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February 14, 2022

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Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission
New Brunswick Superintendent of Securities
Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

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RE: Consultation Climate-related Disclosure Update and CSA Notice and Request for Comment Proposed National Instrument 51-107 Disclosure of Climate-related Matters

Ladies and Gentlemen:
Morningstar Research, Inc. welcomes the opportunity to comment on the Consultation Climate-related Disclosure Update and CSA Notice and Request for Comment Proposed National Instrument 51-107 Disclosure of Climate-related Matters dated October 19, 2021.

Morningstar Research, Inc. is a leading provider of independent investment research, and our mission is to create products that help investors reach their financial goals. Our recent acquisition and integration of the Sustainalytics business is not only a testament to our commitment in the area of sustainable investing, but also our view that investors can benefit both people and planet in addition to their own financial gains through the use of non-traditional financial information. We offer insights in this comment letter from the perspective of an ESG data provider, a research firm covering equities and investment funds, and lastly as an issuer of US-listed stock.

Morningstar applauds the recent announcement of the creation of the International Sustainability Standards Board (ISSB), recognizing the CSA and IOSCO's support in the creation of this entity, and its stated intention to leverage both TCFD and SASB frameworks for reporting of climate related and broader ESG risks and opportunities. Both frameworks have openly stated that they will be using a 'building block' approach, first focusing on financially material risks, then broadening out to impact-oriented metrics. As stated below in comments, we support this approach. Given Canada's successful bid in housing one of the lead offices of the ISSB, we are encouraged with the potential for the ISSB to provide guidance and support to Canadian issuers and engage with Canadian stakeholders as these standards become increasingly important to investors. Though Morningstar is agnostic to the various reporting frameworks, the TCFD framework has gained traction as the major, basic framework for climate disclosures.

Morningstar supports mandating climate-related disclosures when they are financially material to the company, inclusive of Scope 1,2 and 3 GHG emissions. This added transparency helps investors make more informed decisions around climate change. However, we emphasize that a *snapshot* of GHG emissions alone does not encapsulate the *trend* in carbon output for a corporation, which is a crucial consideration for investors as Canada transitions to a carbon-neutral economy. Companies increasingly publish their climate metrics and targets, and they should also disclose their progress against these goals. It is critically important for regulators to compel issuers to do the hard work of establishing clear metrics and targets for managing climate risks and opportunities. Further, to provide useful, financially material disclosures, issuers must be compelled to disclose progress against these metrics. Without such disclosures, investors will find it harder to judge a company's progress or effort in executing its strategies. Further, without such disclosures, it can be difficult to tell if a company is making necessary capital investments to execute the strategy they have outlined.

Scenario analysis is an important part of the TCFD reporting framework. The current disclosure environment in Canada does not reference modern carbon goals like the 1.5-degree scenario outlined in the Paris agreement. As such, scenario analysis adds much-needed context to the degree of climate-related related risks that Canadian companies are faced with given the heavy concentration of issuers tied to the energy and materials sectors. However, we also recognize that the nouveau and yet sophisticated nature of scenario analysis puts a resource burden on issuers through our own experience let alone issuers from other industries. Though we broadly support the use of scenario analysis in disclosures, we do not believe it should be made mandatory via the current CSA proposal, though we thoroughly encourage issuers to actively take steps toward scenario analysis and the CSA to mandate this in the years ahead.

The need for required climate-related disclosures is more evident than ever before, a fact highlighted by the creation of the Net Zero Asset Manager Initiative[1] and Net Zero Asset Owners Alliance[2]. A transparent environment for climate-related disclosures facilitates the flow of capital between large investors and Canadian issuers.

Within the realm of investment funds, there is a strong need for fund disclosures to help investors understand what their sustainable fund does to manage carbon and climate risk. Improving issuer-level disclosures will help asset managers improve these disclosures to individual investors; but our data shows important differences in how funds approach carbon and climate risk, which the CSA should consider as it contemplates new disclosures. For example, while investors likely expect a fund that markets itself as "sustainable" to have low exposure to carbon risk, we find that not all sustainable funds to which we assign a Carbon Risk Score receive our Low Carbon Designation. Though the discrepancy is more prevalent in the US than in Canada, the proliferation of new sustainable funds warrants attention to this detail.

We respectfully address questions as posed in the CSA's consultation paper in the following sections noting that some responses draw from recent regulatory comment letters and publications written by Morningstar which include:

Morningstar's Comment Letter to the FCA regarding CP21/18
Morningstar's Comment Letter to the SEC regarding Climate Change Disclosures
Morningstar's Global Report on Corporate Sustainability Disclosures

These letters and report will be attached to the end of this document for reference.

Experience with TCFD recommendations

1. **For reporting issuers that have provided climate-related disclosures voluntarily in accordance with the TCFD recommendations, what has been the experience generally in providing those disclosures?**

   Morningstar recognizes the TCFD as an effective framework both in terms of depth and breadth, in disclosing climate-related risks and opportunities. As a flagship member of the Net Zero Financial Services Provider Alliance (NZFSPA)[3] as a part of the Glasgow Financial Alliance for Net Zero[4], we note the fact that the TCFD framework requires sophisticated examination of risks, hence Morningstar is positioning itself to produce a formal TCFD filing within the next three years. At present, we present a TCFD-like presentation of opportunities and risks and Scope 1,2 and 3 GHG emissions, however we do not provide scenario analysis. We anticipate other issuers will require similar or expanded timelines to comply fully to the recommendations made by the TCFD.

[1] https://www.netzeroassetmanagers.org/
[2] https://www.unepfi.org/net-zero-alliance/
[3] https://www.netzeroserviceproviders.com/
[4] https://www.gfanzero.com/

Disclosure of GHG Emissions and Scenario Analysis

2. **For reporting issuers, do you currently disclose GHG emissions on a voluntary basis? If so, are the GHG emissions calculated in accordance with the GHG Protocol?**

   Morningstar disclosed GHG emissions in our 2020 corporate sustainability report, released on a voluntary basis, which include Scope 1,2, and 3 emissions. For this process, Morningstar hired an outside firm that calculates emissions, requiring some level of investment that we believe will be a common experience amongst issuers in the financial services space. The disclosures were in accordance with the GHG Protocol.

   Through our experience, we believe the reliance on technology and data will play a pivotal role in ensuring all issuers are able to report emissions with some degree of accuracy. This is of particular relevance in the financial services sector where Scope 3 emissions are not well understood. However, it is not unrealistic for the CSA to demand a path toward the disclosure of Scope 3 emissions given ample runway for firms to seek out solution providers or develop those capabilities in-house.

3. **For reporting issuers, do you currently conduct climate scenario analysis (regardless of whether the analysis is disclosed)? If so, what are the benefits and challenges with preparing and/or disclosing the analysis?**

   At present, Morningstar does not conduct climate scenario analysis for our own reporting. At this point, financial services firms will likely need to build analytics in-house or seek outside providers to obtain the capabilities that allow for the depth of risk assessment required for scenario analysis. We recognize that for many firms, the build-or-buy approach will result in budgetary impacts. These are necessary costs of doing business to align with global goals to reduce GHG emissions and to ensure access to capital as investors increasingly factor this into decision making. Morningstar is committed to doing so in the medium term.

4. **Under the Proposed Instrument, scenario analysis would not be required. Is this approach appropriate? Should the Proposed Instrument require this disclosure? Should issuers have the option to not provide this disclosure and explain why they have not done so?**

   This approach is reasonable at this point in time given the resources required to conduct adequate scenario analysis. However, we do stress that scenario analysis, done in a way that requires issuers to project their revenue under various policy interventions, technological changes, or environmental changes, provides significant value to investors. Such analysis can help investors assess the value at risk in an organization if, for example, regulators introduced a carbon tax, new technology allowed other firms to produce similar products with fewer emissions, or a warming world increased the price of natural resources. Simply put, these analyses show investors under what circumstances value is at risk, and how a company's strategy will move them forward toward long-term profitability and sustainability despite carbon risks. Investors can then evaluate whether, despite a company's current emissions, they have a credible plan for a low-carbon future. Some of this credibility comes from trust in management's governance approach.

Our view is that climate-related risks are increasingly becoming material in many industries, and as such, would support the requirement of scenario analysis as soon as feasible.

5. **The TCFD recommendations contemplate disclosure of GHG emissions, where such information is material.**

   a) **The Proposed Instrument contemplates issuers having the option to disclose GHG emissions or explain why they have not done so. Is this approach appropriate?**

   Carbon emissions are a globally systemic issue. Uncontrolled and increasing GHG emissions, especially carbon dioxide, are a driver in global climate change, impacting the natural cycles on which the economy and society depend. How companies minimize the long-term risks associated with traditional business models while transitioning to a low carbon future is key to understanding and managing carbon risk.

   GHG emission disclosures should be made mandatory where it is material, with an encouragement from regulators in other cases. The widely debated issues of "double materiality" vs "financial materiality" with respect to ESG sustainability reporting and disclosures is of relevance here and a contested point amongst thought leaders in the industry. Given the pace of industry development, Morningstar advocates on a building block approach – proceeding initially with disclosure that is focused on "financial materiality" then subsequently expanding, in time-boxed elements, to impact-oriented metrics as echoed by both TCFD and SASB approaches (the latter as relating to broader ESG risks).

   It is Morningstar's opinion that in the realm of climate related disclosures, the time for "comply or explain" has passed. As we identify in our attached research paper on Corporate Sustainability Disclosures, we believe it is time to move to the next stage and mandate a baseline set of disclosures. Outside of the CSA's own exploratory work in understanding the current state of climate-related disclosures by Canadian issuers, Morningstar points to the fact that companies disclosing material climate-related risk now make up the majority in major markets around the world as can be seen in the below exhibit from the same research report. Moreover, the issuers provide not just a snapshot of GHG emissions, but also disclose the trend in carbon intensity, which we believe is important in helping investors understand the impact of corporate policies and ability for management teams to reach their stated targets.

Exhibit 4 Disclosure Rates of the Most Widely Applicable "E" Indicators

Indicator	Global	Asia/Pacific	Europe	U.S. & Canada	Africa/Middle East	Latin America/Caribbean
Scope of GHG Reporting	64.9	46.6	79.6	69.4	57.8	67.6
GHG Risk Management	63.5	43.2	72.4	75.5	59.6	63.6
Carbon Intensity	58.6	42.0	74.4	60.1	48.8	62.9
Carbon Intensity Trend	56.9	40.9	72.3	58.1	48.8	62.9
GHG Reduction Program	89.8	83.5	97.1	89.7	86.9	89.5
EMS Certification	65.9	63.2	81.3	54.3	75.5	65.9

Source: Sustainalytics, a Morningstar Company. Data as of March 5, 2021.

That said, "comply or explain" still has a role to play, for example, in areas where raw data is still in its infancy; consistent methodologies are still emerging; or in respect of information that is only material to certain issuers or industries. In the case of GHG emission and climate-related risk, we view it as material for a growing number of industries.

a. As an alternative, the CSA is consulting on requiring issuers to disclose Scope 1 GHG emissions. Is this approach appropriate? Should disclosure of Scope 1 GHG emissions only be required where such information is material?

Morningstar Sustainalytics' approach to evaluating the ESG risk that is present in an issuer stem from the analysis of material ESG issues (MEIs). One such MEI centered around a company's own carbon emissions analyzes how companies manage their Scope 1 and Scope 2 emissions. The evaluation of this issue also includes parts of Scope 3 emissions, such as transport and logistics. We note that the magnitude of this issue varies across sub-industries[5] and illustrated in the below table.

[5] https://www.sustainalytics.com/docs/default-source/default-document-library/carbon-own-ops-analysis.xlsx?sfvrsn=2a4d413_0

Industry	# of Companies	Average Exposure Score
Software & Services	62	2
Household Products	37	2
Commerical Services	40	3
Aerospace & Defense	47	3
Auto Components	55	3
Automobiles	45	3
Consumer Durables	32	3
Electrical Equipment	43	3
Machinery	137	3
Retailing	77	3
Healthcare	83	3
Technology Hardware	134	4
Consumer Services	90	4
Food Retailers	71	4
Traders & Distributors	44	4
Homebuilders	19	5
Food Products	171	5
Semiconductors	38	5
Telecommunication Services	90	5
Construction & Engineering	64	5
Paper & Forestry	24	6
Containers and Packaging	30	6
Building Products	30	6
Industrial Conglomerates	46	6
Refiners and Pipelines	58	6
Precious Metals	52	6
Transportation	125	7
Chemicals	140	7
Diversified Metals	57	8
Steel	40	9
Construction Materials	40	9
Utilities	192	9
Oil & Gas Producers	112	9
Total	1187	

Source: Morningstar Sustainalytics, Data as of September 2020

Hence, requiring all issuers to only disclose Scope 1 emissions will not capture GHG emissions effectively given that Scope 2 and 3 emissions vary within subindustries. The lack of this disclosure (if not required) would create gaps in key information that are core to investors' consideration and limit comparability between companies.

b. **Should disclosure of Scope 2 GHG emissions and Scope 3 GHG emissions be mandatory?**

Yes, Scope 2 emissions should be mandatory as should Scope 3 emissions if they are financially material to the subindustry of the issuer.

c. **For those issuers who are already required to report GHG emissions under existing federal or provincial legislation, would the requirement in the Proposed Instrument to include GHG emissions in the issuer's AIF or annual MD&A (if an issuer elects to disclose these emissions) present a timing challenge given the respective filing deadlines? If so, what is the best way to address this timing challenge?**

Yes, we believe this will present a timing challenge specifically if issuers decide to disclose via AIF. During our collection and subsequent analysis of Canadian-listed issuer financials, we note that certain large-cap issuers do not file their AIF at the same time as their financial filings, sometimes with as much as one month's delay. New climate disclosures should be released at the same time as annual financial filings. Such annual temporal alignment of financial and material nonfinancial information in the form of climate change disclosures is the best way to help investors integrate nonfinancial climate change metrics into their decision-making. To address this concern, we suggest that these disclosures be located in the MD&A which we typically see released at the same time as financial filings.

