AMERICAN ACADEMY *of* ACTUARIES

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June 17, 2022

Honorable Gary Gensler
Chair
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: RIN 3235-AM87 The Enhancement and Standardization of Climate-Related Disclosures for Investors – Request for Comment

Dear Chair Gensler,

The American Academy of Actuaries (Academy)[1] Climate Change Joint Task Force (CCJTF) appreciates the opportunity to comment on the Securities and Exchange Commission's (SEC) request for public input on the enhancement and standardization of climate-related disclosures. Actuaries are focused increasingly on risks associated with climate change—both in our roles as risk managers and in developing estimates of insurance premiums, reserves, and capital. The CCJTF commends the SEC for its efforts to standardize disclosures associated with climate risks, making such disclosures, when they are finalized, a better source of information not only for a particular company but across companies.

Subsequent to finalization of new disclosure requirements, the CCJTF encourages the SEC to compile disclosure information as data to measure how meaningful it is and continues to be as well as to report on the resulting levels of risk recognition. In turn, the SEC and other stakeholders could study whether to update and enhance the reporting guidance to provide more comparable and meaningful disclosures.

ACADEMY RESEARCH ON CLIMATE CHANGE AND CLIMATE RISK DISCLOSURES

In addition to perspectives gained from its volunteers' working experience and expertise, the Academy has also spent considerable time in recent years on two research projects that have provided additional insight into changing climate risks and appropriate regulatory deliberations with respect to climate-related financial risk in the insurance sector.

Actuaries Climate Index and Actuaries Climate Risk Index

[1] The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

First, the Actuaries Climate Index (ACI) v 1.1, created and maintained by four North American actuarial associations, including the Academy, documents changes in extreme occurrences of six climate-related elements of weather and sea level. The index, a measure summing the observations across all of the elements, covers the U.S. and Canada, and breaks results down into 12 regions, seven in the U.S. While the index generally shows increasingly extreme climatic conditions since the end of the index reference period, 1961–1990, it also reveals the variability in those increases—both by element and by region. In 2020, the Academy also published a preliminary model, the Actuaries Climate Risk Index (ACRI) v 1.0 and results providing estimates for property losses during the period 1991–2016 that could be attributed specifically to changing climate, controlling for changes in exposure.

As the SEC sets forth its initial climate disclosure requirements, changes in the requirements may be needed over time due to the evolving nature of climate change and climate risk. The CCJTF suggests that the SEC consider the use of indices such as the ACI and ACRI that measure physical risks that are impacted by climate as a way to inform the SEC about how fast climate risk factors are moving to indicate movement on the time horizon and the potential timing for re-assessing the disclosure guidance.

Climate-Related Financial Disclosures

Second, the Climate Related Financial Disclosure (CRFD) Work Group (work group) of the Academy has been examining climate disclosures as they apply specifically to insurers. In the first part of that research, presented to the National Association of Insurance Commissioners (NAIC) in December 2020 and January 2021, the work group examined the climate-related financial disclosures completed by about 70% of the insurance industry in response to the NAIC Climate Risk Disclosure Survey. That survey consisted of nine Yes/No questions, with eight narrative responses required to elaborate. In the second part of that research, presented in January 2022, the work group compared the NAIC Climate Risk Disclosures with the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD) for the same companies.

Six insights from the analysis of these filings potentially useful to the SEC include:
1. TCFD reports generally provide more information than did the NAIC survey responses;
2. The increase in information provided by the TCFD reports is accompanied by an increase in the variability of responses;
3. Certain topics—governance, metrics and model results, and opportunities provided by climate change—are significantly better covered in TCFD reports than in the NAIC survey responses;
4. Certain topics—operational risk, underwriting risk, and engagement with policyholders and key stakeholders—are less completely covered in the TCFD reports than in the NAIC survey responses;
5. Only companies that are relatively large have been voluntarily submitting a TCFD report; and
6. The TCFD responses, as is true of the NAIC survey responses, are difficult to benchmark. The absence of systematic questions—whether Yes/No, multiple choice, or quantitative—makes the creation of benchmarks difficult and, thus, makes it difficult to assess individual companies against those benchmarks.

These lessons suggest at least two issues to which the SEC might give particular attention:

a. Both the Carbon Disclosure Project (CDP) survey and the ClimateWise survey are used by many companies voluntarily, and both are designed to satisfy the requirements of the TCFD reporting guidance. As a result, it might be worth considering studying these two surveys (and others which meet the same criteria of widely used, systematic, and meeting TCFD requirements) more closely to determine how best to draw from them to improve the SEC disclosure requirements;
b. The companies that file more robust responses tend to be larger, and they tend to be operating in multiple lines of business.

