Progress and challenges on the road to net zero: Q&A

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In early March, after years of deliberations, the Securities and Exchange Commission announced a new reporting requirement for U.S.-based public companies. Beginning in 2025, companies that meet a certain threshold of market value will be required by law to report carbon emissions data, as well other information related to climate risk and progress toward decarbonization pledges.

While it was viewed, overall, as a significant step in standardizing and increasing climate-related data for investors to consider, the announcement also received criticism—both from those who felt the SEC went too far and those that felt it didn't go far enough.

The Gazette spoke with Michael Cappucci, managing director of sustainable investing at Harvard Management Company (HMC), to get his thoughts on the new requirements. Cappucci helps lead the effort to accurately and consistently measure the greenhouse gas emissions financed by the Harvard endowment. HMC also released their 2024 Climate Report this week, which dives deeper into some of the topics covered in this conversation.

The interview has been edited for clarity and length.

What's your impression of the new disclosure requirements? Did the SEC go far enough, too far, or did they strike the right balance?

I think, overall, it's a meaningful step forward. From the public comments, it was clear that the SEC had to consider a broad spectrum of competing viewpoints. Because they weren't simply asking, "Should this be something that is required in the U.S.?" But also: "What information is most important and how should it be presented?"

It doesn't go as far as the E.U. legislation, which was published in 2022, or even the California law that passed last year. It includes materiality limitations that may prove challenging for companies to interpret and implement, and Scope 1 and 2 greenhouse gas (GHG) emissions disclosures are only required for larger companies.

That means that companies with small market caps but relatively high GHG emissions may not be required to measure and report their emissions—that is exactly the sort of data that investors, clients, and customers want to know.

There are certainly areas I had hoped would have been structured differently, but I think just getting this on the books is a great first step.

As an endowment, most of HMC's investments go through external asset managers. Would this reporting be useful to HMC?

This information would be helpful to all sorts of groups. Direct investors and indirect investors foremost, but also climate-conscious consumers.

From HMC's perspective, the new rule will help us in two ways. First, it will require companies to disclose material climate risk—the environmental factors that could impact their profitability and how they are addressing them. That's important information for our external managers to evaluate both short-term and long-term risk. And second, as we work to get a baseline measurement of the endowment's financed emissions, the more emissions data available, the better.

Public companies were already the area with the most data available, but it is far from perfect or comprehensive. The rule, in theory, should make the data more reliable and abundant.

To your point about public company data being the most abundant, but still imperfect. Where does it stand to improve?

Certainly, making it a requirement for all public companies is the most critical piece. Then you're not reliant on best guesses for companies that choose not to share that information. But I think having it be standardized and enforceable is probably just as significant.

Knowing that a company could be penalized for misrepresenting data or ignoring a material climate risk gives an investor much more confidence in what they're seeing reported. And being able to compare apples-to-apples with regards to greenhouse gas emissions is still a challenge we encounter.

Is the apples-to-apples issue with emissions data the biggest challenge HMC is dealing with in measuring the endowment's greenhouse gas emissions?

That can be a challenge at times, but I'd say our biggest hurdle is our ongoing need for data that doesn't yet exist. The Climate Report explains this in greater detail, but essentially, the asset classes of private equity and hedge funds are where we need to focus most of our efforts. Combined, they represent more than two-thirds of the endowment portfolio, and they each present different challenges.

For private equity—especially, venture capital and growth stage funds—the issue is that the company may be too young or too small to have implemented emissions tracking. So, when we ask our fund managers for the data, it doesn't exist. Thankfully, a number of our asset managers are working to change that, but building the systems and standards for portfolio companies to report emissions is no small feat and takes time.

Hedge funds are unique for different reasons. The primary one is that we typically don't have real-time access to the fund's holdings. The reason for that has to do with investors being able to simply mirror the hedge fund's investments to get around having to pay fees. Their portfolio is their secret sauce, so to speak. So, if the investments are disclosed at all, it is usually done on a delayed basis.

The other reason is for more esoteric investments, like derivatives or quantitative trading strategies, there isn't yet a standardized methodology for estimating emissions.

That said, we've made good progress and we recognize that HMC's calculations and collection will need to adapt over time. Having regulations like the one the SEC adopted is a step in the right direction.

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