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June 20, 2022

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

Re: <u>File No. S7-10-22</u>
The Enhancement and Standardization of Climate-Related Disclosures for Investors
Release No. 33-11042; 34-94478

Dear Ms. Countryman:

We are grateful for the opportunity to present our views on the above-captioned release (the "Proposing Release") of the Securities and Exchange Commission (the "Commission"), proposing rule changes that would require registrants to include certain climate-related information in their registration statements, annual reports, and audited financial statements. This letter respectfully submits our comments.

We believe that climate change is an important societal issue that deserves appropriate attention by governments, regulators, and the public at large, and that public companies can make critical contributions in this regard. We recognize that investors have increasingly focused on environmental, social and governance factors in their investment and voting decisions, including by seeking more transparency regarding how public companies consider, manage and respond to the risks and opportunities presented by climate change. We agree that the Commission has an important role to play in facilitating consistent and comparable climate-related disclosures for investors. We believe that the Commission can do this in a manner that both facilitates capital formation by providing investors with decision-useful information and fairly considers the associated cost of compliance for public companies.

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The proposed rules are designed to elicit consistent, comparable, and decision-useful information on a topic of great importance to many investors and the public, which we believe is an important and achievable goal. We are, however, concerned that the scale and granularity of the proposed disclosures may go beyond what investors truly need and that the Commission may not have adequately considered the challenge placed on public companies that will need to comply with these requirements, especially on such an accelerated timeline. Importantly, the proposed rules have raised and will continue to raise questions about the Commission's authority, which will only result in delaying achievement of the important goal of clear and consistent climate-related disclosures.

Over the course of several years, the Commission has successfully modernized its disclosure framework, using a principles-based approach to ensure that investors receive information that is material to their decision-making while eliminating disclosures that do not meet this standard, while considering the cost and impact of compliance with new disclosure requirements. Our comments below are designed to provide the Commission with alternatives to consider in connection with the adoption of final rules that are consistent with the Commission's principles-based approach.

We do not believe that the significant burdens the proposed rules would impose on registrants and the extensive related investments in human capital, systems and management time were adequately considered. The work that each registrant will need to perform to determine which components of the new disclosure regime apply to it, to collect relevant data, and to prepare, review and validate responsive disclosure will require significant preparation that demands an implementation period meaningfully longer than what has been proposed. Without a reconsideration of the effective dates for the proposed rules, registrants would need to begin the implementation work prior to the rules even being finalized in order to meet their disclosure obligations under the proposed timeline.

We respectfully submit that certain components of the proposed rules can be modified in ways that are consistent with the needs of investors for decision-useful, comparable disclosures while lessening the burdens and costs for public companies and their shareholders, directors, executive officers and employees.

Financial Statements Disclosure

Proposed Rule 14-02 of Regulation S-X would require registrants to disclose the financial impact of severe weather events and other natural conditions or transition activities on any relevant line item in the consolidated financial statements. It would also require quantifying the amount of mitigation or transition expenditure. We have the following concerns and recommendations with respect to this requirement:

- ***Absence of Traditional Process Preceding New Financial Statement Disclosures.*** The high quality accounting standards underlying public company financial statements are the result of decades-long collaboration among securities regulators and accounting standard setters such as the Financial Accounting Standards Board ("FASB") and the International Accounting Standards Board ("IASB"), public company accounting and financial reporting departments, and auditors. This collaboration is important because it leads to disclosure that is meaningful to investors and that lends itself to validation through effective audit procedures. It does not appear that the financial statement disclosure requirements contained in the proposed rules are the result of a detailed consultation process involving these essential stakeholders.

