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# Climate Risk Disclosures Face Increased Scrutiny and Potential Change to Reporting Requirements

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Company disclosures of climate related risks and opportunities will receive increased scrutiny from regulators, and new climate risk reporting rules may soon be on the horizon, in light of recent Securities Exchange Commission (SEC) announcements and other legislative actions.

President Biden has announced climate change as a top priority, and the SEC is likely to be an important tool to achieving the administration's climate objectives. The SEC has indicated that it will be reviewing the adequacy of existing corporate disclosures of climate-related risks, whether additional SEC guidance is needed, and whether additional prescriptive climate reporting rules need to be adopted.

Companies should be aware of the rapidly changing landscape and assess their current reporting to determine whether it aligns with the materiality standard from an investor perspective, and whether climate risks are appropriately addressed. Companies should also carefully consider their climate-related statements made across all mediums (not just in SEC filings), because statements made in any forum can inform the materiality analysis and whether material information was omitted from SEC reporting.

## SEC 2010 Guidance

In 2010, the SEC issued its Commission Guidance Regarding Disclosure Related to Climate Change ("Guidance"). The Guidance did not change the law—materiality still governs what climate risks need to be disclosed. "Information is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to vote or make an investment decision, or, put another way, if the information would alter the total mix of available information." Guidance at 11.

The Guidance simply identified four specific areas of climate risk that companies should evaluate because, in the SEC's view, those areas have potential to trigger reporting under existing non-financial reporting obligations in Regulation S-K. Those climate risk areas to consider are: (1) the impact of legislation or regulations; (2) the impact of international accords; (3) the indirect consequences of regulation or business trends; and (4) the physical impacts of climate change (such as extreme weather risks).

## Potential for New Climate Risk Reporting Rules and Increased Enforcement under the Biden Administration

A move away from the current "principles based approach" to reporting, to a more prescriptive, rules based reporting framework around climate change issues and other Environmental, Social, Governance (ESG) issues is possible. Recent developments in line with this approach include:

1. **Establishing the SEC Climate and ESG Task Force**

On March 4, 2021, the SEC announced the creation of a Climate and ESG Task Force within the Division of Enforcement. Importantly, the Task Force is expected to use "sophisticated data analysis to mine and assess information across registrants, to identify potential violations." The initial focus of the Task Force will be to "identify any material gaps or misstatements in issuers' disclosure of climate risks under existing rules." The placement of the Task Force within the Division of Enforcement, and selection of Task Force members from across the SEC, signals a change of approach towards increased scrutiny, evaluation, comparison across registrants, and enforcement.

2. **SEC Chair Nomination**

President Biden recently nominated Gary Gensler to serve as the Chair of the SEC. If confirmed by the Senate, Democrats will control three of the five SEC Commissioner seats (the SEC aims to remain non-partisan and no more than three of the five Commissioners may belong to the same party). During the Senate confirmation hearings, Gensler's comments indicated his:

- Support for the SEC role to bring consistency and comparability to disclosure guidelines, acknowledging that there are trillions of investment dollars seeking more information about climate risk;
- Commitment to take public comments, work with the SEC staff, and apply good economic analysis to determine the best approach to improving climate risk disclosure; and
- Commitment to upholding the materiality standard as the disclosure standard, but a willingness to be guided by the investor community to determine what climate risks are "material." Specifically, when asked if a "financially insignificant" decision by a company could ever be material (for example, a decision to obtain a small amount of electricity from fossil fuels), Gensler indicated that the total mix of information must be considered, and that whether to require disclosure will be grounded in an economic analysis and what reasonable investors would consider material.

3. **Potential Changes to Current Reporting Rules**

It is not clear if the SEC will develop new reporting rules, issue new climate risk reporting guidance, increase disclosure through enforcement of existing rules, or some combination of those approaches. However, there are a number of potential avenues for developing new climate reporting rules.

1. *Federal Legislation*

There are at least two proposed bills in Congress that would direct the SEC to issue rules for mandatory climate risk reporting, including:

- Climate Risk Disclosure Act of 2021: This bill would amend the Securities Exchange Act of 1934 to require issuers to disclose various climate change-related risks. It also provides the SEC with two years to set out climate risk disclosure rules.
- Paris Climate Agreement Disclosure Act. This bill would amend the Securities Exchange Act of 1934 to require companies to disclose new information related to their compliance with the Paris Climate Agreement, including “whether the issuer has set, or has committed to achieve, targets that are a balance between greenhouse gas emissions and removals, at a pace consistent with limiting global warming to well below 2 degrees Celsius and pursuing efforts to limit it to 1.5 degrees Celsius.”

2. *New SEC Guidance or Rules*

On February 24, 2021, Acting SEC Chair Allison Lee announced that the SEC would begin reviewing how and whether companies were reporting on the factors identified in the 2010 Guidance, and use the results of that review to update the 2010 Guidance.

3. *State Legislation*

California recently introduced the proposed Climate Corporate Accountability Act, which if enacted, would require certain large companies doing business in California to disclose their greenhouse gas (“GHG”) emissions (including Scope 3 emissions) and develop emission reduction targets.

4. *Trends for Reporting*

In general, trends regarding climate risk reporting are moving toward TCFD-compliant reporting. The TCFD is the Task Force for Climate-Related Financial Disclosures, set up through the G-20, which issued recommendations in 2017 for a climate risk reporting framework. Europe is ahead of the U.S. in this regard and some EU countries are already adopting mandatory disclosure rules consistent with the TCFD framework. TCFD-aligned reporting could be the direction pursued by the SEC or Congress.



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