Updates
March 30, 2022
What Companies Should Know Now About the SEC’s Proposed Rule on Mandatory Climate Disclosures—and How to Plan Ahead

The U.S. Securities and Exchange Commission, on March 21, 2022, proposed detailed and wide-ranging requirements for publicly traded companies to disclose their greenhouse gas (GHG) emissions and climate risks in their registration statements and annual or other periodic reports. The proposed rule, which was approved by a three-to-one vote, would require public companies (including foreign private issuers) to disclose certain climate-related information that would have material impacts on their business or financial reports, most notably mandating companies to disclose certain GHG emission metrics. Many companies would also need to obtain independent third-party attestation for GHG emissions disclosures, and report on progress toward any climate-related targets and goals, such as net-zero commitments. These new requirements, if adopted, would take effect at the earliest with respect to disclosures for fiscal year 2023.

The proposed rules are intended to enhance and standardize climate-related disclosures for investors. SEC staff found that a third of the nearly 7,000 annual reports reviewed in 2019 and 2020 included some disclosure related to climate change. While some companies already report emissions data in SEC and other investor-facing disclosures, the proposed rules would create a framework for all publicly traded companies. The rule builds on SEC guidance issued in 2010 on disclosing information on climate change and was the centerpiece of the White House's October 2021 executive order calling for the federal government to address climate-related financial risk. This update addresses the content of the disclosures under the proposed rule, the presentation and attestation of the disclosures, the phase-in periods for compliance with the proposed disclosures, and practical considerations for companies considering whether to take any action now to prepare for the potential final rules.

Content of the Proposed Disclosures

The proposed climate-related disclosure framework is modeled in part on existing voluntary disclosure frameworks such as the Task Force on Climate-Related Financial Disclosures (TFCD) and the Greenhouse Gas Protocol (GHG Protocol). The proposed required disclosures include the following.

- **Climate-Related Risks That Materially Impact Business and Financial Statements.** The rules require disclosure of climate-related risks that have or are likely to have a material impact on a company's business and consolidated financial statements, considering the magnitude and probability of the risk over the short, medium, and long term. The materiality determination would be "similar to what is required when preparing the management discussion and analysis (MD&A) section in a registration statement or annual report," according to the proposing release.

  The proposed rules define "climate-related risks" as the "actual or potential negative impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations, or value chains, as a whole." Events in the value chain include upstream activities, such as materials sourcing, materials processing, and supplier activities, as well as downstream activities related to a company's operations, including transportation and distribution, and end-of-life treatment of sold products. Climate-related risks include "physical risks," such as short-term extreme weather events and longer-term weather patterns and effects, as well as "transition risks," such as effects attributable to regulatory, technological, and market changes that address the mitigation of and adaptation to climate-related risk. For physical risks, companies would be required to disclose whether the risk is acute or chronic as well as the location (including ZIP code) of the properties, processes, or operations subject to the physical risk.

- **Impacts of Climate-Related Risks on Company's Strategy, Business Model, and Outlook.** The proposed rules require that companies identify the actual and potential effects of climate-related risks on a company's strategy, business model, and outlook, including impacts on its business operations; products or services; suppliers and other parties in its value chain; activities to mitigate or adapt to climate-related risks, including adoption of new technologies or processes; and expenditure for research and development. Where applicable, companies must also disclose the use of carbon offsets or Renewable Energy Credits or Certificates (RECs); the maintenance of an internal carbon price or estimated cost of carbon emissions; and the use of analytical tools such as scenario analysis to assess the impact of climate-related risks or to test the resilience of their strategies under future climate scenarios.
- **Oversight and Governance Disclosure.** The proposed rules require disclosure of the roles of a company's board and management in oversight and management of climate-related risks, including processes by which the board and management are informed about climate-related risks and frequency of discussions; whether any members of the board and management team have expertise in climate-related risks; whether and how the board considers climate-related risks as part of its business strategy, risk management, and financial oversight; and whether management positions or committees are responsible for assessing and managing climate-related risks.
- **Risk Management Disclosure.** The proposed rules require a description of a company's processes for identifying, prioritizing, assessing, and managing climate-related risks and whether such processes are integrated into a company's overall risk management system or processes. This disclosure requirement includes direction to address specific topics regarding how a company considers particular issues and makes determinations. The rules also include disclosures regarding a transition plan to reduce climate-related risks, if the company has adopted such a plan, and a discussion of how the plan mitigates or adapts to physical risks and transition risks.