- ***De Minimis Threshold Too Low***. We do not think the proposed 1% *de minimis* threshold is appropriate for eliciting decision-useful information for investors because it will capture impacts that are immaterial. The Proposing Release notes this threshold was chosen so as to reduce the risk of underreporting but we are concerned that it has been set so low that it creates a new risk of overreporting that inundates investors with irrelevant detail. The 1% threshold is also notably inconsistent with other thresholds used for financial statement disclosure, such as the 5% standard for establishing materiality under Staff Accounting Bulletin No. 99. Additionally, with respect to severe weather events and natural conditions and transition activities, the 1% threshold applies to the value of each line item, which could result in a company providing the required disclosures related to a change that is immaterial to a line item that itself is immaterial. Companies are currently required to discuss in Management's Discussion and Analysis the reasons for material changes in financial statement line items. We have seen this requirement almost uniformly applied as companies responded to the global pandemic and discussed the impact of COVID-19 on their results and financial condition. This proposed new financial statement disclosure would be in addition to this existing requirement and would include impacts on the financial statements that, by implication and definition, are not material. This disclosure would thus focus investors on immaterial financial statement impacts and present a distorted perspective as the focus would only be on climate-related matters, ignoring other factors that could have had a greater financial impact on the registrant's results of operations or financial condition. In fact, disclosure that is solely focused on climate-related impacts while not discussing other factors may be misleading to investors.

- ***Aggregation Concept Unworkable***. The proposed rules compound the challenges of a 1% threshold with an aggregation concept that would require financial statement disclosure not only of any applicable event, condition or activity that has had an impact in excess of that threshold, but also of those with an impact of less than 1% when their aggregate absolute values exceed that threshold. The proposed rules would thus mandate the disclosure and audit of individual events, conditions or activities the impact of which may

be significantly less than 1% on any line item in the registrant's financial statements. The resources that registrants would need to devote to collecting, analyzing, and presenting that information, and having it audited, appears out of proportion to the limited usefulness such information would hold for investors.

- ***Severe Weather Events and Natural Conditions Are Vague Concepts***. The proposed rules leave the concept of "severe weather events and other natural conditions" undefined, other than to illustrate them with examples. These categories are not intuitive, especially in combination. An "event" generally refers to something that occurs at a particular point in time, while a "condition" is typically something the prevails over an extended period. A hurricane could be an event, but would not be a "condition" (although the fact that hurricanes occur more frequently in a particular region or during a particular time of the year may be). Conversely, the fact that winters tend to be cold in the northeastern United States and accompanied by snow and ice is a well-known "natural condition." The proposed rules leave a number of questions unanswered. Should registrants try to isolate the impact of seasonal weather changes on each line item in their financial statements? Or are the proposed rules intended to capture a narrower concept of "natural condition" that is tied to *changes* in natural conditions caused by climate change? If so, how should registrants go about isolating those and distinguishing them from constant natural conditions, or from changes in natural conditions that are due to factors other than climate change?

- ***Operational Perimeter Unclear***. The proposed rules provide little guidance for how registrants are supposed to determine how to define their operational perimeters when assessing the impact of severe weather events and other natural conditions on their financial statements. One of the examples highlighted by the proposed rules are changes to revenue or costs from disruptions to business operations or supply chains. It is unclear how the Commission intends for registrants to comply with this disclosure requirement. If a U.S.-based registrant has a supplier in China, does that registrant need to monitor weather events "and other natural conditions" in China to determine whether those have affected the prices charged by its supplier, or the volume it can deliver, which may have forced the registrant to source a portion of its supplies from other vendors at higher costs? How would registrants go about determining what portion of a price increase was due to severe weather events or other natural conditions, as opposed to general economic conditions, dynamics in the local labor market, raw material prices or other factors?

- ***Audit Burden Not Commensurate With Investor Benefit***. The proposed financial statement disclosure will be subject to internal control over financial reporting and audit procedures, potentially covering several years, which will create costs that are out of proportion to the value of information that is not material to investors. As noted above, quantifying the impact of the relevant factors may involve significant judgments on the

part of management, making the corresponding audit process challenging and time-consuming, all of this for information that may have had an impact of 1% on any line item in the registrant's financial statements.

Recommendations

- ***Eliminate Financial Statement Disclosure***. We respectfully urge the Commission to consider eliminating the proposed financial statement disclosures entirely from the final release. If the Commission believes that requiring this disclosure in the financial statements is important, we recommend that it be preceded by a robust and consultative standard setting process led by the FASB (and, for IFRS reporters, the IASB). The FASB initiated, as part of its 2021 Agenda Consultation process, a dialogue on how financial statements could be enhanced with disclosures related to ESG and the effect of ESG factors on the financial statements. We ask that the Commission allow the FASB's process to continue.

