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Climate Change Disclosure: The SEC's Proposed New Rules & Impact on Public Companies

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Agenda

- Overview and background of the proposed new rules
- Proposed changes to Regulation S-X affecting financial statement disclosures
- Proposed changes to Regulation S-K affecting non-financial statement disclosures
- Proposed scope and phase-in periods
- Practical considerations for public companies

Overview

Background

- The last time the SEC specifically addressed climate-related disclosure was in 2010
- In 2016, the SEC issued a Concept Release regarding possible modernization of Regulation S-K (including climate change) and received hundreds of comments
- In 2018, 2 law professors and investors and organizations representing $5 trillion of assets under management petitioned the SEC to adopt ESG-related disclosure
- In March 2021, the then-acting SEC Chair Lee invited public comments regarding climate change disclosure to which there was substantial response, including dozens of substantive responses (many of which are referred to in the current proposed rules)
- The SEC's published agenda for 2021 included climate-related disclosure proposed rules by last October

Background *(cont'd)*

- Many other jurisdictions either have (or are actively considering) mandatory climate change disclosure, including Brazil, the European Union, Japan, the United Kingdom, Switzerland, New Zealand, and Hong Kong
- A majority of large public companies are already providing some ESG information in non-filed Corporate Sustainability Reports or similar
- Most of the mandatory disclosure regimes require, and many voluntary reports elect to use, Task Force for Climate-Related Financial Disclosure (TCFD)-aligned reporting, which in turn uses Greenhouse Gas Protocol (GHG Protocol) methodologies, including for scope 1, scope 2, and scope 3 emissions
- TCFD has strong support from the G7, G20, the Financial Stability Board, the European Commission, and other international agencies

Overview of the Proposed Rule

- On March 21, 2022, the SEC approved, on a 3:1 vote, its proposed rule "The Enhancement and Standardization of Climate-Related Disclosures for Investors"
- Only Commissioner Peirce dissented
- Comments are due by May 20, 2022 (or 30 days after publication in the *Federal Register*, if later)
- Given the proposed rule's complexity and relatively short comment period, requests for an extension of the comment period are expected; however, many also expect the rule to be adopted substantially as proposed by December 2022
- Legal challenges are also anticipated

Overview of the Proposed Rule

- The proposed rule includes extensive required reporting by covered companies of climate-related financial and non-financial disclosures and related attestation
- Notably, and subject to certain exceptions and transitional provisions to be discussed later, the proposed SEC rules would require that covered companies disclose:
  - 1. Direct greenhouse gas (GHG) emissions (Scope 1) and indirect GHG emissions from purchased electricity and other forms of energy (Scope 2); and
  - 2. 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
- Requires "short-, medium- and long-term" climate-related risk assessments

Overview of the Proposed Rule *(cont'd)*

- Includes amendments to Regulations S-K (Non-Financial Statement Disclosures) and S-X (Financial Statement Disclosures)
- Treats required climate-related disclosure as "filed" rather than "furnished"
- Includes potentially significant practical consequences for corporate governance, business strategy and risk management
- Includes proposed phase-in and transition
- Extends PSLRA "forward-looking" safe harbor to such assessments, if applicable

Companies Covered by Proposed Rule

- Proposal **applies to**
  - Companies with reporting obligations pursuant to Sections 13(a) or 15(d) of the Exchange Act
  - Companies that file a registration statement under the Securities Act or the Exchange Act
  - Foreign private issuers that file annual reports on Form 20-F
  - Emerging growth companies and business development companies
- Proposal **does not apply to**
  - Canadian issuers that file on Form 40-F
  - "Asset-backed issuers"

Proposed Changes to Regulation S-X

Overview of Proposed Amendments to Reg S-X

- **WHEN?** Required in filings that require audited financial statements and corresponding Regulation S-K climate-related disclosure
  - Form S-1, Form S-11, Form S-4, Form 10-K (and corresponding foreign filings)
- **WHERE?** Notes to the financial statements
- **WHAT?** Three categories of information:
  - Financial Impact Metrics
  - Expenditure Metrics
  - Financial Estimates and Assumptions

