American Bankers Association

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California Air Resources Board (CARB)

Via electronic submission

RE: *Information Solicitation to Inform Implementation of California Climate-Disclosure Legislation: Senate Bills 253 and 261, as amended by SB 219*

To The CARB:

The American Bankers Association[1] appreciates the opportunity to comment on the *Information Solicitation to Inform Implementation of California Climate-Disclosure Legislation: Senate Bills 253 and 261, as amended by SB 219* ("The Solicitation"). The Solicitation asks for recommendations and discussion of key aspects of the laws enacted through SB 253 and 261 (the laws) to allow CARB to assess the scope, nature, extent, and timing of reporting under the laws, as well as considerations related to the measurement and assurance related to reporting of greenhouse gas emissions metrics (GHGs) under SB 253.

This letter provides a high-level overview of some of the challenges financial institutions face in climate-related disclosures and the practical recommendations we believe are important for CARB's implementation of SB 253 and SB 261. ABA members consist of a wide range of lending institutions of all sizes and business models. In addition to the large banks that have implemented aspects of climate and GHG reporting through voluntary reports, dozens of mid-sized and community banks in the U.S. are likely to be required to file reports to CARB under the laws. Due to specific definitions within Scope 3 of the Greenhouse Gas Protocol related to financed emissions, however, our recommendations will apply not only to the compliance of banks to submit their respective reports to CARB under SB 253, but potentially also to the many companies in which banks invest in or do business with.

Below, we summarize our key recommendations, which we cover in greater detail in the attached Appendix to the letter.

1. **The Laws Must Allow Companies Broad Flexibility to Comply:** CARB's implementation of both SB 253 and SB 261 must prioritize flexibility to ensure that reporting entities can navigate the complexities of emissions measurement and climate-related disclosures. Preserving the adaptability embedded in frameworks like the GHG Protocol and TCFD will help ensure that disclosures are feasible to implement and maintain as well as meaningful to stakeholders on an ongoing basis.

[1] The American Bankers Association is the voice of the nation's $24.1 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2.1 million people, safeguard $19.2 trillion in deposits and extend nearly $12.7 trillion in loans. Learn more at www.aba.com.

2. **Incorporate the GHG Protocol by Reference without Standardizing Specific Approaches:** Within any specific regulations, CARB should incorporate the GHG Protocol by reference, including its existing reporting flexibilities and methodological guidelines, as the foundation for emissions disclosure under SB 253. As highlighted in greater detail below, the GHG Protocol provides companies with the ability to tailor disclosures to their unique operations, data availability, and the many considerations relevant to their key stakeholders. This flexibility is critical for addressing the diversity of challenges financial institutions face in disclosing GHG emissions. This approach would fully meet the requirements of SB 253 that reporting be "in conformance with the Greenhouse Gas Protocol, standards and guidance," while ensuring disclosures remain practical, meaningful, and adaptable to evolving best practices.

   The Solicitation asks whether CARB should standardize its approach to Scope 1, 2, and 3 emissions disclosures. ABA strongly advises CARB **not** to standardize its approach, as doing so would essentially eliminate the adaptability of the GHG Protocol and may impose rigid methodologies that may often not align with companies' operations or key concerns of their stakeholders. Standardization will also often fail to account for sector-specific differences and evolving practices within GHG accounting.

3. **Allow Flexibility in TCFD-Aligned Disclosure:** In final SB 261 regulations, CARB should align with the language of SB 261, which includes language that provides entities with flexibility in disclosing according to the TCFD framework. Entities should have the option to disclose based on the 2017 TCFD recommendations rather than adopt the more prescriptive and challenging 2021 updates.

4. **Annual Revenue Thresholds should be Based on Investor and Regulatory Norms:** Revenue thresholds for financial institutions should be based on Net Interest Income rather than gross revenue. This adjustment will align with regulatory and investor standards and avoid unnecessary volatility in determining compliance, which can result from factors outside banks' control, such as changes to fiscal and monetary policy.

5. **Annual Revenue Thresholds should Exclude Other Comprehensive Income**: The vast majority of companies in the U.S. report revenues that exclude OCI for public reporting purposes. Computing the $500 million and $1 billion revenue thresholds for companies by excluding OCI items will both simplify the annual revenue formula and, in the financial services industries, also align the criteria with those used by banking regulators and investors.