- ***Move Relevant Disclosure to MD&A***. If the Commission wishes to retain some disclosure regarding the financial statement impact of certain climate-related matters, we respectfully suggest that it would be better positioned in MD&A, where registrants already describe other factors that have had material effects on their results. Determining the external causes for changes in financial statement line items involves a degree of judgment and estimation that is much more subjective and uncertain than that involved in the preparation of financial statements. It is unclear how events or transition activities that are not solely the result of climate-related matters should be disclosed. For example, how would a company that chooses electric vehicles to replace its aging fleet disclose the climate-related financial impact of such a decision? The severe weather events and other natural conditions that the proposed rules would require registrants to analyze for potential financial impacts are similar to the known trends and uncertainties disclosure affecting a registrant's results or financial condition that are required to be considered in MD&A. The relevant discussion in MD&A should be permitted to be qualitative in nature and quantitative only to the extent the relevant information is readily available and material.

- ***Increase Threshold, Narrow Line Items, and Exclude Indirect Effects***. If the Commission nevertheless decides to retain financial statement disclosure, we recommend raising the threshold for disclosure to 5%, reducing the burden on registrants and ensuring that investors are not overloaded with immaterial information in the financial statements. The Commission should also narrow the requirement to specified key line items (e.g., revenue, operating income and expenses, and cash flow from operations) that need to be analyzed and considered for disclosure. Finally, the Commission should

explicitly exclude from required disclosure any indirect effects such as those which are due to the impact on a registrant's customers or suppliers.

Governance, Risk and Targets Disclosure

Proposed Items 1501, 1502 and 1503 of Regulation S-K would require detailed disclosure about board and management processes related to climate-related risks, climate-related business strategy, and climate-related risk management. In addition, proposed Item 1506 of Regulation S-K would require certain disclosure with respect to climate-related targets and goals. Our key concerns with respect this proposed disclosure are as follows:

- ***Distorting Board Priorities.*** The proposed rules would require registrants to provide a great deal of information about their board's approach to climate-related risks, including whether and how the board considers climate-related risks, and the process and frequency by which they stay informed without consideration of the risk prioritization that every board must consider. Public companies face numerous risks in their businesses, of which climate-related risks represent just one category, and for many companies it is not the most important one or even among the top risks the company faces. The required disclosures will pressure companies to elevate climate-related risks over others merely to allow the company to disclose "board level climate action" by putting climate matters on the already full agendas for board and committee meetings in an effort to manage public perception.

- ***Pressure to Add Climate Experts Adverse for Effective Governance***. We are further concerned about the implications of requiring registrants to identify directors who have climate-related risk expertise and to detail the nature of their expertise in public filings. Companies have directors with varied and overlapping skills and experience. The membership of the board is selected to ensure that the board has the members with the necessary skills and experience to effectively oversee management. Requiring disclosure on the climate-related skills of board members may push companies towards adding climate experts to their boards at the expense of a director with more necessary skills or experience. In some cases, climate-related experience on the board may not be the best way for a company and the board to manage and oversee overall enterprise-wide risks as supporting the board with appropriate internal or external resources would provide the board with the subject matter expertise that is needed. Having to select board members for narrowly prescribed subject matter expertise rather than criteria relevant for good governance may adversely affect board effectiveness. (Similar concerns apply to the Commission's separate proposal to require disclosure about director cybersecurity expertise.)

- ***Increased Liability Exposure for Designated Climate Experts***. Importantly, designating certain individuals as climate experts may expose them to increased liability by tagging them with responsibility for oversight or management of these risks.

- ***Forced Disclosure of Internal Goal-Setting and Goal-Tracking***. We are also concerned that the requirement to disclose climate-related targets or goals is overly intrusive and without counterpart in other parts of the Commission's disclosure framework. We recognize that companies that publicly announce specific targets related to climate matters should be required to provide the necessary support to explain how they expect to achieve these publicly announced goals. Public companies, however, are faced with many challenges in growing and managing their businesses and regularly set internal goals on a variety of matters for operational purposes, to motivate teams or to measure performance. Many of these goals are not shared publicly. The proposed rules will subject registrants to increased liability and public scrutiny of their efforts which could have the chilling effect of discouraging companies from embarking on and refining their goal-setting in the first place. The same is true for the required disclosure of any internal carbon price that registrants may be using as part of their climate-related business strategy.