SPECIFIC COMMENTS ON THE QUESTIONS POSED

Based on the work completed on these research projects, and insights gained from our working experiences as actuaries, the CCJTF offers the following responses to select questions in the SEC's *Request for Comment*.

#3 TCFD Framework
Should we model the Commission's climate-related disclosure framework in part on the framework recommended by the TCFD, as proposed? Would alignment with the TCFD help elicit climate-related disclosures that are consistent, comparable, and reliable for investors? Would alignment with the TCFD framework help mitigate the reporting burden for issuers and facilitate understanding of climate-related information by investors because the framework is widely used by companies in the United States and around the world? Are there aspects of the TCFD framework that we should not adopt? Should we instead adopt rules that are based on a 57 different third-party framework? If so, which framework? Should we base the rules on something other than an existing third-party framework?

Response:
Aligning the SEC disclosure requirements has advantages for all stakeholders. However, our research shows that following the TCFD framework without additional questions—either closed-ended, or specific metrics, or questions producing narrative responses that can be reliably scored—is likely to create avoidable problems for stakeholders in making use of the disclosures.

- TCFD is the emerging consensus standard for CRFD reporting. Aligning with that standard will make it easier for regulators, companies, and stakeholders to assess the reports for individual companies.
- Our research indicates that, while TCFD responses may provide substantial useful information, that is not guaranteed. More specifically, our research suggests two major problems likely to arise with the current TCFD-aligned guidance:
    - Relatively few companies are likely to provide robust responses; and
    - The narrative responses at the heart of TCFD are highly variable across companies and very difficult to benchmark, assess, and compare. As a result, both regulators and stakeholders are likely to learn less from the responses—even when companies spend considerable resources producing robust responses—than they might if the TCFD framework was implemented in a way that produced quantifiable metrics based on the responses. Whether the questions are closed ended, or the questions are scored independently once submitted, quantifiable

responses provide regulators and stakeholders the opportunity to benchmark, assess, and compare.

- Our current research seeks to assess two industry surveys which produce quantitative metrics for responses to questions aligned with the TCFD framework. In the near future, the CCJTF hopes to be in a position to assist regulators in supplementing or replacing narrative questions with quantifiable ones.

#8 Material impact, time horizon

Should we require a registrant to disclose any climate-related risks that are reasonably likely to have a material impact on the registrant, including on its business or consolidated financial statements, which may manifest over the short, medium, and long term, as proposed? If so, should we specify a particular time period, or minimum or maximum range of years, for "short," "medium," and "long term?" For example, should we define short term as 1 year, 1-3 years, or 1-5 years? Should we define medium term as 5-10 years, 5-15 years, or 5-20 years? Should we define long-term as 10-20 years, 20-30 years, or 30-50 years? Are there other possible years or ranges of years that we should consider as the definitions of short, medium, and long term? What, if any, are the benefits to leaving those terms undefined? What, if any, are the concerns to leaving those terms undefined? Would the proposed provision requiring a registrant to specify what it means by the short, medium, and long term mitigate any such concerns?

Response:
A requirement that disclosures are made when material and be accompanied by a disclosed time horizon will increase the usefulness of the disclosures even if the SEC does not specify a number of years separately for a short-, medium-, and long-term horizon. To that end and more specifically, the CCJTF has the following comments related to considerations of materiality and disclosure:

- The SEC may wish to consider that by requiring registrants to disclose any climate-related risks that are reasonably likely to have a material impact on their consolidated financial statements investors will better understand the potential impact that the climate-related financial risks can have on a registrant's business, as climate-related financial risks can have a meaningful impact on the future income stream and consequently the performance of a registrant's financial instruments.
- Regarding the materiality definition, the SEC's general position makes sense that a matter is material if a reasonable person would likely consider it important. The proposed rule describes this well. But in actuality, many companies tend to use a much simpler rule of thumb when assessing materiality, e.g. a 5% of equity threshold.
- The SEC may wish to consider that registrants be asked to provide a level of granularity in the risks that are disclosed. For instance, indicating that a registrant is subject to physical and transition risk may not be sufficient—nearly all companies have some exposure to these risks. Rather, we believe that investors are interested in how these risks will impact the registrant, e.g., risk of hurricanes/wildfires/floods causing damage to the registrant's property and disrupting their business, transitional/reputational risk of having involvement with fossil fuels, etc.
- The SEC may wish to consider that the registrant's risks and the associated materiality be described at various time horizons, e.g., short term, medium term, and long term. However, the registrant would be able to define these terms, as its risks would be assessed in a manner

consistent with how the registrant manages its business and develops its strategy. For instance, one registrant may have set a net-zero goal for 2050, while another has set a goal for 2030; these companies may have a different view of what constitutes its long-term risks and strategy.

