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

In reference to S7-10-22

Dear Ms. Countryman:

It is our pleasure to submit comments in support of S7-10-22, the proposed rule "The Enhancement and Standardization of Climate-Related Disclosures for Investors".

By way of background on the signatories, Jon Lukomnik is the managing partner of Sinclair Capital LLC, a strategic consultancy to institutional investors. Jon has been the investment advisor or a trustee for more than $100 billion (including New York City's pension funds) and has consulted to institutional investors with aggregate assets of $1 trillion dollars. He served for more than a decade as the executive director of the IRRC Institute, which researched capital market issues. Jon is currently a trustee for the Van Eck mutual funds, and a board member for The Shareholder Commons. He co-founded the International Corporate Governance Network (ICGN) and GovernanceMetrics International (now part of MSCI). Jon is a Senior Fellow for the High Meadows Institute and a former Pembroke Visiting Professor at the Judge Business School at Cambridge (UK). He has written three books and more than 200 practitioner and academic articles examining the capital markets. His work has been recognized and honored by the ICGN, Council of Institutional Investors, Ethisphere, the National Association of Corporate Directors, Transparency Task Force, and Global Proxy Watch.

Keith Johnson is CEO of Global Investor Collaboration Services, LLC, which provides educational, governance and stewardship-support services to global institutional investors that collectively have more than $5 trillion under management. He previously served as the chief legal officer of the ninth largest public pension fund in the United States and co-chaired the Institutional Investor Services group at Reinhart Boerner Van Deuren s.c. Keith was also President of the National Association of Public Pension Attorneys, Program Director of the University of Wisconsin Law School's International Corporate Governance Initiative, chair of the Intentional Endowments Network Fiduciary Duty Working Group, and co-editor of the Cambridge University (UK) Handbook of Institutional Investment and Fiduciary Duty.

1. <u>The SEC's proposed rules on climate change reporting by companies are clearly within the agency's statutory authority</u>. While much ink has been spilled on whether reporting standards proposed by the SEC cover information that is "material" to the company, that issue is completely irrelevant.

The Supreme Court holdings in *Basic Inc. v. Levinson and TSC Industries, Inc. v. Northway, Inc.*, dealt with liability arising out of inaccurate statements made by the company, which is a completely different issue than authority of the SEC to establish corporate reporting standards.[1] The cases apply materiality to situations involving fraud or deceit, such making an untrue statement of a material fact or to omission of a material fact in circumstances where the omission made the statement misleading. They simply are not applicable to the SEC's rulemaking authority on corporate reporting.

The SEC's rulemaking authority for corporate reporting was granted by Congress in 1933 and 1934. Section 7 of the Securities Act of 1933 gives the SEC explicit power to require disclosure in registration statements of such information *"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] The SEC's authority to prescribe the form and content of other company reports is laid out in the Securities Exchange Act of 1934. The Act explicitly states that companies must file reports "*in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security."*[3]

Congress gave the SEC broad authority to prescribe the content of corporate reports under Federal securities laws, so long as the Commission determines it is *necessary or appropriate in the public interest or for the protection of investors or to insure fair dealing.* There is no mention of "materiality," and the SEC's rulemaking powers are not constrained by notions of materiality.

This broad scope of rulemaking authority on corporate reporting is also supported by the SEC's past regulatory actions. For example, reporting requirements established by the SEC for related party transactions, share repurchases, and executive compensation are not constrained by determinations of materiality.[4]

2. Materiality, as defined by *Basic* is related to the "reasonable investor", not the company. There are good reasons why the SEC's rulemaking authority extends beyond determinations of materiality. Materiality is defined from the perspective of the "reasonable investor," while the determination of what information to disclose is made by corporate management and their lawyers, accountants, and auditors.

There is an inherent conflict of interest in this scenario, where personal experience, incentives, predispositions, and job security concerns of the people who make determinations of disclosure materiality introduce bias in the decision-making process. It is understandably difficult for corporate officials to apply a "reasonable investor" test when they may not understand what investors actually need or use. In fact, an extensive body of research demonstrates that companies often fail to correctly determine what information is material.[5] For example, financial

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[1] *Basic Inc. v. Levinson,* 485 U.S. 224 (1988); *TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1977).*

[2] 15 U.S. Code § 77g.

[3] 15 U.S. Code § 78m(a).

[4] *See* 17 CFR §§ 229.404, 229.402, and Form 10Q, Item 2(c).

[5] An overview of research findings was presented by SEC Commissioner Allison Herren Lee in her May 24, 2021 remarks to the ESG Disclosure Priorities Event hosted by the American Institute of CPAs and several other organizations.

statement revisions (which, as opposed to restatements, have been determined to be immaterial) are more likely to be reported when managers have a strong incentive to avoid restatements, especially when they face the threat of compensation claw backs for reporting a restatement. This suggests that materiality discretion is being used opportunistically by companies to conceal material misstatements that should be restated.[6]

3. Climate change risks are material to today's reasonable investor. While the exact wording of the legal standard for determining materiality varies somewhat from one court decision to another, the prevailing definition is from *Basic Inc. v. Levinson*:

> *"[Something] is material if there is a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."*[7]

Given that the definition references what a "reasonable investor" would find significant in its evaluation of the total mix of information available, the views of investors are central to determination of what is material. It is important to recognize that the standard is not based on what may be material to an issuer.

