New Disclosures for Climate Change

BY CAROLINE TAN

The environmental consequences of energy extraction have drawn attention not only to the energy industry, but also to the financial firms that help fund it. Soon, these firms may feel more pressure to disclose their exposure to financial risks from greenhouse gas emissions, thanks in part to a recent decision by the Securities and Exchange Commission (SEC).

In a significant shift from previous rulings, the SEC decided in February that the shareholders of PNC Financial Services Group had the right to vote on whether the bank must report its risk exposure to climate change. For the first time, a bank was not allowed to exclude a climate change disclosure resolution questioning its lending practices from its proxy ballot. Though manufacturing and electrical companies had already been held to this standard, the SEC had previously reasoned that issues related to the way a bank maintains its lending portfolio fell within its "ordinary business" and did not need a shareholder vote.

As the nation's sixth-largest commercial bank in terms of assets, Pittsburgh-based PNC claims about $300 billion in total assets and is the only major bank headquartered in Appalachia, where coal extraction is a key business. Environmental group Rainforest Action Network estimated that PNC's lending practices accounted for 43 percent of Appalachian coal extracted in 2011 through the controversial "mountaintop removal" mining (MTR) technique.

In light of PNC's role in financing MTR mining, activist shareholders submitted a resolution in November 2012 requesting that the bank report its exposure to climate change risk through its lending, investing, and financing activities. PNC has marketed itself as a "leader in eco-friendly development," and the shareholders expressed concern that mismanagement of climate change issues could pose significant risks to the bank's brand, business operations, and performance. Boston Common Asset Management, which drafted the resolution, told PNC that it is important for investors to "understand in what ways these concerns are being addressed by PNC's lending policies."

PNC's board members unanimously opposed the resolution, requesting an SEC no-action letter that would permit the bank to keep the proposal from a shareholder vote. PNC argued that such an assessment would be costly, unnecessary, and micromanaging. Because PNC was not directly involved in coal mining, the board argued there was no sufficient "nexus" between the bank and the proposal.

The SEC replied that it was "unable to concur" with PNC's request, calling climate change a "significant policy issue." The Commission's decision effectively transferred authority on climate change disclosure from corporate managers to shareholders, for the first time requiring that a bank bring the issue to a shareholder vote. Though shareholders did not pass the resolution at their April 23 annual meeting, more than 22 percent voted in favor — a strong statement, shareholder activists say.

"This decision means that even companies a few steps removed from having a direct climate impact must pay attention to [climate] issues," says Michael Gerrard, director of the Center for Climate Change Law at Columbia University. In effect, some experts argue that the SEC broadened the range of companies for which climate change disclosure resolutions could apply, bringing the banking industry into the fold.

Climate change disclosure may mark a new and challenging phase for the banking industry — one that Chicago environmental lawyer E. Lynn Grayson of the law firm Jenner & Block says may be "darn near impossible" for some firms to accommodate, due in part to limited information and the difficulty of quantifying environmental risks. In 2010, the SEC issued an interpretive guidance to help public companies navigate existing climate change disclosure rules. The Commission emphasized that it was "not opining on whether the world's climate is changing," but rather trying to ensure that disclosure rules were consistently applied. The SEC noted different scenarios — legislation, international accords, changes in demand of a good or a company's reputation, and the physical impact of climate change — that may require a company to disclose its carbon footprint.

The PNC ruling does not necessarily mean that the SEC is "going green." It simply represents an attempt to inform shareholders about risk, Grayson says. To the extent that climate change portends regulatory changes or damage to major capital assets and infrastructure, it counts as risk.

Gerrard expects the SEC's decision to apply to a broad range of financial firms, as "large swaths of the economy are seriously affected by climate change," and he predicts it will inspire many similar resolutions. Indeed, even before the decision, more than 40 percent of shareholder resolutions from 2011 were related to environmental and social issues, a 10 percentage point increase from 2010, according to an Ernst & Young study. (Other resolutions related to political spending and lobbying, human rights issues, and governance matters, including executive compensation.) Still, the SEC told Bloomberg that its decision applied only to PNC and did not create a new duty for the entire financial sector.

It is unclear if a wave of climate change disclosures is in the forecast. That depends on whether the SEC's decision inspires activist shareholders to present similar resolutions — and how shareholders vote if the resolutions make the proxy ballot. At the very least, Grayson says, the ruling marks a "changing tide" for banks and climate change. **EF**