Key Definitions

- **Physical Risks**: May include harm to businesses and their assets arising from acute climate-related disasters such as wildfires, hurricanes, tornadoes, floods, and heatwaves as well as chronic risks and more gradual impacts from long-term temperature increases, drought, and sea level rise
- **Transition Risks**: May arise from potential adoption of climate-related regulatory policies, including those that may be necessary to achieve the national climate goals that may be or have been adopted in the United States and other countries; climate-related litigation; changing consumer, investor, and employee behavior and choices; changing demands of business partners; long-term shifts in market prices; technological challenges and opportunities, and other transitional impacts

Financial Impact Metrics

- Disclose the financial impacts of severe weather events, other natural conditions, transition activities, and identified climate-related risks on the consolidated financial statements *unless* the aggregated impact is **less than one percent** of the total line item for the relevant fiscal year
- Must determine the impacts described above on each consolidated financial statement line item, including:
  - revenue, cost of revenue, selling, general and administrative expenses, sale of property, plant, and equipment (in statement of cash flows), inventories, intangible assets, long-term debt, or contingent liabilities

F/S line-item	F/S balance (from consolidated financial statement)	Impact of Events A and B	Impact of Event C	Impact of Transition Activity D	Absolute value of impacts	Percentage impact
Cost of revenue	$10,000,000	-$300,000	+$70,000	+$90,000	$460,000	4.6%

Source: SEC Release (p. 128)

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Expenditure Metrics

- Disclose the aggregate amount of expenditure expensed or the aggregate amount of capitalized costs incurred *unless* such amount is **less than one percent** of the total expenditure expensed or total capitalized costs incurred, respectively, for the relevant fiscal year
- For each category, disclose separately the amount incurred during the fiscal years presented:
  - (i) toward positive and negative impacts associated with the climate-related events (*i.e.*, severe weather events and other natural conditions and identified physical risks) and
  - (ii) toward transition activities, specifically, to reduce GHG emissions or otherwise mitigate exposure to transition risks (including identified transition risks)

Expenditure category	Current fiscal year balances (from consolidated financial statements)*	Event D	Activity E	Event F	Percentage impact
Capitalized costs (total expenditure incurred during the year that was capitalized)	$8,000,000	$200,000	$100,000		3.85%**
Expense (total expenditure incurred during the year that was expensed)	$3,000,000			$25,000	0.8%

* As expenditures capitalized and expensed are recorded in various financial statement line items, we expect the "total" to be used for disclosure threshold calculation purposes for each category to represent the aggregated expenditures capitalized during the fiscal year and aggregated expenditures expensed during the fiscal year.
** Calculated based on total impact on capitalized costs from Event D ($200,000), Activity E ($100,000), and Event F ($0): $300,000/$8,000,000.

Source: SEC Release (p. 140)

Financial Estimates and Assumptions

- Disclose whether the estimates and assumptions used to produce the consolidated financial statements were impacted by exposures to risks and uncertainties associated with, or known impacts from, climate-related events (including identified physical risks and severe weather events and other natural conditions), such as flooding, drought, wildfires, extreme temperatures, sea level rise
- ***If yes***, provide a qualitative description of how such events have impacted the development of the estimates and assumptions

What Else To Know

- Required to calculate the proposed financial statement metrics using financial information that is consistent with the scope of the rest of the consolidated financial statements included in the filing (*i.e.*, include in any such calculation financial information from consolidated subsidiaries)
- Must apply the same set of accounting principles applied in preparation of the rest of the consolidated financial statements included in the filing
- Disclosure for historical fiscal years would be required
- If not previously presented for such fiscal year and the historical information necessary to calculate or estimate a metric is not reasonably available without unreasonable effort or expense, the registrant may be able to rely on Rule 409 or Rule 12b-21 to exclude a corresponding historical metric

And Don't Forget…

- Because the proposed metrics would be required in the financial statements, they would be
  - (i) included in the scope of any required audit of the financial statements in the relevant filing,
  - (ii) subject to audit by an independent registered public accounting firm, and
  - (iii) within the scope of the registrant's internal control over financial reporting

Proposed Changes to Regulation S-K

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New Item 1501 of Regulation S-K: Governance

- Describe the board of director's oversight of climate-related risks
  - Identity of any board members or board committee responsible for oversight
  - Whether any member of the board has expertise in climate-related risks
  - Processes for board discussion of climate-related risk
- Describe management's role in assessing and managing climate-related risks
  - Internal processes for monitoring climate-related risks
  - Frequency of reporting to the board on climate-related risks
- If applicable, a registrant may also describe the board's oversight of and management's role in assessing and managing climate-related opportunities

