and value chain, down to the *zip code*. Without further limitation, or an established baseline for what events would and would not be considered climate-related, this information will result in reporting *enormous* amounts of information that will not be helpful to those assessing climate risk with respect to an issuer's operational and financial performance.

The Proposal would require a significant undertaking of new accounting processes without any clear standardization of baselines or norms. To be clear, ***no accounting standards currently exist regarding climate reporting***. The Proposal would effectively become the accounting standard. For example, there is no commonly accepted standard for what is a climate-related condition or event beyond the examples cited in the Proposal. Is a blizzard in North Dakota (which is home to the Bakken shale formation) a climate-related event despite North Dakota's routine history of blizzards? How about a drought or heat wave in New Mexico (Permian shale formation) or Texas (Permian, Eagle Ford & Barnett shale formations)? What about hurricanes that make landfall along the Gulf Coast or Southeastern U.S. (offshore oil platforms or onshore production in Louisiana)? How should an issuer think about Spring-time tornadoes in the Midwest U.S.? There are decades of records documenting regularly occurring examples such as these so how is an issuer's management supposed to determine what is "normal" for purposes of the Proposal? And why are they now material risks (in the construct of securities law) given the pervasive history of such events? The lack of any established baseline on these could mean that everything is material to some or not material to others under the Proposal without the SEC establishing or knowing what is appropriate.

The 1% threshold for each financial statement line item is especially problematic on a number of fronts. First, it is significantly below the concept of materiality as currently applied to financial statements. I remind the SEC of the Financial Accounting Standards Board's ("FASB") long-standing guidance regarding application of its Accounting Standards Codification ("ASC") in ASC105-10-05-6…"[t]he provisions of this Codification need not be applied to immaterial items". A 1% threshold (except for maybe the revenue line item) is wholly immaterial in relation to the entirety of the financial statements. Yet the SEC would have investors believe this is an appropriate threshold for which to mandate footnote disclosure:

- for *each line item* (e.g., revenues, cost of sales, SG&A, cash, A/R and A/P, other assets/liabilities, capital expenditures, etc.)
- accompanied with a narrative "describing how each specified metric was derived, including a description of significant and assumptions inputs used…", which means a narrative for each line item affected
- with comparative data for the 3 years presented.

The Proposal will inevitably lead to two separate materiality environments: one for climate-related information and another for all other financial information. A simplistic example of this outcome would involve damage sustained from a hurricane and litigation regarding insurance coverage related to the same. Assume an issuer incurs storm damage to an asset, makes a claim against its carrier, and the insurer denies coverage. The following are fairly reasonable possibilities and outcomes:

- The issuer declares the hurricane a climate-related event
- The issuer must assess the asset for impairment, and if the impairment exceeds the 1% threshold, disclose the impairment amount and significant assumptions/inputs used to calculate the impairment
- The issuer then initiates litigation against the carrier and recognizes litigation expenses as an Other Expense, which if those exceed the 1% threshold for that line item, cause the issuer to disclose its litigation costs and provide situational context
- The issuer settles with the carrier and recognizes Other Income and a receivable in Other Assets, which if that settlement value exceeds the 1% threshold for those line items, cause the issuer to disclose its settlement
- All of which may be immaterial to the financial statements taken as a whole under existing rules and regulations, but is now material simply because of the Proposal's arbitrary 1% threshold.

How does this benefit users of financial statements, especially as an issuer must monitor and assess for climate-related events every single day of the year and then be in a position to extract, aggregate, analyze, validate and disclose the financial effects within a properly functioning Internal Controls over Financial Reporting ("ICFR") environment?

Second, by virtue of requiring this data in a footnote to the audited financial statements, the Proposal requires assurance over this data. As written, the Proposal is wholly unworkable in a number of respects.