- ***Competitively Harmful Forced Disclosure of Internal Scenario Analysis***. We are concerned about the requirement to disclose the details of any scenario analysis that a registrant uses to assess the resilience of its business strategy to climate-related risks. If a registrant has opted to use scenario analysis, it will be required to share the scenarios it considered and the projected principal financial impacts on its business strategy under each scenario, including both quantitative and qualitative information. This would force registrants to reveal highly sensitive financial planning information to competitors.

Recommendations

- ***Revise Climate-Specific Governance Disclosure***. We propose that the required disclosure on board and management governance practices with respect to climate-related risks be revised. If the Commission believes that the current governance disclosure about board risk oversight pursuant to Item 407 of Regulation S-K is inadequate, that disclosure could be expanded to require a discussion of key risks and how boards manage key risks, without mandating a specific discussion of climate risk where a company has not identified climate as a key risk. This more principles-based approach will provide space for boards to handle their own risk management processes while providing adequate information for investors. It will also provide investors with the necessary information to assess whether the board and the company are considering the right risks and if they are managing and overseeing management's handling of the risk adequately.

- ***Eliminate Climate Expertise Disclosure***. Likewise, we propose a more principles-based approach to disclosure around director skill sets. Companies should be required to identify the skills and experience that are sought for in directors taking into account the company's business, its competitive environment, its business strategy and the material risks it faces, rather than specifically identifying whether it has climate expertise or any other particular skill or experience on the board. Current Item 401 of Regulation S-K requires disclosure of specific skills and experiences that make an individual director qualified, which should, for those companies with effectively constituted boards, match up with the skills and experience that the board has identified are necessary to effectively oversee management. For companies where climate-related expertise is a skill and experience that is sought after, the disclosure would describe as much in response to this existing item.

- ***Create Liability Safe Harbor***. If the Commission chooses to retain the requirement to identify climate experts on the board and in management, we respectfully propose that the Commission provide a liability safe harbor similar to the ones available for audit committee financial experts and, under proposed rules, for cybersecurity experts.

- ***Limit Goal-Setting and Goal-Tracking Disclosure to Publicly Announced Targets***. We also respectfully suggest companies be required to disclose information about their climate-related targets only for targets that they have publicly announced. This will ensure that investors have full transparency about the key parameters of climate-related targets, the steps companies plan to take to meet those targets, and the progress they are making in that regard, all without unduly interfering in corporate governance and risk management by forcing companies to disclose internal targets that may be too preliminary or too competitively sensitive to warrant public disclosure.

- ***Eliminate Mandatory Scenario Analysis Disclosure***. We respectfully recommend eliminating the requirement for registrants to provide information about any internal scenario analyses they may have conducted.

<u>Green House Gas Emissions</u>

The proposed rules include very prescriptive disclosure requirements with respect to registrants' greenhouse gas emissions. We have the following concerns:

- ***Unclear Materiality Determination for Scope 3 Emissions***. Proposed Item 1504 of Regulation S-K requires a registrant to disclose its total Scope 3 emissions for a given year if the emissions are material or if the registrant has set a greenhouse gas emissions reduction target or goal that includes Scope 3 emissions. The Proposing Release acknowledges that the proportions of emission types can vary greatly across industries, mentions that some companies consider Scope 3 emissions material that cross a 40%

threshold of total emissions, but also cautions that quantitative analysis alone will be insufficient for a materiality determination.

- ***Scope 3 Emissions Required to be Quantified Even if Ultimately Immaterial***. In the absence of clear materiality guidance, registrants may feel compelled to quantify their Scope 3 emissions in order to determine whether they are in fact material, which will itself be an extensive undertaking. Registrants will need to attempt to collect this information from various outside parties who will vary widely in how prepared or willing they are to provide it. Registrants will not have the ability to compel third parties to report this data and will often not have contracted with suppliers to provide this data as part of their ongoing relationship. Significant resources will need to be expended for this determination effort even if total Scope 3 emissions ultimately turn out not to be material and therefore not subject to disclosure in the absence of a relevant Scope 3 target.

