

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

February 22, 2021

Memorandum

To: Members, Committee on Financial Services
From: FSC Majority Staff
Subject: February 25, 2021, Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets Hearing entitled, “Climate Change and Social Responsibility: Helping Corporate Boards and Investors Make Decisions for a Sustainable World”

The Subcommittee on Investor Protection, Entrepreneurship and Capital Markets will hold a virtual hearing entitled, “Climate Change and Social Responsibility: Helping Corporate Boards and Investors Make Decisions for a Sustainable World” on Thursday, February 25, 2021 at 2:00 p.m. Eastern Standard Time on the virtual meeting platform Cisco Webex. There will be one panel with the following witnesses:

- **Andy Green**, Senior Fellow for Economic Policy, Center for American Progress
- **Heather McTeer Toney**, Environmental Justice Liaison, Environmental Defense Fund and Senior Advisor, Moms Clear Air Force
- **Veena Ramani**, Senior Program director, Capital Market Systems, Ceres
- **James Andrus**, Investment Manager, California Public Employees' Retirement System
- **Vivek Ramaswamy**, Founder & Executive Chairman at Roivant Sciences

Overview

Climate change poses a fundamental threat to America’s financial eco-system, its businesses, and to the global economy. That risk is exacerbated when it comes to the health and welfare of America’s people and communities of color. Further, not only does climate change present a risk to the stability and sustenance of the economy, but it presents risks to individual American businesses. Environmental, social and governance (ESG) criteria constitutes a measurable way to assess a company’s efforts to manage those risks and to hold companies accountable.¹

Climate Change and Its Disproportionate Impact on Communities of Color

Climate change refers to changes in the “average weather patterns that have come to define the Earth’s normal local, regional and global climates.”² Humans are the largest contributing factor to climate change, in particular, through the burning of fossil fuels, “which increases heat-trapping

¹ Alva Group. [What’s the Difference Between CSR and ESG?](#) Oct. 27, 2020.

² National Aeronautics and Space Administration. [Overview: Weather, Global Warming and Climate Change.](#)

greenhouse gas levels in Earth’s atmosphere, raising Earth’s average surface temperature.”³ The impact of climate change is evidenced by various environmental factors, including increasing sea levels, extreme weather events, increases in land and ocean temperatures, and ice loss at the Earth’s poles.⁴ Further, many of these climate-related factors, especially those “related to severe heat, heavy precipitation, and declining snowpack—will increase in frequency and/or severity in North America in the next decades.”⁵ Eventually, experts predict that climate change will lead to strains on vital resources such as water, as well strains on agriculture and the economy, uniquely affecting urban and rural areas.⁶

According to a national survey, climate change has already affected the health of Black communities, with the most common climate-related health effects being caused by “injuries from severe storms, floods, and wildfires; worsening of chronic diseases due to air pollution and hotter temperatures; and an increase in allergies due to mold and other exposures.”⁷ In fact, “people of color are more likely to die of environmental causes.”⁸ Historic and modern segregation and other racist policies are contributing factors to the disproportionate impact climate change has on communities and people of color, causing some scholars to label environmental racism as a “New Jim Crow.”⁹ More specifically, as a result of centuries of segregationist policies in the U.S., many communities of color, particularly Black communities, have been relegated to “low-lying, flood-prone, and amenity-poor” areas, leaving them vulnerable to rising sea levels.¹⁰ Along those lines, studies demonstrate that Southern coastal communities with significant Black populations are at the greatest risk of rises in sea levels.¹¹ For instance, after Hurricane Katrina struck New Orleans in 2005, nearly one third of Black residents were forced to leave their homes and were never able to return and more than half of those who were killed in the hurricane were Black.¹²

In addition to being located in geographic areas that are prone to flooding, communities of color are also disproportionately located in close proximity to fossil fuel energy plants, exposing them to dangerous air pollutants which, in turn, lead to chronic health conditions such as heart disease, birth defects and respiratory illnesses.¹³ In fact, “one million [Black Americans] live within a half-mile of natural gas facilities; over one million [Black Americans] face a cancer risk above [the Environmental Protection Agency’s] level of concern due to unclean air; and more than 6.7 million [Black Americans] live in the 91 U.S. counties with oil refineries.”¹⁴ Additionally, while Black Americans make up only 13% of the population in the U.S., 68% live within a 30-mile radius of a coal-fired plant, compared to just 56% of White Americans. A study published by the Proceedings of the National Academies of Sciences found that “Black and Hispanic communities in the United States are exposed to far more air pollution than they produce through actions like driving and using electricity. By contrast, White Americans experience better air quality than the

³ *Id.*

⁴ *Id.*

⁵ Resources for the Future. [Climate Insights 2020: Natural Disasters](#). Sep. 4, 2020.

⁶ *Id.*

⁷ Environmental Defense Fund. [African American Communities and Climate Change](#), Environmental Defense Fund.

⁸ Princeton University. [Racial Disparities and Climate Change](#). Aug. 15, 2020.

⁹ *Id.*

¹⁰ Geographical Review. [Racialized Topographies: Altitude and Race in Southern Cities](#). Jan. 2006.