6. **The Annual Revenue Criterion Should be Based on the Two Previous Fiscal Years:** Rather than exempting or qualifying a company from reporting under the Laws solely because of routine short-term revenue volatility or of one-time gains or losses that may cause a company to exceed or fall beneath the revenue threshold, we recommend that a company is considered to qualify under the Annual Revenue Threshold if the threshold is exceeded in two consecutive years. Likewise, a company falls out of qualification if its Annual Revenue is under the Threshold for two consecutive years.

7. **Emphasize Wide Judgment in Estimates and Provide Exemptions for Certain Financed Emissions:** Municipal governments, affordable housing partnerships and other entities that are formed strictly to achieve social objectives. If CARB decides to effectively exempt them from the SB 253 reporting requirements, they may nevertheless be required to provide emissions estimates to their investors and other stakeholders because of "financed emissions" requirements under the GHG Protocol. In addition to emphasizing high levels of judgment and the flexible estimation approaches provided in the GHG Protocol, CARB should specifically exempt from reporting the financed emissions (Category 15 of Scope 3 emissions per the GHG Protocol) related to those entities and of non-financial companies. Without these exemptions, such entities, as well as smaller community banks,[2] may be required to provide Scopes 1, 2, and 3 estimates to their equity investors, lenders, and depositors. This would create undue cost burdens that could undermine their ability to support their essential missions.

On the attached Appendix, we have included more detailed discussions of the critical recommendations above.

Thank you for your attention to these concerns and for considering our recommendations. Please feel free to contact me (mgullette@aba.com; 202-663-4986) if you would like to discuss these issues further.

Sincerely,

Michael L. Gullette

[2] Under the GHG Protocol, a proportion of the emissions of a bank would be considered financed by the bank depositors.

APPENDIX: Detailed Discussion of ABA Recommendations

1. The Laws Must Allow Companies Broad Flexibility to Comply.

Both SB 253 and SB 261 emphasize transparency and accountability in their requirements for reporting entities to disclose climate-related information. However, these laws also recognize the need for flexibility in how entities meet these requirements. CARB's implementation of these laws should reflect this intent by ensuring that the reporting frameworks under each law accommodate the diverse operational realities of reporting entities, while maintaining the relevance of the disclosed information for key decision-making.

Flexibility is a cornerstone of established climate disclosure frameworks referred to within each law, including the Greenhouse Gas (GHG) Protocol and the recommendations of the Task Force for Climate-related Financial Disclosure (TCFD). These frameworks were developed to address the inherent complexities and variability of climate-related data collection, allowing entities to apply judgment and focus on emissions and risks relevant to their stakeholders. For example:

- GHG Protocol: The Corporate Value Chain (Scope 3) Standard provides critical flexibilities, such as allowing a variety of options in estimation approaches as well as justified exclusions for emissions categories where data is unavailable or irrelevant, provided these exclusions are disclosed and explained.[3]

- TCFD: The TCFD framework emphasizes forward-looking, qualitative disclosures, explicitly stating that its recommendations are "flexible enough to accommodate evolving practices…as understanding, data analytics, and modeling of climate-related issues…mature."[4]

As a primary role in implementing SB 253 and SB 261, CARB should build on these principles of flexibility to ensure compliance remains practical and operational for reporting entities on an ongoing basis. For SB 253, this means incorporating the GHG Protocol's flexibilities into its regulations by reference, allowing reporting entities to address Scope 3 emissions challenges, such as data availability[5] and time lags,[6] without compromising the quality and usefulness of disclosures. For SB 261, this entails recognizing the significant differences between the 2017 and

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[3] See GHG Protocol Scope 3 Reporting Standard at https://ghgprotocol.org/corporate-value-chain-scope-3-standard. Other options and exclusions are also inclusions within guidance provided by the Partnership for Carbon Accounting Financials (PCAF), which is a source for measuring certain Scope 3 (Category 15) financed emissions within investment portfolios. The PCAF guidance "has been reviewed by the GHG Protocol and is in conformance with the requirements set forth in the Corporate Value Chain (Scope 3) Accounting and Reporting Standard, for Category 15 investment activities." See https://carbonaccountingfinancials.com/standard

[4] See TCFD Recommendations at https://www.fsb-tcfd.org/recommendations/

[5] Within this discussion, data availability relates to the accessibility of data. However, such data must also be relevant, accurate, reliable, comparable, verifiable, and timely.

[6] Time lags in receiving timely information from value chain partners will often occur today. See detailed explanation below on reporting time lags.

2021 TCFD recommendations and ensuring entities have the option to disclose under the 2017 framework, which remains robust and widely adopted.

