

Reducing Systemic Risks: The Securities & Exchange Commission and Climate Change

To reduce their exposure to serious financial risks, investors need clear, comparable information from publicly traded corporations on the material risks and opportunities they face due to climate change. The Securities and Exchange Commission (SEC) should prioritize climate risk as a corporate disclosure issue. By fully implementing its 2010 Interpretive Guidance on climate change disclosure, the SEC can help investors and companies mitigate these risks.

SEC Actions to Improve Climate Change Reporting

The economic and social impacts of climate change are already being felt worldwide. Hurricane Sandy caused the U.S. an estimated \$70 billion in direct damages and lost economic output, while in other areas of the world, escalating drought and water shortages are making food production difficult—often where poverty and hunger are already most acute. To understand the business risks posed by climate change and to help prevent dangerous levels of warming, investors need better information on the climate risks and opportunities they face.

Since its inception in 2003, members of Ceres' Investor Network on Climate Risk (INCR) have urged the Securities and Exchange Commission (SEC) to improve disclosure of climate change risks in companies' annual financial filings.¹

In 2007 investors representing \$1.2 trillion in assets sent a formal petition to the SEC, asking the Commission to issue an interpretive release clarifying that material climate-related information must be included in corporate disclosures under existing law. Over 100 institutional investors worldwide representing \$7.6 trillion in assets have written to the SEC in support of the petition.²

The SEC responded in February 2010 by issuing disclosure guidance that said climate change and related regulations lead to risks and opportunities for companies in a variety of sectors, and those issues, when material, must be disclosed in SEC filings.

Today the business opportunities and risks related to climate change have only grown. Below we provide examples of how leading companies are managing these issues. We also assess the state of climate disclosure in financial filings and make recommendations on how the SEC can improve companies' reporting and performance on climate risk.

¹ See Achieving Full Corporate Transparency on Climate Change (<http://www.ceres.org/investor-network/investors-in-action/sec-climate-disclosure>); Climate and Sustainability Disclosure (<http://www.ceres.org/investor-network/incr/climate-and-sustainability-disclosure>).

² See, e.g., February 8, 2008 letter to SEC from Institutional Investors Group on Climate Change (IIGCC), comprising over 40 members with AUM over \$5.5trillion, re: petition for climate disclosure guidance; see public comments re: File No. 4-547, Sep. 18, 2007, Request for interpretive guidance on Climate Risk Disclosure, available at <http://www.sec.gov/rules/petitions.shtml>.

Businesses are Responding to Climate Risks and Opportunities

Hundreds of leading U.S. corporations understand the business risks and opportunities posed by climate change and have begun disclosing those issues to their investors. These companies have developed comprehensive climate strategies including development of new products and services, risk assessment and mitigation plans, disclosure and governance improvements, and engagement with employees and stakeholders. Many companies report these strategies voluntarily in addition to providing SEC reporting. A small sampling of what companies say about climate risks and opportunities includes:

Coca-Cola: “ITEM 1A. RISK FACTORS... *Water scarcity and poor quality could negatively impact the Coca-Cola system’s production costs and capacity. Water is the main ingredient in substantially all of our products and is needed to produce the agricultural ingredients on which our business relies. It is also a limited resource in many parts of the world, facing unprecedented challenges from overexploitation, increasing pollution, poor management and climate change. As demand for water continues to increase around the world, and as water becomes scarcer and the quality of available water deteriorates, our system may incur increasing production costs or face capacity constraints that could adversely affect our profitability or net operating revenues in the long run.*” (10-K filed 2/27/13)

Colgate-Palmolive: “We understand that businesses have a vital role to play in the global issue of climate change and we are committed to continuously improving our greenhouse gas accounting processes, our performance and our governance around this challenge.... We have continued to expand our understanding and processes related to Greenhouse Gas (GHG) data collection and reporting and are continuing to expand the boundaries of our...emissions reporting.” (CDP questionnaire response, 2013)

Nike: “We believe that we need strong energy and climate policies to protect our supply chains and ensure market certainty, as well as to help create jobs, level the playing field among businesses, enhance economic development and ensure our global competitiveness as we move into the future.... We have been working for well over a decade to understand, track and decrease energy use and greenhouse gas (GHG) emissions across our value chain and to share what we’ve learned with others in industry.” (Sustainable Business Report, 2012)

TJX: “The most substantial business decisions influenced by climate change aspects of our strategy in FY2013 included achieving our corporate GHG emissions reduction target, completing lighting retrofits in more than 700 stores globally, establishing an energy efficiency standard in our procurement process for HVAC equipment, and launching

Associate engagement programs that encourage energy conservation in our stores, distribution centers and home offices, as well as in Associates’ homes and communities.” (CDP questionnaire response, 2013)