So, how do investors view information about how a company will be impacted by climate change? A 2019 study by BNY Mellon and Create Research found that 93% viewed climate change as an investment risk that wasn't yet priced in by all the key financial markets globally More than half (57%) of the respondents said they viewed climate change as a risk and an opportunity, while 36% saw it only as a risk, and 7% viewed climate change as just an opportunity and not a risk.[8] Conversely, Climate Action 100+ says in their Net Zero Company Benchmark Report that only 5% of their focus companies explicitly commit to align capital expenditure plans with the companies' own long-term carbon reduction target. Only 17% of the focus companies have robust quantification decarbonization strategies in place.[9]

Climate change, as an investment risk and opportunity, is clearly now a significant investment consideration for nearly all investors. As was noted in the SEC's proposal, other markets around the globe are years ahead of the U.S. in adoption of climate change reporting standards for both investors and companies. Blackrock, the world's largest investment manager, has published guidance stating that "climate risk—physical and transition risk—presents one of the most significant systemic risk[s] to the long-term value of our clients' investments."[10]

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[6] Thompson, Rachel, Reporting Misstatements as Revisions: An Evaluation of Managers' Use of Materiality Discretion (September 17, 2021). Available at SSRN: https://ssrn.com/abstract=3450828 or http://dx.doi.org/10.2139/ssrn.3450828.

[7] *Basic Inc. v. Levinson*, 485 U.S. 224, 231 - 232 (1988).

[8] Think Advisor, Two Supertanker Trends Reshaping the Future of Investing, (September 16, 2019).

[9] Climate Action 100+, Net Zero Benchmark: Key Findings (March 2022).

[10] BlackRock, Our 2021 Stewardship Expectations (January 2021).

The slow uptake in addressing climate change risks and opportunities on the U.S. corporate side does nothing to alter the conclusion that climate change has become an investment concern for investors that meets the current legal definition of materiality.

4. What is material changes over time. Although climate change may not have been material when *Basic, Inc. v. Levinson* was decided by the U.S. Supreme Court in 1988, investment practices, like the law, evolve. What is material in the "total mix of information" available changes as the "reasonable investor" gains knowledge over time. This dynamism is commonly accepted.

Four years after the *Basic, Inc. v. Levinson* Supreme Court decision, the Restatement (Third) of Trusts was amended to recognize that prudent investment practices are dynamic and evolve over time:

> *"Trust investment law should reflect and accommodate current knowledge and concepts. It should avoid repeating the mistake of freezing its rules against future learning and developments."*[11]

The Employees Retirement Income Security Act ("ERISA") recognizes this principle. Section 404(a)(1)(B) of ERISA, instructs the fiduciary to act *"with the care, skill, prudence, and diligence* ***under the circumstances then prevailing*** *that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims…."* [Emphasis added.] Use of the phrase *"under the circumstances then prevailing*" contemplates paying attention to investment industry changes, like growth in understanding of the impact that climate change and other systematic factors can have on investment returns.

5. Who is a "reasonable investor" has changed over time.
Things have changed since *Basic, Inc. v. Levison* was decided in 1988. In 1988, it was still possible to envision a typical investor as an individual making a decision to invest in one, or a few, companies. But by 2017, approximately 80% of the United States equity market was institutional.[12] Individuals, whether investing through their pension funds, mutual funds, ETFs or other intermediated accounts, now invest through diversified products. As a result, the typical investor is more concerned about the overall market than any one individual security. That makes sense. More than 75% of the variability in their return is caused by the non-diversifiable systematic risk of the market.[13] That dwarfs the impact of any individual security selection. As a result, investors are concerned with what has come to be called "inside out" materiality, or how an issuer affects the systemic risks to the environmental, social and financial systems, which in

[11] Restatement (Third) of Trusts, §227 Introduction.
[12] Charles McGrath, "80% of equity market cap held by institutions", *Pensions & Investments,* April 25, 2017.
[13] Jon Lukomnik and James P. Hawley, "Moving Beyond Modern Portfolio Theory: Investing That Matters", Routledge (2020) p. 32.

turn affect the price levels and create systematic (non-diversifiable0 risks in the capital markets.[14]

Unless one is willing to assume that 80% or more of the market is not "reasonable", applying this change in capital market structure to the Supreme Court's logic in *Basic* means that systemic risks to the environmental, social or financial systems, or to the capital markets which are created by an issuer – such as those contemplated in the SEC's proposed rules on climate reporting – are material to the reasonable investor. Indeed, the United Kingdom's Financial Reporting Council recognized this market change in 2020. Principle 4 reads "Signatories identify and respond to market-wide and systemic risks to promote a well-functioning financial system".[15]

Conclusion

We submit that, while the SEC has clear authority to require climate change reporting that is not constrained by materiality (discussed above), the threshold of materiality has nonetheless been met. Enhanced standards for climate change corporate reporting are recognized by the vast majority of U.S. investors (i.e., the "reasonable investor") as material to their investment management and proxy voting decisions, as well as to compliance with investor fiduciary legal obligations to their fund participants.

Sincerely,

Jon Lukomnik
Managing Partner
Sinclair Capital.

Keith Johnson
Chief Executive Officer
Global Investor Collaboration Services, LLC

[14] See, generally, Lukomnik and Hawley, ibid.
[15] Financial Reporting Council, "The UK Stewardship Code 2020", p. 11