Recommendation: CARB should adopt and emphasize a flexible regulatory approach that aligns with the intent of SB 253 and SB 261. This includes incorporating GHG Protocol by reference, allowing companies significant judgment in assessing measurement options, including justified exclusions for some Scope 3 emissions. This would also ensure entities retain the option to disclose under the 2017 TCFD recommendations.

2. Incorporate the GHG Protocol by Reference Without Standardizing Specific Approaches.

Under SB 253, CARB is tasked with developing and adopting regulations requiring reporting entities to disclose Scope 1, Scope 2, and Scope 3 greenhouse gas emissions in accordance with the GHG Protocol and its associated guidance. To fulfill this mandate, CARB should adopt the GHG Protocol as the foundation for its regulations by explicitly incorporating it by reference within those regulations. This approach means the GHG Protocol's established standards and guidance, including its flexibilities, would become part of the regulatory framework as written, enabling companies to comply with the regulation while addressing the significant challenges associated with Scope 3 emissions reporting.

One of the primary challenges lies in disclosing Scope 3 financed emissions, particularly for financial institutions. Unlike Scope 1 and Scope 2 emissions, which are directly tied to a company's own operations, Scope 3 financed emissions depend on aggregating data from a wide range of counterparties, such as borrowers, investees, and other third parties. These emissions often require sourcing data from external vendors that rely on public disclosures, on proprietary reporting, and on their internal estimates.[7] This process is then complicated by significant time lags, often 12 to 18 months, between the reporting year and the availability of relevant emissions data. For example, a financial institution's financed emissions for fiscal year 2024 would rely on exposure data from 2024 but emissions data from 2022 or 2023, depending on vendor timelines.[8] These challenges are an example for why a flexible approach to Scope 3 reporting is not just preferable but necessary for compliance with SB 253.

The GHG Protocol is well-suited to addressing these challenges due to the flexibilities built into its standards. By explicitly incorporating the GHG Protocol by reference, CARB would allow reporting entities to use established methodologies that accommodate the complexities of Scope 3 reporting. For example, the Corporate Value Chain (Scope 3) Standard of the GHG Protocol includes provisions that enable entities to exclude certain emissions categories that are irrelevant to the business or when data is unavailable.

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[7] Current processes are not normally subject to third party reasonable assurance auditing and may need significant revision once such auditing is performed.

[8] Under PCAF guidance, for example, exposure data would enable a reporting entity to estimate what proportion of an investee's annual emissions are considered "financed" by the investor. Reliable estimates at that point of an investees' value chain emissions would be available only when based on 2022/2023 data.

One such example is Scope 3 Category 12 (End-of-Life Treatment of Sold Products), which accounts for emissions from the waste disposal and treatment of products sold by a reporting company. While this category is significant for manufacturers or retailers, it holds little relevance for financial institutions, which do not sell physical products. Similarly, other categories, or aspects of other categories, may also prove insignificant to a financial institution's emissions profile.

Importantly, these flexibilities are narrowly tailored to maintain the relevance and accuracy of reported GHG emissions inventories. The GHG Protocol explicitly states that companies must not exclude any activity that would compromise the overall relevance of their GHG emissions inventory. Bank stakeholders will normally focus on emissions of certain borrowers in targeted industries. As a result, entities remain accountable while focusing on disclosing their most significant emissions to their stakeholders.

CARB has also asked whether it should standardize the disclosure of Scope 1, Scope 2, and Scope 3 emissions. ABA strongly recommends against this. Standardizing a single disclosure approach would undermine the adaptability that makes the GHG Protocol effective. Furthermore, other major disclosure regimes, such as the EU's Corporate Sustainability Reporting Directive (CSRD), already rely on the GHG Protocol as the foundation for emissions reporting. Introducing a California-specific standardized approach would create significant additional compliance burdens for entities that operate across multiple jurisdictions, requiring them to reconcile between inconsistent reporting requirements. The GHG Protocol was designed to address the diverse operational realities faced by reporting entities and to accommodate evolving best practices and many are using it in mandatory regimes as well as on a voluntary basis. Imposing a prescriptive, one-size-fits-all framework would create unnecessary burdens for reporting entities and could limit the practical value of the disclosures for stakeholders.

Recommendation: To fulfill its statutory mandate under SB 253, CARB should adopt regulations that explicitly incorporate the GHG Protocol by reference, including its flexibilities and methodological guidance. CARB should avoid standardizing specific disclosure approaches, as doing so would conflict with the adaptability embedded in the GHG Protocol, thus creating compliance challenges. Additionally, CARB should adopt the GHG Protocol version in effect as of SB 253's enactment. Entities can disclose how future updates to the GHG Protocol are integrated into their methodologies. Entities should also be allowed to provide or include an index where CARB-required information can be incorporated by reference to where it is elsewise disclosed.