Johnson and Johnson: “In regards to climate change, a variety of risks and opportunities are considered by the board, including regulations such as carbon taxes and cap-and-trade schemes; physical climate change risks and opportunities such as extreme weather events; reputation considerations; and potential climate change links to global health and wellness.... The risks and opportunities resulting from climate change, such as water and resource scarcities and their impacts on human health, are the most important aspects of climate change that have influenced our business strategy. We understand, because of the nature of our business, that climate change can negatively affect human health by increasing water scarcity and frequency of waterborne diseases, decreasing the availability of natural resources and agricultural products because of habitat change, and changing the range and frequency of disease vectors and global pandemics.” (CDP questionnaire response, 2013)

These are leading examples of issues that the SEC should ensure companies disclose in financial filings. The SEC guidance on climate disclosure, discussed below, provides companies with information about how to report on these issues.

SEC Guidance on Climate Change Disclosure

The SEC Interpretive Guidance on climate change disclosure, which became effective in February 2010, covers three major areas: regulatory risks—both domestic and international, indirect effects of regulation or business trends, and physical impacts:

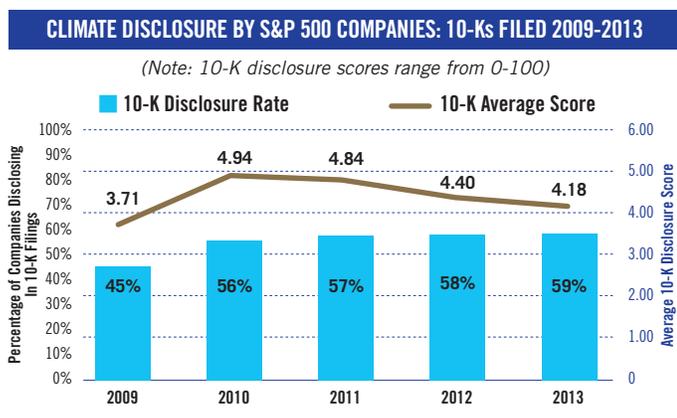
SEC INTERPRETIVE GUIDANCE ON CLIMATE CHANGE DISCLOSURE	
Section of Guidance	Examples of Potential Disclosure Items
Impact of Legislation & Regulation International Accords	<ul style="list-style-type: none"> • Cost to purchase credits in a cap and trade system • Costs to improve facilities to comply with regulatory limits of a cap and trade system • Changes to profit/loss from changed demand for goods and services
Indirect Consequences of Regulation or Business Trends	<ul style="list-style-type: none"> • Decreased demands for goods with significant GHG emissions, or increased demand for those with lower emissions • Increased demand for energy from alternative energy sources • Decreased demand for services related to fossil fuels, such as drilling services or equipment maintenance
Physical Impacts	<ul style="list-style-type: none"> • Disruption of manufacturing or transport for registrants with operations on coastlines • Indirect impacts to major customers or suppliers from severe weather, such as hurricanes or floods • Increased claims and liabilities for insurance and reinsurance companies • Decreased agricultural production due to drought or other weather changes

The State of Climate Reporting by S&P 500 Corporations

A new Ceres report, *Cool Response: The SEC & Corporate Climate Change Reporting*, analyzed climate disclosure in by S&P 500 companies in 10-Ks filed from 2009 to 2013. All U.S. public companies are required to submit a 10-K filing to the SEC once per year. The 10-K report provides a comprehensive overview of the company's business, risks and financial condition and includes audited financial statements.

Ceres examined whether climate-related disclosures were made, and assessed the quality of those that were made. A climate-related disclosure was considered to be present in a particular 10-K report where just a single mention was made, for instance, of climate change, increasingly severe weather conditions, changing precipitation patterns, regulation or disclosure of GHG emissions as actual or potential risk factors for the company.

If climate disclosures were identified, the full set of 10-K disclosures in that year was assigned a score. Scores range from 0 to 100, with the best disclosure over the study period being assigned a score of 100. All other disclosures were calibrated against this standard, and no disclosure received a score of 0. The average disclosure score for 10-Ks filed in 2013 was less than 5 out of 100 points for companies that disclosed climate issues (Figure below):



Key findings from the report include:

- While more companies started making climate-related disclosures in 2010 after the SEC's interpretive guidance was issued, there has been little improvement since 2010. In fact, the average score assigned to 10-K climate disclosures has dropped off since 2010 showing that, while more companies are saying something about climate change, they were less specific in disclosures made in 2013 compared with 2010 reporting.
- A large number of companies fail to say anything about climate change in their 10-K filings. Forty-one percent of S&P 500 companies failed to address climate change in their 2013 filing.
- Climate-related disclosures made by S&P 500 companies in 10-K filings were highly variable in length and quality. For example, electric and gas utilities averaged a score of 16.7 out of 100 points in their 2012 filings, but average scores in 13 other industry groups surveyed were between 0.6 and 2.4.