6. **The Proposed Instrument contemplates that issuers that provide GHG disclosures would be required to use a GHG emissions reporting standard in measuring their GHG emissions, being the GHG Protocol or a reporting standard comparable with the GHG Protocol (as described in the Proposed Policy). Further, where an issuer uses a reporting standard that is not the GHG Protocol, it would be required to disclose how the reporting standard used is comparable with the GHG Protocol.**

a. **As issuers have the option of providing GHG disclosures, should a specific reporting standard, such as the GHG Protocol, be mandated when such disclosures are provided?**

Morningstar agrees that there should be a specific reporting standard referenced to ensure that reported figures are comparable across different issuers, though we are agnostic to any specific standard setter or framework. We've found in our experience that the audit and verification of such disclosures by accounting firms often requires that GHG disclosures reference the GHG protocol or one of its derivatives. As such, it makes sense that such a standard is to be used.

b. **Is the GHG Protocol appropriate for all reporting issuers? Should issuers be given the flexibility to use alternative reporting standards that are comparable with the GHG Protocol?**

The GHG Protocol is appropriate for the majority reporting issuers given that the protocol in itself is not a strict standard but rather a framework and guideline and designed to be applicable to all sub-industries with few exceptions. We note that other frameworks that are sector-specific are derivative of the GHG Protocol and in some cases reference the protocol directly.

c. **Are there other reporting standards that address the disclosure needs of users or the different circumstances of issuers across multiple industries and should they be specifically identified as suitable methodologies?**

The GHG Protocol is a reasonable framework for most industries. The exception is for the financial services industry, where we feel the GHG Protocol may not offer specificities that are granular enough for the reporting of scope 3 emissions, particularly in the realm of aggregating GHG emissions of financial holdings. Here, we point to the standard developed by the Partnership for Carbon Accounting Financials (PCAF) Standard which, while still in development within the TCFD framework, offers a more complete methodology for financial sub-industries to calculate their finance-related emissions. The PCAF Standard is built on the GHG Protocol for measuring scope 1, 2, and 3 emissions across multiple asset classes

7. **The Proposed Instrument does not require the GHG emissions to be audited. Should there be a requirement for some form of assurance on GHG emissions reporting?**

Yes, we firmly believe that having an independent third-party review GHG emissions disclosures is a prudent requirement that ensures disclosures are reliable. In Morningstar Sustainalytics' own assessment of ESG risk, our methodology calls for a higher degree of importance placed on having audited GHG disclosures. Noting that accounting firms who provide this service often service to the GHG Protocol, the requirement to have audited disclosures will help further align issuers to a known standard making said disclosures more comparable across subindustries.

We note that there is already an ecosystem of consultants and traditional accounting firms with the capability to audit and ensure these disclosures. If these standards are not audited, or if there is weak enforcement of ensuring they are accurate, they will not be useful. As noted, even in cases where we have climate or carbon disclosure, it is often not of high-quality hence the need for third-party audit.

8. **The Proposed Instrument permits an issuer to incorporate GHG disclosure by reference to another document. Is this appropriate? Should this be expanded to include other disclosure requirements of the Proposed Instrument?**

Morningstar is agnostic to where GHG disclosures appear, so long as the disclosures are released consistently and simultaneously with traditional financial filings, in addition to the requirement that said documents are placed under scrutiny of regulators.

On this topic, Morningstar continues to encourage the CSA to require all documents be filed using machine-readable formats such as XBRL or at the least plain text files (as opposed to the current .pdf standard) to increase efficiencies in capital markets in Canada, as mentioned in our comment to Ontario's Taskforce for Modernization of Capital Markets. As new types of information like GHG emissions and hopefully other ESG-related disclosures become more relevant, providing an efficient way for data providers, researchers, and investors to ingest and analyze this data allows for an increased flow of information throughout capital markets and creates an environment that fosters innovation.

Usefulness and benefits of disclosures contemplated by the Proposed Instrument

9. **What climate-related information is most important for investors' investment and voting decisions? How is this information incorporated into these decisions? Is there additional information that investors require?**

   The most important climate-related information should help investors fulfill the formal commitments they make as signatories to one of the investor net zero groupings – the Net Zero Asset Owners Alliance or Net Zero Asset Managers Initiative. This means providing verified GHG emissions disclosures using standard measurement methods, like the GHG Protocol and disclosing quantitative short- medium- and long-term emissions reduction goals.

   Disclosure of material climate-related risks help investors to understand how resilient a company's business model is under likely climate scenarios. Climate governance disclosures help investors to understand how well prepared the senior leadership of a company is in ensuring that the company remains competitive as the broader economy transitions to net zero emissions.

   Most institutional investors consider financially material carbon and climate risks using data on issuer emissions, emissions trends, and issuer exposure to regulatory changes on emissions; technological innovation that would weaken their position; market trends and peer comparisons for managing carbon risks; and reputational impacts. These analyses rely on quantitative metrics as well as qualitative analysis. Quantitative metrics include the carbon-intensity trends and scope 1, 2, and 3 emissions, as well as company metrics and targets, while qualitative information include an issuer's greenhouse gas risk management plan, physical climate risk management plan, carbon emissions reduction programs, and renewable energy plans.

10. **What are the anticipated benefits associated with providing the disclosures contemplated by the Proposed Instrument? How would the Proposed Instrument enhance the current level of climate-related disclosures provided by reporting issuers in Canada?**

    Echoing the CSA's own findings, Morningstar also finds that a large percentage of climate-related disclosures by North American issuers are at present missing, incomplete, or insufficient. In

particular, we've found that in particular Scope 3 emissions disclosures are of low quality reinforcing the need for consistent regulation on these disclosures. Having a standard setter like the CSA mandate a baseline set of disclosures allows for investors to make more informed decisions that materially impact financial outcomes. Aligning to a globally recognized standard allows for Canadian companies to access a broader pool of capital. The creation of the Net Zero Asset Managers Initiative and the Net Zero Asset Owners alliance highlights this demand, pointing to the need for standardized reporting metrics from Canadian issuers and magnified by concentration of Canadian issuers in both energy and materials sectors.

Costs and challenges of disclosures contemplated by the Proposed Instrument

11. **What are the anticipated costs and challenges associated with providing the disclosures contemplated by the Proposed Instrument?**

    No comment.

12. **Do the costs and challenges vary among the four core TCFD recommendations related to governance, strategy, risk management, and metrics and targets? For example, are some of the disclosures more (or less) challenging to prepare?**

    No comment.

13. **The costs of obtaining and presenting new disclosures may be proportionally greater for venture issuers that may have scarce resources. Would more accommodations for venture issuers be needed? If so, what accommodations would address these concerns while still balancing the reasonable information needs of investors? Alternatively, should venture issuers be exempted from some or all of the requirements of the Proposed Instrument?**

    No comment.

Guidance on disclosure requirements

14. **We have provided guidance in the Proposed Policy on the disclosure required by the Proposed Instrument. Are there any other tools, guidance or data sources that would be helpful in preparing these disclosures that the Proposed Policy should refer to?**

    We re-iterate our support of the creation of the ISSB which, through its creation, will likely leverage the TCFD framework for climate-related disclosure and SASB framework for broader ESG-related disclosures. Both frameworks are globally recognized and offer detailed guidance. We note that both frameworks also leverage a 'building block' approach focusing first on financially material disclosures, followed by broader impact-oriented metrics in the future. Given

the CSA's support of the IFRS governance process[6], and the successful bid for an ISSB office in Montreal, we hope that additional ongoing guidance will be made available by local ISSB staff.

For many issuers, climate-related disclosures bring a new set of reporting challenges that may not have been considered in the past. Coupled with the rapidly evolving nature of disclosure standards themselves, it would be imperative to create an open channel for ongoing dialogue and check-ins, largely to ensure consistency in guidance. Additionally, per our experience in other markets and in the CSA's own implementation of the Client Focused Reforms, a regularly updated FAQ document would be very useful for issuers going through these disclosures for the first time.

15. **Does the guidance set out in the Proposed Policy sufficiently explain the interaction of the risk disclosure requirement in the Proposed Instrument with the existing risk disclosure requirements in NI 51-102?**

    No Comment.

Prospectus Disclosure

16. **Form 41-101F1 *Information Required in a Prospectus* does not contain the climate-related disclosure requirements contemplated by the Proposed Instrument. Should an issuer be required to include the disclosure required by the Proposed Instrument in a long form prospectus? If so, at what point during the phased-in implementation of the Proposed Instrument should these disclosure requirements apply in the context of a long form prospectus?**

    Per answer 8, Morningstar is agnostic to where climate-related disclosures appear, so long as the disclosures are released conterminously with traditional financial filings, and said documents are placed under scrutiny of regulators. However, for brand new issuers, climate-related disclosures should indeed be included in a prospectus, which will add valuable insights to investors considering an entity for the first time. For prospectuses related to new financing, it would not be unreasonable to re-publish or reference disclosures that appear elsewhere.

Phased-in implementation

17. **The Proposed Instrument contemplates a phased-in transition of the disclosure requirements, with non-venture issuers subject to a one-year transition phase and venture issuers subject to a three-year transition phase. Assuming the Proposed Instrument comes into force December 31, 2022 and the issuer has a December 31 year-end, these disclosures would be included in annual filings due in 2024 and 2026 for non-venture issuers and venture issuers, respectively.**

    a. **Would the transition provisions in the Proposed Instrument provide reporting issuers with sufficient time to review the Proposed Instrument and prepare and file the required disclosures?**

[6] https://www.securities-administrators.ca/news/canadian-securities-regulators-strongly-support-the-establishment-of-the-international-sustainability-standards-board-in-canada/

Yes, we believe this would be sufficient time for issuers to prepare adequate disclosures especially given the removal of scenario analysis which requires the heaviest lift. We refer to question #14 and #17b in regard to how the CSA can support these deadlines.

b. Does the phased-in implementation based on non-venture or venture status address the concerns, if any, regarding the challenges and costs associated with providing the disclosures contemplated by the Proposed Instrument, particularly for venture issuers? If not, how could these concerns be addressed?

The CSA may also wish to consider basing implementation deadlines on sector and industry preparedness rather than solely on issuer size. As shown in Exhibit 1, disclosures in the U.S. and Canada on climate issues are incomplete, but it is not far behind other markets with more regulation. As shown in Exhibit 2, there is variation in the U.S. across sectors as to the typical level of disclosure, and this dispersion likely exists across Canadian companies as well. The exhibit shows the rates of scope 1, 2, and 3 emissions (where material) by industry. That said, these disclosures still vary in their standardization, and their quality. Indeed, we find that many of the disclosures, particularly around scope 3, are of extremely low quality, reinforcing the need for consistent regulation on these disclosures.

Exhibit 1: Disclosure Rates (Percentage) of Quantitative Greenhouse Gas Emissions

Disclosure Types	**Global**	**Asia**	Europe	**US & Canada**	**Africa**	**LatAm & Caribbean**
Material Scopes of Greenhouse Gas Reporting	64.9%	46.6%	79.6%	69.4%	57.8%	67.6%

Exhibit 2: Disclosure Rates of Material Scopes of Greenhouse Gas Emissions by Industry in the United States

Subindustry	Companies Covered	Disclosure Rates
Paper and Forestry	6	100.0%
Precious Metals	4	100.0%
Automobiles	151	94.0%
Diversified Metals	9	88.9%
Construction and Engineering	8	87.5%
Containers and Packaging	29	86.2%
Industrial Conglomerates	19	84.2%
Energy Services	11	81.8%
Transportation	56	71.4%
Utilities	108	70.1%
Household Products	13	69.2%
Food Products	65	62.9%
Construction Materials	8	62.5%
Chemicals	47	61.7%
Building Products	10	60.0%
Semiconductors	22	59.1%
Auto Components	7	57.1%
Telecommunication Services	41	53.7%
Technology Hardware	65	52.3%
Consumer Services	51	47.1%
Oil and Gas Producers	46	45.7%
Traders and Distributors	22	45.5%
Food Retailers	17	41.2%
Refiners and Pipelines	34	41.2%
Machinery	61	39.3%
Consumer Durables	13	38.8%
Electrical Equipment	13	38.5%
Aerospace and Defense	38	36.8%
Healthcare	49	36.7%
Retailing	23	34.8%
Commercial Services	16	31.3%
Software and Services	27	14.8%
Homebuilders	8	12.5%
Steel	6	0.0%
United States	**1100**	**59.5%**

Future ESG considerations

18. **In its comment letter to the IFRS Foundation's consultation paper published in September 2020, the CSA stated that developing a global set of sustainability reporting standards for climate-related information is an appropriate starting point, with broader environmental factors and other sustainability topics to be considered in the future. What broader sustainability or ESG topics should be prioritized for the future?**

    We agree that climate-related requirements should be one component of a broader set of ESG disclosures. Morningstar Sustainalytics looks at more than 100 other disclosures and metrics to address issues across various material ESG issues outside of climate. Environmental, social, and governance factors are increasingly a core investment theme for a growing number of mutual funds, and now play a role in the investment process of many other funds. Through societal issues, investors' awareness of, and desire to consider ESG issues in their investments, is likewise growing. A broader level of ESG disclosures will become increasingly important to minimize the risks of greenwashing and to put measures around the stated ESG ambitions of mutual funds. Here, we re-iterate our support for the ISSB and their pathway to leverage TCFD and SASB as foundational elements of disclosure. The building blocks approach in requiring climate-related disclosures first and broader ESG disclosures later on is a reasonable approach in dealing with double materiality.

In addition to above comments, Morningstar would be pleased to engage with Canadian regulators on an ongoing basis, leveraging our global organization of experts operating in multiple jurisdictions.

