HIGHLIGHTS OF THE SEC'S PROPOSED "RULES OF THE ROAD" FOR CLIMATE-RELATED DISCLOSURES

Mar 22, 2022

On March 21, 2022, the SEC announced proposed new rules that would require public companies to disclose certain climate-related information in registration statements and periodic reports. Under the rules, a company would be required, among other things, to:

- Disclose climate-related risks that are reasonably likely to have a material impact on the company's business, results of operations and/or financial condition, as well as detailed information regarding the company's greenhouse gas emissions;
- Provide climate-related financial metrics in a note to the company's audited financial statements; and
- In the case of accelerated filers and large accelerated filers and subject to certain phase-in provisions, provide an attestation report from an independent attestation service provider covering Scope 1 and 2 greenhouse gas (GHG) emissions disclosures.

The proposal passed by a 3-1 vote, with Commissioner Peirce issuing a vigorous dissent, as discussed below.

The public comment period will remain open until the later of May 20, 2022 or 30 days following publication of the proposing release in the Federal Register. At 60 days, the comment period is closer to the SEC's traditional practice and longer than the comment period provided for some recent proposals under Chairman Gensler which had attracted criticism from some commentators for their brevity.

Background

As discussed in our September 23, 2021 blog post, in 2010, the SEC first issued guidance regarding the disclosure of climate-related risks and, more recently, in September 2021, the SEC issued a sample comment letter supplementing the 2010 guidance. In yesterday's proposal, the SEC made a giant leap forward, proposing rules that would mandate specific detailed climate-related disclosures. The SEC said it believes that investors' needs for climate-related information are not

being met under the current disclosure regime, and that companies need clear rules for the meaningful disclosure of climate-related information regarding their businesses. As observed by SEC Chairman Gensler in a Statement at the Open Meeting, the rules would provide investors with "consistent, comparable, and decision-useful information for making their investment decisions, and it would provide consistent and clear reporting obligations for issuers."

The SEC also noted that the rules would require disclosures that are similar to those already being made by companies that have adopted existing disclosure frameworks, such as the Task Force on Climate-Related Financial Disclosures (the "TCFD") and the Greenhouse Gas Protocol.

Proposed New Disclosure Requirements

The proposed rules would require a public company to disclose information that includes, among other items, information regarding:

- The board's oversight and governance relating to climate-related risks, as well as management's role in assessing and managing such risks;
- How any climate-related risks identified by the company have had, or are likely to have, a material impact on the company's business and/or consolidated financial statements over the short-, medium- and/or long-term;
- How any identified climate-related risks have affected, or are likely to affect, the company's strategy, business mode and outlook;
- The impact of climate-related events (severe weather events and other natural conditions) and transition activities (i.e., activities aimed at reducing a company's carbon footprint and impact on the climate) on the line items of the company's consolidated financial statements, as well as the company's related financial estimates and assumptions used in the financial statements;
- The company's processes for identifying, assessing and managing climate-related risks and whether those processes are integrated into the company's overall risk management systems or processes;
- If the company has adopted a transition plan, a description of the plan, including the relevant metrics and targets used to identify and manage any physical and transition risks;
- If a company uses scenario analysis to assess the resilience of its business strategy with respect to climate-related risks, a description of the scenarios used, as well as of the related parameters, assumptions, analytical choices, and projected principal financial impacts;
- If a company uses an internal carbon price, information about the price and how it is set;

- The company'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, and 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 company's value chain (Scope 3), if material or if the company has set a GHG emissions target or goal that includes Scope 3 emissions; and
- If the registrant has publicly set climate-related targets or goals, information that includes:
  - The scope of the activities and emissions included in the target, the date by which the target is intended to be achieved and any interim targets;
  - How the company intends to meet its climate-related targets or goals;
  - Whether the company is making progress toward meeting its targets or goals and how such progress has been achieved, along with updates each fiscal year; and
  - If carbon offsets or renewable energy certificates ("RECs") have been used to achieve climate-related targets or goals, certain information about them, including the amount of carbon reduction represented by the offsets or the amount of generated renewable energy represented by the RECs.

The proposed rules would exempt smaller reporting companies from the Scope 3 disclosure requirements and would also provide a liability safe harbor for any forward-looking Scope 3 emissions disclosures.

Disclosure Location, Attestation Requirement and Phase-In Periods

Disclosure Location. The proposed rules would require a company (including a foreign private issuer) to:

- Provide the climate-related disclosure mandated by Regulation S-K in separate appropriately captioned sections of registration statements and Exchange Act reports (including Form 10-K);
- Provide the climate-related disclosure mandated by Regulation S-X in a note to the financial statements; and
- Tag both the narrative and the quantitative climate-related disclosures in Inline XBRL.

Attestation. Accelerated and large accelerated filers would be required to obtain an attestation report from an independent attestation service provider. The report would, at a minimum, be required to cover Scope 1 and 2 emissions disclosures.

Phase-In Periods. The proposal includes phase-in periods for all companies with respect to both the disclosure and attestation rules. The compliance dates would depend on a company's filer status. The attestation rule would be subject to a phase-in period for the attestation requirement itself and for the level of assurance required in the attestation (i.e., limited versus reasonable assurance). For example, if the proposal were to become effective in December 2022, for filers with a December 31st fiscal year end, disclosure compliance dates (other than for Scope 3 disclosures to the extent applicable) would range from the 2023 fiscal year for large accelerated filers (i.e., for filings made in 2024) to the 2025 fiscal year for smaller reporting companies (i.e., for filings made in 2026). The SEC's release and accompanying Fact Sheet include tables that provide additional details regarding the phase-in periods.

Commissioner Peirce Dissent

In a lengthy Statement declaring that "We are Not the Securities and Environment Commission – At Least Not Yet," Commissioner Peirce strongly dissented, expressing concern that the "action-packed" proposal would "turn the disclosure regime on its head," including by telling corporate managers how regulators expect them to run their companies. Possibly foreshadowing comments or litigation from opponents to the proposals, Peirce laid out a number of arguments, including arguments that:

- Existing disclosure requirements such as Regulation S-K Items 303 (MD&A), 101 (Description of Business) and 105 (Risk Factors) should already capture material risks relating to climate change, and that recent comment letter exchanges revealing that for many companies, climate change issues are not material;
- The proposal plays "fast and loose" with the definition of materiality, with some elements of the new rules applying to companies without regard to materiality (such as disclosure of Scope 1 and 2 GHG emissions and certain financial metrics), and others using "an expansive recasting" of the standard;
- The new rules would not lead to comparable, consistent and reliable disclosures, such as those relating to suppliers, customers and employees, changing climate regulations, technological developments and changing weather patterns, as well as "transition risk";
- The SEC lacks authority from Congress to propose the new rules, as they are not designed to protect investors, facilitate capital formation or foster fair, orderly and efficient markets; and
- The SEC underestimates the cost to implement the new rules because many companies are not already using established frameworks such as the TCFD in full; climate-related information such as Scope 3 emissions may not be available or tracked by customers and suppliers; and the costs of attestations and audits of new metrics will likely be expensive.

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MEET THE TEAM

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