New Item 1502 of Regulation S-K: Strategy, Business Model, and Outlook

- Describe any climate-related risks that have had, or that are reasonably likely to have, a material impact on the company, its business or consolidated financial statements over the short, medium, and long term, specifying whether they are physical risks or transition risks
- Provide both current and forward-looking disclosures
  - PSLRA safe harbors apply if conditions are met
- Describe the resilience of the registrant's business strategy in light of potential future changes in climate-related risks, providing both qualitative and quantitative information
- Provide internal carbon price disclosure, if applicable
- Provide a narrative discussion of whether and how any climate-related risks have affected, *or are reasonably likely to affect*, consolidated financial statements

New Item 1502 of Regulation S-K: Strategy, Business Model, and Outlook *(cont'd)*

- Disclose the actual and potential impacts, including the time horizon, of identified climate-related risks on:
  - Business operations, including the types and locations;
  - Products or services;
  - Suppliers and other parties in the 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

New Item 1503 of Regulation S-K: Risk Management

- Processes for identifying, assessing and managing climate-related risks
- How does company:
  - Determine relative significance of climate-related risks compared to other risks?
  - Consider existing or likely regulatory requirements or policies?
  - Consider shifts in customer or counterparty preferences, technological changes, or changes in market prices in assessing potential transition risks?
  - Determine the materiality of climate-related risks?
  - Assess potential size and scope of identified climate-related risks?

New Item 1503 of Regulation S-K: Risk Management *(cont'd)*

- How company decides whether to mitigate, accept, or adapt to a particular risk
- How company prioritizes addressing climate-related risks
- How company determines manner to mitigate a high-priority risk
- If a transition plan adopted, describe the relevant metrics and targets used to identify physical and transition risks

New Item 1504 of Regulation S-K: GHG Emissions Metrics

- Total for Scope 1 emissions to be disclosed separately from total Scope 2
  - Calculated from all sources included in organizational/operational boundaries
- Total Scope 3 emissions if
  - Scope 3 emissions for fiscal year are material, or
  - Company set a GHG emissions reduction target or goal that includes Scope 3 emissions
- Scope 1, 2, and 3, emissions disclosure both:
  - In the aggregate, and
  - Disaggregated by each constituent greenhouse gas

New Item 1504 of Regulation S-K: GHG Emissions Metrics *(cont'd)*

- Constituent greenhouse gases
  - Carbon dioxide (CO_2)
  - Methane (CH_4)
  - Nitrous oxide (N_2O)
  - Nitrogen trifluoride (NF_3)
  - Hydrofluorocarbons (HFCs)
  - Perfluorocarbons (PFCs)
  - Sulfur hexafluoride (SF)

New Item 1504 of Regulation S-K: GHG Emissions Metrics *(cont'd)*

- Proposing release illustrates complexity of Scope 3 materiality determination
  - Quantitative analysis alone not sufficient to determine materiality of Scope 3
  - Scope 3 as relatively small portion of overall GHG emissions may be material if
    - Represents a significant risk,
    - Subject to significant regulatory focus, or
    - Substantial likelihood that reasonable investor would consider them important
- For future impacts/transition risk, consider probability and magnitude
- Scope 3 disclosures to identify the categories of upstream and downstream activities included in the calculation

New Item 1504 of Regulation S-K: GHG Emissions Metrics *(cont'd)*

- GHG emissions data for
  - Most recently completed fiscal year, and
  - Historical fiscal years included in its consolidated financial statements in filing
- Companies to describe the methodology, significant inputs, and significant assumptions used in calculation of GHG emissions metrics
- "GHG intensity" – ratio expressing impact of GHG emissions per unit of economic value or per unit of production
  - Disclosure of sum of Scopes 1 and 2 emissions in terms of GHG intensity
  - Separate GHG intensity disclosure for Scope 3 emissions

New Item 1504 of Regulation S-K: GHG Emissions Metrics *(cont'd)*

- Can be difficult to obtain and or verify Scope 3 data from third parties
- Under proposed safe harbor disclosure of Scope 3 emissions would be deemed not to be a fraudulent statement unless shown that
  - Statement was made or reaffirmed without a reasonable basis, or
  - Statement was disclosed other than in good faith
- "Smaller reporting companies" would be exempt from the proposed Scope 3 emissions requirement
- All other companies get an additional year for Scope 3 disclosures beyond compliance date for the other proposed rules

