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SEC ADOPTS CLIMATE CHANGE DISCLOSURE RULES APPLICABLE TO PUBLIC COMPANIES AND OFFERINGS

The Securities and Exchange Commission (the "SEC") has adopted new rules that require public companies to disclose substantial information about the material impacts of climate-related risks on their business, financial condition, and governance (the "Final Rules"). The SEC says that "climate-related risks, their impacts, and a public company's response to those risks can significantly affect the company's financial performance and position."

The SEC observes that many companies currently disclose substantial climate-related information but characterizes this disclosure as "partial," "fragmented," "inconsistent" and "often difficult for investors to find and/or compare across companies." The SEC says that its experience with its existing climate disclosure guidance, in effect since 2010, indicates inadequate disclosures that leave the "need to both standardize and enhance the information available." It says that "providing these disclosures in [SEC] filings also will subject them to enhanced liability that provides important investor protections by promoting the reliability of the disclosures."

The Final Rules require disclosure of a range of climate-related matters, including:

- Any material climate-related risks and their impacts on the registrant's business strategy, results of operations, and financial condition, as well as on the registrant's outlook and business model.
- Any activities, plans, or processes to mitigate, adapt to, or manage material climate-related risks, including the use of transition plans, scenario analyses, or internal carbon prices.
- Any board oversight and management role in assessing and managing material climate-related risks.
- Any targets or goals that have materially affected or are reasonably likely to materially affect the registrant's business, results of operations, or financial condition.
- Scope 1 and/or Scope 2 greenhouse gas emissions ("GHG") by certain larger registrants when those emissions are material, and the filing of an attestation report covering the required disclosure of such emissions, in each case, on a phased-in basis.
- The financial statement effects of severe weather events and other natural conditions, including costs and losses.

The SEC adopted these rules after considering, over a two-year period, some 4,500 unique comment letters from various authors. The SEC made some modifications from the proposed rules, which were released on March 21, 2022[1] (the "Proposed Rules"), most conspicuously withdrawing the requirement that registrants disclose greenhouse emissions from the users of their products and services (so-called Scope 3 emissions) and curbing requirements concerning those from a company's own operations (Scope 1) or those of its suppliers (Scope 2).

The SEC emphasized that its objective is limited to advancing investor protection, market efficiency, and capital formation, and not to address climate-related issues more generally. It stressed that the Final Rules must be read in that context, specifically highlighting that whenever the Final Rules reference materiality this "refers to the importance of information to investment and voting decisions about a particular company, not to the importance of the information to climate-related issues outside of those decisions."

In the two years since the Proposed Rules were released, European rules have been finalized and California has adopted climate-change disclosure requirements (although these are the subject of a litigation challenge). The SEC acknowledges in the adopting release that there are many regulatory schemes. However, it notes that it is focused on its "mission to protect investors, maintain fair, orderly, and efficient markets, and promote capital formation by providing disclosure to investors of information important to their investments and voting decisions." In some cases, the Final Rules draw on requirements similar to those in the Task Force on Climate-Related Financial Disclosures (TCFD) framework[2] and concepts developed by the GHG Protocol, as updated from time to time,[3] but deviate from those in certain respects.

PRINCIPAL DIFFERENCES FROM THE PROPOSED RULES

The Final Rules differ from the Proposed Rules in several ways. The principal differences are:

- Requiring disclosure of Scope 1 and Scope 2 emissions only for large accelerated filers ("LAFs") and accelerated filers ("AFs") when material, with a phased-in approach and a delayed option, and exempting smaller reporting companies ("SRCs") and emerging growth companies ("EGCs");
- Modifying the assurance requirement for Scope 1 and Scope 2 emissions by extending the phase-in period for LAFs and requiring only limited assurance for AFs and extending other phase-in periods;
- Eliminating the Scope 3 emissions disclosure requirement;
- Qualifying a number of requirements to provide climate-related disclosures based on materiality;
- Focusing the disclosure of financial statement effects of severe weather events and other natural conditions in the notes to the financial statements;
- No longer requiring disclosure of: board oversight and executive management of climate risks; board members' climate expertise; or the impact of climate-related factors on each financial statement line item;
- Extending a safe harbor from private liability for certain forward-looking disclosures related to climate-related matters;

- Eliminating the requirement for private companies involved in business combination transactions and public companies to update their quarterly reports to provide certain climate-related disclosures; and
- Requiring disclosure of material expenditures directly related to climate-related activities as part of a registrant's strategy, transition plan and/or targets and goals disclosure under Regulation S-K rather than Regulation S-X.

