Climate-Related Disclosures and SEC Agenda-Setting

An Analysis using the Multiple Streams Approach

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Introduction

Until 2021, the Securities and Exchange Commission (SEC), the financial market regulator in the United States (US), followed an incremental approach to climate disclosure, meaning the direction veered little from the status quo (Lindblom, 1959). Although securities issuers were to consider climate risk disclosures within the scope of material information (information that could be reasonably expected to affect investor decision-making), there were no substantial changes like a rule (prescribed legal requirements) for climate disclosure (Horn, Moffat and Weiman, 2021). This principles-based approach left flexibility in climate-related disclosure requirements, causing inconsistent information for investors.

This shifted when the SEC sought comments regarding their climate-related disclosures approach in 2021 (Benjamin, 2022), culminating in a proposed rule in March 2022. What led to prescriptive climate-related disclosures becoming a priority on the SEC policy agenda? We will answer this question by analyzing the agenda-setting process through Kingdon's (2013) Multiple Streams Approach (MSA), which is appropriate for analyzing ambiguous topics like climate regulation in a complex and politically charged policy environment like the US.

The MSA has five elements. Three are streams; Problem (identifying issues), Policy (potential policy solution development) and Politics (political climate including national mood (public opinion)). The others are, Policy Windows (a policy opportunity opening through all three streams converging) and Policy Entrepreneurs (agents of change that push a policy solution) (Kingdon, 2013). These elements interact, resulting in decisions that lead to a policy outcome.

We begin with background on the policy and actors before moving to analysis and conclusions regarding the effectiveness of the MSA to answer our question.

Background

In March 2024, after years of debate and consultation on its proposed climate-related disclosure rule, the SEC issued a final rule requiring issuers to provide climate-related disclosures in annual filings. This will be phased in depending on the type and size of the issuer and include information to be disclosed within the financial statements (subject to audit) and other requirements within filings but outside the financial statements (Knachel *et al.*, 2024).

The SEC's role is to protect investors and maintain effective markets (SEC, no date). Climate risks pose a systemic threat to financial stability. The world economy may shrink by 10% if climate goals are unmet (Guo, Kubli and Sanner, 2021). The climate rule is intended to standardize climate-related disclosures by issuers in the same way financial accounting standards lead to comparable and consistent information, resulting in reduced information asymmetry (where one party to a transaction has more information than another) for decision-makers. Making well-informed decisions on capital allocation by reducing information asymmetry will aid in avoiding a financial crisis, such as the 1929 stock market crash that was caused by mispriced assets from a lack of financial standards (SEC, no date).

The SEC acts as an independent regulatory body. Their regulatory policies concentrate policy costs among securities issuers and policy benefits among investors. Per Knill and Tosun (2020), concentrated costs and benefits produce interest group politics, leading to incremental policy change due to conflicts between these groups, previously the SEC approach to climate-related disclosures. Accordingly, the SEC agenda is influenced by the following actors.

Inside Actors (within the policy-making process)

The President influences agenda-setting by appointing SEC commissioners and a chair totalling five representatives. At most, three commissioners can be from the same political party; however, political influence is inherent in the choice of chair, who significantly influences agenda priorities.

The legislative branch of the US government, Congress, comprising of the Upper Body Senate and Lower Body House of Representatives, oversees the SEC, whose independence and deference were granted by several statutes passed by Congress (Karmel, 2019).

The judiciary branch has an increasing influence on SEC agenda-setting. Judicial push-back on the SEC's independence has increased given the politicization of the courts and friction between the Judicial, Executive and Legislative branches of government (Karmel, 2019).

The US is a two-party system consisting of the Democratic Party, which is supportive of climate-related regulation and the Republican Party which is against. National mood heavily influences policy through politics.

Outside Actors (outside the policy-making process)

Issuers and interest groups for and against regulations influence SEC agenda-setting through formal responses to consultations and litigation threats regarding the scope of SEC rulemaking (Benjamin, 2022). The threat of litigation, particularly from influential rent-seeking organizations (seeking to increase one's own wealth without benefits to society) like petroleum companies, increases the potential for regulatory capture in the SEC.

