DEUTSCHE BÖRSE GROUP

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

June 14, 2021

Re: Public Input on Climate Change Disclosures

Dear Chair Gensler,

Deutsche Börse Group (DBG) welcomes the opportunity to provide comments to the Securities and Exchange Commission (hereafter the "Commission") regarding its recent public statement and request for input on climate change disclosure. We appreciate the renewed efforts undertaken by the US administration as demonstrated by the Leaders' summit and echo the recent call by G7 finance ministers for mandatory climate related disclosures standards to be based on the framework of the Taskforce on Climate-related Financial Disclosures (TCFD).

DBG believes that the global shift toward sustainable investing represents a profound and transformative change in financial management and laud the Commission's initiative to seek public input on this matter of great significance to the global economy, society, and financial services industry.

As one of the largest providers of market infrastructure worldwide, we offer a broad range of products and services, including supporting market participants in making well-informed investment decisions with a particular view on sustainability criteria. For example, we develop market leading ESG indices and analytics solutions via our subsidiary Qontigo (with its brands STOXX, DAX, Axioma), offer ESG derivatives via our derivatives exchange Eurex and provide ESG data and analytics via Institutional Shareholder Services Inc. (ISS).

Following are our views with regard to the Commission's questions, building on considerations across our group.

Yours sincerely,

Niels Brab
Head of Group Regulatory Strategy
Deutsche Börse Group

Regulating climate disclosures

To unlock the necessary private investments, it is essential that policymakers provide clarity and certainty on the road ahead. Predictable and well-communicated policies are important for market participants to adapt their commercial, operational and legal processes to new regulation and policies. We support developing a long-term sustainable finance vision which is built on a solid understanding of the role of financial markets and how these can facilitate the transition towards a low-carbon future and does not lead to unintended consequences for market players in terms of risk management. A transparent and consistent approach, in line with ESG aspects, by the real economy, financial industry and regulators holds great opportunities for international capital markets, both in the area of risk assessment and for the identification of new business areas. This requires a long-term vision that is proportional to company size and ensures a level playing field between public and private markets.

There are various formats for company ESG disclosures. ESG information can be published in annual reports, sustainability reports or integrated reports (see the International Integrated Reporting Council as the standard on integrated reporting). What is vital is that information is clear, easy to find, well-structured, timely and comparable across reporting years. To allow investors to use ESG information in their stewardship activities, especially voting and shareholder resolutions, ESG information should be published at the same time as financial information or at least in advance of the annual general meeting. It could be useful if reference to relevant ESG information is also made in meeting materials.

Regulation should not only require reporting but also a) provide a framework b) provide a repository to report to and c) monitor and review the disclosures made to ensure proper reporting based on the standards. In the interest of scalability, preventing greenwashing, and minimizing cost burdens, climate disclosures should be mandatory and consistent across markets, sectors, asset categories, issuers, and economic activities. The framework and guidance should be clear, comparable, and easy to understand from the investors' perspective.

The recent developments in climate-related regulations across different markets have highlighted significant issues around divergent standards and hence a potential risk of capital misallocation. Given the international nature of the investment space, we recommend that any climate disclosure framework being considered in the US align with the EU Sustainable Finance Disclosure Regulation and the EU Taxonomy Regulation. We also recommend that rule-makers consider the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD), as it is a framework already being utilized by more than 1,500 organizations across the world.

Regarding where such disclosures should be provided, we believe they should be integrated within mainstream financial filings, e.g. in annual reports and sector-specific pre-contractual disclosure documents.

In addition to mandating climate-related disclosures, regulators should create a strong foundation of governance and accountability mechanisms to ensure that the information being provided to investment decision-makers is accurate and reliable. We believe that some assurance or third-party verification should be required.

