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SEC Issues Proposed Rules for Enhancement and Standardization of Climate-Related Disclosures

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Today, the U.S. Securities and Exchange Commission (SEC) issued proposed rules that would require reporting companies to enhance and standardize climate-related disclosures.

Specifically, the commission voted to approve moving forward with proposed changes related to information about climate-related risks contained in registration statements and periodic reports, such as a company's annual Form 10-K, that are likely to have a material impact on the business, results of operations or financial conditions, and also related to certain climate-related financial statement metrics in a note contained in their audited financial statements. Under the proposed rule amendments, the required information about climate-related risks also would include disclosure of a registrant's greenhouse gas (GHG) emissions, which have become a commonly used metric to assess a registrant's exposure to such risks.

The SEC's press release on the proposed rules can be found **here**. In addition, the SEC has published an informative **Fact Sheet** on its proposed enhancement and standardization of climate-related disclosures. The proposed rules will be published on SEC.gov and in the Federal Register, upon which they will be open for public comment. The comment period will remain open for 30 days after publication in the Federal Register, or 60 days after the date of issuance and publication on sec.gov, whichever period is longer.

Background

The SEC began efforts to provide investors with material information about environmental risks facing public companies in the 1970s and most recently provided related guidance in 2010. The commission is of the view that many investors are concerned about the potential impacts of climate-related risks to individual businesses and, as a result, are seeking more information about the effects of climate-related risks on a company's business to inform their investment decision-making. Investors also have expressed a need for more consistent, comparable and reliable information about how a registrant has addressed climate-related risks when conducting its operations and developing its business strategy and financial plan.

In theory, the 2010 guidance addressed the SEC's intended objective of improved disclosure. That guidance required discussion of material direct and indirect impacts from climate change in a company's SEC filings in the Description of Business, Risk Factors, Legal Proceedings, and Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) sections. The facts and circumstances driving such disclosures included developments such as climate-related legislation or regulations, international agreements, indirect consequences of business trends including changing demand for goods, and the physical impacts of climate change. These requirements resulted in what the SEC described as "a general increase" in climate change disclosures.

However, today's proposal notes the following deficiencies cited by the SEC staff in the present disclosure regime:

- Considerable variation in the content and detail in the climate-related disclosures presented.
- Considerable variation in the location of these disclosures, i.e., in reports filed with the commission, in sustainability reports posted on registrant websites, or elsewhere.
- Significant inconsistency in the depth and specificity of disclosures by registrants across industries and within the same industry.
- Significantly more extensive information is presented in registrants' sustainability reports and other locations such as their websites as compared with their reports filed with the commission, which in the SEC's view would hold more prominence for investors.
- Disclosures in annual reports frequently contain general, commonplace and boilerplate discussions that provide limited information as to registrants' assessments of their climate-related risks or their impact on their businesses.

In summary, many issuers currently seek to provide climate-related information to meet stakeholder demands, but the above points indicate that current disclosure practices are largely voluntary, and therefore fragmented and inconsistent.

Accordingly, the SEC's proposal is intended to address the above issues by enhancing and standardizing climate-related disclosures to address investor and other stakeholder information needs. The proposed rules would help issuers more consistently, efficiently and effectively disclose these risks, which would benefit both investors and issuers.

Summary of the proposed disclosures

The proposed rules would amend both Regulation S-K (SEC rule covering qualitative reporting requirements for various public filings by public companies) and Regulation S-X (SEC rules covering financial statements and related reporting).

Qualitative reporting requirements

Regulation S-K nuances would require a registrant, in its periodic reporting, to disclose information about the following:

- The oversight and governance of climate-related risks by the registrant's board and management;
- How any climate-related risks identified by the registrant currently or are likely to:
  - Have a material impact on its business and consolidated financial statements, which may manifest over the short-, medium- or long-term;
  - Affect the registrant's strategy, business model and outlook;
- The registrant's processes for identifying, assessing and managing climate-related risks and whether any such processes are integrated into the registrant's overall risk management system or processes;
- If the registrant has adopted a transition plan as part of its climate-related risk management strategy, a description of the plan, including the relevant metrics and targets used to identify and manage any physical and transition risks;
- If the registrant uses scenario analysis to assess the resilience of its business strategy to climate-related risks, a description of the scenarios used, as well as the parameters, assumptions, analytical choices and projected principal financial impacts;
- If a registrant uses an internal carbon price, information about the price and how it is set;
- The impact of climate-related events (severe weather events and other natural conditions) and transition activities on the line items of a registrant's consolidated

financial statements, as well as the financial estimates and assumptions used in the financial statements;

- The registrant's direct GHG emissions (Scope 1) and indirect GHG emissions from purchased electricity and other forms of energy (Scope 2), separately disclosed, expressed both by disaggregated constituent greenhouse gases and in the aggregate, in absolute terms, not including offsets, and in terms of intensity (per unit of economic value or production);

- Indirect emissions from upstream and downstream activities in a registrant's value chain and related to the GHG effects from the use of the issuer's products and services by customers and in managing the related lifecycle considerations (Scope 3), if material, or if the registrant has set a GHG emissions target or goal that includes Scope 3 emissions, in absolute terms, not including offsets, and in terms of intensity; and

- If the registrant has publicly set climate-related targets or goals, information about:

  - The scope of activities and emissions included in the target, the defined time horizon by which the target is intended to be achieved and any interim targets;

  - How the registrant intends to meet its climate-related targets or goals;

  - Relevant data to indicate whether the registrant is making progress toward meeting the target or goal and how such progress has been achieved, with updates each fiscal year; and

  - If carbon offsets or renewable energy certificates (RECs) have been used as part of the registrant's plan to achieve climate-related targets or goals, certain information about the carbon offsets or RECs, including the amount of carbon reduction represented by the offsets or the amount of generated renewable energy represented by the RECs.

