Testimony before the
U.S. House Committee on Financial Services
"Beyond Scope: How the SEC's Climate Rule Threatens American Markets"

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April 10, 2024

Chairman McHenry, Ranking Member Waters and Members of the Committee, it is an honor to participate in today's hearing on the SEC's Final Climate Rule. My name is Jill Fisch, and I am a professor at the University of Pennsylvania Carey Law School where I teach and write in the areas of corporate law, corporate governance, and securities regulation. I also serve as the co-director of the Penn Institute for Law & Economics. Prior to joining the faculty at Penn, I taught at Fordham Law School for almost twenty years. Before that I worked as a corporate litigator at Cleary, Gottlieb, Steen & Hamilton in New York and in the criminal division of the U.S. Department of Justice.

The U.S. capital markets are the largest in the world and are among the deepest, the most liquid, and the most efficient. They have proven to be dynamic and resilient, responding to changes in economics, market practices, politics and technology. The U.S. markets have fueled the unparallelled and enormously successful entrepreneurial and industrial business growth in the U.S. In addition, many significant foreign issuers voluntarily list on the U.S. markets to obtain the reputational benefits of being subject to U.S. securities regulation. Critically, equity ownership is economically important not just for businesses, but for individuals. Today more Americans own stock than ever before through a combination of retirement investments, mutual funds and investments in individual securities, and many depend primarily on the strength of the capital markets to secure their savings for a home, the education of their children, or their retirement.

The key to this success is the distinctive system of U.S. securities regulation. Since Congress adopted the federal securities laws in 1933 and 1934, the U.S. has relied on a disclosure-based system to regulate the markets. Disclosure enables market forces to evaluate the attractiveness of securities offerings. At the same time, as Louis Brandeis famously observed, disclosure has the practical effect of discouraging fraud and misconduct because, when an issuer must disclose the details of its business to the market, a problematic business will be less able to attract capital.

Congress expressly delegated the structure and oversight of this disclosure system to the Securities & Exchange Commission (SEC) as part of the original federal securities laws. In 1933, Congress adopted the Securities Act of 1933, which created a system of mandatory disclosure in connection with public offerings and specified, in Schedule A, thirty-two items of required disclosure.[1] In 1934, Congress adopted the Securities Exchange Act of 1934, which expanded this transaction-based disclosure system to one that required ongoing disclosure by pubic companies, and created the SEC as the body that would rely on its expertise to study the capital markets and to refine the disclosure-based system as necessary. Both the 1933 and the 1934 Acts explicitly authorized the SEC to require, in addition to the information required by Schedule A, "such other information, and be accompanied by such other documents, as the Commission may by rules or regulations require as being necessary or appropriate in the public interest or for the protection of investors."[2] To be clear, disclosure is not just incidental to what the SEC does – it is the central feature of our regulatory structure, and Congress has delegated to the SEC the responsibility for determining the components of that disclosure system.

Over its ninety-year history, the SEC has regularly added to and subtracted from the federal disclosure requirements in response to a range of new developments. These changes have addressed a range of topics including executive compensation, Y2K risks, cybersecurity, environmental risk, human capital, political risk, and, most recently, the impact on businesses of the Covid-19 pandemic. In addition to quantitative disclosures such as those contained in an issuer's financial statements, the SEC has placed increasing importance on qualitative disclosure, identifying a variety of topics that issuers are required to address in their management discussion and analysis (MD&A) and in risk disclosures.[3] Importantly, the required disclosures focus on providing investors not just with historical numbers but with management's perspective on those numbers, the dynamics of the business and both short and long term trends and risks. The value of this information includes enabling investors to understand current performance as well as to "ascertain the likelihood that past performance is indicative of future performance."[4]

Critically, although the core of the SEC's mission is to protect investors and the capital markets, in adopting the federal securities laws, Congress explicitly recognized the importance of market integrity to the broader public interest. As Congress explained, "National emergencies, which produce widespread unemployment and the dislocation of trade, transportation, and industry, and which burden interstate commerce and adversely affect the general welfare, are precipitated, intensified, and prolonged by manipulation and sudden and unreasonable fluctuations of security prices …."[5] Congress recognized, and the SEC's mandate thus reflects the fact that orderly and efficient capital markets contribute to the strength of the U.S. economy and protect interests beyond those of investors.