- ***Defining and Collecting Scope 3 Data Challenging***. As the Commission acknowledges, measuring Scope 3 emissions would be challenging for many registrants. This is particularly true of companies with large and diverse sets of different types of customers and suppliers. Those companies are typically not in a position to request value chain emissions information from those customers or suppliers, and many of those customers or suppliers do not report their emissions data publicly, if they collect it at all. Practices around the definition and reporting of Scope 3 emissions are still very much evolving, and forcing a one-size-fits-all standard in this regard seems premature.

- ***Including Entities That Are Not Fully Consolidated***. The proposed rules would require registrants to include non-controlled equity investees on a proportionate basis in all of their greenhouse gas emissions disclosure. This provides less flexibility than the GHG Protocol and will not be practical for registrants that lack rights to receive that information from their equity investees.

Recommendations

- ***Scope 3 Disclosure Only for Companies that have Publicly Set Scope 3 Targets***. We respectfully suggest that the Commission revise proposed Item 1504 of Regulation S-K to require disclosure of Scope 3 emissions information only in the event a company has publicly set a Scope 3 target or goal. Given the challenges around determining materiality and the diffuse nature of Scope 3 emissions, the disclosure burden should be limited to only those companies that have publicly committed to a corresponding target. If the Commission wishes to retain the materiality trigger, we propose modifying the requirement so registrants without a Scope 3 target but with material Scope 3 emissions are permitted to describes their strategies for addressing those in a qualitative manner.

- ***Permit Alternative Scope 3 Definitions***. The proposed rule should also be modified so that the registrant is able to reasonably define what comprises their Scope 3 emissions and then provide a narrower set of decision-useful metrics related to the target that has been set, such as their Scope 3 baseline, the timetable they have set and the progress made towards the target, rather than the more extensive disclosure contained in the proposed rules.

- ***Limit Emissions Disclosure to Fully Consolidated Entities***. To protect registrants against having to report emissions information without access to the underlying data, we recommend that mandatory emissions disclosures be limited to registrants and their fully consolidated subsidiaries.

Disclosure Location

The proposed rules would include the new disclosures in registrants' annual reports and registration statements. We believe that until greenhouse gas emissions reporting has become a more standardized process, registrants should not be required to report emissions information on the same timeline as the audited financial statements that must be included in an Annual Report on Form 10-K. To allow sufficient preparation time, we recommend that registrants be permitted to report that information in a Current Report on Form 8-K by the end of the registrant's second quarter of the following fiscal year. This information can be incorporated into the Annual Report on Form 10-K in the same manner as the Part III information in the Annual Report on Form 10-K is incorporated from the later filed proxy statement on Schedule 14A.

We further recommend that the disclosure of climate-related risks, governance, and risk management are all more appropriate in a registrant's proxy statement or information statement, where it can naturally be presented in the context of the registrant's other disclosures about governance and risk management oversight. We believe that investors would expect to see these disclosures in the proxy statement and that these disclosures would be more useful to investors when presented together with those other governance and risk management matters. This information can be required in the Annual Report on Form 10-K as Part III information, which would also be permitted to be included in the later filed proxy statement.

Separating these disclosures from the Annual Report on Form 10-K would provide companies with more time to prepare and consider these disclosures set apart from the pressure of completing fiscal year end filings.

Compliance Accommodations and Timelines

We believe that the proposed rules present particular challenges in certain mergers and acquisitions transactions, in relation to newly public companies, and from an overall timeline perspective. Our concerns are the following:

- ***Newly Acquired Businesses and Stock Mergers***. In their current form, the proposed rules do not provide any relief for newly acquired subsidiaries of public companies or for private targets in business combinations with public companies. Given the scale of the disclosure and work necessary to comply with the proposed rules, we anticipate that registrants will need to screen potential business combination partners for those who are in a position to produce this extensive disclosure quickly if no accommodations are added to the final release. Having to prepare this disclosure for a private target on a stand-along basis before the acquiring registrant can file its Form S-4 or F-4 to register the securities being issued in connection with the business combination would materially delay those filings and significantly extend the overall transaction timeline. This would put public companies at a disadvantage when competing for attractive private targets.