Total estimated compliance costs are reduced significantly. However, the dissenting Commissioners pointed out in their open meeting remarks that, despite the differences and adjustments, the costs are still vastly higher than, and more certain than, the benefits associated with the new disclosure requirements.

PRESENTATION OF THE CLIMATE-RELATED DISCLOSURES

Climate-related disclosures must be included by domestic registrants and foreign private issuers in registration statements and in periodic filings made under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The Final Rules do not apply to Canadian issuers filing under the SEC's Multi-Jurisdictional Disclosure System ("MJDS"). Consistent with the Proposed Rules, the Final Rules do not apply to asset-backed issuers.

The adopting release notes that climate-related risks may be relevant for some of the pooled assets comprising asset-backed securities; however, the SEC points out that "adoption of climate-related disclosure requirements for certain types of securities, such as asset-backed securities, should consider the unique structure and characteristics of those securities." The adopting release notes that the SEC may consider climate-related disclosure requirements for asset-backed securities issuers in the future.

The Regulation S-K climate-related disclosures (other than Scope 1 and/or Scope 2 emissions disclosures) are required to be included in a separate, appropriately captioned section of a registrant's filing, or in another appropriate section such as Risk Factors, Description of Business, or Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") (or the disclosures can be incorporated by reference as long as the disclosures meet the electronic tagging requirements). Otherwise, the Final Rules leave the placement of the climate-related disclosures, other than the financial statement disclosures, largely up to each registrant.

A registrant must provide the financial statement disclosures required under Regulation S-X for the registrant's most recently completed fiscal year, and to the extent previously disclosed or required to be disclosed, for the previous fiscal year(s) included in the filing, in a note to the registrant's audited financial statements. The registrant must electronically tag narrative and quantitative climate-related disclosures in Inline eXtensible Business Reporting Language ("Inline XBRL").

If the registrant is required to disclose Scope 1 and Scope 2 emissions, then these should be presented:

- For a domestic filer, in its annual report on Form 10-K, in its quarterly report on Form 10-Q for the second fiscal quarter in the fiscal year immediately following the year to which the GHG emissions metrics disclosure relates (with the disclosure being incorporated by reference into the previously filed Form 10-K) or in an amendment to its Form 10-K filed no later than the due date for the Form 10-Q for its second fiscal quarter. In the case of a foreign private issuer, in its annual report on Form

20-F, or in an amendment to its annual report on Form 20-F, due no later than 225 days after the end of the fiscal year to which the GHG emissions metrics disclosure relates.

- If filing a registration statement under the Securities Act of 1933, as amended (the "Securities Act") or the Exchange Act, as of the most recently completed fiscal year that is at least 225 days prior to the date of effectiveness of the registration statement.
- Such disclosure should be provided for the registrant's most recently completed fiscal year end and, to the extent previously disclosed, for the previous fiscal year(s) included in the filing.
- If required to provide an attestation report over Scope 1 and Scope 2 emissions, the registrant should provide such attestation report and any related disclosures in the filing that contains the GHG emissions disclosures to which the attestation report relates.

CHANGES TO REGULATION S-K (NON-FINANCIAL STATEMENT DISCLOSURES)

The Final Rules create Subpart 1500 of Regulation S-K containing the requirements for climate change disclosure outside of the financial statements. The new climate-related information would be required in specified registration statements and periodic reports.

We provide a table that includes the rule text from the adopting release, reprinted for convenience, which can be accessed here.

Key provisions of proposed Subpart 1500 of Regulation S-K are described below.

NEW ITEM 1500 OF REGULATION S-K: DEFINITIONS

The climate-related disclosures introduce many specialized terms to the securities law reporting regime. These terms are defined in Item 1500 of new Subpart 1500 of Regulation S-K.

NEW ITEM 1501 OF REGULATION S-K: GOVERNANCE DISCLOSURE

The Final Rules require a registrant to disclose under Item 1501 certain information about their board of directors' oversight of climate-related risks. The Final Rules are somewhat less prescriptive than the Proposed Rules, which elicited substantial concerns from commenters on various grounds, such as potential intrusion into board processes, influence on board composition and practices, and disclosure of immaterial or sensitive information. The SEC has scaled back some of the proposed requirements and eliminated others, while retaining key elements that will affect how a company reports climate-risk governance. Under the Final Rules, a company will have to disclose:

- A description of the board of directors' oversight of climate-related risks, if the board exercises such oversight.
- The identification, if applicable, of any board committee or subcommittee responsible for overseeing climate-related risks and a description of the processes by which the board or such committee is informed about such risks.

