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SEC Proposes New Rules To Standardize Climate-Related Disclosures

Article By:

Isabelle A. Dinerman

David P. Hooper

Highlights

The SEC has proposed broad new rules that would require registrants to make certain climate-related disclosures, including regarding greenhouse gas emissions, in their SEC filings

Under the proposed rules, accelerated and large accelerated filers would need to obtain third-party attestation reports covering certain emissions disclosures

The most controversial proposal under the new rules would require registrants, under certain circumstances, to disclose indirect greenhouse gas emissions from their value chain

The Securities and Exchange Commission (SEC) recently voted to propose extensive new climate-related disclosure rules that, if implemented in their current form, would require registrants to provide certain new and extended climate-related disclosures in their SEC filings.

The proposed rules would require registrants to include certain climate-related disclosures in their registration statements and annual reports, such as:

- Disclosure of any climate-related risks reasonably likely to have a material impact on the registrant's business and consolidated financial statements
- The actual and potential impacts of those risks on the registrant's strategy, business model and outlook
- The registrant's governance of climate-related risks and relevant risk management processes

The SEC vote in favor of the proposed rules was a 3-1 split decision. SEC Chair Gary Gensler stated that he supported the proposal because, “if adopted, it 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.”

However, SEC Commissioner Hester Peirce, who was the lone dissenter, argued the opposite view, stating in her dissent that the proposed rules “will undermine the existing regulatory framework that for many decades has undergirded consistent, comparable, and reliable company disclosures.” Peirce also argued that the proposal exceeds the SEC’s statutory limits and that the SEC lacks the authority to adopt the proposed rules. The positions taken by the SEC’s leadership potentially foreshadow the comment process and public debate on these proposed rules.

A public comment period will remain open until the later of 30 days following the publication of the proposed rules in the Federal Register, or May 20, 2022.

The rules also would require disclosure of the registrant’s direct greenhouse gas (GHG) emissions (Scope 1 emissions), indirect emissions from purchased electricity or other forms of energy (Scope 2 emissions), and, in certain circumstances, disclosure of indirect greenhouse gas emissions from upstream and downstream activities in a registrant’s value chain (Scope 3 emissions).

In addition, they would require that accelerated filers and large accelerated filers obtain third-party assurance and provide an attestation report covering their Scope 1 and Scope 2 emissions disclosures. They would further require that all registrants include certain climate-related financial statement metrics and related disclosures in a note to their audited financial statements. A registrant would also be required to make additional disclosures under the proposed rules, to the extent that it has publicly set climate-related targets or goals or adopted a transition plan as part of its climate-related risk management strategy.

Phase-In Period

If adopted, the SEC is proposing 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.

At the earliest, the new rules would take effect for large accelerated filers in fiscal year 2023 and begin to apply to their SEC filings in 2024, with Scope 3 emissions disclosures required by large accelerated filers in fiscal year 2024 and apply to their SEC filings in 2025. The new rules would take effect for accelerated filers in fiscal year 2024 and begin to apply to their filing in 2025, with Scope 3 emissions disclosures required for fiscal year 2025 and apply to their filings in 2026. Smaller reporting companies would need to begin complying with the new rules for fiscal year 2025 for filings made in 2026 and would be exempt from Scope 3 emissions disclosures.

The proposed rules also provide a safe harbor from liability for Scope 3 emissions disclosure, as well as forward-looking climate disclosures pursuant to the Private Securities Litigation Reform Act.

Details of New or Expanded Disclosures

The proposed rules include the following new or expanded disclosures for annual reports and registration statements:

- **Climate-Related Risks.** The proposed rules would require a registrant to:

1. **Identify Risks**. Identify and disclose any climate-related risks reasonably likely to have a material impact on the registrant, including the registrant's business or consolidated financial statements, which may manifest over the short, medium, and long term. The registrant should also state whether an identified climate-related risk is a physical or transition risk so that investors can better understand the nature of the risk and the registrant's actions or plan to mitigate or adapt to the risk.