New Item 1505 of Regulation S-K: Scope 1 and Scope 2 Emissions Disclosure Attestation

- Any accelerated filer or a large accelerated filer, including foreign private issuer, to include
  - Attestation report covering Scope 1 and Scope 2 emissions in the SEC filing
  - Related disclosures about the third party providing attestation services
- Attestation provider
  - Does not have to be a public accounting firm registered with the PCAOB
  - Has to be an expert in GHG emissions by virtue of having significant experience in measuring, analyzing, reporting or attesting to GHG emissions
  - Has to be independent of the company and its affiliates

New Item 1505 of Regulation S-K: Scope 1 and Scope 2 Emissions Disclosure Attestation *(cont'd)*

- Attestation report to be provided pursuant to standards that are publicly available at no cost and are established by a body or group that has followed due process procedures
- Company to disclose information regarding the GHG emissions attestation provider such as any license, oversight or record-keeping requirement
- Initially limited assurance, scaling up to a reasonable assurance
- Phased compliance date based on the company's filing status
- Companies voluntarily disclosing a GHG attestation report are subject to disclosure requirements regarding such attestation

New Item 1506 of Regulation S-K: Targets and Goals

- Descriptions of climate-related targets or goals, to include as applicable:
  - Scope of activities and emissions included in the target
  - Unit of measurement and whether the target is absolute or intensity-based
  - Time horizon for intended achievement of target and whether timing is consistent with goals established by treaty, law, regulation, policy, or organization
  - Baseline time period and baseline emissions for tracking progress, with consistent base year set for multiple targets
  - Any interim targets set by the company
  - How the company intends to meet its climate-related targets or goals
- Disclose data indicating:
  - Whether the company is making progress toward meeting the target or goal
  - How such progress has been achieved
- Update each fiscal year by describing actions taken during the year to achieve its targets or goals
- If carbon offsets or renewable energy credits used to achieve targets or goals, disclose:
  - Amount of carbon reduction represented
  - Source of the offsets or credits
  - Description and location of underlying projects
  - Any registries or other authentication and the cost

New Item 1507 of Regulation S-K: Interactive Data Requirement

- Companies would be required to tag climate-related disclosures in Inline XBRL
- Both block text tagging and detail tagging of narrative and quantitative disclosures
- Inline XBRL requirements apply both to the Regulation S-K and Regulation S-X disclosures

Proposed Scope and Phase-in Periods

Disclosure Compliance Dates

Registrant Type	Disclosure Compliance Date	
	All proposed disclosures, including greenhouse gas emissions metrics: Scope 1, Scope 2 and associated intensity metric, but excluding Scope 3	Greenhouse gas emissions metrics: Scope 3 and associated intensity metric
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)
Accelerated Filer and Non-Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)
Small Reporting Company	Fiscal year 2025 (filed in 2026)	Exempted

Note: Dates assume adoption by December 31, 2022 and Filer Fiscal Year ended December

GHG Emissions and Assurance Standard Compliance Dates

Filer Type	Scopes 1 and 2 Greenhouse Gas Disclosure Compliance Date	Limited Assurance	Reasonable Assurance
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)	Fiscal year 2026 (filed in 2027)
Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Fiscal year 2027 (filed in 2028)

Note: Date assumes adoption by December 31, 2022 and Filer Fiscal Year ended December

Practical Considerations

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- Review and, as necessary, “upskill” Board and management climate risk assessment/reporting capabilities
- Assess and supplement as required other internal resources and capabilities
- Invest as needed in people, software and systems to support climate-related risk assessment and reporting
- Embed climate risk assessment in traditional business management, including M&A
- Consider and use, as needed, third-party assistance

Practical Considerations *(cont'd)*

- Focus current resources on “vulnerable” areas of the business
- Don’t make a net-zero commitment unless you are confident that you can adequately collect/report scope 3 emissions
- Be sure to review disclosure controls and procedures, internal control over financial reporting and committee charters and revise as appropriate
- Be sure any other climate disclosure is consistent with what is disclosed pursuant to new rules

Additional Resources

READ MORE:

- SEC Proposes Climate Change Disclosure Rules Applicable to Public Companies
- Market Trends 2021: Disclosure Related to Climate Change

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