SEC Comment Letters on Climate Change: 2010-2013

As required by the Sarbanes-Oxley Act of 2002, SEC staff undertake some level of review of each company's reporting at least once every three years, and review a significant number of 10-K filings more frequently.

For climate risks and other financial reporting issues, the SEC's best tool to ensure high quality reporting is staff reviews of company 10-K filings. The reviews involve "evaluating the disclosure from a potential investor's perspective and asking questions that an investor might ask when reading the document. When the staff identifies instances where it believes a company can improve its disclosure or enhance its compliance with the applicable disclosure requirements, it provides the company with comments" ("comment letters").

In addition to analyzing S&P 500 filings, Ceres also surveyed the 40,000+ SEC comment letters sent to companies in the last 4 years. Forty-nine letters related to climate change were sent to companies and asset managers in 2010 and 2011, while only 3 such letters were sent in 2012 and 2013. Large companies facing the greatest risks from climate change received the fewest comment letters: only five companies with a market capitalization of above \$5 billion received climate-related letters in the last four years.

SEC COMMENT LETTERS ON CLIMATE CHANGE: 2010-2013				
Industry	Number of Letters Sent to Companies & Asset managers			
Year	2010	2011	2012	2013
Total Comment Letters for Year	38	11	3	0
Asset Manager	21	6		
'Blank Check' Company	1			
Electric & Gas Utilities	3			
Insurance Services	3	1	1	
Manufacturing	1	1		
Mining	2			
Oil & Gas	2			
Real Estate Finance/ Property Development	1	1	2	
Renewable Fuels	2	1		
Services (Personal Services)	2			
Services (Water Utility)		1		

As the table above illustrates, the SEC has paid minimal attention to climate risk reporting in the last four years, and has not prioritized using the review process to improve the quality of material climate disclosures. Three key observations highlighted in the report:

- 1 The number of SEC comment letters that mentioned climate risk was very small. Only 52 comment letters were sent in the last four years, including only three in 2012 and 2013.
- 2 Firms in high-risk sectors were not well represented among companies that did receive comment letters. For example, only two oil and gas companies and two manufacturers received letters, and no transport, agriculture, food, basic materials and chemical companies received letters.
- 3 SEC comment letters on climate risk disclosure were limited in scope. Many letters only asked companies if they had considered the Guidance, and few addressed important dimensions of climate risk disclosure such as regulatory or physical risks.

Recommendations for the SEC

Clearly the SEC needs to refocus on climate change reporting, in order to protect investors and help companies manage the significant risks posed by climate change; and to take advantage of business opportunities presented by the need to transition to a low carbon economy.

Ceres and our investor partners recommend that SEC staff:

- Issue more comment letters to companies with inadequate disclosure of material climate issues.**
 First, staff should prioritize firms in sectors facing significant climate risks and opportunities. These include firms in high-emitting sectors that are already subject to regulation; firms whose financial performance is tied to global climatic changes, in particular the insurance sector; and firms whose business operations and operational infrastructures are most likely to be disrupted by changing weather patterns. Second, staff should focus on the adequacy of disclosures concerning recent, major physical and regulatory developments, which may pose material risks to companies.
- Create a federal interagency working group focused on climate risks and opportunities to businesses.**
 This would improve information sharing about the climate issues companies face, a critical first step for the SEC. A number of federal agencies have looked closely at these risks. For example, a 2013 Department of Energy report on energy sector vulnerabilities to extreme weather found threats and opportunities in a number of industries from increasing temperatures, decreasing water availability and other events related to climate change. Since 2010, the EPA has collected data on GHG emissions from U.S. electric power plants, chemical plants, refineries and other facilities. The SEC could make valuable use of this data to identify companies and industries where climate risk disclosure is especially critical, and subject these filings to increased scrutiny.



Cool Response: The SEC & Corporate Climate Change Reporting

examines climate risk disclosure in financial filings from 2010-2013. The report evaluates SEC implementation of its 2010 climate disclosure guidance, as well as S&P 500 reporting in 10-K filings. The full report is available at www.ceres.org.

FOR MORE INFORMATION, CONTACT:

Jim Coburn

Senior Manager, Investor Programs
 Ceres
coburn@ceres.org
 617-247-0700 ext. 119
www.ceres.org
www.incr.com

Ceres is a nonprofit organization mobilizing business and investor leadership on climate change, water scarcity and other sustainability challenges. Ceres directs the Investor Network on **Climate Risk (INCR)**, a network of over 100 institutional investors with collective assets totaling more than \$11 trillion. www.ceres.org