3. Allow flexibility in TCFD-Aligned Disclosure.

SB 261 requires covered entities to prepare and publicly disclose a climate-related financial risk report aligned with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), or an equivalent framework, such as the IFRS Foundation's International Sustainability Standards Board (ISSB) standards. ABA recognizes and appreciates that SB 261 provides broad flexibility, allowing entities to disclose under various versions of the TCFD

recommendations or equivalent frameworks. While such flexibility is a critical aspect of the statute, ABA wishes to reiterate its importance by highlighting some of the challenges entities face with the 2021 TCFD recommendations, which were also incorporated into the ISSB.

Many financial institutions have not fully adopted key aspects of the 2021 recommendations because they often conflict with how banks manage and disclose climate-related risks in practice. New disclosure recommendations on financial impacts, transition plans, and executive remuneration, among others, impose prescriptive requirements that do not align with the way financial institutions integrate climate risks into their existing risk management frameworks. For example, related to financial impacts, a significant challenge is isolating financial impacts attributable solely to climate-related risks, as outcomes like credit losses are often influenced by multiple factors, including economic conditions, regulatory changes, and climate drivers. Financial institution responses to climate risk can also vary, based on underwriting guidelines and pricing, in which the direct climate-related impacts are highly obscure. Further, institutions face methodological hurdles, including limited access to high-quality, reliable data and inconsistencies in their availability across markets.

Recommendation: The 2017 TCFD recommendations are a robust set of disclosures. In the final regulations, CARB should explicitly affirm that the 2017 TCFD recommendations are sufficient for compliance. This will avoid setting an expectation that entities must align with the 2021 updates.

4. Annual Revenue Thresholds should be Based on Investor and Regulatory Norms.

The $500 million (for SB 261) and $1 billion (for SB 253) annual revenue thresholds are relatively straightforward and understandable. Determining “revenue,” however, can be subject to different accounting and regulatory practices that differ from industry to industry. Driven by the unique business models of regulated banking institutions, both investors and banking industry regulators typically prefer total revenue for regulated banking institutions to be based on net interest income (gross interest income, less interest expense).

In compliance with regulatory safety and soundness requirements, regulated banking institutions invest their customer deposits primarily through making loans and holding debt securities. The level of customer deposits and resulting interest income are highly influenced by Federal fiscal and monetary policies. For example, due to pandemic-era support programs and tax policies, banking industry deposits rose significantly during 2020 and 2021. The related interest income and expenses from deposits were then highly influenced by monetary policy actions (such as increases in the Federal Funds rate) conducted by the Federal Reserve. While individual institution marketing and lending practices have an impact on reported interest income and interest expense, the vast majority of changes in each generally result from powers outside of company control (namely fiscal and monetary policies). It is the change in the net amount that banks are managing and, as a result, both banking regulators and bank investors use net interest income (interest income less interest expense) as the base metric in which total bank revenue (which adds non-interest income) is based. This is reflected in regulatory Call Reports, as well as bank financial statements.

For the purposes of compliance with the Laws, applying total interest income (without deducting interest expense) as the starting point would subject regulated banking institutions to revenue volatility that may scope an entity both into and out of the reporting requirements solely because of fiscal and monetary policies that the institution has no control over. For example, when general interest rates increase, both interest income and expense will increase without significant change in the profitability of the institution.

Recommendation: ABA, therefore, recommends that the total annual revenues threshold be based on Net Interest Income for regulated banking institutions.

5. Annual Revenue Thresholds should Exclude Other Comprehensive Income.

Companies in many industries will commonly have long-term investment and hedging activities that may result in short-term market value gains and losses that are not included within net income in their financial statements. The short-term changes in the value of instruments used in these activities are presented as other comprehensive income (OCI) in the financial statements and normally reverse into net income within three to four years. As a result, the vast majority of companies in the U.S. report net income and not the net comprehensive income that would also include OCI.

If CARB decides to include OCI within the revenue calculation, it will need to also state whether OCI items that decrease Accumulated OCI will be counted to decrease "annual revenue" for the purposes of inclusion under the Laws. Like the problem noted above related to inclusion of gross interest income, inclusion of these items in OCI within the definition of "revenue" will subject companies to revenue volatility that may scope an entity both into and out of the reporting requirements on a yearly basis. We do not believe that CARB intends the laws to work this way.

