Opinion: Climate risk is not the only environmental risk companies should disclose

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On March 21, the Securities and Exchange Commission (SEC) proposed rules requiring publicly traded companies to disclose their climate risk. According to the SEC Press Release:

"The Securities and Exchange Commission today proposed rule changes that would require registrants to include certain climate-related disclosures in their registration statements and periodic reports, including information about climate-related risks that are reasonably likely to have a material impact on their business, results of operations, or financial condition, and certain climate-related financial statement metrics in a note to their audited financial statements. The required information about climate-related risks also would include disclosure of a registrant's greenhouse gas emissions, which have become a commonly used metric to assess a registrant's exposure to such risks."

I am delighted to see this recognition of the material impact of one of many financial risks posed by environmental conditions. When Wall Street pays attention, we know that serious money is at stake. There will certainly be ideologues in the U.S. Congress and editorial writers in the Wall Street Journal who believe that these risks are over-stated and simply expressions of an opposing ideology. It's true that there is an ideological component to the climate finance debate. Still, investors must be provided with information to assess and understand the exposure to risk present in a company's external setting. Some of these risks relate to market conditions, and some relate to social, cultural, political, and environmental conditions. Companies that are abandoning their Russian operations in the face of Russia's cruel and senseless invasion of Ukraine will be disclosing the losses and prospects of recovery in their next financial reports. Politics creates financial risk, and our ecological environment creates financial risk as well.

My only objection to the SEC proposal is that it is limited to climate risk and does not encompass the full range of environmental risk. The need for a broader framework of environmental sustainability metrics was highlighted in a recent Wall Street Journal interview conducted by reporter Ed Ballard of Alison Bewick, the head of risk management at Nestle. According to Ballard:

"A Nestlé SA executive who helped put together a new framework for biodiversity reporting said that companies should release integrated disclosures related to climate change and nature, because the two things are so interconnected. Alison Bewick, head of risk management at Nestlé, was one of the executives involved in creating the initial framework from the Taskforce on Nature-related Financial Disclosures that was published last week. The framework, devised by businesses working in collaboration with scientific organizations and nonprofit sustainability standard-setters, is meant to serve as a guide for companies about reporting on nature-related risks and opportunities. It follows the model of the climate-risk framework devised by the Task Force on Climate-Related Financial Disclosures."

As Ms. Bewick clearly understands, the overall issue is environmental risk. Climate change is seen by some as the most important risk and an "existential" threat as well, but it's a little silly to hold a contest between environmental risks. At any one time, any number of risks could threaten us. Recently we started to think about the risk of radioactive contamination from nuclear power plants damaged by war. We are still living through the risk posed by an invasive virus called COVID-19. There are no shortages of environmental risks caused by the unanticipated impacts of modern technology. Nestle's Bewick concretely calls for integrating the biodiversity measurement and disclosure framework with the climate framework. In the Wall Street Journal interview, she observed that:

"When we think about how we can address our carbon footprint, a lot of it's through nature-based solutions. It's beyond just the greenhouse-gas measurement, it's around the availability of water, it could be the soil profile, how you approach land-use in terms of rotation of crops, that type of thing. I think the underlying principle is that this should be ultimately an integrated disclosure, because there's a very strong interconnectivity and dependency between nature and climate."

The resistance to climate science we see in the political world and in fossil fuel companies reminds me of the resistance to medical science's connection between smoking tobacco and cancer. The relationship is clear and has been established for many years, but economic interests continue to dominate health concerns. In 2019, 1.1 billion people smoked, and 7.7 million people died from tobacco. So much for science…Climate change is similar, and if anything, the economic interests threatened are far more powerful than the tobacco industry. Perhaps that is why climate change is such a dominant environmental issue. Mitigating climate change requires fundamental changes in the technologies that drive our economic system.

Climate science is relatively straight forward and some of the impacts of climate change are well understood. But at a certain point, the relatively simple physics of climate change intersect with far more complex biological and ecological systems. Those changes and the damage to ecosystems caused by non-climate related human impacts are not as well understood and are far more difficult to measure. The web of relationships in the living world of ecology is more subtle and complex than the massive impact of greenhouse gasses on our climate. And yet millions of subtle changes to our biosphere can add up to an impact easily as massive as that caused by climate change.

Ms. Bewick's call for integrating climate and biodiversity measures in a single framework makes sense because the two sets of impacts are interconnected. It is also a way for the relatively less "popular" biodiversity impacts to cash in on the currency and "fame" of climate impacts. What is most important is that we get beyond this improvisational stage in environmental sustainability metrics. In the world of corporate finance, accounting terms are defined and regulated by the government, not by NGOs. When the SEC began during the New Deal, it was responsible for the development of Generally Accepted Accounting Practices. The SEC or some other part of the U.S. federal government needs to start the process of developing Generally Accepted

Environmental Sustainability Metrics. If these are to become routine elements of corporate disclosure, companies need clear definitions of what they must disclose. This might begin with the climate disclosures now proposed but should then expand into broader measures of environmental impact and risk.

The aim of the SEC rule is precisely to provide clearer metrics for climate disclosure. According to Richard Vanderford's report in the Wall Street Journal:

"The [SEC Climate Disclosure] rule is meant to bring order to what has been uneven climate reporting by different public companies. In place of voluntary sustainability reports which use handpicked metrics, companies would have to disclose in much greater detail how much carbon they emit and how they plan to address looming climate risks. In theory, investors could then make more informed comparisons of businesses."

He notes, however that the rule would open up firms to litigation for mistakes in reporting, and he also commented that the "…500-page proposal for a set of climate disclosure requirements that would, if adopted, be among the most expansive and complex disclosure requirements the agency has yet put forward…Observers already have noted that the new regime would require companies to expend considerable resources to craft these disclosures."

There is little question that adding sustainability metrics to management will be complicated, and we will make mistakes as we learn how to do this. Just as financial reporting keeps accounting firms in business, complying with environmental sustainability metric reporting requirements will cost companies serious amounts of cash and fund a growing profession of sustainability professionals. But if we want to grow our economy without destroying our planet, we need to do a better job of measuring and managing our environmental impacts. I am encouraged by the fact that these disclosure and measurement issues have finally reached the political agenda. To quote a "Druckerism," "in order to manage something, you must be able to measure it." Without measurement, you can't tell if the actions management takes are making things better or worse. We will not have adequate management of environmental sustainability without these measures. The SEC proposal is an important first step. It must proceed but then be built on and improved.

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