- None of today's accountants with substantive career experience, whether employed as auditors or corporate accountants, were originally trained to be climate or weather experts.
- The timeline does not adequately provide issuers an opportunity to integrate a robust ICFR framework for the footnote disclosure, especially with the 2023 calendar year as the initial disclosure period.
- The Proposal's lack of clarity + the 1% threshold + the fact that this is a new disclosure regime + the innumerable variables and management decision points along the way inherently lead to such a complicated process that instituting a well-functioning (and auditable) ICFR framework is simply not realistic.
- There do not exist any auditing standards (e.g., those promulgated by the Public Company Accounting Oversight Board) by which assurance firms can reasonably provide attestation services.

Bluntly stated, the SEC either doesn't realize or doesn't care that the Proposal would have the resultant effect of forcing companies to aggregate, analyze, validate and disclose an avalanche of immaterial information (all subject to assurance in 2023) such that it completely undermines the intention of the materiality standard to protect investors from being overwhelmed by such information. Either conclusion is, at a minimum very startling and indicative of willful incompetence, or worse, reflective of how the SEC is overtly attempting to supplant the invisible hand of self-interest with its own regulatory hand tethered to a minority vocal of special interest activist groups to the detriment of reasonable investors.

I believe it's important to highlight my concurrence with Commissioner Peirce's public statements of March 21, 2022 and March 19, 2021, on this very topic. To quote from the March 2022 statement, "Existing rules require companies to disclose material risks regardless of the source or cause of the risk. These existing requirements, like most of our disclosure mandates, are principles-based and thus elicit tailored information from companies. Rather than simply ticking off a preset checklist based on regulators' prognostication of what should matter, companies have to think about what is financially material in their unique circumstances and disclose those matters to investors. Financial statements and their accompanying disclosure documents are intended to present an objective picture of a company's financial situation."

To quote from the March 2021 statement, "To get to broad ESG disclosure mandates for issuers, we have to reimagine materiality. But reimagining materiality is the same as tossing it in favor of a more malleable new edition. Materiality has served us well, and undermining it to accommodate ESG will harm investors. I reiterate a point I have made before—I am happy to consider new SEC mandates for specific metrics that are likely to be material to every issuer in every industry. ESG standards, however, continue to be talked of in broad strokes that obfuscate the immaterial nature of many of the specific underlying disclosures."

Commissioner Peirce's public statements serve as a prelude to a subsequent section addressing executive agency authority and incorporating disparate opinions into the process. If the Commission itself can't agree on the fundamental nature of materiality as it pertains to this Proposal, the Commission should reconsider the nature and scope of the Proposal.

I support the continued reliance on the existing materiality definition, believe the current structure of Regulation S-X provides the appropriate framework for issuers, and oppose any new mandated footnote disclosure requirement (and especially the Commission's arbitrary use of a 1% threshold, or any prescribed threshold).

<u>The Commission failed to adequately consider the economic consequences of the Proposal</u>
The Commission has a statutory obligation to consider the economic implications of the Proposal upon investors, registrants, and the public at large. For example, the Securities Act requires that "[i]n addition to the protection of investors," the Commission must consider "whether the action will promote efficiency, competition, and capital formation." This means that the Commission must, among other things, "determine as best it can the economic implications of the rule." (American Equity Investment v SEC D.C. Cir. 2010) And the Supreme Court has explained that rules predicated on an administrative determination that regulatory change is "necessary" or "appropriate" require a meaningful evaluation of the costs and benefits involved (Michigan v EPA 2015).

Adequate consideration of the costs and benefits requires a detailed and evenhanded assessment. Even where some costs are uncertain or unquantifiable, the Commission must "do what it can to apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation before it decides whether to adopt the measure." (Chamber of Commerce v SEC D.C. Cir. 2005) The Commission may not "inconsistently and opportunistically frame[] the costs and benefits of the rule;" fail to "quantify the certain costs or to explain why those costs could not be quantified;" "neglect[] to support its predictive judgements;" "contradict[] itself" in its economic analysis in order to achieve a preferred outcome;" or "fail[] to respond to substantial problems raised by commenters" about the economic analysis (Business Roundtable v SEC D.C. Cir. 2011). The Commission must also explain why a change from the status quo is necessary at all (American Equity Investment v SEC D.C. Cir. 2010).