Information required

To conduct a comprehensive analysis of the climate performance of their portfolio companies, investors will require disclosure to consider several climate-related metrics, including but not limited to GHG emissions and reduction targets, climate risk governance, physical and transition risk exposure, and GHG reduction momentum. To enable robust decision-making, investors need to consider climate information that is forward-looking and calculated on the basis of actual physical output. For example, several existing methodologies use enterprise value or revenue of a firm to calculate GHG intensity. These metrics can be volatile, have the potential to be inflated, and can thereby lead to capital misallocation from a carbon risk point of view and strong rebalancing risks among sectors.

Some concrete specifics: As part of Deutsche Börse Group, ISS ESG supports investors with a wide range of analysis on their investments, including Transition Risk, Physical Risk, Scenario Analysis and GHG emissions. In this work, ISS ESG observes that both investors and regulators often use different metrics interchangeably, indifferent to which questions the data should address. Risk reporting (what does climate change mean for the company/ investment) and impact reporting (what does the business/ investment do to the climate), for example, require different sets of metrics.

Likewise, in setting reporting standards, it is important to differentiate:

- Between cross-sectoral measurable indicators (such as GHG emissions) and sector specific ones (such as energy produced, reserves etc);
- Between current (e.g. GHG emissions) and future (e.g. targets) quantifiable indicators. The latter helps to analyse a company's climate change preparedness.
- Desirable disclosure includes not only Net Zero and Science Based Targets, but also CapEx regarding climate transition as well as on investment in carbon removal technologies to contribute to Net Zero;
- Between the TCFD categories of Governance, Risk Management, Strategy and Metrics & Targets;
- Between transition risks (where carbon markets come into play) and physical risks (being enforced by a lack of sufficient transition).

Guiding thought for any reporting regulation should be the understanding that the ultimate goal is not climate transparency, but climate action.

Industry-level considerations

Including relevant stakeholders, especially those to which the standards/requirements will apply to, in the development of disclosure frameworks is vital for success, acceptance and relevance. However, to make sure the results are ambitious and fit for purpose, the Commission should either lead such efforts or define a range of clear parameters and minimum expectations. Given that we are still at the infancy of climate risk and impact analysis, the Commission should avoid a rigid standardization of the status quo and make sure to also foster innovation for better analysis.

If the Commission were to involve industry participants to develop disclosure standards mutually agreed by them, there should at least be minimum standards to ensure a minimum level of ambition.

Sector-specific elements

When defining ESG standards it is important to take sector specific elements into account. Introducing a differentiated approach (factoring in the nature and ESG risk of the business) where standards could be adapted to certain types of businesses could lead to a more tailored approach. Allowing a natural focus on the core business per sector would support both companies in reporting as well as investors in receiving the information and improve transparency and relevance of information. Given the different levels of GHG intensity and carbon budgets amongst different sectors, the rate at which they need to decarbonize is also different.

At the same time, comparability across sectors is very important. Climate-related disclosures need to be comparable across sectors to be decision-useful. To ensure comparability as well as relevance, one part of a reporting standard could be general and cross-sectoral, while for the sector-specific aspects there could be standards for different industries. As mentioned under question 3, such standards should be developed via a collaborative approach including cooperation with respective industries and stakeholders.

Additionally, collaboration across jurisdictions is important as well to ensure that the standards being developed are compatible in quantity and quality.

Incorporation of existing frameworks and standard setting

The work undertaken by existing market initiatives on company reporting, such as the TCFD, SASB, CDSB, the Global Reporting Initiative, the International Integrated Reporting Council, the CDP (previously the Carbon Disclosure Project), and the Climate Action 100+ Net Zero Benchmark, have resulted in established and respected market standards in terms of both reporting topics and reporting quality. They have been developed and evolved over several years with support from experts across the investment, regulatory, and non-profit communities. In addition, they are already widely adopted, used, and endorsed by various corporations and investors. This will help with quick adoption of the legislation. For climate reporting, especially the TCFD recommendations are a widely acknowledged best practice framework. It would therefore be useful to reference them. It should be noted, however, that the TCFD framework does not contain specific standards. In general, strengthen linkages between non-financial and financial information, in line with the TCFD recommendations can help to further improve the understanding of financial impacts of non-financial matters, which are often missing in corporate managements reports. Information should be presented with a clear structure, using, for example, table of contents, indicators of which information fulfils certain requirements or disclosure frameworks and cross-references between sections that are interlinked.

