

SPEECH

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A Path Forward to a Fit-for-Purpose Approach to Climate-Related Disclosure for Public Companies 2021 General Membership Meeting

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[Watch the video here.](#)

As prepared for delivery.

Good afternoon, and welcome to ICI's 62nd General Membership Meeting—the first ever in a virtual format. I want to echo Lisa's sentiment in thanking the many people who have helped organize this conference and all of you for joining us today by video.

The history of this conference reaches back more than 60 years. Since 1959, professionals from across the regulated fund industry have convened to hear timely insights from business leaders and policymakers, to share perspectives and experiences with peers, and to delve into the complex issues that the industry faces in working to advance the interests of fund shareholders.

Of course, last year was the exception, when we had to dramatically limit contact with one another to slow the spread of COVID-19.

Over a year later, the pandemic has changed the way many of us look at the world. We, as a society, have reassessed what is important to us and what we value, including how we think about natural developments and the environment.

That reassessment includes a heightened focus on climate change. Science tells us that the unabated rise of the average surface temperature of the Earth will result in catastrophic environmental consequences, which in turn could have equally catastrophic consequences for the global economy and society. Without a doubt, there is a sense of urgency today among a growing number of investors—both in the United States and globally—that the world must act now to prevent these consequences.

Recent announcements by the Biden Administration make clear that the US government will take an all-hands-on-deck approach to fighting climate change. Most significantly for the regulated fund industry, the Administration has recognized that the financial sector will play a major role in this shift to a lower-carbon society and that private capital is essential to financing any transition of the current economy to a more sustainable one.

Regulated funds invest and act on behalf of more than 100 million investors—who together hold nearly \$30 trillion in investment capital here in the United States. As the world's largest economy, the United States can lead the transition to a lower-carbon economy through its preeminent role in the global financial system. And in this regard, the fund industry has an important perspective, which should be considered in policy discussions involving climate change.

In response to mounting investor demand for sustainable investments, our industry has created new products that give investors the ability to allocate their investments in ways that can facilitate the transition to a lower-carbon economy.

In 2020, more than 90 new ESG criteria funds—focused on climate and broader ESG criteria—opened in the United States, representing about 16 percent of total US open-end fund launches that year, and several existing funds added ESG criteria to their prospectuses. Assets of ESG criteria funds in the United States increased from \$321 billion to \$465 billion, and equity funds using ESG criteria experienced inflows, even as equity funds as a whole saw outflows.

This innovation has empowered investors to contribute to the transition to a more sustainable future on their own terms—selecting among professionally managed funds that invest in companies with varying degrees of commitment to addressing climate risk.

Today, I would like to speak about one of the primary policy questions that must be answered as we consider the future of sustainable finance in the United States: how should public companies disclose climate risk? Answering this question is a necessary precondition for any discussion of how regulated funds, banks, and other financial market participants should direct capital to businesses to support the transition to a lower-carbon economy.

Seeking a Climate-Related Disclosure Approach that Is Fit for Purpose

Securities and Exchange Commission (SEC) leadership recently has expressed openness to examining the SEC disclosure framework to facilitate the production of more reliable, consistent, and comparable climate-related information among public companies. Such information would help fund managers make informed investment decisions on behalf of fund shareholders.

In 2010, the SEC did provide guidance to public companies regarding the Commission's existing disclosure requirements as they apply to climate risk matters. That guidance may have been adequate to meet the demands of investors a decade ago, given the degree of recognition of the link between climate risk and corporate performance back then.

But this is not where we are today. As a result, the 2010 guidance does not provide sufficient direction about what climate risks should be disclosed. It is appropriate, therefore, that the SEC consider how it should respond to industry and market developments over the past decade.

In recent years, a number of organizations and standard-setting bodies have developed

voluntary disclosure reporting regimes. These regimes include the 2017 recommendations by the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD), as well as disclosure standards developed by the Sustainability Accounting Standards Board (SASB), the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), and the International Integrated Reporting Council (IIRC).

The work of these groups is of critical importance to our industry, and ICI members have actively participated in the development and continued refinement of these standards.