When responding to any of the proposed rules' provisions concerning governance, strategy and risk management, a registrant may also disclose information concerning any identified climate-related opportunities.

Presentation and attestation matters

Under the proposed rules, the SEC would also require registrants, including foreign private issuers, to:

- Provide the climate-related disclosure in its registration statements and Exchange Act annual reports, for example on Form 10-K;
- Provide the Regulation S-K mandated climate-related disclosure in a separate, appropriately captioned section of its registration statement or annual report;
- Provide the Regulation S-X (SEC rule covering annual reports and financial statements) mandated climate-related financial statement metrics and related disclosure in a note to its consolidated financial statements. (Note: Including this information in a note to audited financial statements adds this disclosure to the external financial statement auditor's purview, as well as to a registrant's internal control over financial reporting processes and considerations);
- If an accelerated or large accelerated filer, the issuer is required to obtain an attestation report from an independent attestation service provider covering, at a minimum, Scopes 1 and 2 emissions disclosures. (Note: While the SEC states that this need not be done by an independent public accounting firm, as a practical matter, since the items required by the proposed changes to Regulation S-X will require a registrant's auditor to be involved, synergies and potential duplication of cost and effort need to be considered.)

Timing for compliance

The SEC's proposed rules include a phase-in period for all registrants, with the compliance date dependent on the registrant's filer status, and an additional phase-in period for Scope 3 emissions disclosure. Assuming the SEC adopts the proposed rule later this year and a filer has a December 31 fiscal year-end, these climate-related disclosures would be required under the following deadlines:

Registrant type	Disclosure compliance date	
	All proposed disclosures, including GHG emissions metrics: Scope 1, Scope 2, and associated intensity metric, but excluding Scope 3	GHG emissions metrics: Scope 3 and associated intensity metric
Large accelerated filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)
Accelerated filer and non-accelerated filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)
Smaller reporting company	Fiscal year 2025 (filed in 2026)	Exempted

The assurance (i.e., attestation) requirement also is phased in:

Filer type	Scopes 1 and 2 GHG disclosure compliance date	Limited assurance	Reasonable assurance
Large accelerated filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)	Fiscal year 2026 (filed in 2027)
Accelerated filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Fiscal year 2027 (filed in 2028)

Our point of view/considerations for registrants

Companies should consider the following action items coming out of this proposed rulemaking development:

- Stakeholder interests have driven **more than 450 companies in the S&P 500** to make voluntary disclosures regarding environmental, social and governance (ESG) matters. Whether the current form of the SEC's rule or some alternative comes into effect, given such stakeholder interests, every public company and any private company looking to go public should consider their readiness to meet the reporting requirements of this rule.

- To the extent that a company will have to make these disclosures, readiness considerations should include an understanding of who (inside or outside the company) will be able to access and provide the necessary data, some of which involves complicated calculations, and the use of data from sources which are not familiar to the CFO, FP&A and other financial reporting teams that will be responsible for the filings.

- As noted above, the requirement to include climate-related metrics and related disclosures in a note to the financial statements adds complications from a control environment standpoint. Insofar as these disclosures are concerned, the vague and subject-to-interpretation disclosure controls and procedures requirement addressed in the Section 302 quarterly executive certifications will give way to the more rigorous internal control over financial reporting framework as set forth in Section 404. This point alone merits careful consideration sooner rather than later in evaluating the processes by which the related metrics and disclosures are generated.

- Because an attestation will be required in some form, consider whether to use the company's external auditor to deal not only with the required S-X financial footnote attestation, but also any other attestation ultimately needed for the S-K data.

- Bring the audit committee (and internal audit) and SEC counsel into the conversation during the planning phases so that resources and priorities can be aligned, assuming this rule or some form thereof is ultimately approved and goes into effect.

As the SEC noted in its deliberations, the impetus for this action emanates from market interest and the need for consistency and accountability. With its prior action on **Human Capital Reporting disclosures**, the SEC put some of the "S" in ESG into play. With this proposed action, an important aspect of the "E" in ESG will be added to the mix. And, although these are both new or emerging areas of required disclosure for registrants, it would be surprising if any public company, or any private company looking to go public via the traditional IPO route or through a merger with an already public SPAC, hasn't already fielded questions from investors, employees, vendors, customers, lenders and other stakeholders regarding ESG information. Consequently, regardless of the timing or final form of the rule, companies would be well-advised to be, and otherwise will benefit from becoming, aware of their readiness for disclosure and attestation on climate data.

Concluding comments: the winds of change

This action by the SEC has been long anticipated ever since Gary Gensler was appointed chair of the commission. The proposal is an integral part of the Biden administration's focus on creating transparency for institutional investors, activists, regulators and other stakeholders. Transparency means accountability and the ultimate impact could mean shifts in capital flows.

Some observers have noted that the proposal, in its present form, could result in legal challenges around such issues as the SEC's authority and Scope 3 disclosures. However, change is in the winds. An explicit climate change rule, in one form or another, is coming. Issuers and public company aspirants had best prepare for it.

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