2. **Describe Impacts of Risks**. Describe the actual and potential impacts of any identified climate-related risks on its strategy, business model, and outlook. This includes impacts on any business operations, including the types and locations of its 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; expenditure for research and development; and any other significant changes or impacts.

- **Governance and Risk Management Processes.** The proposed rules would require a registrant to disclose, as applicable, certain information concerning:

1. **Board Oversight**. The board's oversight of climate-related risks, including identifying any board members or board committees responsible for the oversight of climate-related risks; disclosing whether any member of a registrant's board of directors has expertise in climate-related risks, with the disclosure required in sufficient detail to fully describe the nature of the expertise; a description of the processes and frequency by which the board or board committee discusses climate-related risks; disclosing whether and how the board or board committee considers climate-related risks as part of its business strategy, risk management, and financial oversight; and disclosing whether and how the board sets climate-related targets or goals and how it oversees progress against those targets or goals, including the establishment of any interim targets or goals.

2. **Management Oversight.** Management's role in assessing and managing any climate-related risks, including disclosing whether certain management positions or committees are responsible for assessing and managing climate-related risks and, if so, identifying such positions or committees and disclosing the relevant expertise of the position holders or members in such detail as necessary to fully describe the nature of the expertise; disclosing the processes by which the responsible managers or management committees are informed about and monitor climate-related risks; and disclosing whether the responsible positions or committees report to the board or a board committee on climate-related risks and how frequently this occurs.

- **Greenhouse Gas Emissions.** The proposed rules would require a registrant to include the following:

1. **Scope 1 and 2.** 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, and in absolute terms, not including offsets, and in terms of intensity (per unit of

economic value or production).

2. **Scope 3.** Indirect emissions from upstream and downstream activities in a registrant's value chain (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.

3. **Assurance.** If an accelerated or large accelerated filer, obtain an attestation report from an independent attestation service provider covering, at a minimum, Scopes 1 and 2 emissions disclosure.

- **Financial Statement Metrics.** The proposed rules would require a registrant to disclose, in a note to its financial statements, certain disaggregated climate-related financial statement metrics that are mainly derived from existing financial statement line items, falling under the following three categories of information:

1. **Financial Impact Metrics**. The proposed rules would require a registrant to disclose the impacts arising from climate-related events, including physical risks identified by the registrant and severe weather events and natural conditions, such as flooding, drought, wildfires, extreme temperatures, and sea level rise. A registrant also would be required to disclose the financial impact of transition activities (including transition risks identified by the registrant), such as efforts to reduce GHG emissions or otherwise mitigate exposure to transition risks on any relevant line items in the registrant's consolidated financial statements.

2. **Expenditure Metrics.** The proposed rules would require a registrant to separately aggregate amounts of expenditure expensed and capitalized costs incurred during the fiscal years presented.

3. **Financial Estimates and Assumptions.** The proposed rules would require a registrant to disclose whether the estimates and assumptions used to produce the consolidated financial statements were impacted by risks and uncertainties associated with, or known impacts from, severe weather events and other natural conditions, such as flooding, drought, wildfires, extreme temperatures, and sea level rise.

- **Targets, Goals and Transition Plans.** The proposed rules would require a registrant to disclose the following:

1. **Targets or Goals.** If a registrant has publicly set climate-related targets or goals, the registrant would be required to disclose the target or goal; 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; and 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.

2. **Transition Plan.** If a registrant has adopted a transition plan as part of its climate-related risk management strategy, the registrant would be required to disclose a description of the plan,

including the relevant metrics and targets used to identify and manage any physical and transition risks.

3. **Carbon Offsets and Renewable Energy Credits.** If, as part of its net emissions reduction strategy, a registrant uses carbon offsets or renewable energy credits or certificates (RECs), it would be required to disclose the role that carbon offsets or RECs play in the registrant's climate-related business strategy, including the amount of carbon reduction represented by the offsets or the amount of generated renewable energy represented by the RECs.

The proposed climate-change disclosure rules already have garnered significant attention in the financial and legal communities. While it remains unclear when and to what extent the proposed rules will become final, a consensus is building that more environmental impact disclosures, including climate change disclosures, are becoming a market norm for companies across industries.

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