At the same time, some US public companies have responded to growing investor interest in climate risk by providing more information about their environmental impact, mapping their climate risks to one or more of these voluntary disclosure frameworks. It is important to underline that these public companies are disclosing to investors climate-related information on a voluntary basis in sustainability reports.

However, while US public companies are making the effort to provide more climate-related information using sustainability reports, the information is—not surprisingly—inconsistent and difficult to compare. Companies lack a standardized approach as to what and how to report.

Recently, five international reporting organizations—including SASB, the Carbon Disclosure Project, CDSB, GRI, and IIRC—announced a [commitment to create joint market guidance on how the existing ESG frameworks and standards “can be applied in a complementary and additive way.”](#) The guidance would also incorporate elements of the TCFD recommendations.

This commitment is hugely welcome. However, it is merely a first step and must be followed by additional work, which can only occur with the participation of the SEC.

For this reason, we applaud recent statements by SEC leadership, as well as the Biden Administration, that the United States will prioritize developing an approach for more fulsome disclosure of climate risk by US public companies.

In addition, the SEC has issued a request for public input on company climate risk disclosures. We welcome this move and believe that the SEC could accelerate the movement already underway to improve climate risk disclosures.

Given this call for action by the Biden Administration and the SEC, what is the right path forward? The SEC should consider a fit-for-purpose approach to climate-related disclosure for public companies, guided by three defining features:

- a principles-based architecture.
- incorporation of the long-standing, well-understood definition of financial materiality applied as a dynamic concept; and
- the use of existing voluntary disclosure standards to better identify considerations of climate risks as the risks evolve and our understanding of them improves.

A Principles-Based Architecture

Given that we are still in the nascent stages of understanding the impact of climate change and the transition toward a lower-carbon economy, it is critical that any approach to public company disclosure can keep pace with new scientific evidence, market changes, and technological innovation.

Such an approach should be principles-based. Principles-based architecture offers flexibility while enabling the SEC to set the necessary rules of the road to ensure that public companies provide reliable, consistent, and comparable information to investors.

This flexibility can provide investors with more useful information as companies would not be hampered by prescriptive, “hard-wired” disclosure requirements—which would be nearly impossible to set today to successfully govern disclosure between now and 2050, the target date set by President Biden to reach a climate-neutral economy.

The flexibility afforded by a principles-based architecture is more conducive to capturing the evolving nature of climate-related issues where the architecture is better able to keep up with market and technological developments.

Dynamic Nature of Materiality

A second defining feature of a fit-for-purpose approach to climate-related disclosure is to acknowledge the dynamic nature of materiality.

The SEC’s public company disclosure framework is rooted in the concept of financial or economic materiality as articulated by the Supreme Court in 1976.

The Court held that “there must be 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.”

From a public company’s point of view, a materiality determination triggers a legal duty to disclose financially material information to investors and subjects the company to liability under the securities laws.

From an investor’s point of view, financially material information from a company is necessary to make informed investment decisions about the company.

What is considered material can and does change over time. It is in this context that materiality should be viewed—not as a static concept, but as a dynamic one.

Materiality is adaptive, meaning that the definition of what is financially material unfolds and evolves over time. So, what is considered not financially material a decade ago—and thus did not need to be disclosed by a public company—may very well be financially material today, triggering the need for more fulsome disclosure. This is likely the case with climate risk, where the market is recognizing the link between a company’s sustainability and its performance.

What compels the shift from not financially material to financially material is difficult to pinpoint and is specific to each company. It can be spurred by cataclysmic events, by increased knowledge and understanding of particular matters, or by some combination of these or other external factors.

We should be explicit in acknowledging the dynamic nature of materiality and encourage companies to consider on a continuous basis the significance of climate risks to their business operations.

Use of Voluntary Disclosure Standards

The third feature of a fit-for-purpose approach to climate-related disclosure is to encourage

public companies to use existing voluntary disclosure standards to better identify considerations of climate risks as the risks evolve and our understanding of them improves.

