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To the Point

SEC — proposed rule

SEC proposes enhancing and standardizing climate-related disclosures

The proposal is intended to provide consistent, comparable and reliable information to investors about how a registrant has addressed climate-related risks.

What you need to know

- The SEC proposed requiring registrants to disclose their greenhouse gas emissions in a separately captioned section of their registration statements and annual reports and to provide other disclosures about climate-related risks and the actual or reasonably likely material impacts on their business, strategy and outlook.
- Registrants would also have to disclose their climate-related targets and goals and how the board of directors and management oversee climate-related risks.
- Registrants would be required to quantify certain climate-related impacts in a note to their audited financial statements.
- Disclosures by accelerated and large accelerated filers about Scope 1 and Scope 2 greenhouse gas emissions would be subject to third-party assurance.
- The compliance date would depend on a registrant's filer status and would be phased in, beginning with fiscal year 2023. Comments are due at the later of 30 days after publication of the proposal in the Federal Register or 20 May 2022.

Overview

The Securities and Exchange Commission (SEC) proposed new rules to enhance and standardize disclosures that registrants make about climate-related risks, their climate-related targets and goals, their greenhouse gas (GHG) emissions and how the board of directors and management oversee climate-related risks. The proposal would also require registrants to quantify the effects of certain climate-related events and transition activities in their audited financial statements.

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In a statement, SEC Chair Gary Gensler said the proposed rules would provide investors with consistent, comparable and decision-useful information and would provide registrants with a consistent and clear framework for reporting. The proposing release said climate disclosures are "fundamental" to investors' understanding of a registrant's business and prospects and, therefore, need to be provided in a new "Climate-Related Disclosures" section of registration statements and annual reports, though they could be incorporated by reference from other parts of the reports (e.g., risk factors).

The proposal draws on the framework developed by the Task Force on Climate-related Financial Disclosures (TCFD) and the Greenhouse Gas Protocol that are already starting to be used around the world. Registrants would be required to disclose information about climate-related risks that have or are reasonably likely to have material impacts to their business or financial statements. Accelerated and large accelerated filers would also be required to obtain assurance over their Scope 1 and Scope 2 emissions data.

In a new note to the audited financial statements, registrants would have to quantify and describe the effects of climate-related events and transition activities on individual line items and disclose the impact of climate-related events and transition activities on estimates and assumptions used in preparing the financial statements. The proposal would affect all registrants, including smaller reporting companies and foreign private issuers.

How we see it

The proposal would appear to apply to companies, including emerging growth companies, that are entering the US capital markets for the first time by conducting initial public offerings or as acquisition targets of public companies in a Form S-4. It also does not provide relief for recently acquired companies, which means registrants would need to include those operations in their disclosures upon consolidation.

Non-financial statement disclosures

Climate-related risks and their impact on a registrant

The proposal would require registrants to disclose climate-related risks reasonably likely to have a material impact on their business or consolidated financial statements over the short, medium and long term. These terms are not defined in the proposal and registrants would be required to disclose how they define them.

The proposal defines climate-related risks as the actual or potential negative effects of both physical risks and transition risks. Physical risks would include acute events, such as hurricanes, and chronic effects from weather patterns, such as those that lead to higher temperatures or rising sea levels. Transition risks would involve regulatory, technological and market changes to address the mitigation of climate risks, such as higher costs due to changes in law or policy or reduced demand for carbon-intensive products. Registrants would be required to disclose the nature of each risk, whether it is an acute or chronic physical risk or a transition risk, and their plans to mitigate or adapt to the risk. For physical risks, they would also need to make other disclosures, such as the percentage of properties that are located in flood hazard areas, including their locations.

Registrants would be required to describe the actual and potential impacts of each risk over time on their strategy, business model and outlook. A registrant that uses an internal carbon price to, for example, identify climate-related risks and opportunities would be required to disclose information about the price and how it is set.

Registrants would also be required to discuss whether and how any of the risks have or are reasonably likely to affect their financial statements, including any metrics they disclose in the proposed note to the audited financial statements.

The proposal also would require registrants to describe the resilience of their business strategy and any analytical tools, such as scenario analysis, they use to assess the risks. Registrants that use scenario analysis would have to describe the scenario(s) used (e.g., an increase in temperature of up to 1.5°C above pre-industrial levels) and the projected principal financial impacts of each scenario, among other things.

Governance and risk management

Registrants would be required to disclose whether any board members have climate-related expertise and, if so, describe that expertise. They would also be required to identify board members or committees responsible for the oversight of climate-related risks, whether and how the board considers climate-related risks, how it is informed about climate-related risks and the frequency of those discussions. Registrants would also need to disclose whether and how the board of directors sets climate-related targets or goals and how the board oversees progress toward those targets or goals.

Disclosures about management's role in assessing and managing climate-related risk would also be required. This would include the titles of people involved, their expertise and whether and how frequently they report to the board. The proposal would also require disclosures about how registrants identify, assess and manage their climate-related risks, including how they determine the relative significance and materiality of climate-related risks and how they consider existing or likely regulatory requirements or policies and changes in customer preference, technology or market prices. A registrant that has adopted a transition plan would be required to describe that plan, including any relevant metrics and targets used to identify and manage transition risks.