Sincerely,

Michael Jantzi	Scott Mackenzie
CEO & Founder, Sustainalytics	President & CEO
Morningstar Research Inc.	Morningstar Research Inc. (Canada)
Jackie Cook	Alex Osborne-Saponja
Director, Stewardship, Product Strategy & Development	Associate Director of Methodology & Product Architecture, Climate Solutions
Morningstar Research, Inc. (Canada)	Jantzi Research Inc.
Gabriel Presler	Ian Tam, CFA
Director of Sustainability Strategy	Director of Investment Research, Canada
Morningstar Inc.	Morningstar Research Inc. (Canada)

Appendix

(1) Morningstar's Comment Letter to the FCA regarding CP21/18
(2) Morningstar's Comment Letter to the SEC regarding Climate Change Disclosures
(3) Morningstar's Global Report on Corporate Sustainability Disclosures

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Public Response to FCA CP21/18

From Morningstar Inc. and Sustainalytics, a Morningstar Company

Submitted on 10th September 2021 **by email** to CP21-18@fca.org.uk

Dear Sirs,

Morningstar welcomes the opportunity to comment on the proposed climate-related disclosures and ESG topics in capital markets. We bring several perspectives to this comment letter. First, we have a long track record of categorizing and rating mutual funds that pursue different sustainability strategies. Second, our equity analysts use environmental, social, and governance (ESG) analysis as part of their approach to assessing investments. Third, Sustainalytics, which is now part of the Morningstar family, a leading global provider of ESG ratings, research and data to asset owners, investment managers, financial institutions, issuers/corporates, and a variety of other financial intermediaries. Third, DBRS Morningstar, Morningstar's independent credit rating agency subsidiary, has historically incorporated, and continues to incorporate, ESG considerations into its credit analysis. In early 2021, DBRS Morningstar published the *DBRS Morningstar Criteria: Approach to Environment, Social and Governance Risk Factors in Credit Ratings*, which provides the market with greater clarity and detail with respect to its analysis of ESG risk factors, their definitions and their significance to credit ratings across all sectors. For the avoidance of doubt, unless otherwise indicated, the responses from Morningstar group provided below generally reflect our collective experiences and views, and express references in our response to either Morningstar or to Sustainalytics apply only to those entities.

Morningstar group's response draws from our collective experience in evaluating ESG risks associated with equity issuers and pooled funds as well as the relevant ESG risk factors in the determination of credit ratings on issuers and debt obligations, as appropriate. To provide more background information on the questions you posed, we attach a recent Morningstar research paper to this response letter - Corporate Sustainability Disclosures: An Improving Picture, But Regulation Would Induce a More-Complete and Comparable Baseline of Material Information for Investors.

Fundamentally, as the effects of climate change and governments' responses to it around the world- accelerate, climate and carbon risk has increasingly become material for a host of sectors and many publicly traded companies. Therefore, moves toward mandatory, consistent, actionable disclosures on climate change are vital because they are financially material. As the FCA expands this important work, we would recommend a greater focus on investor needs as the nature and scope of the related disclosures are being considered. Based on our experiences and interactions with investors, we believe that:

1. investors need standard quantitative metrics such as scope 1, 2, and 3 (when material) emissions information from issuers, but these snapshots of carbon emissions are insufficient on their own for investors to evaluate the material financial risks a company faces due to climate change or a shift to a low-carbon economy.

2. investors also need much more consistent disclosures discussing companies' strategies and governance structures to address carbon and climate risks.
3. furthermore, investors need disclosures of companies' respective metrics and targets as well as reporting on progress and performance against these metrics and targets.
4. companies should also provide scenario analysis so that investors can evaluate the extent to which companies' strategies will perform given likely shifts to a low-carbon economy.
5. as we show with data in question 7, TCFD-aligned disclosures are increasingly robust, particularly for certain industries, but there are still gaps in the disclosures available to investors.

Further, Morningstar is broadly in agreement with the FCA description of the ESG data and rating landscape, subject to specific points raised in our answers to the individual questions posed. In particular, one issue touched on is the importance of the clarity and meaningful transparency around ESG ratings and the related methodologies so that investors are armed with the relevant information to understand the meaning and limitations of ESG ratings in the context of their intended use. We would submit that this focus on end-user needs would need to permeate across all relevant market participants – from the issuers providing data that feeds ratings; to product manufacturers' use of them in product design and marketing; to the providers of the ratings themselves.

Given the flow of investments that take into consideration quality ESG ratings, Morningstar group believes it is appropriate to require ESG rating providers to seek some form of certification or accreditation from regulators, adopting a principles-based approach focused on the integrity, independence and quality of ESG ratings. As the FCA text highlights, there are distinct differences between ESG ratings and credit ratings, both in terms of typical business models, and what is being assessed. As per the FCA's accurate description, ESG ratings are multi-dimensional, while credit ratings have a widely accepted common definition. In addition to these differences, we tend to think credit ratings and ESG ratings each are one component or insight to be considered by the relevant market participants alongside multiple other pieces of data and information in making investment decisions.

Diversity of views about the relative weights of the multi-dimensional E, S and G factors exists across users of ESG ratings and should be able to vary across raters, as it does for example across equity research firms more broadly, provided that the methodologies meet transparency requirements.

On behalf of Morningstar group, we again thank you for the opportunity to contribute and will be happy to engage further, answer other questions or provide additional information that may be helpful.

Yours faithfully,

Andy Pettit
Director, Policy Research (EMEA)
Morningstar

SECTION 1 of 3: ISSUER DISCLOSURES

Q1: Do you agree with our proposal to extend the application of our existing TCFD-aligned disclosure requirement (set out in LR 9.8.6R(8)) to issuers of standard listed equity shares, excluding standard listed investment entities and shell companies? If not, what alternative scope would you consider to be appropriate, and why?

Fundamentally, as the effects of climate change and governments' responses to it around the world- accelerate, climate and carbon risk has increasingly become material for a host of sectors and many publicly traded companies. Therefore, moves to expand mandatory, consistent, actionable disclosures on climate change to more companies, as proposed, are essential because such disclosures are financially material, and we believe that investors need

1. standard quantitative metrics such as scope 1, 2, and 3 (when material) emissions information from issuers, but these snapshots of carbon emissions are insufficient on their own for investors to evaluate the material financial risks a company faces due to climate change or a shift to a low-carbon economy.
2. much more consistent disclosures discussing companies' strategies and governance structures to address carbon and climate risks.
3. disclosures of companies' own metrics and targets as well as progress and performance against these metrics and targets.

Further, as shown in our attached report, *Corporate Sustainability Disclosures: An Improving Picture, But Regulation Would Induce a More Complete and Comparable Baseline of Material Information for Investors*, voluntary disclosures have increased over time and mandated disclosures would not be a significant overhead for many companies.

Finally, we are supportive of standard listed investment entities instead being treated under the same rules as for asset managers, for the purposes of consistency of information for investors in pooled investment products.

Q2: Do you consider that issuers of standard listed GDRs and standard listed issuers of shares other than equity shares should also be subject to our TCFD-aligned disclosure requirements? If not, what alternative approach would you consider to be appropriate, and why?

We are supportive, for the same reasons we outlined in our response to Q1.

Q3: We welcome views from market participants on whether to apply TCFD-aligned disclosure rules to issuers of standard listed debt (and debt-like) securities, and how best to do this. In particular, we seek input on the following:

a. What climate-related information from issuers of these securities would market participants find decision useful and how far would these information needs be met by TCFD-aligned disclosures?

Information that reflects sound business strategy and resilience is as useful for debt securities as for equity instruments. In addition, information on climate-related performance covenants or climate/SDG-linked pricing (i.e. spread) differentials would be helpful.

Furthermore, it would be useful to have disclosure of second party opinions or external verifications of debt instruments.

b. Do market participants' information needs differ according to the different types of issuer in LR 17?

Morningstar group believes all financial and non-financial corporations should be expected to provide consistent climate-related disclosures with respect to their equity or debt (or debt-like) issuances.- A more tailored, risk-based approach (to the extent the relevant disclosures are not already provided at the operating entity level by the relevant transaction parties) may be more appropriate for climate-related disclosures in respect of securitisations.

c. If you consider that we should apply TCFD-aligned disclosures rules to issuers of standard listed debt (and debt-like) securities, should some issuer types be excluded from the rule to deliver an effective and proportionate approach? If so, which types of issuers should be included/excluded and how can the scope best be defined?

Please see the previous response to 3b.

d. Are there any other matters we should take into consideration – eg, competitiveness, complexity of the application of the rule, burden on issuers in LR 17, or the feasibility to comply with any potential rules?

As we show in the Morningstar Corporate Sustainability Report, voluntary disclosures have trended upward. Increased levels -standardized disclosures are vital to consistency and transparency - in terms of the information that is available to all investors.

Q4: Do you agree with our proposal to mirror the structure and wording of LR 9.8.6R(8) and LR 9.8.6BG to LR 9.8.6EG for companies with a UK premium listing? If not, what alternative approach would you consider to be appropriate, and why?

Morningstar agrees with the proposed approach. There is much fragmentation across existing and emerging ESG disclosure regulation internationally, and no benefit to increasing that within the UK listed universe.

Setting minimum standards for companies helps ensure comparability across companies and will help investors and asset managers in evaluating their portfolios or describing the carbon risks associated with a pooled investment.

The existing structure and wording allow for proportionality and for a limited comply-or-explain approach.

Q5: Do you agree that, subject to the TCFD's final guidance materials being broadly consistent with those proposed, we should incorporate them into our existing and proposed

handbook guidance provisions as described (including both the existing guidance relating to LR 9.8.6R(8) and our proposed new guidance relating to LR 14.3.27R):

a. the TCFD's proposed updates to the TCFD Final Report and TCFD Annex

b. the TCFD's proposed standalone guidance document on metrics, targets and transition planning

c. the TCFD's technical supplement on measuring portfolio alignment. If not, what alternative approach would you prefer?

Morningstar supports the embracement of the TCFD framework for disclosures because (i) its disclosure requirements align well with the needs of outside sustainability ratings organizations as well as asset managers and other institutional investors; (ii) it is already in widespread use, which will reduce the burden on issuers who need to comply; and (iii) regulators around the world have embraced the TCFD.

Q6: Do you agree that we should update the Technical Note 801.1 to reflect the proposed new rule and associated guidance in this CP?

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Q7: Do you agree with our encouraging listed companies to consider the SASB metrics for their sector when making their disclosures against the TCFD's recommended disclosures, as appropriate? If not, please explain.

A balance is needed between standard quantitative metrics and more company-specific information. The widely debated issues of "double materiality" vs "financial materiality" with respect to ESG sustainability reporting and disclosure also needs addressing. Morningstar supports a building block approach – proceeding initially with disclosure that is focused on "financial materiality" then subsequently expanding, in time-boxed elements, to impact-oriented metrics.

TCFD and SASB offer established frameworks to support such an approach and **l**everaging the TCFD work on best practices for disclosures on strategy, governance, scenario analysis, and metrics and targets is a sensible approach. These disclosures should account for industry-by-industry materiality, while also ensuring that key measures can be compared across companies, industries, and sectors. Such comparability is increasingly critical as investors examine their carbon risk and exposure to climate change at a portfolio level. That said, the TCFD framework is not a corporate reporting standard for metrics

SASB standards offer the kind of industry-specific financially material metrics that most institutional investors require, as they consider financially material carbon and climate risks using data on issuer emissions, emissions trends, and issuer exposure to regulatory changes on emissions; technological innovation that would weaken their position; market trends and peer comparisons for managing carbon risks; and reputational impacts. These analyses rely on quantitative metrics as well as qualitative analysis. Quantitative metrics include the carbon-intensity trends and scope 1, 2, and 3 emissions discussed above, as well as company metrics

and targets, while qualitative information include an issuer's greenhouse gas risk management plan, physical climate risk management plan, carbon emissions reduction programs, and renewable energy plans.

Exhibit 1 quantifies the extent to which TCFD-aligned disclosures are already available in many corporate disclosures, particularly in the UK. It shows the average strength of disclosures on five TCFD aligned indicators. The strength of the disclosure is based on the average number of criteria disclosed for each indicator; however, while it reveals the quantity of information, we caution that not all issuers disclose data of the same quality.

Exhibit 1: Climate-Related Disclosure Rates (percentages) in the UK and Internationally

Indicator	UK	Global	Asia/Pacific	Europe	U.S. & Canada	Africa/Middle East	Latin America/ Caribbean
Scope of GHG Reporting	88.9	64.9	46.6	79.6	69.4	57.8	67.6
GHG Risk Management	71.5	63.5	43.2	72.4	75.5	59.6	63.6
Carbon Intensity	86.9	58.6	42.0	74.4	60.1	48.8	62.9
Carbon Intensity Trend	86.5	56.9	40.9	72.3	58.1	48.8	62.9
GHG Reduction Programme	98.8	89.8	83.5	97.1	89.7	86.9	89.5

Source: Sustainalytics Data

Note: These disclosures are based on a Sustainalytics universe of issuers that face material ESG risk[1].

Considering these factors, we agree with the proposed approach, while continuing to monitor the international developments toward more standardisation are escalating, both via the IFRS

[1] Sustainalytics' ESG Risk Ratings measure a company's exposure to industry-specific material ESG risks and how well a company is managing those risks. Further information can be found at https://www.sustainalytics.com/docs/default-source/meis/definitionsofmeis.pdf?sfvrsn=8e7552c0_4

and IOSCO, as well as the closer coordination of various standards bodies. In this regard, we also note the July 2021 cooperation agreement announced by EFRAG and GRI.

Q8: Do you agree with our approach to maintain a 'comply or explain' compliance basis until such time as a common international reporting standard has been published and adopted in the UK? If not, what alternative approach would you prefer, and why?

The time for "comply or explain" is past. As we identify in our attached research paper on Corporate Sustainability Disclosures, we believe it is time to move to the next stage and mandate a baseline set of disclosures. Pragmatically, this may best be done in conjunction with, and relation to, the IFRS international standard-setting developments referenced earlier, and note the FCA expectation of moving to a mandatory requirement in the event those developments are significantly delayed.

That said, "comply or explain" still has a role to play, for example, in areas where raw data is still in its infancy; consistent methodologies are still emerging; or in respect of information that is only material to certain issuers or industries. It has been an important and positive development in ESG disclosure regulations, helping to overcome challenges arising from older regulatory text which allowed for disclosure of ESG factors only if relevant. Those rules made it difficult for regulators to police disclosure and, more important, for investors to be fully aware of an investment product's credentials and understand more about the extent, if any, of a product's internal and external approaches to sustainable investing.

Q9: Do you agree with our approach not to require third-party audit and assurance for issuers' climate-related disclosures at this time? If not, what additional requirements would you consider to be appropriate?

There is already an ecosystem of consultants and traditional accounting firms with the capability to audit and assure these disclosures. Ultimately, if standards are not audited, or if there is weak enforcement of ensuring they are accurate, they will not be useful. Our research indicates that even in cases where we have climate or carbon disclosure, it is often not high-quality. That said, we do not believe that these functions should be restricted solely to accounting firms.

Q10: Do you agree that our new rule should take affect for accounting periods beginning on or after 1 January 2022? If you consider that we should set a different timeframe, please explain why.