With respect to climate-related issues, the TCFD recommendations and SASB standards are two of the most widely used voluntary public disclosure regimes, and the Board of Governors of the Investment Company Institute last December unanimously called for public companies to provide disclosure consistent with these regimes to help improve the quality and quantity of comparable ESG data available to regulated funds and other investors.

TCFD has developed a principles-based framework that outlines climate risk disclosures focused on the financial implications of such risks.

SASB's industry-specific disclosure standards are applicable across ESG issues and are intended to capture sustainability matters that are financially material and reasonably likely to impact the financial condition or operating performance of a company. SASB has identified the ESG issues that are most relevant to financial performance in 77 industries.

The TCFD recommendations and the SASB standards are complementary. Together, they create a robust framework with industry-specific metrics to evaluate a company's exposure to, and management of, climate risks and opportunities. The regimes facilitate the production of industry-specific information that is consistent, comparable, and reliable.

The SEC should encourage the use of the TCFD and SASB regimes and look to their already well-developed considerations of climate risks to enhance understanding of what financially material information public companies should disclose to investors.

A Proposed Path Forward

The challenge of the moment is how to improve climate risk disclosures to provide reliable, consistent, comparable, and industry-specific information in the current environment—an environment where investors' sensitivity to climate change is evolving, where the risks and opportunities associated with a transition to a lower carbon economy are still being comprehended, and our understanding of how to measure these risks is developing.

We are too early in this journey to be able to define with specificity what climate-related information public companies should disclose. But we can say this: before setting forth prescriptive measures in an inflexible disclosure framework based on what we know now or our best guess, we should aim to foster a regulatory environment that permits disclosure practices to develop organically, but also deliberately, shaped by expertise and grounded in the legal concept of financial materiality.

This approach will serve us well as our understanding of climate change and its effects become more apparent and better metrics are developed, allowing companies to innovate and seize opportunities as we move through this incredible economic transition—a transition that will rival in impact the Industrial Revolution of the 19th century, the scientific-technical revolution of the mid-20th century, and the Digital Revolution of the past 50 years.

To this end, the path forward should consist of pursuing a fit-for-purpose SEC public company disclosure approach for climate risk.

In the long term, the approach should consist of the SEC, working together with technical

experts, other regulators and government authorities, and various market participants (including public companies and regulated funds), to develop a greater understanding of the impact of physical and transitional climate risks on the economy and determining how to describe, measure, and evaluate such impact on public companies.

In seeking input from market participants and technical experts, the SEC—in an iterative process of considering their recommendations, encouraging public companies to begin disclosing such information, and reviewing the quality of the resulting disclosure—would develop over time a comprehensive approach for climate risk disclosure that would provide reliable, consistent, and comparable information for investors. This process would be well-suited to complement the work of voluntary standard setters.

In the more immediate term, the SEC should seek to encourage greater voluntary disclosure by public companies in accordance with the TCFD and SASB regimes. Such encouragement would produce more robust sustainability reporting by companies and provide investors with more consistent and comparable information based on standards that the investor community knows and in which they have confidence.

The goal would be to encourage companies to provide *more detailed information* about climate risk rather than having them provide bland, boilerplate disclosure that is geared mainly at minimizing legal liability.

Ultimately, market dynamics will reward the companies that are transparent about the steps they are taking to address the risks and opportunities that climate change presents for their businesses and will encourage other companies that may be lagging to keep up with the transition.

Meanwhile, the SEC should conduct a staff study of new disclosure trends by monitoring the voluntary disclosure process and consider how to enhance climate risk metrics to create more robust disclosure reporting.

Under such a strategy, the SEC and market participants would have the opportunity to work together to develop a disclosure approach for today as well as into the future.

Conclusion

The task before the SEC is by no means easy. The development of a fit-for-purpose approach to climate-related disclosure will require finding answers to a series of complicated legal, scientific, and economic questions. That is why it is important to pursue this work in a manner that builds upon existing work, that involves the active participation of market participants, and that encourages fulsome disclosure.

Given the importance of climate change to millions of investors and society at large, the regulated fund industry stands ready to assist in carrying out this task.

Thank you.