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[1] 15 USC section 77aa, Schedule A. Thus item-by-item, as opposed to "principles-based" disclosure dates back to 1933. Other than the correction of a typo in 1998, Schedule A has never been amended.

[2] 15 USC section 77g; 15 USC section § 78l; see also 15 USC section § 78m (SEC "may prescribe as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security … such annual reports … and such quarterly reports … as the Commission may prescribe" and "may prescribe, in regard to reports made pursuant to this chapter, the form or forms in which the required information shall be set forth…").

[3] The SEC adopted the MD&A requirement, in its current form, in 1980. Securities Act Release No. 6231 (September 2, 1980) [45 FR 63630]. The origins of the requirement, however, date from 1968. See Securities Act Release No. 4936 (December 9, 1968) [33 FR 18617]. The MD&A has also been interpreted to required quantitative but non-financial disclosures, in the form of key performance or risk indicators. See SEC Rel. Nos. 33-10751; 34-88094. Separately, the SEC requires disclosure of "risk factors." Securities Act Release No. 33-10825 (Nov. 9, 2020) [85 FR 63726].

[4] Financial Reporting Manual, Securities & Exchange Commission (last updated Sep. 30, 2008), https://www.sec.gov/corpfin/cf-manual/topic-9.

[5] 15 U.S.C. § 78(b).

The SEC's climate rule is a component of this longstanding framework. The rule focuses on material climate-related risks, an issuer's process for identifying and managing those risks, and the impact of those risks on an issuer's current and future operations. We see examples of such risks throughout the capital markets – from the need for water-intensive businesses to change their sourcing in response to droughts, and the ability of an issuer's physical assets to withstand floods and earthquakes, to the impact of regulation and shifts in consumer demand requiring auto manufacturers to increase the percentage of electric vehicles they sell. In evaluating a corporation's operational results, it is critical for investors to understand both the impact of such risks on current and future results and the extent to which corporate officers and directors are identifying and considering these risks in strategic planning and risk management. Investors have also cited the importance of this information in evaluating management quality – it may be a red flag if an issuer's management is not monitoring risks that are likely to materially impact the issuer's financial condition. As Louis Lowenstein famously explained, "you manage what you measure."[6]

Investors use securities disclosures to determine the value of public companies and the price that they are willing to pay for the companies' securities. The incorporation of information into securities prices has the effect of both protecting investors and increasing the efficient allocation of capital. Notably, capital market information is a public good. The information disclosed by one company provides value not just to investors and potential investors in that company but also to investors in peer companies and even to other issuers, and the information is used for investment decisions, valuations and the informed exercise of shareholder voting power and other governance rights. Full and fair information across the market is a foundation for American economic success.

Although many issuers voluntarily disclose at least some climate-related information,[7] investors have presented the SEC with extensive evidence that this information is under produced, and the academic literature offers a variety of reasons for this under production. Even where issuers disclose the information voluntarily, it is often inconsistent, incomplete, inaccurate, unassured, and unreliable, materially reducing its decision-usefulness for investors. In addition, voluntary disclosure increases costs for both issuers and investors. Issuers face variable and inconsistent demands for information from a variety of sources and, as the comment letters to the SEC detailed, often expend substantial resources responding to those requests. Because voluntary information is typically not included in an issuer's securities filings, investors face wasteful and duplicative search costs obtaining such information.

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[6] Louis Lowenstein, Financial Transparency and Corporate Governance: You Manage What You Measure, 96 Colum. L. Rev. 1335 (1996).

[7] For example, information presented to the SEC indicates that "60 percent of Russell 3000 companies and 90 percent of Russell 1000 companies provide some form of climate-related information; and nearly 60 percent of Russell 1000 companies disclose Scopes 1 and 2 greenhouse gas (GHG) emissions." Statement of Commissioner Jaime Lizárraga, Enhancing and Standardizing Climate-Related Disclosures for Investors, Mar. 6, 2024, https://www.sec.gov/news/statement/lizarraga-statement-mandatory-climate-risk-disclosures-030624#:~:text=60%20percent%20of%20Russell%203000,greenhouse%20gas%20(GHG)%20emissions; see also Securities Act Rel. No. 33-11280 (Apr. 4, 2024) at notes 2666-83 and accompanying text (reviewing third party data on climate disclosures and results of SEC staff study of same).