The 1 January 2022 commencement date is reasonable given the urgency of the issue, and as referenced above, our research shows a relatively high level of existing voluntary disclosure that indicates it should not be a big burden for many issuers.

Q11: Do you agree with the conclusions and analysis set out in our cost benefit analysis (Annex 2)?

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SECTION 2 of 3 – Green Bonds – SUSTAINALYTICS DRAFTING RESPONSES

Q12: If future changes were considered in relation to the UK prospectus regime, we would welcome views on also taking the opportunity to introduce specific requirements in relation to UoP bond frameworks and their sustainability characteristics?

Morningstar recommends introduction of specific disclosure and reporting requirements applicable to issuers in relation to their UoP bond frameworks that are in line with the existing recommendations in the Green Bond Principles. Such requirements could include, prospectus disclosure on the types of projects/ activities for which an issuer will use the proceeds of an offering, management by that issuer of such proceeds and minimum target impact levels, along with the expected timelines for regular reporting. In addition, each such issuer should also provide the post-offering periodic reporting on the use and management of proceeds of an offering as well as actual impact levels (in reference to originally disclosed minimum target impact levels). Morningstar believes such initial disclosures and periodic reporting by issuers would be beneficial to investors and for the issuers themselves, improving the credibility of such instruments.

We believe a requirement for issuers to include in their UoP bond frameworks a commitment to obtain an initial external review on the framework as well as regular (annual) updates on the use of proceeds thereafter would also be a positive step. The issuers should also be expected to provide disclosure on their related commitments in their related prospectuses. This approach could be instrumental in preventing the so-called 'green washing' scenarios, and enable investors to seek recourse against each issuer upon failure to meet its related commitments.

To be effective, such requirements regarding the elements to be included in the UoP bond frameworks should also be bolstered with strong contractual covenants in the related underlying agreements. In addition to potential statutory remedies to protect the interests of investors that make investments upon reliance of issuer commitments related to use and management of proceeds that are disclosed in prospectuses, consideration could be given to extending contractual remedies for the benefit of investors upon failure by an issuer to meet such commitments.

However, we believe that such requirements should not restrict the issuer flexibility to engage different review providers during the different reporting cycles.

From the review provider's perspective, it is important to note the following:

a. such reviewers (i.e., Sustainalytics) provide opinions based *primarily* on the *information made available by the issuer*
b. ESG data and rating providers are not auditors, and should not be expected to act in an auditor capacity.
c. ESG data and rating providers are not in a position to, and should not be expected to, establish if there are additional undisclosed facts related to a particular bond or use of

related proceeds, beyond the related information the issuer makes available to the review provider.

Based on the foregoing, we believe the liability on the review providers should remain limited to performing best judgement based on the information disclosed. To enhance the credibility and quality of such reviews performed, as noted above, it would be appropriate to require public disclosure by issuers of information on the use of proceeds.

Furthermore, given the fast-paced evolving market, we recommend UoP bond frameworks to be limited to 2 years to ensure reliability of the data provided by issuers to investors and consistency of the frameworks and reviews with the updated versions of the market standards.

Currently, Sustainalytics offers both pre issuance review services, as well as Annual Reviews of allocation and impact reporting to confirm that proceeds has been allocated as promised in the respective framework. The latter are an enhancement of our services, designed to meet market needs, both pre-bond issuance, as well as post-bond issuance, opining on use of proceeds.

Q13: Should the FCA explore supporting the UoP bond market by recognising existing standards (eg, ICMA Principles), potentially through our recognition of industry codes criteria and process?

We are fully supportive of the FCA's following existing standards. In a global market, setting up different standards for different jurisdictions is likely to become disruptive and affect all interested parties: additional costs for compliance/ alignment for issuers; different processes and methodologies for review providers and data that is not comparable for investors, given the different definitions/ interpretations of sustainable activities.

Q14: We would also welcome views on more ambitious measures the FCA could consider, for example to require that the central elements of UoP bonds be reflected in contractual agreements and set out in the prospectus

Please see answer to question 12 above.

Q15: We would welcome views on the potential harm set out above and what, if any, actions the FCA or the Treasury should consider.

We believe that the potential harms identified by the report may have a negative effect over the SPO/reviewer market if not mitigated in a consistent way.

Given some common characteristics of the SPO/reviewer market and the ESG ratings market, and the fact that SPO providers are also acting as ESG rating providers, we are of the opinion that employing consistent regulatory principles for both arms of the industry would be beneficial for all interested parties and mitigate any related regulatory arbitrage risk. However, we submit that ESG ratings, on the one hand, and ESG related opinions (such as SPOs), on the other hand, remain two different and distinct disciplines that should be addressed separately from a regulatory perspective. Morningstar recommends not capturing

ESG related opinions (such as SPOs) in upcoming regulatory framework focused on ESG ratings.

Therefore, as alluded to above, we are of the opinion a regulatory framework on SPO providers should focus on:

a. transparency of the key elements of their methodology, mirroring the similar requirement for ESG rating providers,
b. Standards related to data and information provided by issuers to SPO providers, including practices and processes to assess the sufficiency of the quality of such data and information,
c. quality assurance mechanisms/ programs applicable to the processes to produce SPOs and end deliverable,
d. Sufficiency and training of provider's personnel
e. Set up robust policies on managing potential conflicts of interest, disclosure of such potential conflicts
f. Mechanisms and measure to facilitate reporting of complaints and timely and adequate remediation of such complaints

In our view, such a framework should provide sufficient elements to enable mitigation of the potential harms identified.

Our conflict management framework is built around the requirements described in Commission Delegated Regulation no. 2017/565, and is organized around 6 pillars: I. Internal organization of teams; II. Office facilities and IT infrastructure; III. Data usage, storage and separation; IV. Managing private interests; V. Research process and methodology; VI. Communication with companies

that address the need for analyst independence, consistency of process, data protection and systems separation. An Abstract of the framework described above is available on our website, and further inquiries from third parties about conflicts of interest are managed by our compliance team.

Furthermore, information about our products and high-level information on the relevant methodologies are available on our website.

Q16: Should the FCA, alongside the Treasury, consider the development and creation of a UK bond standard, starting with green bonds?

Yes, provided it is in line with existing EU GBS or other international standards/principles (e.g. ICMA).

SECTION 3 of 3 – REGULATING ESG RATING AND DATA PROVIDERS

Q17: Do you agree with how we have characterised the challenges and potential harms arising from the role played by ESG data and rating providers? If not, please explain what other challenges or harms might arise?

The FCA description of the ESG rating landscape is reasonable in the opinion of Morningstar and this is where we believe the focus should be, as explained in our response to Q20b below.

Paragraphs 4.44 – 4.49 link several different, but related issues, from data gaps, to ratings correlation between providers, to methodologies and scope of ESG matters considered and disclosure thereof.

Regardless of the directionality of impact of more complete and consistent issuer disclosures by issuers on ESG ratings correlation (4.47), having consistent issuer disclosures can strengthen ESG rating firms' analyses and improve the consistency of individual corporate ESG ratings. Different assumptions around data gaps are likely not part of purposeful differentiation by ratings firms, or at least not a key methodology difference.

Diversity of views about the relative weights of the multi-dimensional E, S and G factors exists across users of ESG ratings and should be able to vary across raters, as it does for example across equity research firms more broadly, provided that the methodologies meet transparency requirements.

Investors use ESG research and ratings for different uses, from best-in-class investment analysis to ESG integration to thematic investing to engagement and voting, and while Sustainalytics evaluates ESG issues from a material risk lens, other firms use a broad stakeholder approach, with different views on what is a material ESG issue and on what is measured, outcomes will vary.

Q18: Would further guidance for firms on their use of ESG ratings – and potentially other third-party ESG data – be useful, potentially clarifying expectations on outsourcing arrangements, due diligence, disclosure and the use of ratings in benchmarks and indices? Are there other aspects such guidance should include?

As a provider of ESG ratings and data, Morningstar remains focused on providing meaningful transparency such that our research is user-friendly and responsive to the needs of market participants that consider that research.

As such, ESG rating providers should be expected to make relevant information available to the market. This may comprise disclosure of detailed methodologies to clients (encompassing technical details such as the process for treatment of missing data), while end investors may be best-served by higher-level, consumer friendly overviews of how ESG ratings are compiled and how to interpret them.

Q19: We would welcome views on whether there is a case either to encourage ESG data and rating providers to adopt a voluntary Best Practice Code, or for the FCA to engage with the Treasury to encourage bringing ESG data and rating providers' activities inside the FCA's regulatory perimeter.

Sustainability ratings will continue to play an increasing role in fund flows and be an integral part of investing. As such, it is the view of Morningstar that ESG rating activities should be bought within the regulatory perimeter.

This FCA work is a positive step. A greater degree of commonality in regulatory frameworks across different jurisdictions would lower the risk of potential inconsistencies among regulatory frameworks, increase the comparability of ESG ratings and investor-end user confidence in such ratings and minimize the risks of inadvertently reducing the usefulness and breadth of sustainability-related regulation. This FCA work, together with the recent IOSCO draft recommendations, are positive steps in this regard.

Q20: If there is a case for closer regulatory oversight of ESG data and rating providers, we welcome views on:

a. Whether transparency, governance and management of conflicts of interest are the right aspects of ESG data and rating providers' operations and activities to prioritise in regulatory oversight, and if not, what other aspects should be considered

Transparency, independence and quality of ESG ratings, and management of conflicts of interest are the right areas of focus in our opinion.

In addition to our responses to Q17 (which we do not repeat here), the point that you highlight about the absence of common definitions and terminology is a key one. Ideally the industry should begin to migrate toward a common taxonomy of sustainable strategies (including those that address climate change) so that investors can understand what to expect (and what they should not expect). In the financial product arena, Morningstar has developed a sustainable investing framework that can help investors understand what overall role sustainable investing plays in a strategy (no role, supporting role, leading role) and the specific types of approaches that may be employed: (i) the use of exclusions, (ii) the use of corporate ESG evaluations to better assess risk, (iii) the use of corporate ESG evaluations to identify investment opportunities, (iv) orienting active ownership activities around ESG considerations, (v) a focus on sustainability themes, (vi) and the incorporation of impact assessments.

Potential conflicts of interest are an important issue and at a minimum, ESG rating providers should publicly disclose the sources of potential conflicts of interest in their business model as well as the steps they take to mitigate these conflicts of interest. Beyond these public disclosures, ESG rating providers should disclose any potential conflicts of interest to specific clients if those conflicts could be relevant. We believe this could be beneficial to all players involved and promote plurality and innovation in this market.

Associated governance processes to manage the above aspects are vital and having a culture of compliance and written processes is a necessary requirement for ensuring quality, although public disclosure of such processes would seem excessive. We provide further specific comments in our responses to subsequent IOSCO recommendations below.

Companies should have a right to respond to ESG rating providers, while preserving the independence of the ESG ratings and opinions. Morningstar already submit our ratings and research for pre-publication feedback to around 4,500 companies because we agree with the importance of providing them with a chance to inform us of any factual errors in our assessments.

b. Whether and how regulatory priorities should differ between ESG rating providers and other ESG data providers

Morningstar believes regulation should focus solely on "ESG ratings", with there being no policy argument to single out and regulate "ESG data providers" (entities that aggregate, create and/or distribute ESG data) since data aggregation/ distribution is not otherwise regulated in any other sphere of financial services industry. To the extent an ESG rating provider also offers ESG data services, and such data (aggregation/distribution) services may represent potential conflicts in the context of provision of ESG ratings, such conflicts can be identified, managed and mitigated as part of the governance of all potential conflicts that are relevant for ESG rating business. Presence of any such potential conflicts does not necessitate regulation of ESG data.

c. The similarities and differences between the policy issues that arise for ESG rating providers and those that arise for CRAs, and how far these similarities and differences might inform the appropriate policy response

There are distinct differences between ESG ratings and credit ratings, whereby the latter have a widely accepted common definition and the former are multi-dimensional and still evolving. Such differences, in part informed by the feedback provided by Morningstar's independent credit rating subsidiary, DBRS Morningstar, are referenced elsewhere in our response, as appropriate. Morningstar group would welcome an opportunity to engage further with the FCA to review the related considerations in more detail.

Despite these differences, transparency is key in ensuring that users of ratings understand the purpose and methodology of each rating and are equipped to understand the rationale for different issuers receiving different ratings from different providers. Similarly, given the evolving nature of ESG analysis, transparency is also vital in ensuring that users of ESG ratings are aware of and understand when and how methodologies, and thus potentially individual ratings, change.

Further, the issue raised about 'ratings shopping', or factors that might influence which rating providers an issuer works with goes to the heart of why mandatory issuer disclosure is needed. Consistent issuer disclosures will likely result in more informed ESG ratings and reduce the impact of issuers prioritizing information provision to some ESG rating providers ahead of others.

Q21: What other ESG topics do you consider that we should be prioritising to support our strategic objective? Please explain.

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June 9

The Honorable Gary Gensler
Chairman
Securities and Exchange Commission
100 F St. NE
Washington, DC, 20549

Re: Public Input Welcomed on Climate Change Disclosures

Dear Chairman Gensler:

Morningstar, Inc. welcomes the opportunity to comment on the questions you posed regarding climate change disclosures for registrants. In our response, we draw from our experience evaluating environmental, social, and governance (ESG) risks associated with equity issuers and pooled funds. To provide more background information on the questions you posed, we are attaching five Morningstar research papers to this response letter:

1) Sustainable Funds U.S. Landscape Report: More Funds, More Flows, and Impressive Returns in 2020;
2) Measuring Transition Risk in Fund Portfolios: The Morningstar® Portfolio Carbon Risk Score;
3) Investing in Times of Climate Change: An Expanding Array of Choices for Climate-Aware Investors;
4) Pitchbook Sustainable Investing Survey 2020; and
5) Corporate Sustainability Disclosures: An Improving Picture, But Regulation Would Induce a More-Complete and Comparable Baseline of Material Information for Investors.

As we address the questions, we will refer to these papers to provide more detail on the methodologies and findings that support our conclusions. The first paper presents data on the flows into various sustainable fund strategies, the second describes our approach to measuring a portfolio's carbon risks, the third discusses the various approaches asset managers take to incorporating climate and carbon risk into their strategies, the fourth provides research on the degree to which private equity investors consider sustainability issues, and the fifth provides detail on the sustainability disclosures we are able to collect today from issuers in the U.S. and around the world.