¹¹ Washington Post. [Climate Change Is Also A Racial Justice Problem](#). Jun. 29, 2020.

¹² *Supra* Note 7

¹³ Princeton University. [Racial Disparities and Climate Change](#). Aug. 15, 2020.

¹⁴ *Id.* (internal quotations omitted).

national average, even though many pollutants are used for exports, services and transportation, which are overwhelmingly consumed more by Whites Americans.^{15,16}

Climate Change and Systemic Financial System Risk

Climate change poses a risk to the stability of the U.S. economy.¹⁷ Earlier this month, the Federal Reserve Bank of San Francisco published an economic letter finding that “the ongoing trend of climate change—including higher temperatures and more extreme weather—will result in economic and financial losses for many businesses, households, and governments” and that “such climate-related financial risk may threaten the safety and soundness of individual financial institutions and the stability of the overall financial system.”¹⁸ This stability may be threatened either by financial stress from a single financial institution or stress experienced by a number of small correlated financial institutions.¹⁹ Importantly, the impact of climate change is not limited to the U.S. economy. A 2020 Oxford Economics study found that “more than 20 percent of global gross domestic product will be at risk by 2100” due to the impacts of climate change.²⁰

According to a report by the Financial Stability Board (“FSB”), financial stability threats from climate change are typically divided into two categories: physical risks and transition risks.²¹ Physical risks from extreme weather events include risks to agriculture due to the unavailability of land, human capital risks stemming from adverse impacts individuals’ health and living conditions, and supply chain disruptions.²² Due to the uncertainty these physical risks create with respect to demand and growth, physical risks can reduce the value of investments.²³ The second category is transition risk, which is the risk associated with transitioning to a low carbon economy.²⁴ Failure to appropriately assess and address transition risk may have negative impacts.²⁵ However, deferring the transition altogether may lead to increased emissions which, in turn, can lead to heightened physical risks described above.²⁶

Climate Change, Other ESG Factors and Materiality

There is growing evidence that climate change risk, as well as other ESG disclosures, are material to investors, but are not necessarily being disclosed by companies. As an initial matter, climate change and ESG factors affect a company’s profitability. For instance, the Carbon Disclosure Project—a coalition of bankers, fund managers, advocacy groups, and politicians—issued a 2019 report that found climate change will cost the 215 largest listed companies nearly \$1 trillion over the next five years alone.²⁷ Additionally, research suggests that climate change, “if left unmanaged, could cost the world’s financial sector between \$1.7 trillion to \$24.2 trillion in net

¹⁵ Washington Post. [Climate Change Is Also A Racial Justice Problem](#) . Jun. 29, 2020.

¹⁶ Proceedings of the National Academy of Sciences. [Inequity In Consumption of Goods and Services Adds to Racial–Ethnic Disparities in Air Pollution Exposure](#). Nov. 2, 2018.

¹⁷ Commodities Futures Trading Commission. [Managing Climate Risk in the U.S. Financial System](#).

¹⁸ Federal Reserve Bank of San Francisco. [Climate Change is A Source of Financial Risk](#). Feb. 8, 2021.

¹⁹ Center for American Progress. [Climate Change Threatens the Stability of the Financial System](#). Nov. 20, 2019.

²⁰ Global Financial Markets Association [Climate Finance Markets and the Real Economy](#). Dec. 2020.

²¹ Financial Stability Board. [The Implications for Climate Change on Financial Stability](#). Nov. 23, 2020.

²² *Id.*

²³ *Id.*

²⁴ S&P Global. [Linking Climate Transition Risks and Credit Risks](#). Oct. 1, 2020.

²⁵ Financial Stability Board [The Implications for Climate Change on Financial Stability](#). Financial Stability Board. Nov. 23.

²⁶ *Id.*

²⁷ Reuters. [World’s Biggest Firms Foresee \\$1 trillion Climate Cost Hit](#). Reuters. Jun. 4, 2019.

present value terms.²⁸ Further, investors have been demanding more — and better — disclosure of ESG information from public companies.²⁹ Many investors view ESG information as important not just for evaluating reputational risks, but for evaluating companies' *financial* performance as well as long-term viability.³⁰ In a 2015 report, Blackrock Investment explained that “[c]ompanies that score high on ESG measures tend to quickly adapt to changing environmental and social trends, use resources efficiently, have engaged (and, therefore, productive) employees, and face lower risks of regulatory fines or reputational damage.”³¹ The credit rating agencies also now incorporate ESG factors into their ratings methodologies. For instance, Standard & Poors has taken over 100 rating actions based on environmental and climate concerns.³²