Investors, particularly large institutional investors, influenced the agenda by advocating for better climate-related disclosures.

The roles of these actors will be expanded on below.

Multiple streams approach

Problem Stream

There is a universe of agenda items for policymakers to consider and several informal agenda levels for problems to move through to arrive at the formal institutional agenda (Birkland, 2007). Kingdon (2013) explains a problem captures the attention of policymakers to land on the formal agenda through indicators demonstrating the magnitude of a problem, focusing events like a crisis and feedback centring attention through cases and complaints within the existing system.

A combination focused SEC attention on climate-related disclosures.

Indicators

In 2010, emissions from industrial business activities to produce goods for human consumption represented 30% of global emissions (Fischedick M. *et al.*, 2014). Emissions were the highest in history, and the rise of severe risks from climate change on natural systems was confirmed by the 2014 Intergovernmental Panel on Climate Change report (Pachauri and Meyer). This gave rise to business risks, given their dependence upon the natural world for resources. The Economist Intelligence Unit (2015) reported up to $43 trillion in value could be at risk by the end of the century.

Focusing Events

Financial systemic climate risk gained global attention in 2015 when Bank of England Governor, Mark Carney, made a landmark speech outlining the risks climate change posed to investors (Carney, 2015). This was followed by the Financial Stability Board (FSB), an international body that makes recommendations on the world financial system (FSB, 2020), setting up a Task Force on Climate-Related Financial Disclosures (TCFD) to look into climate-related impacts on the financial system (Perry, 2015).

The same year, the 21st Conference of the Parties (COP21) resulted in the Paris Accord to decrease global emissions (United Nations, no date). This signalled to investors that the transition to a low-carbon economy was inevitable.

Various financial institutions began to recognize threats to financial stability. Research reports were released from the Bank of England, the Netherlands Central Bank, and the European Systemic Risk Board (Sen and von Schickfus, 2020).

Feedback

In 2017, the TCFD released recommendations, a voluntary reporting framework that received broad support as a climate-risk assessment tool, giving some consistency to disclosed information (TCFD, 2017).

Investor demands for consistent and comparable information to price climate risks effectively increased with comment letters to the SEC and petitions for rule-making (Lee, 2020). The largest global asset manager, Blackrock's (Statista, 2024) 2020 letter to CEOs declared, "Climate risk is investment risk" (Fink, 2020).

By 2021, 97% of institutional investors rated climate risk as important in investment decisions (Vasantham *et al.*, 2021). It can be asserted that a turning point was achieved, creating advantageous conditions for policy entrepreneurs.

Policies

When problems are identified, policy entrepreneurs look for a solution (Brunner, 2008).

The investment community is a highly concentrated group (Eccles and Klimenko, 2019). Per Kingdon (2013, P.119), a closely knit community generates a common outlook and language. These commonalities were a unified voice akin to an epistemic community, calling for comparability and consistency in disclosures to facilitate effective decision-making to mitigate systemic climate-related risks. Large investment firms are so big that they cannot hedge systemic risks, and pension funds require an intergenerational view of portfolio performance (Eccles and Klimenko, 2019). The push from Investment communities led to securities regulation floating to the top of the "primeval soup" (policy ideas that float around until the most acceptable come through) as a solution (Kingdon, 2013, P.116).

In 2020, the national mood shifted, and for the first time, environmental protection rivaled the economy as a top policy concern (Pew Research Center, 2020).

By 2021, net-zero pledges covered 68% of the global economy (Mooldijk *et al.*, no date). However, reporting on progress proved vague, lacking consistent and complete disclosures (Bjørn *et al.*, 2022). Concerns over greenwashing (when a corporation misleads on environmental practices) led to increased concerns of information asymmetry for corporate disclosures.

A rapid global rise of sustainability regulation followed, and by late 2021, regulators from Britain to New Zealand declared intent to make climate disclosures mandatory (The Economist, 2021). Policy diffusion across global borders continued, with varying degrees of securities and corporate climate-related regulatory disclosures arising worldwide. The US continued to have a policy gap (The Economist, 2021).