Fundamentally, as the effects of climate change—and governments' responses to it around the world—accelerate, climate and carbon risk has increasingly become material for a host of sectors and many publicly traded companies. Therefore, the SEC must move toward mandatory, consistent, actionable disclosures on climate change because such disclosures are financially material. As the SEC takes on this important work, it should focus on the disclosures that investors need.

1) Investors need standard quantitative metrics such as scope 1, 2, and 3 (when material) emissions information from issuers, but these snapshots of carbon emissions are insufficient on their own for investors to evaluate the material financial risks a company faces due to climate change or a shift to a low-carbon economy.

2) Investors also need much more consistent disclosures discussing companies' strategies and governance structures to address carbon and climate risks.
3) Furthermore, investors need disclosures of companies' own metrics and targets as well as progress and performance against these metrics and targets.
4) Companies should also provide scenario analysis so that investors can evaluate the extent to which companies' strategies will perform given likely shifts to a low-carbon economy.
5) As we show with data in question 5, TCFD-aligned disclosures are increasingly robust, particularly for certain industries, but there are still gaps in the disclosures available to investors.
6) A standard-setter is likely to use the Task Force on Climate-related Financial Disclosures framework to guide their disclosure requirements. We are not endorsing a particular standard-setter, but should the SEC empower one to provide standards, it will need to have strong governance and be able to adapt as the disclosures mature by providing ongoing guidance and revisions.

We address selected questions in more detail below.

1. *How can the Commission best regulate, monitor, review, and guide climate change disclosures in order to provide more consistent, comparable, and reliable information for investors while also providing greater clarity to registrants as to what is expected of them? Where and how should such disclosures be provided? Should any such disclosures be included in annual reports, other periodic filings, or otherwise be furnished?*

As the SEC begins the necessary work of enhancing corporate climate disclosures, Morningstar believes the following principles should guide the Commission's activity.

First, any new climate disclosures should appear in the 10-k disclosures or at least be released at the same time. Such annual temporal alignment of financial and material nonfinancial information in the form of climate change disclosures is the best way to help investors integrate nonfinancial climate change metrics into their decision-making.

Second, as we will detail throughout our response, the SEC should promulgate a clear expectation on the framework for disclosure and align it with those that other jurisdictions have already adopted. This approach will minimize the burden on issuers and investors alike.

Third, as we discuss further in questions 2 through 6 as well as 8, the SEC should balance requiring standard quantitative metrics with more company-specific information, leveraging the work done by the TCFD and others on best practices for disclosures on strategy, governance, scenario analysis, and metrics and targets. These disclosures should account for industry-by-industry materiality, while also ensuring that key measures can be compared across companies, industries, and sectors. Such comparability is increasingly critical as investors examine their carbon risk and exposure to climate change at a portfolio level.

Turning to registered funds, as sustainable strategies proliferate, the SEC should ensure that fund disclosures help investors understand what their sustainable fund does to manage carbon and climate risk. We believe that improving issuer-level disclosures will help asset

managers improve their disclosures to individual investors; but our data shows important differences in how funds approach carbon and climate risk, which the commission should consider as it contemplates new disclosures. For example, while investors likely expect a fund that markets itself as "sustainable" to have low exposure to carbon risk, we find that slightly less than half of the sustainable funds to which we assign a Carbon Risk Score do not receive our Low Carbon Designation. This data point—based on the asset-weighted Sustainalytics carbon-risk rating of companies held in a fund's portfolio—reveals a possible disconnect between investor expectations and the realities of the portfolios in which they might invest. (For more information on this data, please see the first attached white paper, "Sustainable Funds U.S. Landscape Report: More Funds, More Flows, and Impressive Returns in 2020." For details about how we calculate and assign the Low Carbon Designation, please see the second attachment, "Measuring Transition Risk in Fund Portfolios: The Morningstar® Portfolio Carbon Risk Score™.")

We also believe the SEC should focus on disclosures that will help investors identify which kind of carbon-aware strategy they are investing in, so investors can choose funds that match their goals. In a recent analysis, Morningstar identified six kinds of funds that focus on carbon risk or promoting transitions to a low-carbon economy: Low Carbon, Ex-Fossil Fuel, Climate Conscious, Climate Solutions, Green Bond, and Clean Energy/Tech. (For more information on the specific categories please see the third attachment, "Investing in Times of Climate Change: An Expanding Array of Choices for Climate-Aware Investors.")

2. *What information related to climate risks can be quantified and measured? How are markets currently using quantified information? Are there specific metrics on which all registrants should report (such as, for example, scopes 1, 2, and 3 greenhouse gas emissions, and greenhouse gas reduction goals)? What quantified and measured information or metrics should be disclosed because it may be material to an investment or voting decision? Should disclosures be tiered or scaled based on the size and/or type of registrant)? If so, how? Should disclosures be phased in over time? If so, how? How are markets evaluating and pricing externalities of contributions to climate change? Do climate-change-related impacts affect the cost of capital, and if so, how and in what ways? How have registrants or investors analyzed risks and costs associated with climate change? What are registrants doing internally to evaluate or project climate scenarios, and what information from or about such internal evaluations should be disclosed to investors to inform investment and voting decisions? How does the absence or presence of robust carbon markets impact firms' analysis of the risks and costs associated with climate change?*

Most institutional investors consider financially material carbon and climate risks using data on issuer emissions, emissions trends, and issuer exposure to regulatory changes on emissions; technological innovation that would weaken their position; market trends and peer comparisons for managing carbon risks; and reputational impacts. These analyses rely on quantitative metrics as well as qualitative analysis. Quantitative metrics include the carbon-intensity trends and scope 1, 2, and 3 emissions discussed above, as well as company metrics and targets, while qualitative information include an issuer's greenhouse gas risk management plan, physical climate risk management plan, carbon emissions reduction programs, and renewable energy plans.

Climate risk disclosures must include standardized, comparable data on carbon emissions, which can be quantified, measured, and used by investors in a variety of ways. For example, some investors already look at the total carbon footprint of their portfolio, or the carbon footprints of otherwise similar companies. Investors also sometimes generate their own carbon-intensity metrics by dividing carbon emissions by a company's revenue, profits, or material produced. At a minimum, the SEC could require each issuer to disclose scope 1 and 2 emissions, as well as material emissions under scope 3.

Most major new disclosure regimes require some phase-in, but we think that basing it more on sector and industry preparedness rather than solely on issuer size will be helpful. As shown in Exhibit 1, disclosures in the U.S. on climate issues are incomplete, but it is not far behind other markets with more regulation. As shown in Exhibit 2, there is variation in the U.S. across sectors as to the typical level of disclosure. This exhibit shows the rates of scope 1, 2, and 3 emissions (where material) by industry. That said, these disclosures still vary in their standardization, and their quality. Indeed, we find that many of the disclosures, particularly around scope 3, are of extremely low quality, reinforcing the need for consistent regulation on these disclosures.

Exhibit 1: Disclosure Rates (Percentage) of Quantitative Greenhouse Gas Emissions

Disclosure Types	**Global**	**Asia**	**Europe**	**U.S & Canada**	**Africa**	**LatAm & Caribbean**
Material Scopes of Greenhouse Gas Reporting	64.9%	46.6	79.6	69.4	57.8	67.6

Source: Sustainalytics data.

Note: For further information on these and similar disclosure data, see the attached paper "Corporate Sustainability Disclosures."

Exhibit 2: Disclosure Rates of Material Scopes of Greenhouse Gas Emissions by Industry in the U.S.

Disclosure Type	Companies Covered	Disclosure Rates
Paper and Forestry	6	100%
Precious Metals	4	100
Automobiles	151	94.0
Diversified Metals	9	88.9
Construction and Engineering	8	87.5
Containers and Packaging	29	86.2
Industrial Conglomerates	19	84.2
Energy Services	11	81.8
Transportation	56	71.4
Utilities	108	70.4
Household Products	13	69.2
Food Products	62	62.9
Construction Materials	8	62.5
Chemicals	47	61.7
Building Products	10	60.0
United States	1,100	59.5
Semiconductors	22	59.1
Auto Components	7	57.1
Telecommunication Services	41	53.7
Technology Hardware	65	52.3
Consumer Services	51	47.1
Oil and Gas Producers	46	45.7
Traders and Distributors	22	45.5
Food Retailers	17	41.2
Refiners and Pipelines	34	41.2
Machinery	61	39.3
Consumer Durables	13	38.5
Electrical Equipment	13	38.5
Aerospace and Defense	38	36.8
Healthcare	49	36.7
Retailing	23	34.8
Commercial Services	16	31.3
Software and Services	27	14.8
Homebuilders	8	12.5
Steel	6	0.0

Source: Sustainalytics data.

Even during a phase-in, we would urge the commission to set minimum standards even for companies that do not yet need to comply with broader disclosure requirements. Doing so helps ensure comparability across companies and will help investors and asset managers in evaluating their portfolios or describing the carbon risks associated with a pooled investment.

Finally, with regard to the sub-question about the cost of capital, we do believe that ESG risks increase the uncertainty of a business, and therefore reduce the price at which an investor should buy a company's equity, all else being equal. However, as a technical matter, our assumed discount rates (which are the weighted average cost of capital) are intended to capture systematic risks that are not diversifiable. For example, we typically increase our discount rate for firms and industries with higher cyclicality relative to those with lower cyclicality. We regard ESG risks as idiosyncratic, and, therefore, diversifiable. As a result, we view our uncertainty rating, which is intended to capture idiosyncratic risks, as the best place to capture ESG risks, not the cost of capital. This has real-world implications when investors think about a company's ability to generate returns on capital at or above its cost of capital (an important factor in measuring a company's competitive advantage, in our opinion), make comparisons across industries when determining appropriate cost of capital assumptions, or determining whether a company has optimally structured its capital and balance sheet.

3. *What are the advantages and disadvantages of permitting investors, registrants, and other industry participants to develop disclosure standards mutually agreed by them? Should those standards satisfy minimum disclosure requirements established by the Commission? How should such a system work? What minimum disclosure requirements should the Commission establish if it were to allow industry-led disclosure standards? What level of granularity should be used to define industries (e.g., two-digit SIC, four-digit SIC, etc.)?*

In general, we find that while some climate change issues are specifically material mostly to companies in certain industries, industry-specific frameworks have impeded comparisons across issuers and accurate, clear, and useful portfolio-level metrics. When industries develop their own standards they often choose disclosures that lead to "greenwashing" as the industries have a strong incentive to disclose information that will generally paint a positive picture. We have also seen industry-led groups change the rules of the game to make their disclosures look better. With regard to mutual funds, we believe the industry should begin to migrate toward a common taxonomy of sustainable strategies (including those that address climate change) so that investors can understand what to expect of their fund (and what they should not expect). Morningstar is working on a new taxonomy for funds so that investors can understand whether their fund manager: 1) simply considers ESG in making investment decisions as a pecuniary factor; 2) commits to investing in companies with strong sustainability profiles, and if so, which kinds; 3) avoids issuers with certain kinds of controversies; or 4) focuses on a specific kind of impact.

4. *What are the advantages and disadvantages of establishing different climate change reporting standards for different industries, such as the financial sector, oil and gas, transportation, etc.? How should any such industry-focused standards be developed and implemented?*

While we support the inclusion of industry-specific metrics to the extent they are material and add additional decision-useful information for investors, climate change disclosures must also allow for inter-industry comparability to be useful for investors, particularly those that wish to benchmark their portfolios against target levels of emission. Greenhouse gas reporting and reduction programs should be a core requirement across all firms. Industry-specific guidance could include discussions on typically material scope 3 emissions for

companies in various industries, and additional disclosures on risk management and strategy for select industries such as asset managers, energy producers, materials manufacturers and builders, and others.

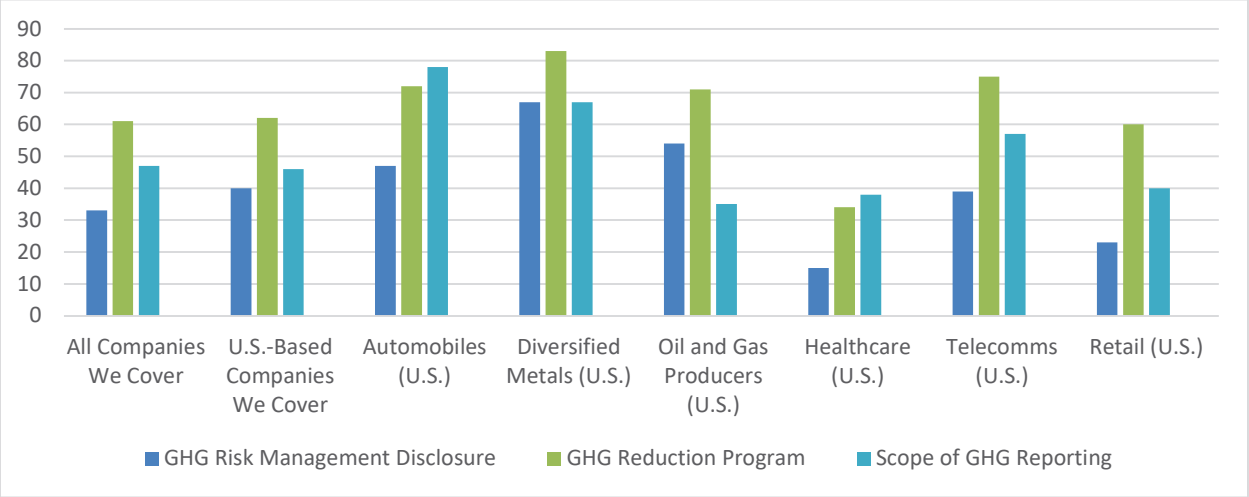
5. *What are the advantages and disadvantages of rules that incorporate or draw on existing frameworks, such as, for example, those developed by the TCFD, the Sustainability Accounting Standards Board (SASB), and the Climate Disclosure Standards Board (CDSB)?[7] Are there any specific frameworks that the Commission should consider? If so, which frameworks and why?*

These standards are already highly interlinked. The CDSB is responsible for enabling reporting that meets the TCFD framework, and SASB's disclosures incorporate TCFD recommendations. More-detailed disclosure frameworks, such as those maintained by the Carbon Disclosure Project, also have significant overlap with the TCFD.