How we see it

These proposed requirements underscore the SEC's focus on how management and the board identify, assess and manage risk. The SEC recently proposed similar disclosure requirements about cybersecurity governance and risk management.

Targets and goals

Registrants that set climate-related targets or goals (e.g., goals to reduce GHG emissions) would be required to disclose the activities and emissions included in the target, how they intend to meet the target or goal, whether they are making progress toward meeting the target or goal, any interim targets they have set and details about any carbon offsets or renewable energy credits (RECs) that are part of the plan to achieve the target or goal.

GHG emission metrics

Registrants would be required to disclose direct GHG emissions from operations they own and control (Scope 1) and indirect emissions from purchased electricity and other forms of energy their operations consume (Scope 2). Registrants that are not smaller reporting companies would also be required to disclose indirect emissions from upstream and downstream activities in their value chain (Scope 3), if material, or if they have set a GHG emissions reduction target or goal that includes Scope 3 emissions.

Materiality would be assessed using the Supreme Court's reasonable investor standard, considering both quantitative and qualitative factors. The proposal says registrants would consider whether Scope 3 emissions make up a significant portion of their total GHG emissions and notes that some companies use a threshold of 40%. But it says registrants would also consider qualitative factors, such as whether they operate in an industry like the automotive industry that is already transitioning to lower-emission products.

Registrants would be required to disclose total GHG emissions for each scope required and emissions for each of the seven greenhouse gases[1] for all years reported in the financial statements and for all entities that it consolidates or that are accounted for as equity method investees in their financial statements. Registrants would be required to exclude any purchased or generated offsets from these disclosures. They would also have to disclose the intensity of their emissions (e.g., tons of carbon dioxide equivalent per unit of revenue).

How we see it

The proposal would align the operations included in Greenhouse Gas Protocol emissions disclosures with a registrant's consolidated financial statements. Registrants that currently report emissions voluntarily under the more flexible GHG Protocol should evaluate how this might affect their reporting.

The proposal would provide a safe harbor from liability under the federal securities laws for Scope 3 emissions data due to the challenges of compiling it. Under the provision, a Scope 3 emissions disclosure would not be deemed to be fraudulent unless it is shown that the statement was made without a reasonable basis or disclosed other than in good faith. Registrants would also be required to describe the methodology, significant inputs and significant assumptions they used to calculate their GHG emissions.

The proposal would require registrants to quantify and disclose certain climate-related effects on existing financial statement line items.

Because all of the proposed non-financial statement disclosures would be included in registration statements and annual reports, registrants would need appropriate disclosure controls and procedures for the information.

Financial statement disclosures

Registrants would be required to disclose in a note to the audited financial statements the following climate-related impacts:

- The positive and negative financial impacts of severe weather events and other natural conditions and transition activities on each financial statement line item, unless the aggregate impact on an absolute value basis is less than 1% of the total for the line item
- The aggregate amount of climate-related costs incurred that are both expensed and capitalized, unless the aggregate is less than 1% of expenditures or capitalized costs incurred
- Whether and how climate-related events and transition activities impacted the estimates and assumptions they used in preparing the financial statements

Assurance requirements

Scope 1 and Scope 2 emissions would initially be subject to limited assurance and later reasonable assurance by an independent provider for accelerated and large accelerated filers. Assurance providers would need to be independent and would need to have significant experience in measuring, analyzing, reporting or attesting to GHG emissions. A registrant would be required to make certain disclosures about the assurance provider, including whether the provider has a license from a licensing or accreditation body, whether the engagement is subject to an oversight inspection program and whether the provider is subject to record-keeping requirements for the engagement. The proposal doesn't specify the attestation standards that would need to be used but establishes criteria for the standards that would be acceptable.

Registrants that voluntarily obtain assurance on their required emissions disclosures would be required to make certain disclosures, including identifying the provider and any oversight program to which it is subject, describing the standards used and the results of the engagement and describing any relationships (including professional services) that might impair independence.

How we see it

Companies should consider their readiness for assurance over these disclosures. While some companies that currently provide voluntary Scope 1 and Scope 2 emission disclosures in separate sustainability reports already obtain assurance over those disclosures, new disclosures would be required about the provider and the attestation standards used. The assurance provider would be required to consent to its report being included in a filing.

Transition period

Companies with 31 December fiscal year ends would be required to comply on the following schedule, assuming the rules are adopted by the end of this year:

Registrant type	Compliance date		
	All disclosures, except for Scope 3	**Scope 3 GHG emission disclosures**	**Assurance on Scope 1 and Scope 2 emission disclosures**
Large accelerated filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)	Limited assurance – 2024 Reasonable assurance – 2026
Accelerated filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Limited assurance – 2025 Reasonable assurance – 2027
Non-accelerated filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Exempt
Smaller reporting company	Fiscal year 2025 (filed in 2026)	Exempt	Exempt

Endnote:

1 The seven greenhouse gases are carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, sulfur hexafluoride and nitrogen trifluoride.