Materiality: Financial vs. Impact

- While materiality is usually thought of in terms of the impact on a company's financial statements (financial materiality), some argue that financial materiality only captures a part of the relationship between a company's operations and climate change.
- While climate change may affect the finances of the company ("financial materiality"), the company's operations may also affect climate change (for example, by increasing or decreasing the likely emissions of greenhouse gasses (GHGs)) ("impact materiality").
- These stakeholders argue that the solvency/creditworthiness of companies in the short term may only require attention to financial materiality, that longer term solvency/creditworthiness and the ability to assess efforts to limit and mitigate climate change depend on the reporting of impact materiality as well.
- For insurance companies, impact materiality increases the salience of Scope 3 reporting.
- Impact materiality assessment for preparing disclosures may require different skill sets than those currently deployed. Impact materiality may require the involvement of climate scientists, while financial materiality is well within the bounds of actuaries (and other financial professionals involved in developing information for insurance companies' financial statements).

#9 Definition of climate-related risks

Should we define "climate-related risks" to mean the actual or potential negative impacts of climate-related conditions and events on a registrant's consolidated financial statements, the operations of, a partnership, limited liability company, or a direct participation investment program, an offering of securities by a blank check company; a roll-up transaction; or a going private transaction; or (ii) by an issuer of penny stock. See Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act. Also, the statutory safe harbors do not, absent a rule, regulation, or Commission order, apply to forward-looking statements by certain "bad actor" issuers under Section 27A(b)(1)(A) of the Securities Act and Section 21E(b)(1)(A) of the Exchange Act. 72 business operations, or value chains, as proposed? Should we define climate-related risks to include both physical and transition risks, as proposed? Should we define physical risks to include both acute and chronic risks and define each of those risks, as proposed? Should we define transition risks, as proposed? Are there any aspects of the definitions of climate-related risks, physical risks, acute risks, chronic risks, and transition risks that we should revise? Are there other distinctions among types of climate-related risks that we should use in our definitions? Are there any risks that we should add to the definition of transition risk? How should we address risks that may involve both physical and transition risks?

Response:

The definitions of climate-related financial risk to a company are broad and need to cover the broad spectrum of risks that may be material to the company. In particular, relatively small risks to some companies may be material to others and aggregate across companies. A specific transition risk, that of reputational risk—while hard to anticipate—may be significant.

- The definitions for all material risks need to be broad, whether physical or transition, acute or chronic. The broad definition of risk includes the consideration of not just a single material risk but potential aggregated impact from risks.
    - Relatively small risks may add up to very substantial risks to particular companies.
    - And relatively small risks added up across companies might pose substantial risk to the country or to global financial stability.
- Within transition risk, it is important to highlight reputation risk.
    - Reputation risk is difficult to anticipate but not impossible.
    - One of the most likely sources of reputation risk (with risk to climate change) arises from activities (whether directly by the company or in the company's value chain) which impact climate change adversely, whether or not the activities have a material financial impact. In this way, impact materiality, as discussed above, may be important to assess as an indicator of the likelihood of reputation risk.

#17 Negative impacts on value chain? Value chain to include both upstream and downstream activities?

Should we include the negative impacts on a registrant's value chain in the definition of climate-related risks, as proposed? Should we define "value chain" to mean the upstream and downstream activities related to a registrant's operations, as proposed? Are there any upstream or downstream activities included in the proposed definition of value chain that we should 75 exclude or revise? Are there any upstream or downstream activities that we should add to the definition of value chain? Are there any upstream or downstream activities currently proposed that should not be included?

Response:

While CCJTF has been unable to locate the definition of the value chain referenced in footnote 401, relying on an intuitive definition we expect that the primary risks for insurance companies from their value chain lie in their downstream activities, i.e., those of their policyholders and customers. While some of those risks are captured in the underwriting process, some risks remain outside of that process and might be acknowledged under disclosures of material risks originating in the value chain.