We believe the SEC should embrace the TCFD framework for disclosures because 1) its disclosure requirements align well with the needs of outside sustainability ratings organizations as well as asset managers and other institutional investors; 2) it is already in widespread use, which will reduce the burden on issuers who need to comply; and 3) regulators around the world have embraced the TCFD, and U.S. adoption of the framework will likely enhance comparability. For example, the European Union referenced the TCFD in voluntary standards for nonfinancial disclosure regulations, and they have now begun to examine how to make these standards mandatory. We think they will continue to draw from the TCFD framework for this project.

Exhibit 3 quantifies the extent to which TCFD-aligned disclosures are already available in many corporate disclosures. It shows the average strength of disclosures on three TCFD-aligned indicators. The strength of the disclosure is based on the average number of criteria disclosed for each indicator; however, while it reveals the quantity of information, we caution that not all issuers disclose data of the same quality.

Exhibit 3: TCFD-Aligned Disclosure Strength Abroad, in the U.S. and in Select U.S. Industries



Source Sustainalytics Data.

Note: These disclosures are based on a Sustainalytics universe of issuers that face material ESG risk.

Regardless of the standard-setter the SEC picks, we believe corporate climate disclosures must include, at least for certain industries where such information is material, climate strategy information, metrics and targets, and scenario analysis so that investors can validate the extent to which a strategy is likely to help mitigate financially material climate risk.

Companies increasingly publish their climate metrics and targets, and they should also disclose their progress against these goals. It is critically important for regulators to compel issuers to do the hard work of establishing clear metrics and targets for managing climate risks and opportunities. Further, to provide useful, financially material disclosures, issuers must be compelled to disclose progress against these metrics. Without such disclosures, investors will find it harder to judge a company's progress or effort in executing its strategies. Further, without such disclosures, it can be difficult to tell if a company is making necessary capital investments to execute the strategy they have outlined.

Similarly, no matter which standard-setter the SEC chooses for climate risk disclosures, the SEC should also ensure that issuers include scenario analysis, in which they try to project an their revenue under various policy interventions, technological changes, or environmental changes. Such analysis can help investors assess the value at risk in an organization if, for example, regulators introduced a carbon tax, new technology allowed other firms to produce similar products with fewer emissions, or a warming world increased the price of natural resources. Simply put, these analyses show investors under what circumstances value is at risk, and how a company's strategy will move them forward toward long-term profitability and sustainability despite carbon risks. Investors can then evaluate whether, despite a company's current emissions, they have a credible plan for a low-carbon future. Some of this credibility comes from trust in management's governance approach, which we discuss in question 8.

6. *How should any disclosure requirements be updated, improved, augmented, or otherwise changed over time? Should the Commission itself carry out these tasks, or should it adopt or identify criteria for identifying other organization(s) to do so? If the latter, what organization(s) should be responsible for doing so, and what role should the Commission play in governance or funding? Should the Commission designate a climate or ESG disclosure standard-setter? If so, what should the characteristics of such a standard-setter be? Is there an existing climate disclosure standard-setter that the Commission should consider?*

The SEC should designate a standard-setter, but the standard-setter for climate risks need not be the same standard-setter for other ESG disclosures.

Outside of a set of core, comparable scope 1 and scope 2 disclosures, standards, and general principles which we believe the SEC should require for issuers, an outside standard-setter is likely to be able to provide more-current guidance than would the SEC. Even guidance around which scope 3 emissions—much less appropriate scenario analysis—is likely to change over time faster than the Commission can address these changes through notice and comment, necessitating a standard-setter. Guidance on disclosures of scenario analysis, governance, strategy and targets, and metrics disclosures will need to evolve rapidly as companies begin to report them.

The level of international coordination is escalating. The IFRS is conducting exploratory work into a Sustainability Standards Board, endorsed by IOSCO. Five existing standards-setting bodies have announced more formal collaboration. We encourage the SEC to continue to lend its support and expertise to these types of collaborative efforts ahead of developing independent rules.

The Commission should look to align with existing frameworks that already provide guidance in multiple jurisdictions to enhance consistency and reduce reporting burdens. As we noted before, for climate change, the TCFD framework has gained traction as the major, basic framework for climate disclosures. We also expect that this framework will support the work of the IFRS in constructing its disclosure recommendations.

7. *What is the best approach for requiring climate-related disclosures? For example, should any such disclosures be incorporated into existing rules such as Regulation S-K or Regulation S-X, or should a new regulation devoted entirely to climate risks, opportunities, and impacts be promulgated? Should any such disclosures be filed with or furnished to the Commission?*

If the rules were incorporated into regulation S-K (and S-X, should the commission endorse an outside standard-setting organization), then investors would benefit from receiving nonfinancial climate disclosures that were temporally aligned with financial disclosures. We would also encourage the commission to continue to build on the increasingly successful efforts to tag such filings in in-line XBRL, to make the information more digestible and faster to access and compare.

As a practical matter, we believe that scenario analysis to explain how a company anticipates addressing climate risks is critical, and such analysis could fit into the risks discussion on the S-K.

With regard to mutual funds, the commission could consider adding some level of clear and concise sustainability disclosure into the proposed simplified annual reports that show investors' returns, fees, risks, and portfolio holdings. As the industry moves toward a common taxonomy for funds, such a disclosure may help investors easily compare funds by ESG or sustainability strategy, as the commission intends for them to do for other common points of comparison.

8. *How, if at all, should registrants disclose their internal governance and oversight of climate-related issues? For example, what are the advantages and disadvantages of requiring disclosure concerning the connection between executive or employee compensation and climate change risks and impacts?*

Governance and oversight disclosures are critical for investors to properly assess the degree to which an issuer aligns its resources with addressing climate risk. The credibility of disclosures of strategies, scenario analysis, or even the relevance of targets and metrics depends on corporate governance. In particular, we look for details of overarching governance relating to climate-related risks. Issuers with mature sustainability reporting practices will be familiar with such approaches.

As a minimum, companies should disclose to what degree there is board-level oversight and responsibility for mitigating climate risk, as well as other climate risk management activity. Investors also need to understand the degree to which a corporate board has expertise on climate risks, how a company integrates climate risks into their investment planning and strategy, and if the company incentivizes performance by linking compensation to hitting climate-related targets. Regarding compensation relating to climate risk management or carbon performance, we currently see relatively low uptake of this practice. However, to the extent the companies do, or plan to, tie compensation to meeting climate goals, this information would be useful.

9. *What are the advantages and disadvantages of developing a single set of global standards applicable to companies around the world, including registrants under the Commission's rules, versus multiple standard-setters and standards? If there were to be a single standard-setter and set of standards, which one should it be? What are the advantages and disadvantages of establishing a minimum global set of standards as a baseline that individual jurisdictions could build on versus a comprehensive set of standards? If there are multiple standard-setters, how can standards be aligned to enhance comparability and reliability? What should be the interaction between any global standard and Commission requirements? If the Commission were to endorse or incorporate a global standard, what are the advantages and disadvantages of having mandatory compliance?*

Standard disclosures for all would help investors who consider climate risk as part of their process. Setting universal minimum disclosure requirements would help investors across the globe more easily understand issuer risk management practices for most publicly traded companies. Further, such a standard would empower investors to make comparisons across issuers in different jurisdictions and allow for consistent benchmarking, which would in turn lead to a wider understanding of industry and sector performance managing climate risk and

carbon emissions. For issuers, disclosures, a universal reporting requirement would reduce reporting burdens.

10. *How should disclosures under any such standards be enforced or assessed? For example, what are the advantages and disadvantages of making disclosures subject to audit or another form of assurance? If there is an audit or assurance process or requirement, what organization(s) should perform such tasks? What relationship should the Commission or other existing bodies have to such tasks? What assurance framework should the Commission consider requiring or permitting?*

There is already an ecosystem of consultants and traditional accounting firms with the capability to audit and ensure these disclosures. If these standards are not audited, or if there is weak enforcement of ensuring they are accurate, they will not be useful. As we noted, even in cases where we have climate or carbon disclosure, it is often not high-quality. That said, we do not believe that Commission should restrict these functions solely to accounting firms.

11. *Should the Commission consider other measures to ensure the reliability of climate-related disclosures? Should the Commission, for example, consider whether management's annual report on internal control over financial reporting and related requirements should be updated to ensure sufficient analysis of controls around climate reporting? Should the Commission consider requiring a certification by the CEO, CFO, or other corporate officer relating to climate disclosures?*

We believe that it is a best practice for companies to disclose who has responsibility for oversight of carbon and climate disclosures and what role they have at an issuer, but we are not aware of any evidence that requiring CEO attestations or certifications necessarily enhances the quality of disclosures.

12. *What are the advantages and disadvantages of a "comply or explain" framework for climate change that would permit registrants to either comply with, or if they do not comply, explain why they have not complied with the disclosure rules? How should this work? Should "comply or explain" apply to all climate change disclosures or just select ones, and why?*

The "comply or explain" approach has been an important and positive development in ESG disclosure regulations elsewhere. Early regulatory text allowed for disclosure of ESG factors only if relevant, making it difficult for regulators to police disclosure and, more important, for investors to be fully aware of an investment product's credentials and understand more about the extent, if any, of a product's internal and external approaches to sustainable investing.

13. *How should the Commission craft rules that elicit meaningful discussion of the registrant's views on its climate-related risks and opportunities? What are the advantages and disadvantages of requiring disclosed metrics to be accompanied with a sustainability disclosure and analysis section similar to the current Management's Discussion and Analysis of Financial Condition and Results of Operations?*

Please see our answers to questions 2 through 6 as well as 8. To reiterate, we believe the such a discussion accompanied by scenario analysis that is guided by a common framework, such as the TCFD, is enormously helpful alongside key metrics.

14. *What climate-related information is available with respect to private companies, and how should the Commission's rules address private companies' climate disclosures, such as through exempt offerings, or its oversight of certain investment advisers and funds?*

In our 2020 survey of private equity general and limited partners, we found that while private equity is increasingly looking at ESG risks as part of the investment process, the biggest challenge continues to be a lack of clear metrics and a lack of clear data on ESG for private companies, which is not surprising. For the complete survey results, please see the fourth attachment, "Pitchbook Sustainable Investing Survey 2020."

15. *In addition to climate-related disclosure, the staff is evaluating a range of disclosure issues under the heading of environmental, social, and governance, or ESG, matters. Should climate-related requirements be one component of a broader ESG disclosure framework? How should the Commission craft climate-related disclosure requirements that would complement a broader ESG disclosure standard? How do climate-related disclosure issues relate to the broader spectrum of ESG disclosure issues?*

Climate-related requirements should be one component of a broader set of ESG disclosures. Sustainalytics looks at more than 100 other disclosures and metrics to address issues across various material ESG issues outside of climate. For more details on our views on the value of additional regulations, please see the attached paper, "Corporate Sustainability Disclosures: An Improving Picture, but Regulation Would Induce a More-Complete and Comparable Baseline of Material Information for Investors."

Environmental, social, and governance factors are increasingly a core investment theme for a growing number of mutual funds, and now play a role in the investment process of many other funds. Through societal issues, investors' awareness of, and desire to consider ESG issues in their investments, is likewise growing. A broader level of ESG disclosures will become increasingly important to minimize the risks of greenwashing and to put measures around the stated ESG ambitions of mutual funds.

To conclude, we are pleased the SEC is rexamining climate, carbon and other sustainability disclosures, and we thank you for the opportunity to comment.

Very truly yours,

Aron Szapiro
Head of Policy Research

Morningstar, Inc.

CC:

Honorable Hester M. Peirce, Commissioner
Honorable Elad L. Roisman, Commissioner
Honorable Allison Herren Lee, Commissioner
Honorable Caroline A. Crenshaw, Commissioner

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POLICY RESEARCH

Corporate Sustainability Disclosures

An improving picture, but regulation would induce a more-complete and comparable baseline of material information for investors.

7 June 2021

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Executive Summary

Corporate disclosure of environmental, social, and governance information is trending upward, but progress will remain patchy and haphazard as long as it remains voluntary. Voluntary disclosures have another adverse impact, in the form of overstating progress owing to a bias to disclosing when something's being done well—if you look good, why not tell the world? If you look bad, don't shout about it.

Despite regulators' emphasis on climate disclosures, our research finds broadly similar rates of disclosures across the range of ESG topics, though they all suffer from the same lack of consistency. That said, the growing adoption of standards from the Task Force on Climate-Related Financial Disclosures is improving the consistency and completeness of climate indicators. The EU taxonomy[1] of sustainable activities will further help at the broader environmental level when companies start reporting in 2022.

While there is a growing rate of disclosure across all ESG categories, many companies fail to disclose key widely relevant indicators such as gender pay. Looking deeper and analyzing disclosures by sub-industry groups unearths low disclosure of industry-specific material indicators; for example, media companies with no formal editorial guidelines, or food companies without a formal policy on genetically modified organisms.

Although general rates of disclosure for the "E" and "S" indicators are similar, the social indicators related to employees generally see some of the poorest disclosure. Given the public interest in social indicators—particularly in the form of gender pay and broader diversity metrics—disclosure is

1 EU Taxonomy Regulation: https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/eu-taxonomy-sustainable-activities_en

surprisingly low. It's only to a small extent explained by local data privacy rules constraining what and how this type of data can be gathered and reported.

Overall, European companies are setting the pace with disclosure rates approaching 75%; followed by the United States at around 67%; and Asian companies lagging, disclosing on average a little over half of the indicators. The headline numbers mask varying pictures when looking at specific topics and industries; for example, carbon and emissions data is most prevalent in Europe, while politics and lobbying information is most disclosed by U.S. companies. To some degree this reflects the existence of disclosure rules in specific areas.

However, even where rules do exist, and have had demonstrable impact, they often only apply to the largest companies, as, for example, the E.U. Non-Financial Reporting Directive.[2] Proportional extension of reporting requirements to the biggest private companies and small and medium enterprise public companies is needed if investors are to be able to evaluate investments equally. The April 2021 EU Corporate Sustainability Reporting proposals are heading down exactly this path. For their part, companies could get some easy wins by voluntarily disclosing information that will become public anyway via third-party sources, for example, opensecrets.org informing about companies' lobbying activities.