Politics, The Policy Entrepreneur and Veto Players

Although the problem and policy streams were suitable for a policy change, the streams finally converged, creating a policy window with Democratic President Biden's inauguration in 2021. Although the previous Democratic administration declared climate a key issue before taking office, priorities changed with the 2008 financial crisis (Benjamin, 2022). The following Republican administration immediately withdrew from the Paris Accord and unwound executive actions aligned with the agreement (Benjamin, 2022).

Climate was a high priority for the Biden administration. Biden immediately rejoined the Paris Accord and appointed Allison Lee as acting SEC chair. As a commissioner before becoming chair, Lee was a policy entrepreneur, publicly critiquing the SEC's approach to climate-related disclosures in 2020, stating that the current principles-based approach was not producing sufficiently detailed disclosures to satisfy investor needs and efforts to modernize SEC reporting requirements have been notably silent on climate (Posner, 2020). This led to a heated debate within the commission. Determined to strengthen climate-related disclosures, Lee shifted the SEC response to the issue by creating a Climate and ESG task force (Lee, 2021).

As the SEC considered proceeding with a climate disclosure rule, policy container interest groups, including the US Chamber of Commerce, cautioned the SEC against proceeding 'beyond its mandate' (Williams, 2024). This was a warning regarding future legal challenges, such as those used in the courts to strike down part of the SEC's conflict mineral rule (Davies, Fortt, and Huber, 2024).

After the SEC released its draft climate-related disclosure rule, policy expanders and containers continued to influence outcomes. In April 2024, the rule was voluntarily paused pending judicial review after a flurry of legal action upon issuing the final rule (Countryman, 2024), leaving the policy stage at adoption (Lasswell, 1956).

The recent Republican changes in the Supreme Court's composition has altered bureaucratic freedom to address new policy problems, using the "major questions doctrine" (MQD) (Aughenbaugh, 2023). MQD states that without explicit permission from Congress, agencies may violate a core principle of constitutional theory when issuing regulations with a large impact on the public or the economy (Aughenbaugh, 2023). The MQD was recently used to limit bureaucratic authority in regulating emissions.

With the power to void legislation, constitutional courts are veto players (actors who can block a policy) (Tsebelis, 2002) in policymaking (Brouard and Hönnige, 2017). Justices may be guided by their ideological policy preferences and the ideologies of the government that appointed them. Tsebelis's seminal book did not include the courts as veto players, given their views are usually "absorbed" into the policy process through the appointment process (2002, p.227), however, in theory, a court absorbed by other veto players should not veto new legislation (Brouard and Hönnige 2017).

Effectiveness of the MSA

The MSA effectively explains the agenda-setting phase of the SEC's climate-related disclosure policy process. It helps us understand that despite evidence and policies, political sensitivities and timing are crucial for policy windows (Kern and Rogge, 2018).

However, when it comes to agencies like the SEC, the increasing prevalence of the judiciary as a veto player generates uncertainty in regulatory policy-setting by undermining the deference of the agencies put in place for their expertise to set policies.

As the courts' influence increases and we consider lifetime appointments of some justices, the MSA as an analysis tool for the agenda-setting process will need to contemplate this. The current understanding of agenda-setting may not be as helpful in the future if it is consistently undermined by the weaponization of parts of the federal system intended for public protection, such as the judiciary.

Therefore, further research should be undertaken examining how increased judiciary review could affect executive branch policy agendas, particularly for independent agencies. Regulatory policies going from the hands of un-elected agencies with significant expertise to non-elected judiciary actors with largely unchecked powers, risks allowing particular ideological views to dominate policy areas long-term.

Conclusion

Through the analysis above, we have answered our initial question by demonstrating the establishment of a clear problem, policy, and political stream that opened a policy window and allowed policy entrepreneur Allison Lee to put climate-related disclosures on the SEC's institutional agenda. This led to the policy outcome of a final SEC rule on climate disclosures.

Although the MSA is a useful tool for analyzing how issues come to be on the decision agenda, further research is necessary to determine whether the changing nature of the judicial branch of government will increase incrementalism among independent agencies, influencing future agenda-setting due to the fear of litigation with potentially binding consequences.

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