The cost of complying with the Proposal will be astronomically high. The Commission itself estimates that compliance will cost registrants over $10.2 billion in external expenses and in excess of 43 million internal hours (or >20,000 man years assuming a standard 2,080-hour work year). But prior experience indicates that the underlying factors in the Commission's estimate for the Proposal substantially *underestimate* the costs. The most comparable example with such an expansive rule involves the Commission's estimated compliance costs with the Section 404 requirements promulgated pursuant to the Sarbanes-Oxley Act. The Commission estimated it would cost companies about $91,000 per year. That turned out to be predictably and laughably low. Indeed, Daniel Goezler (former Board Member, Public Company Accounting Oversight Board) observed in a March 2005 speech that a survey by Financial Executives International of its members yielded an average first year expenditure of $4.4 million. That was in 2004 dollars. Applying a 2.4% inflation rate from 2004 to 2022 (consistent with the Consumer Price Index) yields a value of ~$6.7 million in today's dollars. The Commission's $10.2 billion estimate would only capture costs for ~1,500 issuers using the inflation-adjusted Section 404 amount, a far cry from the 7,000+ issuers affected by the Proposal. And the $6.7 million estimate assumes the Proposal is no more complex than SOX 404; my experience informs me otherwise.

The implementation of the Proposal would require the creation and deployment of entirely new accounting, financial, and in some cases scientific processes in a matter of months. The challenges for issuers to report brand new metrics in filed financial statements, for which there are no well-established and sanctioned regulatory guidelines, in such a short time may be insurmountable for some and extraordinarily expensive for all. The Proposal would require issuers to report the financial impacts of "severe weather events, other natural conditions, such as flooding, drought, wildfires, extreme temperatures, and sea level rise on any relevant line items in the registrant's consolidated financial statements during the fiscal years presented," at an immaterial and absurdly low 1% threshold. The granularity of this requirement and its impact on registrants cannot be overstated. Even if a higher percentage threshold level were proposed, issuers would still have to track and code all expenses, capital, and revenue items that *may* be related to weather events and maintenance, for all line items, regardless of how minor to determine whether the threshold – whatever it is set at – is met. Further still, issuers would have to estimate expenses, capital expenditures, and revenues that did *not* occur due to weather and climate-related events. A company would literally have to hire a climate-based workforce to comply with just the Regulation S-X disclosure mandate.

Companies will require the development of new accounting systems and techniques to track and delineate revenues, capital expenditures, and expenses, along with the development of new software, training, and auditing approaches. Current IT systems were not designed to track and report such attributes, particularly at a 1% threshold. Company personnel will need to establish a process and guidance for identifying the relevant costs, including training materials for the personnel. The company will then need to develop new review processes that would be repeatable, defensible, sustainable, and compliant with ICFR. And it will need to reproduce this across multiple organizations. This will be an immense effort. Even mid-cap companies routinely process millions of individual invoices in a given year, each of which would need to be assessed under the Proposal to identify with adequate precision the climate-related line-item impact. And that effort relates only to current reporting. Going back to track, calculate, and delineate these costs for past reporting years, as the Proposal would require, would involve unprecedented forensic evaluations for which much of the data will not be available (particularly where past costs were not material and were not specifically identified as weather related). It would require an intensely detailed retrospective assessment of invoices to assess their potential climate-related purpose.

I also remind the Commission that there aren't any clear accounting or auditing standards governing this type of information. The Commission may believe that its Proposal provides sufficient clarity but I fervently disagree. The lack of a clear accounting and auditing framework will only serve to increase confusion, thereby resulting in higher costs to comply. I have personal experience, at a registrant, in managing the implementation process of the FASB's two most recent significant projects: Accounting Standards Codification ("ASC") 606 (Revenue from Contracts with Customers) and ASC 842 (Leases). Each of those ASCs was hundreds pages long, with each of the Big 4 publishing their own interpretive guidance that was also several hundred pages long. As a preparer, I at least had the benefit of detailed guidance whether it be from the FABS itself, or a Big 4 interpretative publication, or our external assurance team. My feedback to the Commission is that the Proposal is woefully inadequate to form a clear basis for the underlying accounting, especially as none of us accountants were trained on climate reporting.