Key Takeaways

- Disclosure rates are improving, but we still find that companies only disclose on about two thirds of material topics.
- Regulatory mandates improve consistency, quality, and completeness of disclosures, and would not be placing a huge new burden on many companies, given the progress already made.
- Individual country regulators are helping, but most benefit will come from coordinated international disclosure rules.
- Investors will need to digest a hodgepodge of noncomparable data for as long as different countries apply different rules and companies can cherry-pick how to disclose nonfinancial metrics.
- Companies will disclose the good and hide the bad while disclosure remains voluntary.
- Materiality is key, to avoid so much data that investors can't see the forest for the trees, and to ensure the most important information is available for each industry.
- A small core set of consistent metrics—published by companies of any size, in any industry—would create the starting point for a level playing field for companies to be assessed by investors.

2 NFRD: https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en

Background

Environmental, social, and governance factors are viewed as material by more and more investors and are now a "must have" in the investment process. The global sustainable funds universe attracted USD 185.3 billion[3] in net inflows in the first quarter of 2021, helping assets reach a record high of USD 1,984.5 billion as of the end of March.

Many asset managers consider ESG factors to some degree, but these products especially are coming under increasing pressure, and in some jurisdictions, regulatory requirements, to substantiate their objectives and their degree of success in meeting them. To do so, they are increasingly dependent on reliable and consistent data being available from their investee companies.

This reporting is critical for investors who need to manage not only climate and other environmental risks, but other ESG risks such as worker health and safety, product safety and recalls, or business ethics, which, if unmanaged, mismanaged, or not addressed, could damage a company's reputation and negatively affect its profits.

More and more companies are supplementing their financial disclosures with so-called nonfinancial data. In some segments this is a regulatory requirement and in others it's emerging as best practice. Either way, the increased transparency goes some way to meeting investor demand for ESG information, although producing a sustainability report is only an indicator of minimum practices. Best practice is an annual, integrated report that addresses material ESG issues which are clearly linked to core business drivers, giving investors more knowledge about if and how a firm is considering ESG issues in the running of its business.

Unfortunately, there is currently little to no consistency across these disclosures and information is not easy to consume, let alone compare across different businesses. Sustainability reports are often voluminous, non-standardized, not temporally aligned with financial disclosures, unaudited, and heavily textual. They frequently signpost readers to separate reports for different information—remuneration details may be found in the annual report and accounts; gender pay information may be in a separate gender pay report, and so on. Equity analysts must work hard to find the information they seek, plug gaps in data with estimates, and normalize the information across industries and geographies.

We believe that corporate reporting and disclosure will continue to be incomplete and inconsistent until there is a regulatory requirement to enhance ESG disclosures. Encouragingly, there are various moves toward more convergence between the existing work of independent standards bodies and local country and regional regulators. In 2020, five of the independent bodies announced their intent to jointly collaborate, and IOSCO, the global regulatory standards setter, established a board-level

3 Morningstar: Global Sustainable Fund Flows: Q1 2021 in Review: https://www.morningstar.com/lp/global-esg-flows

task force which supports IFRS Foundation proposals to establish a Sustainability Standards Board, parallel to the International Accounting Standards Board.

Markets would benefit from establishing an ESG reporting and disclosure structure that adheres to the same principles as applied to financial accounting.

Analysis

Disclosure is trending in right direction but remains far from ideal. The current status is shown in Exhibit 1, where overall disclosure stands at 64%, as measured by the Sustainalytics company database, across the 160 indicators used in the ESG Risk Rating. And to be clear this is among an information set that has been selected for its financial materiality on an industry-specific basis; this does not include impact-focused metrics.

Exhibit 1 Disclosure Rates by Region and Type (%)

	Global	Asia/Pacific	Europe	U.S. & Canada	Africa/Middle East	Latin America/Caribbean
All Indicators	64	52	73	66	58	62
Environmental	65	53	76	66	55	66
Social	63	51	70	67	63	58
Governance	63	51	74	65	55	62

Source: Sustainalytics, a Morningstar Company. Data as of March 5, 2021.

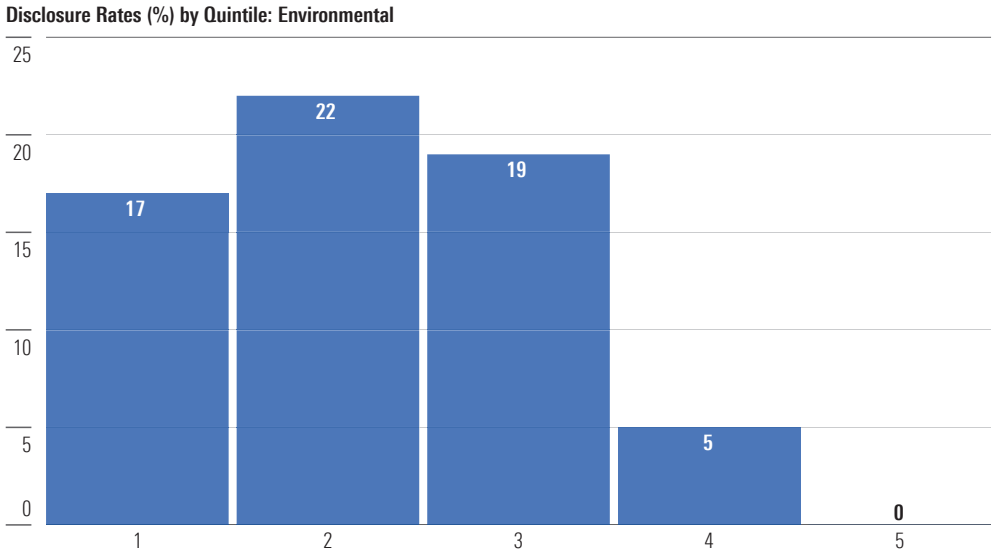
As with any average, the numbers mask underlying nuances, with some measures seeing near comprehensive disclosure and others very low rates. For instance, 38 of these indicators see less than half of issuers disclose information. Ultimately, this patchy and inconsistent disclosure hinders investors from making well-informed investment decisions on the risks facing their investee companies.

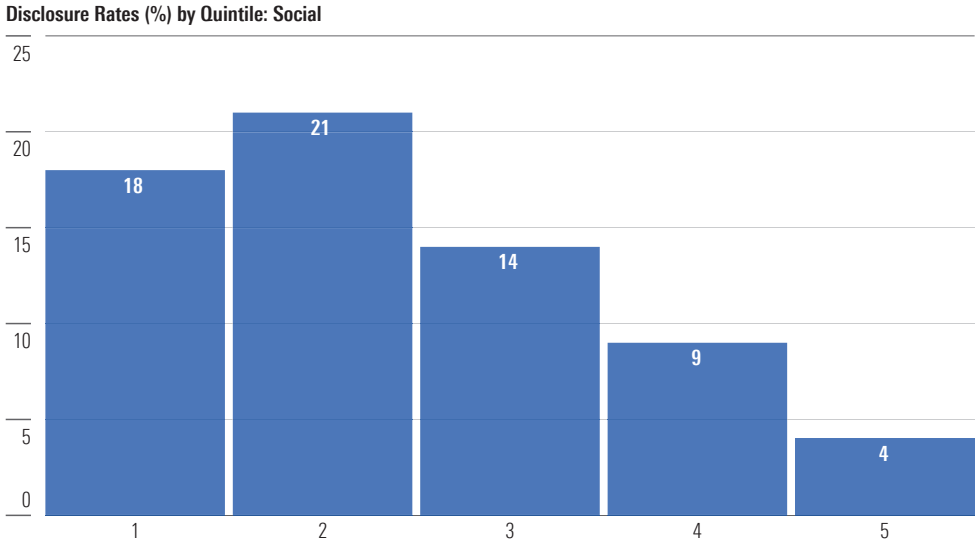
The figures, though, do highlight that regulatory levers would not be placing a huge new burden on many companies but rather, in many cases, rounding out work that they are already undertaking.

The data that we track, though, does appear to belie the common narrative that environmental disclosures are more common than those relating to social indicators. In fact, this is true in all regions, with broadly consistent levels of disclosure across the different types of indicators and can be useful to regulators in seeing what is being disclosed. The information not being disclosed will be more pertinent for analysts and highlight areas where regulatory intervention can help. For example, 11 of the 16 indicators for which less than one third of companies disclose on are social indicators, highlighting a wider dispersion of disclosure levels. Exhibit 2 illustrates that the number of indicators

with medium to high levels of disclosure is very similar across environmental and social issues, but of the remainder, there are more social indicators with lower rates of disclosure.

Exhibit 2 Disclosure Rates by Quintile: Environmental versus Social





Source: Sustainalytics, a Morningstar Company. Data as of March 5, 2021.

The Sustainalytics data framework categorizes the range of indicators into one of five types: Disclosure, compliance, and initiatives; Policy; Program and Management; Quantitative; and Signatories. We explore these more in the following sections where the social and governance indicators in particular see a broad split between indicators that are material to most companies and those that are specific to certain industry groups. Environmental indicators tend to be material by industry as opposed to across the spectrum.

For some indicators, we assume no disclosure is synonymous with no policy—if you had a policy, why wouldn't you tell your stakeholders? One example is a freedom of association policy, which on this basis sees disclosure at only 40%. Similar reasoning applies to certifications, such as health and safety certifications. There are perhaps a couple of contributory factors: One is the grey line between companies abiding by local laws and not expending extra effort on specifically disclosing what they consider to be a given; and this relates to the second factor of size, with smaller companies less likely to allocate budget to developing formal policies around elements they consider to be in their DNA.

For some longstanding issues, disclosure trends have improved. Taking a sample of data points, Exhibit 3 shows that over 90% of companies researched by Sustainalytics have some level of disclosure regarding bribery and corruption, and diversity and discrimination. However, even for these issues not all companies disclose adequately. For more-complex, newer ESG issues such as climate change the disclosure rates are much less satisfactory. For example, over one third of companies in sectors where climate change is a material issue are not disclosing their greenhouse gas emissions. Even amongst those that are reporting, there is considerable variance between disclosure of scope 1, 2, and/or 3 emissions. As a consequence, carbon-intensity-calculated metrics, which are dependent on issuers' scope of GHG reporting, see even lower rates of completeness.

Exhibit 3 Disclosure Rates for Bribery and Corruption; Carbon; and Diversity Indicators

Topic	Indicator Type	Indicator Name	Disclosure (%)
Bribery and Corruption	Program and Management System	Bribery and Corruption Programs	86.4
Bribery and Corruption	Policy	Bribery and Corruption Policy	91.9
Carbon	Quantitative Performance	Carbon Intensity Trend	56.9
Carbon	Quantitative Performance	Carbon Intensity	58.6
Carbon	Program and Management System	GHG Risk Management	63.5
Carbon	Disclosure, Compliance and Initiatives	Scope of GHG Reporting	64.9
Carbon	Quantitative Performance	Carbon Intensity of Generation	68.8
Carbon	Quantitative Performance	Carbon Intensity Trend of Generation	47.8
Carbon	Program and Management System	GHG Reduction Program	89.8
Diversity	Program and Management System	Diversity Programs	86.0
Diversity	Policy	Discrimination Policy	92.6

Source: Sustainalytics, a Morningstar Company. Data as of March 5, 2021.

Environmental

The individual environmental indicators are predominantly relevant to specific sub-industries. Eight indicators, though, are material to over half of the firms covered by Sustainalytics, for which two have near universal disclosure: Environmental Policy (Policy) at 97% and Environmental Management System (Program) at 96.8%.

The other six of these indicators all see significantly lower disclosure rates as shown in Exhibit 4. Unsurprisingly, considering the EU's established Sustainable Finance Action Plan, Europe leads the way while Asia significantly lags in these areas.

Exhibit 4 Disclosure Rates of the Most Widely Applicable "E" Indicators

Indicator	Global	Asia/Pacific	Europe	U.S. & Canada	Africa/Middle East	Latin America/Caribbean
Scope of GHG Reporting	64.9	46.6	79.6	69.4	57.8	67.6
GHG Risk Management	63.5	43.2	72.4	75.5	59.6	63.6
Carbon Intensity	58.6	42.0	74.4	60.1	48.8	62.9
Carbon Intensity Trend	56.9	40.9	72.3	58.1	48.8	62.9
GHG Reduction Program	89.8	83.5	97.1	89.7	86.9	89.5
EMS Certification	65.9	63.2	81.3	54.3	75.5	65.9

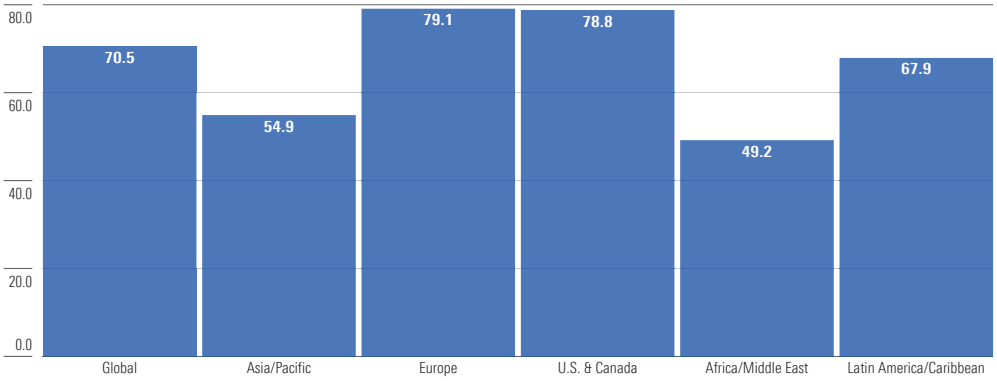
Source: Sustainalytics, a Morningstar Company. Data as of March 5, 2021.

A further climate indicator, material to many sub-industries and around one fourth of Sustainalytics' company universe, is that of physical climate risk management. As seen in Exhibit 5, disclosure rates are generally even higher than the other climate-related indicators in Exhibit 4, aided by prior regulatory actions such as EU Guidelines on Reporting Climate-Related Information[4] and U.S. National Association of Insurance Commissioners Climate Change Initiatives Survey.[5] Growing numbers of countries imposing TCFD reporting requirements will improve things further.

4 EU's guidelines on reporting climate-related information.
https://ec.europa.eu/finance/docs/policy/190618-climate-related-information-reporting-guidelines_en.pdf

5 https://content.naic.org/sites/default/files/cipr_insights_climate_risk_data_disclosure.pdf

Exhibit 5 Disclosure of Physical Climate Risk Management (%)



Source: Sustainalytics, a Morningstar Company. Data as of March 5, 2021.