- If the company has disclosed a target or goal related to climate change or a transition plan, whether and how the board oversees progress against the target or goal or transition plan.

These disclosure requirements will apply only to companies that have information responsive to them, meaning that companies whose boards do not exercise oversight of climate-related risks or do not have any climate-related targets, goals, or transition plans will not have to disclose anything under these rules, including a lack of board oversight or targets, goals or transition plans.

The SEC has omitted from the Final Rules some of the more detailed requirements that were proposed, such as:

- The identity of specific board members responsible for climate-risk oversight.
- Whether any board member has expertise in climate-related risks and the nature of the expertise.
- How frequently the board is informed of climate-related risks.
- Information regarding whether and how the board sets climate-related targets or goals, including interim targets or goals.

The SEC stated that these changes are intended to avoid any misperception that this information is required for all companies, particularly those without existing processes or information to disclose, and to eliminate any unintended effects on the company's governance structure and processes by focusing on one area of risk at the expense of others. The SEC clarified that the Final Rules do not seek to influence companies' decisions about how to manage climate-related risks or favor any governance structure or process, but rather focus on disclosure of companies' existing or developing climate-risk governance practices.

Similar to the proposed disclosures on board oversight, the Proposed Rules would have required a registrant to disclose extensive detailed information about management's role in the assessment and management of climate-related risks. While the Final Rules require most of such information as proposed, they are somewhat more streamlined.

The Final Rules require that a registrant describe management's role in assessing and managing the registrant's material climate-related risks. The Final Rules also provide a non-exclusive list of disclosure items that a registrant should address, as applicable, when describing management's oversight of climate-related risks, such as:

- Whether and which management positions or committees are responsible for assessing and managing climate-related risks, and the relevant expertise of such position holders or committee members;
- The processes by which such positions or committees assess and manage climate-related risks; and
- Whether such positions or committees report information about such risks to the board of directors or a committee or subcommittee of the board of directors.

The Final Rules limit such required disclosure to material climate-related risks, consistent with the SEC's general disclosure framework and in response to comments that expressed concerns about the potential burden and relevance of disclosing non-material climate-related matters.

As with its board governance disclosure rules, the SEC says that its Final Rules do not seek to influence or change a registrant's governance practices or organizational structures, nor do they require a registrant that does not engage in the oversight of material climate-related risks to disclose any information.

NEW ITEM 1502 OF REGULATION S-K: STRATEGY

A registrant will be required to disclose any climate-related risks that have materially impacted or are reasonably likely to have a material impact on the registrant, including on its business strategy, results of operations, or financial condition. Item 1502(a) requires that the registrant describe whether the risks are reasonably likely to manifest in the short-term (i.e., the next 12 months) and separately in the long-term (i.e., beyond the next 12 months). In this new requirement, and in several others, the Final Rules substitute "results of operations" and "financial condition" for "consolidated financial statements" (included in the Proposed Rules) in order to be more consistent with other Regulation S-K disclosure requirements.

"Climate-related risks" are defined to mean the actual or potential negative impacts of climate-related conditions on the registrant's business, results of operations, or financial condition. The Final Rules eliminate the reference from the Proposed Rules to impacts on the registrant's value chain. Item 1502 provides a non-exclusive list of disclosures for a registrant to consider addressing subject to applicability. The adopting release notes that in evaluating materiality, a registrant should rely on "the traditional notions of materiality."

Item 1502(b) requires a registrant to describe the actual and potential material impacts of any climate-related risk identified in response to Item 1502(a). The Final Rules add an explicit materiality qualifier to this item. The registrant should consider various impacts, including those identified in the non-exclusive list in Item 1502(b).

Item 1502(c) requires a registrant to discuss whether and how the registrant considers any material impacts described in response to Item 1502(b) as part of its strategy, financial planning, and capital allocation. This includes whether the impacts of the climate-related risks described in response to Item 1502(b) have been integrated into the registrant's business model or strategy, including whether and how resources are being used to mitigate climate-risks; and how any of the targets referenced in Item 1504 or in a described transition plan relate to the registrant's business model or strategy.

Item 1502(d) requires a discussion of how climate-related risks described in the section have materially impacted or are reasonably likely to materially impact the registrant's business, results of operations, or financial condition. The discussion should include a quantitative and qualitative discussion of the material expenditures incurred and material impacts on financial estimates and assumptions that, in management's assessment, directly result from activities in Item 1502(b).

