CME Group

August 16, 2022

VIA EMAIL
Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File Number S7-17-22

Dear Ms. Countryman:

CME Group Inc. ("CME Group") appreciates this opportunity to provide comments on the Securities and Exchange Commission's ("SEC" or "Commission") Notice of Proposed Rulemaking on Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices (the "Proposal").

CME Group, a corporate holding company, wholly owns Chicago Mercantile Exchange Inc. ("CME"). CME is a CFTC-registered derivatives clearing organization ("CME Clearing"). CME Clearing offers clearing and settlement services for futures and options contracts, including those listed on CME Group's CFTC-registered designated contract markets ("DCMs"), and cleared swap derivatives transactions. These DCMs are CME, Board of Trade of the City of Chicago, Inc., New York Mercantile Exchange, Inc. and the Commodity Exchange, Inc.

The SEC proposal is one part of the Administration's larger whole of government approach to climate change, one component of which is the agency actions directed by Executive Order 14030.[1] The SEC's embrace of investor interest in robust ESG disclosures aligns with the larger policy goals set forth by the Administration and FSOC; however, this Proposal raises potential unintended consequences for derivatives markets that must be addressed and considered by the Commission. Accordingly, our comments are limited to addressing the Proposal's treatment of derivatives in general, and Questions 110 and 112 in particular. In short, derivative instruments should be excluded from the scope of the Proposal in general and from the definition of "investment companies" in particular.

The Proposal's approach to calculating the Green House Gas (GHG) emissions of derivatives in "portfolio companies" is "designed to identify companies engaged in business activities that generate GHG emissions."[2] The Proposal defines derivatives investments to include any swap, security-based swap, **futures contract,** forward contract, option, any combination of the foregoing instruments, or any similar instrument, and treats exposure through a derivatives investment as equivalent to holding

[1] *See e.g.* Executive Order 14097, 86 FR 70935, Dec. 13, 2021 (Reducing federal government carbon emissions to net zero by 2050); *see also* Financial Stability Oversight Council, *Report on Climate Related Financial Risk, 2021*, available at: https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf
[2] *Enhanced Disclosures by Certain Investment Advisers and Investment Companies about Environmental, Social, and Governance Investment Practices*, 87 FR 36654, June 17, 2022, at p. 100.

securities of the "portfolio company" referenced in the "derivatives instrument" because "derivatives can inherit the risk profile of the underlying security."[3]

An approved methodology for accounting for and reporting Scope 3 greenhouse gas (GHG) emissions for derivatives has not yet been developed. Accounting for and requiring disclosure of greenhouse gas emissions associated with derivatives is challenging for a wide variety of reasons. Holders of derivatives do not have direct ownership in the equity or debt in the underlying companies, debt, or projects, and unlike investors, they cannot participate in or influence the activities of the investee. Moreover, the potential for "double counting" cannot be ignored. GHG emissions of equity and debt investments held by a reporting company are currently calculated as a prorated amount of the investee's current emissions.[4] Taking a similar approach to calculating GHG emissions associated with derivatives (noting that derivatives contracts often exist in multiples of the same underlying) could result in the reporting company "double-counting" its GHG exposure. Many derivatives only provide for the transaction or contract to be settled in cash and not by delivery or transfer of the underlying. Even where a contract or transaction does provide for physical settlement, it may very well be closed out or terminated before physical settlement of the underlying is required to take place.

The Commission implicitly recognized these and other challenges in the Proposal by excluding foreign exchange derivatives and interest rate swaps from its scope "because these investments do not generate GHG emissions."[5] In a counter-intuitive twist, however, the Proposal *would* include credit and equity swaps in its definition of "portfolio companies."[6] While at first blush, the Proposal does not implicate GHG reporting requirements for other types of derivatives, including commodity derivatives, the potential inclusion of credit and equity swaps in the Proposal and the resulting problems start the Commission on a slide down a very slippery slope toward rendering GHG reporting for derivatives both difficult to comprehend and illogical.

Investors use derivatives, including credit and equity swaps, to hedge risk and discover prices; associating derivatives with GHG emissions would complicate those uses to dubious ends. The links between derivative investments to the GHG emissions of the underlying are tenuous at best. Holders of derivatives have no direct ownership or participation in the underlying, raising the question of why they should be treated as equivalent to securities in the "portfolio company" for GHG reporting purposes by the Proposal. The current language in the Proposal raises a high potential for erroneous reporting or "double-counting," undercutting the goals of the Proposal. The reality of cash settlement of derivative transactions reflects no exposure to actual emissions. Finally, should companies be allowed to net "long" and "short" positions in derivatives to hedge or reduce GHG emissions on the "short" side and correspondingly be counted against emissions on the "long" side, a well-intentioned disclosure regime could incentivize "greenwashing" through derivatives. For these reasons, derivative instruments should be excluded from the scope of the Proposal in general and from the definition of "investment companies" in particular. If the Commission feels that credit and equity derivatives offer enough benefits to its disclosure goals to overcome these concerns, it should take every available step to ringfence reporting to these asset classes only, to avoid the deleterious consequences outlined above.

* * *

---

[3] *Id., at 224.*

[4] *See,* Greenhouse Gas Protocol Corporate Value Chain (Scope 3) Standard, 2011; *see also Partnership for Carbon Accounting Financials, The Global GHG Accounting and Reporting Standard for the Financial Industry (First Edition), 2020.*

[5] *Supra note 3* at p. 100-101. *See also,* Question 112 at p. 116.

[6] *Id.*

CME Group appreciates the opportunity to submit these comments to the Commission. If you have any questions regarding the issues raised in our letter, please feel free to contact me at [redacted] or via email at [redacted]

Sincerely,

Timothy Smith
Managing Director and Deputy General Counsel