Climate-risk disclosure, let me count the ways

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June 8, 2022

The Securities and Exchange Commission's proposal for climate-risk disclosure should not bring to mind love poems, but yet, Elizabeth Barrett Browning's "How Do I Love Thee" seems strangely apt, if in reverse. While some environmental advocates, consultants, and asset managers selling "sustainable" investment products have found a myriad of things to love about the proposal, there are far more reasons to criticize the SEC's bold move: it's a menace that threatens harm upon financial markets, the SEC itself, and even the cause of environmentalism.

Under the proposal, about 7,000 companies would have to report their "climate-related risks and impacts." The SEC estimates that these new rules would raise the annual cost of compliance from $3.8 billion to $10.2 billion. That's no small change. And the SEC's estimates of $420,000 to $530,000 in annual expenses, including the services of climate modelers and emissions accountants, places a substantial burden on companies, particularly smaller ones.

To appreciate the folly of this proposal, one need only consider its two laughable justifications. First, the SEC says that it must "protect investors" from an ongoing "market failure" involving "difficulties locating and assessing climate-related information when making their investment or voting decisions." Second, the agency purports that it must correct "market inefficiencies" resulting in capital flows that supposedly do not reflect the true threat of global warming.

Both claims fail the sniff test. There are no market failures here. Corporate managers should already account for "climate-related risks" (if any) while trying to maximize long-term shareholder value in highly competitive securities markets, and the SEC already requires disclosure of such risks where they are material to an investor's decision making. The upshot is that the proposal is "missing…a credible rationale," to borrow phrasing from Commissioner Hester Peirce, the lone dissenting voice on the SEC.

The SEC is also duplicating another agency's work. A major component of the proposal is a requirement that companies disclose their greenhouse gas emissions, yet the Environmental Protection Agency—actually tasked with protecting the environment—already requires emissions reporting. Even though EPA requirements capture 85-90 percent of emissions, the SEC seeks to require more detailed disclosures for public companies, perplexingly implying that investors' needs are greater than the EPA's. It's hard to imagine a worse case of mission creep.

Although big companies can afford to comply without disrupting their business, the same can't be said for small companies or those with tight margins, all of whom would face a longer road to profitability. And it's not just public companies in the crosshairs: smaller private companies will be subject to emissions reporting in their roles as suppliers and customers of public companies.

The indirect costs are even more worrisome. All information is not created equal, and there is a limit to the amount of information that an investor can process. Indeed, a company can mislead investors by deluging them with useless information just as surely as it can through concealment. For this reason, the SEC has a responsibility to consider whether required disclosure will result in irrelevant, redundant, and trivial information. The SEC's climate proposal undermines that responsibility. By mandating an unprecedented degree of specificity for disclosure of climate-related risks—real or imagined—the SEC threatens to flood investors with extraneous information and sow confusion.

This proposal also spells trouble for the SEC. We know this because the agency experimented with environmentalist disclosure proposals in the 1970s. The idea failed then largely because it was infeasible. That is, the SEC recognized that it could not simultaneously serve both ethical investors and economic investors because they have different goals. To be sure, proponents of the SEC's proposal try to square this circle by claiming that "the perceived barrier between social value and market value is breaking down," in the words of Commissioner Allison Herren Lee. But who believes that? After all, the world's largest oil company, Exxon-Mobil, has seen its stock price increase almost 40 percent this year in a difficult market, despite its supposed gigantic climate risks. Meanwhile, the world's largest ethical investing fund is down about 19 percent.

Finally, the proposal could very well prove counterproductive to environmentalism. The SEC's climate-risk disclosure proposal is quirky in that the regulatory burdens ratchet up for companies that have made public commitments about their climate policy. This provides a big incentive for companies to altogether avoid such activity. These rules—particularly their high costs—also may work to deter innovation vital to the solve the environmental consequences these rules seek to prevent.

Like Elizabeth Barret Browning's love, the list of reasons the SEC's climate-risk proposal is ill-consider goes on and on. But Browning's conclusion to her sonnet is as applicable to love as it is to the SEC's proposal: "I shall but love thee better after death." The SEC should find a final resting place for this proposal, and soon.

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