For these reasons, the SEC's climate rule is both squarely within the scope of its congressionally authorized rulemaking authority and consistent with its mission to protect investors, the capital markets and the public interest. The SEC's rule will increase the standardization and comparability of key climate-related disclosures, reduce search costs by requiring such disclosures to be made in federal securities filings, and increase the reliability of those disclosures by bringing their preparation within the securities reporting process, subjecting them to SEC staff review and, in some cases, requiring attestation by independent auditors.

Some commentators have argued that the SEC's rule exceeds its authority by requiring disclosure of non-material information. Such criticisms are not well founded. First, the final rule limits required disclosures, in virtually all instances,[8] to information that has materially impacted or is reasonably likely to have a material impact on an issuer's business strategy, results of operations or financial condition.[9] By incorporating this materiality qualifier, the rule expressly requires only information that is likely to have a substantial impact on the investment or voting decisions of a reasonable investor.[10]

Second, and perhaps more importantly, the SEC's authority has never been limited to requiring disclosures that were individually financially material, and there are many historical examples to the contrary such as required disclosures of related party transactions, share buybacks and executive compensation. As an example, Regulation S-K requires companies to disclose "the total value of perks and other personal benefits provided to named executives who receive at least $10,000 of such items during the year, identifying each perk by type."[11]

At the same time many commentators have made the oddly inconsistent claim that the SEC's climate rule is unnecessary because issuers are already required to disclose all material information. It is perhaps difficult to understand the concerns about the projected costs of the SEC's rule if, in fact, issuers are already disclosing all material climate-related information. More to the point, it misstates the law – there is simply no legal requirement that U.S. public companies disclose all material information.[12]

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[8] The only significant exception relates to board oversight, which is not costly to disclose, of independent value to investors, and consistent with other governance disclosure requirements that are not individually qualified by materiality limits.

[9] I note that the materiality qualifier, and the issuer- and context-specific factors that it incorporates, will have the effect of reducing the degree to which climate-related disclosures are comparable and consistent across issuers.

[10] Commentary also argues that SEC should be limited to rules that meet the definition of materiality set out by the Supreme Court in *TSC Industries, Inc. v. Northway, Inc.*, 426 U. S. 438, 449 (1977) and *Basic Inc. v. Levinson*, 485 U.S. 224 (1988). Those cases, however, concerned the legal standard under which those who made fraudulent statements could be held liable in private civil litigation. In those cases, the Supreme Court borrowed, as with many elements of private civil litigation, from the elements of common law fraud and did so for the purpose of imposing a limit on fraud-based liability exposure for money damages. Neither decision addressed explicitly or implicitly, however, the scope of the SEC's rulemaking authority. In 1989, the SEC itself stated as much, explaining in connection with its rulemaking under Item 303 of the MD&A that that "The probability/magnitude test for materiality approved by the Supreme Court in Basic, Inc. v. Levinson, 108 S. Ct. 978 (1988), is inapposite to Item 303 disclosure. Management's Discussion and Analysis of Financial Condition and Results of Operations; Certain Investment Company Disclosures, Securities Act Release No. 6835, Exchange Act Release No. 26,831, Investment Company Act Release No. 16,961, 54 Fed. Reg. 22,427, 22,430 n. 27 (May 24, 1989).

[11] 17 CFR § 230.405.

[12] As the Supreme Court explained in *Basic Inc. v. Levinson*, 485 U.S. 224, 239 n. 17 (1988), "[s]ilence, absent a duty to disclose, is not misleading under Rule 10b-5."

As this discussion explains, the SEC has acted squarely within its wheelhouse in promulgating the climate rule, both from a legal and a pragmatic perspective. It has acted after a multi-year, multi-step public process that went well beyond anything required by administrative law. The SEC's extensive legal, policy and cost-benefit analyses demonstrate that the rule is the product of its careful study, including its detailed study of thousands of public comments, and the application of its technical expertise to the complex issue of capital market disclosure. In addition, the SEC's analysis demonstrates convincingly that the rule focuses on the most critical and decision-useful climate-related information for investors and the markets.