Did the Commission adequately assess the increased costs of financial auditing and legal expenses that will be caused by the Proposal? Auditors are advertising a significant commitment to staff and resource their operations in anticipation of addressing climate and other ESG issues companies are facing. For example, according to a Wall Street Journal article published on March 29, 2022, KPMG said "it planned to spend more than $1.5 billion over the next three years on climate-change-related initiatives, including training on environmental, social and governance issues for all 227,000 employees and efforts to advise businesses on how to meet net-zero emission targets." Similarly, Ernst & Young indicated the company "would spend $10 billion over the next three years on audit quality, sustainability and technology," while PricewaterhouseCoopers unveiled a five-year plan of $12 billion, including to "train employees on climate-related matters and hire 100,000 new people." This underscores the scope and extent of work that would need to be conducted to implement the Proposal if it were adopted as proposed. Let's not forget that the Big 4 are in business to make money for their partners and will undoubtedly pass these costs along to the issuers.

Additionally, the Proposal will impact arrangements with private companies and other entities that contract with registrants as they will likely be forced to collect and provide data to registrants in a manner that would attempt to support the registrant's climate disclosure obligations. Some private companies and other businesses not directly subject to the SEC's disclosure mandates may be able to shoulder the cost of collecting and providing information that registrants need, but many will not be able to afford to undertake the effort. It is likely that this distinction would become a defining factor in a registrant's choice of supplier or vendor and create an unintended cost to the economy, thus having a significant impact across registrant value chains that the Proposal does not adequately take into account in assessing the costs and benefits.

In the end, I don't believe the SEC adequately captured the full range of costs and impacts arising from the Proposal. This includes costs for new personnel, new and ongoing training of existing personnel, new IT systems, revisions to existing IT systems, incremental burden related to data gathering, analysis, validation and reporting, legal, consulting, and assurance expenditures. Even if many of these costs are difficult to quantify, the Commission failed to give them equal treatment to the purported benefits of the Proposal. In fact, the Commission failed to calculate the incremental value of the benefits or whether they justify the immense costs of the Proposal. This illustrates a fundamental defect with the Proposal as a whole: it does not address the complexity and granularity of the information that, or even ask whether, reasonable investors, acting as investors focused on material information that is important to financial returns, would *on net* be better off as a result of the changes the Proposal would make if adopted when the benefits are balanced against the costs.

<u>The SEC is not the appropriate entity to establish standardized climate reporting</u>
Although there may be a desire for further standardization of some climate data or information, the SEC did not adequately explain why it should be the particular agency to undertake this effort in the manner that the Proposal would mandate or that it is particularly the appropriate time to do so. The demand for climate information from a small, yet outsized vocal group of investors is still relatively recent and continues to evolve. A persistent lack of consensus among financial stakeholders exists about which climate information is material and little guidance is available regarding how it is assessed. This is evidenced by the variety of voluntary reporting initiatives and third-party certification organizations. The marketplace is still evolving in this area. The Proposal itself acknowledges that standards and methodologies are evolving. The SEC's one-size-fits-all approach seems to be a solution in search of a problem.

Instead, if the SEC believes that climate reporting beyond the current reporting framework is important, it should encourage the FASB to undertake such a project. The FASB's process is very deliberative and allows for ample consideration of intended & unintended consequences, provides a more appropriate transition period (as compared to the SEC's ridiculously short transition period for the Regulation S-X reporting), harmonization of disparate views, and greater input and visibility into the actual rule-making process itself.

<u>Executive agency authority</u>
I am not a lawyer nor am I trained in the art of legal interpretation so my comments on this topic are from a layman's perspective. I believe there are two very important themes to highlight.