  A company may also describe how it plans to achieve any identified "climate-related opportunities," defined as "actual or positive impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations, or value chains, as a whole." The proposal notes this requirement has been made optional to allay concerns about requiring disclosure that might have anti-competitive effects.

- **GHG Emissions Disclosure.**
  - **Scope 1 and 2 Emissions:** Scope 1 emissions are direct GHG emissions from operations that are owned or controlled by a company, and Scope 2 emissions are indirect GHG emissions from the generation of purchased or acquired electricity, steam, heat, or cooling consumed by internal operations. The proposed rules would require all companies to separately disclose Scope 1 and Scope 2 emissions metrics, expressed both by disaggregated constituent GHGs and in the aggregate, as well as in gross terms (metric tons of CO_2e) and intensity terms (metric tons CO_2e per unit of total revenues or per unit of product produced).
  - **Scope 3 Emissions:** Scope 3 emissions are all indirect GHG emissions occurring in the upstream and downstream activities in a company's value chain. Scope 3 emissions must be disclosed only if a company determines them "material," or if a company has set a GHG emissions reduction target or goal that includes Scope 3 emissions. Materiality would be determined in the same way that it is determined for other SEC disclosure items, based on whether there is a substantial likelihood that a reasonable investor would consider the information important when making an investment or voting decision. The proposed rules include a "safe harbor" for Scope 3 emissions disclosure from certain forms of liability under federal securities law; an exemption for smaller reporting companies (SRCs); and an additional year to comply with the disclosure requirement beyond the compliance date for the other proposed rules.

- **Targets and Goals Disclosure.** If a company has set any climate-related targets or goals, the proposed rules would require certain information about those targets and goals, including the scope of activities and emissions included in the target; the unit of measurement; the defined time horizon for achievement of the target; and whether the time horizons are tied to climate-related treaties, laws, regulations, or policies. As earlier mentioned, a company would be required to disclose its use of carbon offsets or RECs to achieve climate-related targets or goals.
- **Financial Statement Metrics Disclosure.** Companies would be required to include in a note to its financial statements disaggregated metrics reflecting the impact of and expenditures related to severe weather events, climate-related transition activities, and climate-related risks. In addition, the rule would require disclosure of whether the estimates and assumptions used to produce the consolidated financial statements were affected by exposures to risks and uncertainties associated with, or known impacts from, limited related events.

Presentation and Attestation of the Disclosures

The proposed rules would require a company to:

- Provide the climate-related disclosure in its registration statement and Exchange Act annual report on Form 10-K or 20-F, as well as updates or amendments to these in periodic reports;
- Provide the Regulation S-K mandated climate-related disclosures, including the attestation if required, in a separate section of its registration statement or annual report captioned "Climate-Related Disclosure," or incorporate the information by reference from another section such as Risk Factors, Description of Business, or MD&A;
- Provide the Regulation S-X mandated climate-related financial statement metrics and related disclosures in a note to its audited financial statements; and
- Electronically tag both narrative and quantitative climate-related disclosures in Inline XBRL.

The proposed rules would require an accelerated filer or a large accelerated filer to include in the relevant filing an attestation report covering, at a minimum, the disclosure of Scope 1 and Scope 2 emissions and to provide certain related disclosures about the service provider.