Within that context, the SEC's final rule on climate-related disclosure is incredibly modest. It is a disclosure rule only – it mandates no change in business strategy or operations. It focuses on a small subset of the environmental risks and sustainability concerns that market participants have identified as most important.[13] It requires a very limited, and in some cases no, disclosure of greenhouse gas emissions (GHG) despite the fact that investors demand for GHG disclosures is overwhelmingly high.[14] As explained above, this was entirely unnecessary from a legal standpoint. For example, the final rule does not require any issuers to disclose Scope 3 emissions data even when that information is material. The rule also prioritizes issuer disclosures where the potential is high for greenwashing, such as the disclosure of targets and transition plans. Nonetheless, a review of the comment file that the SEC relied upon provides more than ample basis for the SEC to have gone much further.

In addition, the SEC has adopted a variety of measures that reduce the costs of compliance. These include the materiality qualifiers discussed earlier. They include limiting the required disclosure of GHG emissions only to the largest public companies and further limiting it to issuers for which those disclosures are material. They include limiting the attestation requirement and, in some cases, shielding attestation reports in connection with registration statements from liability under Section 11.[15] They include extended timelines for implementation, giving issuers the time and space both to develop the necessary information systems and to get their disclosures right. And they include a variety of safe harbors that dramatically reduce the potential for climate-related disclosures to subject issuers to liability risk, including a new extension of the safe harbor for forward looking statements to climate-related disclosures made in connection with initial public offerings, to which liability safe harbors conventionally do not extend. Although these measures will reduce compliance costs, in some cases they will do so by sacrificing information standardization or reliability. Although the SEC

[13] I note that Professor Cynthia Williams and I, with the support of investors reflecting more than $5 trillion in assets, submitted a request for rulemaking to the SEC in 2018. Request for Rulemaking from Cynthia A. Williams & Jill E. Fisch to Brent J. Fields, Sec'y, SEC (Oct. 1, 2018), https://www.sec.gov/rules/petitions/2018/petn4-730.pdf. In addition to climate-related disclosures, the petition identified a variety of other sustainability issues, such as human capital management, where investors view existing disclosures as both important and inadequate. The SEC's current climate rule is the only response to that petition to date.

[14] See Steven Rothstein, Analysis shows that investors strongly support the SEC's proposed climate disclosure rule, Ceres, Oct. 11, 2022, https://www.ceres.org/news-center/blog/analysis-shows-investors-strongly-support-secs-proposed-climate-disclosure-rule (reporting that 99% of institutional investors who addressed the issue in comments to the SEC supported mandatory disclosure of Scopes 1 and 2 emissions and that 97% supported mandatory disclosure of Scope 3 emissions where material).

[15] 15 U.S.C. § 77k.

was not legally required to adopt these measures, the trade-off is the kind of difficult choice that Congress has long tasked the SEC to make.

Significantly, the SEC's adoption of its climate rule is not occurring in a vacuum. The European Union (EU) has adopted the Corporate Sustainability Reporting Directive, which will require large issuers, including many non-EU companies, to report on a much more extensive number of sustainability-related issues than the SEC's rule. Similarly, California has adopted two laws, the Climate-Related Financial Risk Act[16] and the Climate Corporate Data Accountability Act.[17] Both laws will require large companies that do business in California to report certain climate-related information including Scopes 1, 2 and 3 emissions. The International Sustainability Standards Board (ISSB) announced standards for sustainability disclosure,[18] and a number of jurisdictions, including the United Kingdom have announced their intention to adopt the ISSB standards.[19] The existence of these disclosure requirements will reduce – for issuers that are subject to any of these reporting systems – the actual cost of compliance with the SEC's rule which is, in many cases, far less demanding. At the same time, they suggest that the SEC could have been more ambitious in its disclosure mandate or, sought to reduce the need for issuers to be subject to multiple and potentially conflicting disclosure requirements. In the absence of an SEC reporting requirement, or should the SEC's rule be curtailed, it is likely that these alternative disclosure frameworks will set a different and more demanding baseline for investors to demand and receive climate-related disclosures.

Thank you, Chairman McHenry and Ranking Member Waters, for inviting me to participate in today's hearing, and I look forward to your questions.

[16] SB 261 (2023).
[17] SB 253 (2023).
[18] See IFRS, ISSB issues inaugural global sustainability disclosure standards, June 26, 2023, https://www.ifrs.org/news-and-events/news/2023/06/issb-issues-ifrs-s1-ifrs-s2/.
[19] Dep't of Bus. & Trade, UK Sustainability Disclosure Standards, Gov.UK (Aug. 2, 2023), available at https://www.gov.uk/guidance/uk-sustainability-disclosure-standards.