SEC Wants Corporations To Calculate Climate Impact Of Companies They Do Business With

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ESG investing has exploded from a niche movement to encompass more than one-third of managed assets in the U.S., with the trend line continuing to rise. To satisfy ESG investors' desire to better see where companies stand in the fight against climate catastrophe, the top U.S. financial regulator is now proposing the most sweeping addition to corporate disclosure in years — requiring public companies to calculate for investors how environmentally sound their practices are.

One sticking point: Under certain circumstances, corporations will also be required to disclose the environmental impact of companies they do business with.

"The proposal turns the disclosure regime on its head," said Hester Peirce, the lone Republican on the Securities and Exchange Commission, which is proposing the requirement. "Current SEC disclosure mandates are intended to provide investors with an accurate picture of the company's present and prospective performance through managers' own eyes. The proposal, by contrast, tells corporate managers how regulators, doing the bidding of an array of non-investor stakeholders, expect them to run their companies."

The provision that companies calculate and disclose the climate impact of contractors and counterparties is called Scope 3, and Peirce, among others, questions whether the information is material to a company's share price. Supporters say leaving Scope 3 out of the requirement would make it easy for corporations to foist their dirty work on the other companies. As the SEC proposal goes into its public comment phase ahead of a final vote, Scope 3 promises to be a main point of friction.

The Scope 3 provision wouldn't affect all public companies, just those for whom the data is material to their stock price and those that make pledges, such as net-zero emissions. Scope 3 would try to eliminate any fudging those companies might try to do on whether they've achieved their goals.

“Materiality will be a real issue here,” said Jennifer Schulp, director of financial regulation studies at the Cato Institute, a libertarian think tank. “The SEC has said that they’re looking for consistent, reliable, comparable data and Scope 3 is heavily dependent on assumption and may very well not provide that type of reliable data that the SEC is even claiming that it’s looking for here. So I’m not sure that Scope 3 meets the goals the SEC has set out for itself.”

ESG funds, which take into account companies’ impact on the environment, their activity on social issues and the quality of their governance, grew to a record $649 billion in U.S. inflows in the first 11 months of last year, up from $542 billion and $285 billion in the entirety of 2020 and 2019, respectively, according to data from Refinitiv. Globally, ESG funds now account for 10% of assets and by 2025 will grow to $53 trillion, or one-third of managed assets worldwide, according to prognostications by Bloomberg Intelligence.

Disclosures about things like carbon footprints are now voluntary, and proponents of ESG investing, with their growing clout, decry so-called greenwashing, where a company says all the right things about the environment and reaps the benefits without backing up the rhetoric with action.

“The more information you give investors, the more ability they have to make a smart decision to invest in your company,” Ross Gerber, the CEO of Santa Monica, California-based investment-management firm Gerber Kawasaki, told *Forbes*. “Investors care and they deserve the transparency to know if the companies they’re investing in have good policies or not.”

The disclosure requirements will make life easier for Jon Hale. As director of sustainability research at Morningstar subsidiary Sustainalytics, Hale manages an environmental-accountability ratings system based on company data that can vary in quality and that many companies don’t even divulge. Hale points out that the proposed SEC rule will standardize basic data such as emissions, and will improve companies’ performance in these metrics because of the calculations they’ll be forced to do.

Public companies will be better off “because it’s been difficult for many of them to get a handle on how climate change may affect their business and especially their long-term business model,” Hale told *Forbes*.

Opponents are targeting Scope 3, and the proposal is subject to change over the next few months. A final decision is expected in late summer or early fall with experts saying that the current 30-day comment period is likely to be extended.

“It’s couched in terms of disclosure,” said Howard Fischer, a partner at Moses & Singer and a former SEC senior trial counsel. “But the practical effects are going to push companies to minimize greenhouse gasses and other forms of climate-changing activity.”