Recommendation: Computing the $500 million and $1 billion revenue thresholds by excluding OCI items will both simplify the formula and align the criteria with those used by banking regulators and investors. **Therefore, ABA recommends that items in Other Comprehensive Income in financial statements be excluded from the calculation of total annual revenues.**

6. The Annual Revenue Criterion Should be Based on the Two Previous Fiscal Years.

Both SB 253 and SB 261 state that reporting compliance will be based on "prior fiscal year" annual revenues. For companies in certain industries, routine yearly volatility in revenues may cause a company to exceed or fall beneath the revenue threshold on a regular basis. Revenue volatility can occur because of one-time gains and losses from sales of operating units. In the banking industry, one-time gains can sometimes be unforeseeable from a planning perspective. For example, Federal Financial Assistance provided to a bank by the Federal Deposit Insurance Corporation (FDIC) in its duty to resolve a failing bank can be a sudden and significant one-time gain that would not be recurring. We do not believe CARB intends for reports to be issued only once.

Recommendation: Rather than exempting or qualifying a company from reporting under the Laws solely because of routine short-term revenue volatility or of one-time gains or losses that may cause a company to exceed or fall beneath the revenue threshold, we recommend that a company is considered to qualify under the Annual Revenue Threshold if the threshold is exceeded in two consecutive years. Likewise, a company falls out of qualification if its Annual Revenue is under the Threshold for two consecutive years.

7. Emphasize Wide Judgment in Estimates and Provide Exemptions for Certain Financed Emissions.

While SB 253 seeks to promote transparency and accountability, the practical implications of requiring such entities to measure and report GHG emissions could lead to costly unintended consequences. Specifically, while financed emissions reporting under Category 15 in Scope 3 of the GHG Protocol may require financial entities to measure Scopes 1, 2, and 3 of their borrowers, it could necessitate similar detailed emissions estimates by a wide range of socially-chartered entities and small businesses.

- ***Municipal entities and projects, affordable housing partnerships, and other investments that support Federal, state, and local social programs***

  In question 1b of the Solicitation, CARB effectively asks whether federal or state government entities that generate revenue should be included in the scope of the laws. Municipal entities and projects, such as affordable housing partnerships, often support critical federal, state, and local social programs. While CARB may effectively exempt such entities from SB 253 reporting by deciding they fall outside the statutory definitions of a "business entity" that does business in California,", these entities could still face costly indirect burdens if security holders, such as financial institutions, require their GHG emission data for Scope 3 financed emissions reporting. Without clear enforcement practices that recognize this challenge, these indirect burdens could undermine the intended exemptions and disproportionately impact municipalities nationwide, especially if other states adopt similar laws without providing comparable relief.

- ***Other small entities that are parts of large corporate value chains***

  Responding to question 4 of the Solicitation, small businesses, such as contractors, small farmers, grocers, and restaurants, also face disproportionate challenges in Scope 3 emission reporting. While normally exempt from SB 253 reporting requirements, they may, nevertheless, need to provide emissions data to larger corporate value chain partners who have reporting obligations, particularly when reasonable assurance attestations are required. Additionally, small community banks with corporate depositors could be required to measure and provide financed emissions estimates to these entities. These requirements could impose significant costs on small businesses and small financial institutions, creating inefficiency without necessarily advancing transparency goals.

To address these challenges, SB 253 already permits reporting entities to use reasonable estimates, proxy data, and sectoral averages for Scope 3 emissions reporting. These tools are essential for financial institutions and other entities, as they allow reporting to remain achievable when precise data is unavailable from counterparties, particularly smaller businesses and exempt organizations. For example, financial institutions often rely on sectoral averages or estimates to calculate financed emissions for borrowers and investees, as granular emissions data from these counterparties is frequently inaccessible or unreliable.

Recommendation: ABA notes the following challenges to highlight that CARB should similarly recognize the importance of the existing flexibilities under SB 253, including the use of reasonable estimates, proxy data, and sectoral averages for Scope 3 emissions reporting. These methodologies are critical for addressing the practical challenges faced by financial institutions and other reporting entities in collecting emissions data from smaller companies, municipal entities, and exempt organizations. By emphasizing these approaches, as well as the high level of judgment – informed by both quantitative and qualitative factors – needed to implement them, CARB can reduce unintended compliance burdens while maintaining the law's focus on transparent reporting. ABA further recommends, however, that CARB provide broad exemptions that exclude financed emissions from Scope 3 non-financial institutions, which would alleviate the need for smaller banks from providing this information to their corporate depositors.