- While many insurance companies certainly face climate risks (both physical and transitional) in their underwriting (and treaty-writing) operations, even more companies will face climate risk in their value chain's downstream, i.e., from the risks faced by policyholders and customers beyond the current customer transaction into future years.
- While the risks to individual policyholders are likely captured largely in the underwriting risk for companies (at least within the time horizon of the policy), some commercial policies include risks which go beyond those typically incorporated in underwriting. For example, transition risk (due to new government regulations, for example) which affect a policyholder in a way that is covered by current policy language but was not anticipated in pricing and underwriting.

- Value chain downstream risk is one way in which reputation risk, in particular, of companies which are insured by a particular insurance company, becomes a financial risk for an insurance company.

#59 Financial impact metrics
Should we require registrants to disclose the financial impact metrics, as proposed? Would presenting climate-specific financial information on a separate basis based on climate related events (severe weather events and other natural conditions and identified physical risks and transition activities (including identified transition risks) elicit decision-useful or material information for investors? Are there different metrics that would result in disclosure of more useful information about the impact of climate-related risks and climate-related opportunities on the registrant's financial performance and position?

Response:
As our research related to climate-related financial disclosures have shown, closed-ended questions that can be compiled into a comparable data source is useful in comparing the responses from one company to the next. The next step of comparability are disclosed metrics that are defined specifically enough in the disclosure such that the results can be compared across companies. More specifically, the CCJTF has the following comments about disclosing quantifiable metrics.

- Identification of material risks without sufficient quantitative disclosure of financial impact would not benefit investors, so investors want to understand the relative magnitude of various climate risks, track the size of various climate risks over time, and compare the climate risk of different registrants.
- However, for many registrants, it may be difficult to quantify these climate impacts (the example given is oversimplified). Furthermore, the precise impact may not be known for several years after the occurrence of a catastrophic event.
- Requiring metrics provides an added benefit, in that the registrant's management would develop a more thorough understanding of potential financial impacts and this will likely lead to better decision-making and risk management.
- Using the 1% standard for each individual impact seems arbitrary and below the threshold of materiality.
- The point was made that the types of disclosures being discussed in this section would already be required by existing financial statement disclosure requirements. However, releasing this guidance specific to climate-related risks would give more insights into the SEC's expectations for disclosure and be helpful to registrants in that regard.

#98 Disclosure of "material" Scope 3 emissions
Should we require a registrant to disclose its Scope 3 emissions for the fiscal year if material, as proposed? Should we instead require the disclosure of Scope 3 emissions for all registrants, regardless of materiality? Should we use a quantitative threshold, such as a percentage of total GHG emissions (e.g., 25%, 40%, 50%) to require the disclosure of Scope 3 emissions? If so, is there any data supporting the use of a particular percentage threshold? Should we require registrants in particular industries, for which Scope 3 emissions are a high percentage of total GHG emissions, to disclose Scope 3 emissions?

Response*:*
Relative to requiring Scope 3 emissions standard disclosures, our comments consider materiality for specific companies, recognizing that Scope 3 emissions may be more material than Scope 1 and Scope 2 for some companies and not material for others. More specifically, the CCJTF has these further thoughts about Scope 3 disclosures.