First, a series of letters were submitted to the SEC by Members of the Senate and Members of the U.S. House of Representatives. The Senators' letter submitted on April 5, 2022 stated, "[t]he proposed rule is not within the SEC's mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. It is unclear from where the SEC has derived this drastic change in authority. The SEC is not tasked with environmental regulation, nor has Congress amended the SEC's regulatory authority to pursue the proposed climate disclosures."

The Representatives' letter submitted on April 11, 2022 conveyed to the SEC that they believe the proposal will "…far exceed the authority that Congress explicitly granted the SEC."

Notably, both letters were countersigned by several Members who serve on committees that provide Congressional oversight of the SEC. I find it enlightening that some of the very people who not only make the laws but in whom we entrust Congressional oversight of the SEC are advising the SEC (in a very direct manner) that it does not have the power to promulgate these new regulations. These Members obviously do not constitute the majority of the U.S. House of Representatives or the U.S. Senate. However, when there exists a set of disparate opinions on a given topic amongst very experienced and knowledgeable professionals, it would behoove the SEC to carefully consider and incorporate such disparate opinions into its process.

Second, I find the aforementioned National Federation decision illuminating in that it explicitly states, "Administrative agencies are creatures of statute. They accordingly possess only the authority that Congress has provided. The Secretary has ordered 84 million Americans to either obtain a COVID–19 vaccine or undergo weekly medical testing at their own expense. This is no everyday exercise of federal power…We expect Congress to speak clearly when authorizing an agency to exercise powers of vast economic and political significance."

The SEC itself identified that the proposed rules will affect almost 7,000 domestic and foreign issuers. Yet these rules would also affect many private entities, ranging from the public accounting & consulting firms (who employ hundreds of thousands) that will undoubtedly race towards a government-sponsored opportunity to increase revenues by providing assurance, consulting and/or implementations services, to private parties not subject to the SEC's existing regulations but will be asked to provide information by issuers so that the issuer may comply with these rules. In plain English, these proposed rules are clearly an exercise of powers of vast economic and political significance.

When considering the lack of an explicit legislative mandate by Congress, the Congressional letters explicitly stating that the SEC does not have legislative authority for the Proposal, plus the Supreme Court's guidance in the National Federation decision, there is significant uncertainty as to whether the Proposal itself is constitutional.

<u>Conclusion</u>

I close my letter with some additional data I believe the Commission should consider.

- The two best performing stocks for the calendar year 2021 in the S&P 500 were oil and gas producers
- Six of the top 20 performing stocks for calendar year 2021 in the S&P 500 were oil and gas producers
- The S&P 500 Energy sector was the best performing sector in the S&P 500 for calendar year 2021
- The S&P 500 Energy sector is currently the best performing sector on a YTD basis (thru June 16, 2022), with a superior return of ~+39%, and the only sector with a positive performance for 2022 (the next closest sector is Utilities at -9%)

If climate-related financial reporting and GHG emissions volumetric disclosures are fundamental to investment decisions (especially for the energy sector as so prominently mentioned in the

Proposal), and the lack of current reporting and disclosure compels the Commission to issue a mandate, why is the energy sector such a clear leader in shareholder returns since 2021?

I also highlight to the SEC that the average holding period for an equity security is approximately 6 months (as per a June 2020 analysis conducted by Refinitiv using NYSE data) and has been growing shorter and shorter since 1990. I feel that fact is important because one premise of the Proposal is purportedly to require improved disclosure of short, medium and long-term risks resulting from climate change; it seems as if the goal of the Proposal is severely misaligned with the overall trend on the average holding period. While I am an advocate for proper disclosure of risks an issuer faces, the shareholder return and holding-period data support a position that reasonable investors aren't as focused on long-term risks, climate-related financial metrics, or GHG volumes as the Commission so believes.

My personal conclusion is that reasonable investors currently have all the pertinent and material information necessary on which to base a decision. The Proposal will merely heap incremental costs onto an issuer and require said issuer to inundate the reader with immaterial, inconsistent, incomparable and perhaps even unreliable information.

Respectfully,
Gregory Farris, CPA
Fort Bend County, Texas