Phase-In Periods and Accommodations for the Proposed Disclosures

The proposal provides a phase-in period for all companies, with the compliance date for disclosures dependent on a company's filer status. For example, if the proposed rules were adopted in final form in December 2022 and the filer has a December 31 fiscal year end, the compliance date for the proposed disclosures in the annual report, other than the Scope 3 disclosure and attestation requirement, would be:

- For a large-accelerated filer, fiscal year 2023 (filed in 2024);
- For an accelerated or non-accelerated filer, fiscal year 2024 (filed in 2025); and
- For a SRC, fiscal year 2025 (filed in 2026).

As noted above, those subject to the proposed attestation report and Scope 3 disclosure requirements would have an additional year to comply with these additional requirements. The fact sheet issued in conjunction with the proposed rules provides tables detailing the phase-in periods.

Practical Considerations

The proposed rules, if adopted, would have significant impacts on many companies—both those that have already been disclosing certain climate-related information and those that have not yet started. Given the significant cost and complexity of compliance, and potential risk of noncompliance, companies should begin assessing their readiness for climate disclosure reporting now. Some questions to consider include:

- Should oversight of climate related risks be assigned to a new or existing committee? Should the board consider whether to seek new members that have experience related to climate-related risks or transition plans to address such risks?
- Does the company have established teams in charge of climate-related reporting? What knowledge gaps need to be addressed?
- Does the company already track and report on its Scope 1 and 2 GHG emissions? If not, what processes need to be established to facilitate such reporting?
- How does the company collect and verify third-party data related to climate? What are the barriers to collecting and calculating Scope 3 emissions data?
- Has the company made any climate-related commitments, including GHG emissions reductions or net-zero goals, and has it assessed its ability to achieve such goals, and any risks that might prevent achievement?
- Has climate risk been integrated into the company's risk management framework?
- Has the company begun to consider the possibility that it will need to seek attestation of its Scope 1 and 2 emissions disclosures, and possibly other disclosures?
- Does the company's external auditor have climate-related expertise? What preparation does the financial reporting team need to do in order to measure and disclose the climate-related metrics in the financial statements?
- How much additional lead time will be required to include the various disclosure requirements, including the attestation report and audited financials, in its annual report?

The disclosures will generally be filed rather than furnished and therefore subject to officer certifications and increased liability exposure. Companies should therefore ensure that their climate disclosures are subject to disclosure controls and procedures and allocate enough resources to hire and train teams with the necessary expertise to accurately analyze and report on climate-related information and risks.

The proposed rules may have the perverse effect of discouraging companies from taking certain climate-related actions. For example, before choosing to use scenario analysis or setting climate targets or internal carbon prices, companies would need to carefully weigh the costs of triggering an ongoing disclosure obligation against the benefits of taking climate action. The proposed rules may also incentivize private companies to delay or halt their plans to go public because of increased costs and compliance burdens.

Looking Ahead

The comment period will remain open through May 20, 2022, or 30 days after the proposal is published in the Federal Register, whichever is longer. Given the far-reaching scope and complexity of the proposed rules, comments are expected to be extensive, and companies should consider preparing a comment letter or participating with industry groups that are preparing comment letters. The SEC will take those comments into consideration before issuing a final rule, which will be voted on by the SEC's four commissioners. The final rule is likely to face legal challenges over whether the SEC has the authority to mandate these disclosures. Regardless, the comprehensive scope and detailed reporting requirements included in the SEC's proposed climate disclosure rules are a call for immediate action, and are likely to influence how investors, key stakeholders and the outside world measure a company's commitment to sustainability and combatting climate risks from here on out.

For additional discussion of practical considerations of the proposed rules, see our series of blog posts regarding the proposal on PublicChatter.com.

Authors

Explore more in

Environment, Energy & Resources Sustainability & Corporate Responsibility Corporate Governance White Collar & Investigations Climate Law

Related insights

Update

Two Tools for Trump To Dismantle Biden-Era Rules: the Regulatory Freeze and the Congressional Review Act

Update

The FY 2025 National Defense Authorization Act: What's New for Defense Contractors