- ***Insufficient Overall Preparation Time***. Under the effective dates contemplated by the Proposing Release and assuming the proposed rules are adopted with an effective date in December 2022, registrants would be required to begin including the extensive new disclosure in public filings as early as fiscal year 2023 for large accelerated filers, fiscal year 2024 for accelerated and non-accelerated filers, and fiscal year 2025 for smaller reporting companies. We are concerned that this timeline does not allow sufficient time for registrants to prepare. The proposed rules represent a dramatic addition to required disclosure and include some complex components, notably the financial statement disclosure and the greenhouse gas emissions disclosure, which will require significant lead time.

- ***Need to Retain and Onboard Attestation Providers and Other Vendors***. In addition to creating their own internal processes, registrants will need to develop relationships with third parties for purposes of determining greenhouse gas emissions and to satisfy the Scope 1 and Scope 2 attestation requirement. It is not clear how many entities are currently in a position to make Scope 1 and Scope 2 attestations and it may take some time for a sufficient number of independent third parties to be viable. Auditors will also need adequate time to develop processes to audit the new financial statement disclosures. These challenges are exacerbated by the fact that the new rules are not yet in final form and will not be until later this year.

Recommendations

- ***Phase-In for Inclusion of Newly Acquired Businesses***. We respectfully propose that the Commission include an accommodation for newly acquired businesses similar to the one currently afforded with respect to the reports and audits regarding internal control over financial reporting for newly acquired businesses. Registrants are permitted to exclude an acquired business from the assessment and audit of internal control over financial reporting for the year in which the acquisition occurred. This recognizes the time it may

take following the consummation of the acquisition to establish familiarity with the internal controls at the acquired business. Registrants should similarly be able to delay providing disclosure under the proposed rules for a newly acquired business for a year to allow registrants and their attestation providers and financial statement auditors to familiarize themselves with those businesses and gather and analyze the information relevant for the extensive disclosures required under the new rules. This is of particular importance for the emissions and the financial statement disclosures.

- ***Phase-In for Newly Public Companies and Exemption for EGCs***. To balance the benefits of additional climate-related disclosures with the adverse impact the extensive new disclosure requirements may have on capital formation, we recommend that newly public companies benefit from the same accommodations as smaller reporting companies, at least as they relate to emissions and financial statements disclosures, until the end of the first full fiscal after their going public transaction. Consistent with the exemption of emerging growth companies from the auditor attestation report on their internal control over financial reporting, we also recommend that emerging growth companies be exempt from any attestation requirements with respect to their emissions disclosures for as long as they retain that status.

- ***Exclude Private Targets in Stock Mergers***. We also respectfully recommend that the modifications to Forms S-4 and F-4 in the Proposing Release should not be adopted. If the target in a proposed merger is a private business, it is unlikely to have the extensive climate change disclosure prepared in advance of entering into a business combination with a public company.

- ***Extend Overall Compliance Timeline***. We respectfully propose delaying each of the compliance dates for one fiscal year in order to allow registrants, third parties, and auditors sufficient time to prepare, review and audit the new disclosures. This additional time will allow registrants to create thoughtful and sustainable internal processes and forge relationships with trustworthy third parties. Additional time will also create space for climate-focused early adopters to set the tone by complying early and showcasing best practices that other registrants can then emulate.

- ***Extend Attestation and Scope 3 Timelines***. In addition to pushing back all the compliance dates by one year, we suggest further delaying the compliance dates for the Scope 1 and 2 emissions information attestation Scope 3 emissions information by an additional year. With respect to attestation, this will allow sufficient time to identify and retain relevant providers and develop procedures. For Scope 3 emissions, the additional time will let registrants set expectations with third parties from which they need to obtain information and to create processes to collect that information moving forward.

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We hope the Commission and its staff find our comments useful in further considering the proposed revisions and formulating the final rules. If there are any questions about any of our comments, we would welcome an opportunity for further discussion. Please do not hesitate to contact Richard Alsop, Harald Halbhuber or Lona Nallengara of this firm at 212-848-4000.

Very truly yours,

/s/ Shearman & Sterling LLP