When building on existing standards, it is important to ensure that all necessary aspects are captured. For example, net zero requires removal of emissions from the atmosphere, yet this receives hardly any attention by net zero initiatives.

Standards should not be static, as this could be detrimental to innovation. They need to evolve and adapt over time. The Commission should be in charge of modifying and improving disclosure requirements, taking into account development of internationally acknowledged reporting standards as well as any future initiatives, such as work under way by the IFRS.

However, while standards need to evolve with time, one must also consider that ad hoc or frequent changes in requirements can generate significant cost and further blur the visibility and transparency over product methodologies.

International alignment

Company reporting on ESG matters forms the basis of responsible investment. Without such information, investors cannot evaluate the sustainability risks and performance of portfolio companies and integrate this information into their investment decisions. To enable comparison between company performance across jurisdictions, reported information must be comparable globally, which necessitates internationally acknowledged standards.

The work initiated by the IFRS to develop a global reporting standard seems promising and could be a viable solution. The Commission could support the IFRS in its work and then endorse or incorporate the IFRS standard, making it mandatory in its jurisdiction to ensure broad uptake and comparability. The advantages of developing a single set of global standards for climate disclosures applicable to companies around the world would be immense, as financial market participants regularly offer products in several jurisdictions. A globally aligned framework would greatly benefit investors looking to use climate disclosures as the basis to fulfill suitability requirements and to design sustainable products across various markets.

Establishing a minimum global set of standards as a baseline that individual jurisdictions could build upon would be advantageous, as there will always be regional political preferences. By giving jurisdictions the option to add disclosure requirements, an agreement on such baseline standards could be easier to achieve.

It must be noted that this approach could, however, lead to a variety of diverging requirements worldwide, unless there is reciprocal recognition of the standards issued by the respective standard setters. Therefore, for international alignment to be effective, we recommend collaboration with global standard setters, such the International Organization Securities Commissions, Bank for International Settlements, and Financial Stability Board.

Additionally, if the Commission were to endorse or incorporate a global standard, we would recommend that it be made mandatory. There currently exist several voluntary environmental, social, and governance (ESG) disclosure frameworks developed by both private players and regulators. While this has increased information availability on ESG issues, it has led to a lack of comparability and cost inefficiencies for investors, in addition to confusion about what “best of breed” data is.

Disclosure reliability and assurance

In order to increase the credibility and acceptance of ESG-related data, it would be beneficial to subject it to external assurance. An assurance framework for ESG information would also help place it at par with financial statements. Third-party assurance of ESG data could be part of general auditing.

We believe that third-party assurance standards can significantly increase investor confidence in the data and process-based information being reported. Assurance practices, such as internal control processes, audits for data and processes, and third-party verification, can help reduce potential manipulation and greenwashing by the reporting entities. The Public Company Accounting Oversight Board (PCAOB), with its high level of expertise and reach, is a body well-placed to develop mandatory assurance and verification practices for climate-related standards.

Comply or explain approach only as first step

To create a legislation that goes as far as it can on disclosure, comply and explain can only be the first step as it gives companies the option to not comply. To ensure broad uptake, a level playing field and adequate disclosures, climate reporting should rather be mandatory. Having said that, individual aspects of disclosure requirements could be "comply or explain" for certain lower impact/lower risk sectors or for companies below a certain size (SMEs).

Disclosures beyond metrics

Disclosure should include targets and a clear action plan to reach them, as well as a discussion on risks and opportunities and how the registrant addresses these. Thus, quantitative metrics need to be accompanied with qualitative information.