- For registrants in many industries, Scope 3 emissions will be more important than Scope 1 and Scope 2 and may be how the registrant defines its net-zero targets (often the case for financial services sectors). In general, a company that has high Scope 3 emissions may struggle to decarbonize under its current business model, so investors will want to understand that such registrants may have a difficult transition.
- However, a threshold could be set for required Scope 3 disclosure. The SEC text referenced a commenter who suggested requiring disclosure when the Scope 3 emissions exceed 40% of a registrant's total emissions. While this is a good concept, the threshold could be set even lower—perhaps around 25%—as this would clearly signal that the Scope 3 emissions are material to the registrant's overall carbon footprint. Regardless of what is decided in terms of a reporting threshold, it can be assumed that for registrants with low Scope 3 emissions, transition risk is relatively low and there is little benefit to required Scope 3 disclosure. (Calculating Scope 3 emissions is more difficult than Scope 1 and Scope 2, so the SEC may wish to consider it be required only when material.)
- When it is determined that Scope 3 emissions are immaterial, the SEC may wish to consider that the registrant disclose the methodology used in reaching that conclusion.
- The proposed rule to require disclosure of immaterial Scope 3 emissions when a registrant has set reduction targets on that basis makes sense and could be effective in preventing "greenwashing."
- The requirement to calculate emissions for each specific greenhouse gas is important because this is the only way to understand overall emission levels and to set and pursue reduction targets. However, it may be of little benefit to disclose emissions data for each type of GHG, as most investors will not have much use for this data.
- Using a universally consistent unit of measurement—carbon dioxide equivalent (CO_2e) —is important to enable investors to understand emissions levels.
- Requiring disclosure of gross emissions (before any purchased/generated offsets) is also important because the value of offsets is highly variable (e.g., if a registrant is planting 1 million trees to generate an offset—how would we determine the value of this? There is not one single species and size of tree.) Any incorporation of the value of the offset will be more effective if a description of the methodology for its determination is included.
- Requiring disclosure of Scope 3 emissions by individual category would be somewhat useful to investors. Depending on the category of emissions, investors would be able to understand how difficult it will be for the registrant to transition (e.g., it is relatively easier to make changes to the investment portfolio than it is to figure out a green way to transport and distribute the registrant's sold products).
- Given that determination of Scope 3 emissions is much more difficult than Scope 1 and Scope 2, the SEC may wish to consider that the guidance emphasize that these are to be calculated and disclosed on a best-efforts basis.
- Another issue not mentioned is what to do when new information becomes available after disclosures have been made (e.g., does this get treated in a similar way as when a material

error is identified on the balance sheet or income statement)? The SEC may wish to consider that this be discussed explicitly in the guidance.

#168 Disclosure of targets for reduction of GHG emissions
Should we require a registrant to disclose whether it has set any targets related to the reduction of GHG emissions, as proposed? Should we also require a registrant to disclose whether it has set any other climate-related target or goal, e.g., regarding energy usage, water usage, conservation or ecosystem restoration, or revenues from low-carbon products, in line with anticipated regulatory requirements, market constraints, or other goals, as proposed? Are there any other climate-related targets or goals that we should specify and, if so, which targets or goals? Is it clear when disclosure under this proposed item would be triggered, or do we need to provide additional guidance? Would our proposal discourage registrants from setting such targets or goals?

Response:
In considering the need to require a disclosure articulating whether a company has set targets for GHG emission reduction as well as the next step of describing the targets, year-over-year progress in achievement of the targets as well as ancillary targets that may be components of getting to reduced GHG emission, the CCJTF offers the following input:

- Yes, it is important for investors to understand any reduction targets that have been set, so this disclosure is necessary. If a registrant has set reduction targets but does not want to disclose them—this could signal either weak targets or greenwashing.
- The elements of the disclosure described in the proposed rules, e.g., unit of measurement, time horizon, interim targets, etc., all are valid.
- It is particularly important to describe progress made in achieving targets since the prior year's disclosure. This will give investors an idea of how closely registrants are pursuing their transition plans and how well they are managing their climate risks.
- Regarding other targets—such as water usage or conservation policy or recycling programs, etc. —these are not particularly useful if they cannot be expressed in terms of GHG emissions reductions.
- Regarding the SEC's question whether this proposal will prevent registrants from setting goals, it seems that this likely will happen on occasion. These rules may discourage some registrants from setting ambitious reduction targets until they have developed an execution plan. The lack of a reduction target is a potential additional disclosure item to address this concern.

FINAL GENERAL COMMENT:

The proposed SEC disclosure requirements are primarily designed to help investors understand the climate component of the environmental, social, and governance (ESG) profiles of potential investments. An added benefit of these disclosures might be that many insurance companies are looking for resources on how to better consider climate and ESG in the underwriting process. The information described in the SEC disclosures will provide quite a bit of useful data for underwriters to use in that regard. This will help create a positive feedback loop, with insurers wanting to insure the best climate and ESG risks and corporate insureds making the determination that they can lower their insurance costs by developing better climate and ESG credentials. While the Academy's Climate Change Joint Task Force has focused on the considerations here to insurance companies and underwriting, these considerations also apply to insurance companies' investment portfolios.

If you would like to have a further discussion on our comments or if you have additional questions, please contact the Academy's Risk Management and Financial Reporting Analyst, Samuel Owen at owen@actuary.org (202) 223-8196.

Respectfully submitted,

Lisa Slotznick, MAAA, FCAS
Chairperson
Academy Climate Change Joint Task Force

Michelle Young, MAAA, FSA
Vice Chairperson
Academy Climate Change Joint Task Force