Investors want better climate risk disclosure, says study

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Institutional investors want companies to report more about their climate risk, according to a new study from a researcher at The University of Texas at Austin.

In a survey of 439 institutional investors, the study found growing evidence that investors demand disclosure of climate risk, because that information can affect a company's health and performance.

"There has been an ongoing debate about the differences between mandatory and voluntary disclosure. Our work suggests that the current largely voluntary reporting regime does not enable fully informed climate-related investment decisions," said Laura Starks, a finance professor at the McCombs School of Business. "Our study shows that mandatory disclosure does have an effect on investors' decisions."

The study was selected as the Editor's Choice paper in *The Review of Financial Studies*.

The survey of investors by Starks and her co-authors—Emirhan Ilhan of the National University of Singapore, Philipp Krueger of the University of Geneva and Zacharias Sautner of the Frankfurt School of Finance & Management—found:

- 79% consider climate risk disclosure to be at least as important as financial disclosure, while almost one-third consider it more important.
- 67% think existing company disclosures are not precise enough.
- 73% believe that standardized and mandatory climate risk reporting is necessary.

Several countries require mandatory disclosure of climate risks, and the Securities and Exchange Commission is considering a rule for the U.S. However, associated costs of disclosure can affect the demand, Starks said.

"The disclosures can be costly for companies," she said. "Our evidence shows there are situations where they don't appear to demand all disclosures from all firms because of the costs."

To support the survey findings, the researchers also looked at data from CDP (formerly known as the Carbon Disclosure Project), which surveys companies every year about climate risks. They found that companies disclosed risks more fully if they had higher percentages of ownership from climate-conscious institutional investors.

"Climate risk disclosure is financially material to the majority of institutional investors," Starks said.

More information: Emirhan Ilhan et al, Climate Risk Disclosure and Institutional Investors, *The Review of Financial Studies* (2023). DOI: 10.1093/rfs/hhad002

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