The importance of looking more closely at individual industries and the indicators that are most material to them is vital, and underscored by looking at a few selective examples, as in Exhibit 6.

Exhibit 6 Select Industry-Specific Environmental Indicators Disclosure (%)

Sub-industry	Indicator	Global	Asia/ Pacific	Europe	U.S. & Canada	Africa	Latin America/Caribbean
Chemicals	Hazardous Substances Management	48.2	36.4	72.2	58.3	0.0	20.0
Food	GMO Policy	27.7	14.9	49.4	20.5	41.7	27.8
Oil	Oil Spill Disclosure and Performance	41.5	27.7	43.4	55.0	0.0	26.8

Source: Sustainalytics, a Morningstar Company. Data as of March 5, 2021.

It's perhaps surprising that growing consumer interest in food ingredients hasn't yet spurred firms into having GMO policies. Equally surprising is the low disclosure around oil spills, which would seemingly be an easy win for such firms to demonstrate to investors that they are at least starting down the transition road.

Other contributory factors influence these numbers, like for example, the largest cohort of companies in the chemicals sector being based in Asia, the region that overall sees the lowest rates of disclosure currently.

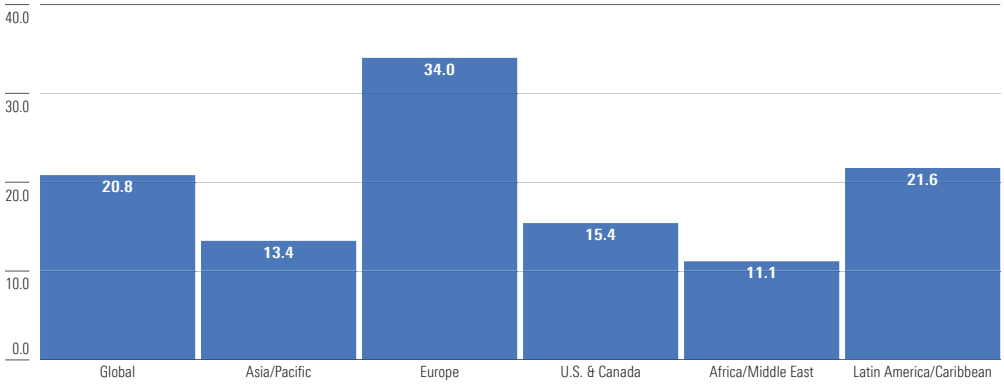
Social

Social considerations broadly split into those focusing on a company's own workforce and those related to wider societal issues. Of the former, six indicators are material to almost all companies, two of which—"Human Capital Development" and "Discrimination Policy"—see more than 90% of companies disclosing.

The third area in which a sizable majority (86%) of companies regularly disclose some data is workforce "Diversity Programs," in response to growing investor interest. For example, shareholders have submitted many resolutions over the past decade requesting information about board diversity, indicating their interest in using it to assess corporate governance. The reason for this interest is clear: A company with less board diversity than its peers may raise questions for investors. In his July 2020 post to the Harvard Law School Forum on Corporate Governance, Jared Landaw (COO and general counsel at Barington Capital Group LP.) commented that "[T]he most common corporate governance weaknesses we find at the underperforming companies we invest in are issues with the composition of their boards. Many of these companies have a board comprised of a homogeneous group of directors."[6]

The standout topic, material to over half of companies, with some of the universally worst disclosure, is gender pay, at only 20% globally. The firms with good disclosure are predominantly European, and by some distance, albeit at a lowly 34%. This is possibly indicative of existing regulatory requirements in individual countries, though is one area that is not the subject of an EU-level dictat, although it is under consideration.[7]

Exhibit 7 Gender Pay Disclosure (%)



Source: Sustainalytics, a Morningstar Company. Data as of March 5, 2021.

The power of a regulatory reporting requirement is evidenced when looking at a European country level, as in Exhibit 8. Two of the larger markets, with higher disclosure levels, Spain[8] and the U.K.[9], both have local country legislation that requires disclosure by companies with more than 50 and 250 employees, respectively. Even here, though, only up to half of the disclosures are considered by Sustainalytics analysts to be better than adequate.

6 See: https://corpgov.law.harvard.edu/2020/07/14/maximizing-the-benefits-of-board-diversity-lessons-learned-from-activist-investing/
7 https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_961
8 https://www.mercer.com/our-thinking/law-and-policy-group/spain-publishes-gender-equality-pay-transparency-laws.html
9 https://www.gov.uk/guidance/who-needs-to-report-their-gender-pay-gap

Exhibit 8 Gender Pay—European Country Disclosure

Country	Disclosure (%)	Total # Companies
Spain	78.3	46
Czech Republic	66.7	6
Hungary	50.0	4
Slovakia	50.0	2
United Kingdom	49.4	334
Italy	47.7	44
France	41.7	127
Russia	33.3	9
Norway	32.3	65
Finland	32.0	25
Luxembourg	28.8	66
Poland	26.1	23
Netherlands	25.2	127
Austria	24.0	25
Greece	22.2	9
Sweden	20.2	84
Iceland	20.0	5
Switzerland	20.0	70
Ireland	18.3	60
Germany	13.9	122
Belgium	12.5	32
Denmark	9.7	31

Source: Sustainalytics, a Morningstar Company. Data as of March 5, 2021.

Given the high international profile of the topic, we would have expected more firms to at least have a gender pay equality program, but even this only runs to 30% disclosure.

Another indicator of wide general interest, employee turnover rate, offers a prime example of the inconsistency of voluntary disclosure. It sees a low rate of disclosure of only 42%, but 319 of the firms that are reporting do not report on gender pay. Conversely, 1,274 firms that do report gender pay, don't disclose turnover. Outcomes like these reinforce the need for a mandatory set of minimum disclosures—to aid investors; to enhance ratings accuracy; and to avoid firms cherry-picking what they disclose.

As with the environmental indicators, analyzing social indicators material to specific industries also highlights some surprises. For example, in the media, software, and telecoms sectors we track the quality of editorial guidelines. Disclosure is only at 50%. Worse, looking at just the media sector alone, it is only 45%.

Social and governance issues intersect when it comes to the board room. Some companies report their board composition using broad groupings, such as "minority" or "ethnically diverse," while a few report by specific racial or ethnic groups. For example, one disclosure from a large *Fortune* 500 company reads "At year-end 2018, 44 percent of the board's independent directors were female or an ethnic minority." Another peer company simply reports that "the company's Board of Directors is composed of exceptional leaders with diverse backgrounds who help ensure that the company's decisions and actions advance and respond to shareholders' interests."

These disclosures provide little actionable or decision-useful information for investors, but several established independent organizations have created voluntary frameworks companies may use to disclose such ESG factors. These are being joined by more regulatory disclosure requirements, such as Nasdaq's proposal to require statistical information in a suggested uniform format on a company's board of directors related to a director's self-identified gender; race; and other statuses such as LGBTQ+.

Regulatory initiatives such as California Consumer Privacy Act, the New York Privacy Act, and the EU's GDPR have also spurred an uptick in reporting of societal indicators. Data privacy and security policies are considered a material issue to approaching half of the companies in the Sustainalytics universe, and almost all U.S. and EU companies disclose such a policy, together with 84.9% of Asian-domiciled companies.

Governance

In the governance arena, there are more indicators that are material to substantially all companies, three of which are reported on by over 90% of companies—ESG governance, Bribery & Corruption Policy, and Whistleblower Programs at 97.5%, 91.9%, and 91.3%, respectively.

At the other end of the spectrum, the indicators in Exhibit 9 are disclosed by far fewer firms. The U.S. and Europe are where more companies disclose a political involvement policy. The lobbying and political expenses indicator highlights the proportion of companies which are making political donations and/or that actively lobby. It is most prevalent amongst U.S. companies, perhaps because of legal requirements to disclose lobbying activities as part of the Lobbying Disclosure Act, but these filings are separate from outside corporate reporting rules and apply to public and nonpublic companies. Interestingly, in the U.S., the SEC is barred from promulgating rules on lobbying, and state and local governments require different disclosures than those required by the federal government, so corporate disclosures may well be incomplete when they are available.

Exhibit 9 Governance Disclosures (%)

Indicator	Global	Asia/Pacific	Europe	U.S. & Canada	Africa/	Latin America/Caribbean
Lobbying and Political Expenses (Quant)	30.9	7.7	33	54.1	9.0	15.3
Political Involvement Policy (Policy)	66.6	38.3	76.6	84.3	38.3	54.5

Source: Sustainalytics, a Morningstar Company. Data as of March 5, 2021.

The quantitative Lobbying metric provides an example of how distortions might occur without mandatory disclosure. In this case, the numbers reflect the proportion of companies that do not appear to have incurred expenses on the function, but does not differentiate between a positive disclosure of no expense versus no disclosure at all.

As with environmental and social indicators, the importance of analyzing governance indicators material to specific industries is evidenced. One such example is the animal testing policy area, which sees only 54% disclosure across firms in chemicals, healthcare, household products, pharmaceuticals, textiles, and apparel.

Conclusions and Recommendations

For some time now, many companies—Morningstar included—have called on regulators to standardize and mandate ESG disclosures to address the mismatch between investors' needs for clear, comparable, and material ESG data and the current state of ESG disclosures. This analysis reveals the specific areas on which regulators should focus. It also shows that in many areas, many companies have made major strides in disclosing ESG information to investors, and regulators have a tremendous opportunity to focus on gaps in disclosure or data consistency issues to meet investors' needs without creating an undue burden on issuers. Companies tend to do best disclosing plans and narratives (which are undoubtedly valuable), but lag on specific, quantitative metrics.

With regard to climate risk, we see the greatest levels of disclosure, particularly in Europe. This should be no surprise as the EU has led with requiring such disclosures, and is extending these requirements to even more companies[10] in the years ahead. Still, globally, somewhere between one third and one fourth of companies do not provide adequate disclosures around key metrics such as carbon intensity or scope 1 emissions, and material scope 2 and scope 3 emissions. Policymakers should maintain momentum and balance clear core metric disclosures for quantifiable climate risk disclosures with more-flexible requirements that leverage the work done by the TCFD and others for qualitative disclosures. These disclosures should account for industry-by-industry materiality, while also ensuring that key measures can be compared across companies.

10 EU Corporate Sustainability Reporting Directive: https://ec.europa.eu/finance/docs/law/210421-proposal-corporate-sustainability-reporting_en.pdf

With regard to social disclosures, it is clear that investor demand has led to high levels of qualitative disclosures, but some of these may be self-serving or filtered, and they must be combined with other common metrics. For example, almost nine in 10 companies we cover worldwide disclose information on their diversity programs, but specific information on workforce relations such as turnover or gender pay differences is disclosed much less frequently.

Investors have long been interested in corporate governance and we see high levels of disclosure on bribery and corruption policies, whistleblower programs, and other safeguards. We see very low levels of disclosure on lobbying expenditures and performance targets that might align incentives for management with their stated ESG goals, which are gaps regulators might look to fill with mandates. Ironically, in the U.S., where current law bars the SEC from requiring political contribution disclosures, more than half of companies disclose at least some information on their lobbying, leading the world.

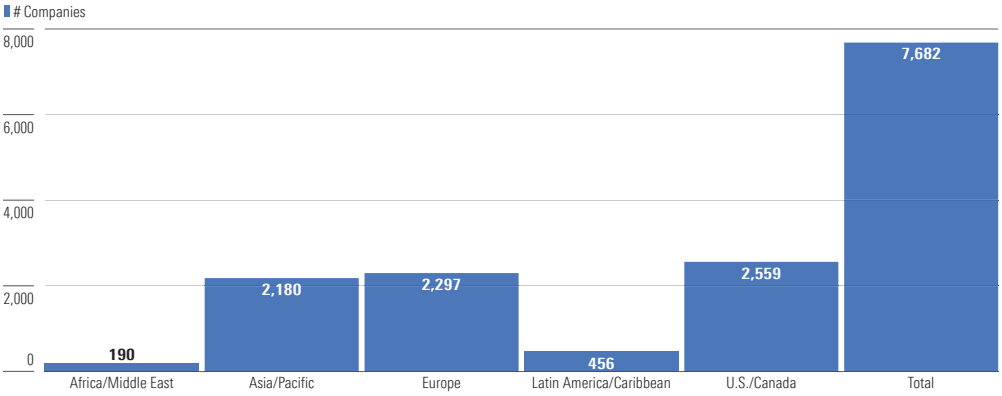
Worldwide, policymakers can continue to improve ESG investing by collaborating and working with expert groups to standardize key data, terminology, and disclosures. Investors need a concise subset of core decision-useful ESG metrics that are easy to consume, which companies can and should supplement with more company-specific disclosures about material ESG risk.

We support mandating ESG disclosures, but we do not believe that ESG mandates should be expected to lead to a consistency in ratings or assessments by analysts using these disclosures. In fact, such consistency would mean that the disclosures had failed to meaningfully inform investors. Different investors focus on different ESG disclosures. Investors have a variety of views on the weights that should be given to different ESG disclosures. Investors have different views of sustainability, where sustainability could on one hand focus on the impact corporations have on society and the planet, while on the other hand sustainability could focus on the risks that corporations are exposed to in these areas, which they need to manage. Just as it is true that traditional financial disclosures do not lead to consistent valuations, and investor opinions differ, nonfinancial disclosures should produce a similar dispersion in opinions. M

Appendix

The universe of companies on which our analysis is based comprises a broadly similar number of firms headquartered in Asia, Europe, and North America, though many of these are multinational businesses.

Exhibit 10 Company Coverage by Region



Source: Sustainalytics, a Morningstar Company. Data as of March 5, 2021.

Exhibit 11 Categories of Material ESG Issues

Access to Basic Services	Emissions, Effluents, and Waste
Bribery and Corruption	ESG Integration – Financials
Business Ethics	Human Capital
Carbon – Own Operations	Human Rights (Own and supply chain)
Carbon Products and Services	Land Use and Biodiversity (Own and supply chain)
Community Relations	Occupational Health and Safety
Corporate Governance	Product Governance
Data Privacy and Security	Resilience
E&S Impact of Products and Services	Resource Use (Own and supply chain)

Source: Sustainalytics, a Morningstar Company. Data as of March 5, 2021.

Disclosures

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