Climate Change, Other ESG Disclosures and Corporate Social Accountability

In October 2019, the Guardian reported that just 20 companies were responsible for 35% of the total carbon emissions world-wide.³³ The top 15 U.S. food and beverage companies, reportedly, emit more greenhouse gases every year than the entire continent of Australia.³⁴ Also, a 2017 report found that “100 energy companies have been responsible for 71% of all industrial emissions since human-driven climate change was officially recognized.”³⁵ This underscores the important role that corporate accountability must play in addressing the climate change crisis. ESG criteria constitute a measurable way to assess a company’s efforts³⁶ and to hold the company accountable, not only when it comes to climate change, but in terms of issues such as pay equity, diversity, supply transparency and political spending. For instance, a \$0.97 wage gap for Black women can result in Black women earning hundreds of thousands less than their White male counterparts over the course of their careers.³⁷ Further, lack of supply chain transparency prevents shareholders and potential investors from adequately assessing a company’s potential legal exposure and risk of reputational harm.³⁸ In addition to creating clear criteria to measure corporate social accountability, requiring companies to disclose these risks, also forces companies to assess them. Without assessing the risks, companies cannot ascertain whether they are material.

Legislation

- **H.R. _____, ESG Disclosure Simplification Act of 2021 (Vargas)**, which would establish new disclosure requirements regarding ESG metrics and creates a Sustainable Finance Advisory Committee within the SEC.

²⁸ New York Times. [Companies See Climate Change Hitting Their Bottom Lines in the Next 5 Years](#). Jun. 4, 2019.

²⁹ See e.g., Donnelly Financial, *The Future of ESG and Sustainability Reporting: What Issuers Need to Know Right Now*, at 3 (November 14, 2018) (finding that 65% of institutional investors “often or always consider environmental and social issues in their investment decisions,” and 95% “often or always consider governance issues — for all investments.”).

³⁰ See e.g., Bank of America, *ESG: Good Companies Can Make Good Stocks*, at 1 (December 18, 2016) (finding that “[ESG] metrics have been strong indicators of future volatility, earnings risk, price declines and bankruptcies.”); Nordea, *Cracking the ESG Code*, at 1 (September 5, 2017) (“Companies that score higher on ESG demonstrate better operational performance, with regards to both the level and the stability of returns.”).

³¹ Blackrock Investment Institute. [The Price of Climate Change: Global Warming’s Impact on Portfolios](#). Oct. 31, 2015.

³² Standard & Poor’s. [How Does S&P Global Ratings Incorporate Environmental, Social, and Governance Risks Into Its Ratings Analysis](#). Nov. 21, 2017.

³³ The Guardian. [Revealed: the 20 firms behind a third of all carbon emissions](#). Oct. 9, 2021.

³⁴ National Resources Defense Council. [Corporate Honesty and Climate Change: Time to Own Up and Act](#). Feb. 26, 2019.

³⁵ *Id.*

³⁶ Alva Group. What’s the Difference Between CSR and ESG? Oct. 27, 2020.

³⁷ PayScale. [The Racial Wage Gap Persists in 2020](#).

³⁸ Harvard Business Review. [What Supply Chain Transparency Really Means](#). Aug. 20, 2019.

- **H.R. 1087, Shareholder Political Transparency Act of 2021 (Foster)**, which would require public companies to submit quarterly reports to both the SEC and investors detailing the amount, date, and nature of the company's expenditures for political activities and other related information.
- **H.R. _____, Disclosure of Tax Havens and Offshoring Act (Axne)**, which would require public companies to disclose (in their 10-Qs and 10-Ks) their total pre-tax profits, and total amounts paid in State, Federal, and foreign taxes. The bill would also require companies to disclose a number of specific tax-related items for each of its subsidiaries, as well as on a consolidated basis, such as total accrued tax expenses, stated capital, and total accumulated earnings.
- **H.R. _____, Climate Risk Disclosure Act (Casten)**, which would require public companies to disclose in their annual reports information relating to the financial and business risks associated with climate change. The bill would also require the SEC to establish, in consultation with other relevant Federal agencies, climate-related risk disclosure metrics and guidance, which will be industry-specific, and will require companies to make both quantitative and qualitative disclosures.
- **H.R. _____, Greater Accountability in Pay Act (Velazquez)**, which would require public companies to disclose the pay raise percentage of its executives and the pay raise percentage of its median employee over the past year and compare each to the rate of inflation, and would require public companies to disclose the ration between the two pay raise percentages.
- **H.R. _____, Improving Corporate Governance Through Diversity Act of 2021 (Meeks)**, which would require public companies to disclose racial, ethnic, and gender compositions of their boards of directions and executive officers, and veteran status. This bill would also require covered companies to disclose any plan to promote diversity and requires the Securities and Exchange Commission to establish a Diversity Advisory Group.
- **H.R. _____, Paris Climate Agreement Disclosure Act (Velazquez)**, which would require covered issuers to disclose the steps they are taking to be in compliance with the requirements set forth in the Paris Climate Agreement, including whether the issuer has set or committee to achieve targets that are a balance between greenhouse gas emissions and removals at a pace consistent with limiting global warming to below 2 degrees Celsius.
- **H.R. _____, Oil and Minerals Corruption Prevention Act (Sherman)**, which would direct the SEC to reissue its December 2016 final rule requiring SEC-registered resource extraction issuers to disclose payments made to U.S. and foreign governments for the commercial development of oil, natural gas, or minerals.