Disclosures of private companies

Private companies are often opaque about their climate strategies, mostly because they typically have not embraced the topic yet. Regulation of private equity investment vehicles can change this and make private companies more climate-literate.

Climate-related requirements as one component of a broader ESG disclosure framework

While climate change has been and continues to be the most widely considered sustainability risk, other topics have come to prominence and should be considered with similar urgency. Regarding environmental risks, such topics include biodiversity and water. Evidence of this growing concern is the upcoming creation of a Task Force on Nature-related Financial Disclosures (TNFD), mirroring the success of the Taskforce on Climate-related Financial Disclosures, to develop an international reporting standard for biodiversity and natural capital risk. An Informal Working Group under the auspices of the United Nations Development Programme has been set up to prepare the launch the TNFD.

At the same time, the current Covid-19 pandemic as well as movements such as Black Lives Matter and #MeToo have highlighted the significance of social issues, and their relevance and materiality as ESG risks. We therefore suggest developing a broader disclosure framework covering environmental, social and governance risks. Existing market initiatives on company reporting, such as the Global Reporting Initiative (GRI) and the Sustainability Accounting Standards Board (SASB) have developed globally acknowledged standards in terms of both reporting topics and reporting quality.

We would also like to highlight the importance of materiality. On the one hand, there is the principle of 'financial materiality'. The financial materiality definition is one that typically focuses on direct impacts to a company's balance sheet. On the other hand, there is the concept of 'sustainability or stakeholder materiality' which typically focuses on ESG aspects that are important for the decision-making of long-term investors, since they not only impact society and the environment but can have repercussions on a company's business/financial performance, competitiveness and future viability. This broader materiality concept takes into account risks related to all relevant stakeholder groups along the value chain, including employees, suppliers, customers, communities, and ecosystems. There is a strong link between stakeholder and financial materiality, as ESG risks and impacts are not a separate category in and of themselves. Both ultimately translate into financial risks such as:

- Market risks and opportunities, relating to shifting consumer behaviour towards more sustainable products and services, as well as regulation targeting unsustainable products;
- Operational risks and opportunities, such as those relating to physical risk including flooding or water scarcity, protection of IT systems against cyberattacks, as well as difficulties in attracting and retaining top talent; and lastly
- Reputational risks relating to controversial business activities, which may be decisive for maintaining a license to operate.

ESG risks and impacts are thus highly relevant for the competitiveness, business continuity and financial success of a company. There is growing evidence of the financial outperformance of companies with good ESG management – and not only in the long run. The vast majority of studies confirm that the financial performance of companies with high ESG performance is above benchmark (e.g. Clark, Feiner and Viehs, '*From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance*', 2015; Deutsche Asset and Wealth Management, '*ESG and Corporate Financial Performance: Mapping the global landscape*', 2015; NN Investment Partners and ECCE, '*The materiality of ESG factors for equity investment decisions: academic evidence*', 2016; Deutsche Performancemessungs-Gesellschaft (DPG) and ISS ESG, '*Outperformance through use of the ISS ESG prime standard*', 2020.)

As mentioned above, comparability is highly important. Therefore, on top of defining topic areas such as environment, human rights, labor rights, business ethics and corporate governance, it would be desirable to set key performance indicators (KPIs), which can take the form of both quantitative metrics (e.g. resource consumption, emissions, accident rates, diversity ratios) as well as qualitative data (e.g. human rights policies and due diligence, environmental management systems, climate change strategies, biodiversity management). Further, it should address both backward-looking information (historical data to assess trends) as well as forward-looking data (targets and objectives, action plans, strategies). General KPIs applicable to all sectors could be complimented by sector-specific indicators asking about e.g. deforestation policies, hazardous waste management, or water management.

We believe company reporting should cover the entire value chain, including e.g. supplier standards and due diligence processes. Finally, as taxonomies are being developed in several jurisdictions, there is a strong need for information on a company's business activities, broken down by activity/product and reported in percentage of revenues.