Item 1502(e) requires a registrant to describe any transition plan it has adopted to manage a material transition risk. The adopting rule makes clear that not every registrant will have a transition plan and the Final Rules do not prescribe a particular approach with respect to climate-related risks. The Final Rules require that a registrant update its annual report disclosure about the transition plan each fiscal year, reporting on actions taken during the year under the plan, and the effect of such actions on the business, results of operations or financial condition. The Final Rules pare back the required disclosures by, for example, eliminating the need to discuss all relevant metrics and targets.

Item 1502(f) requires the disclosure of a registrant's use of scenario analysis if it is used to assess the impact of climate-related risks, and if, based on that analysis, the registrant determines that a risk is reasonably likely to have a material impact on its business, results of operations, or financial condition.

Item 1502(g) requires a registrant that uses internal carbon pricing to disclose certain information about the internal carbon price, if such use is material to how it evaluates and manages a climate-related risk that, in response to Item 1502(a), it has identified as having materially impacted or is reasonably likely to have a material impact on the registrant, including on its business strategy, results of operations, or financial condition.

NEW ITEM 1503 OF REGULATION S-K: RISK MANAGEMENT DISCLOSURE

New Item 1503 requires companies to describe their risk management processes, but takes a much less prescriptive approach given that disclosures should be tailored. A registrant must describe processes for identifying, assessing, and managing material climate-related risks and consider, as applicable, a non-exclusive list of disclosure items specified in Item 1503(a). If the registrant is managing a material climate-related risk, the registrant must disclose whether and how the processes described in response to Item 1503(a) have been integrated into the overall risk management system or processes.

NEW ITEM 1504 OF REGULATION S-K: TARGETS AND GOALS DISCLOSURE

The SEC had proposed to require a registrant that has set any climate-related targets or goals to disclose certain information about those targets or goals, as well as data regarding its progress toward achieving these, and the progress achieved, and then to update the disclosures regularly. The SEC also had proposed to require a registrant that, as part of any net emissions reduction strategy, uses carbon offsets or RECs (defined using the EPA definition meaning a credit or certificate representing each purchased megawatt hour of renewable electricity generated and delivered to a registrant's power grid) to disclose the role that carbon offsets or RECs play in the strategy.

The Final Rules (Item 1504(a)) require a registrant to disclose any climate-related target or goal if such target or goal has materially affected or is reasonably likely to materially affect the registrant's business, results of operations, or financial condition. Item 1504(b) requires that the registrant provide any additional information or explanation necessary to an understanding of the material impact or reasonably likely material impact of the target or goal. The discussion should include quantitative and qualitative disclosures of material expenditures and material impacts on financial estimates and assumptions. Item

1504(c) requires that the registrant discuss its progress toward meeting the target or goal and this disclosure must be updated each fiscal year.

Finally, Item 1504(d) requires that if carbon offsets or RECs form a material component of the registrant's targets or goals, it should separately disclose the amount of carbon avoidance, reduction or removal represented by the offsets or the amount of generated renewable energy represented by the RECs, as well as additional information regarding the RECs. The targets and goals discussion can be provided as part of the registrant's disclosure pursuant to Item 1502 on its transition plan or when the issuer discusses the material impacts of climate-related risks on its business strategy or model. An issuer also can include the targets and goals disclosure in its risk management discussion in response to Item 1503.

NEW ITEM 1505 OF REGULATION S-K: GHG EMISSIONS DISCLOSURE

The Proposed Rules would have required companies to disclose GHG emissions, including total Scope 1 emissions separately from total Scope 2 emissions after calculating them from all sources included in the registrant's organizational and operational boundaries. Most controversial, the Proposed Rules would have required disclosure of a company's total Scope 3 emissions for a fiscal year if material, or if the company had set a GHG emissions reduction target or goal that included Scope 3 emissions.

The Final Rules made substantial changes. The adopting release continues to state the view that investors view information about GHG emissions, including Scope 1 and Scope 2 emissions, as a "central measure and indicator of a registrant's exposure to transition risk as well as a useful tool for assessing its management of transition risk." The Final Rules, as indicated in the chart below, require disclosure of Scope 1 emissions and/or Scope 2 emissions metrics by LAFs and AFs that are not SRCs or EGCs on a phased-in basis, if such emissions are material. The registrant should apply traditional notions of materiality in making this assessment. The adopting release provides some guidance regarding how or why a registrant's Scope 1 and/or 2 emissions may be material, including that the amount of a company's emissions alone does not determine materiality.

The Final Rules also only require disclosure to be expressed in the aggregate in terms of carbon emissions. If a registrant is required to make the Scope 1 and/or 2 emissions disclosures and any constituent gas of the disclosed emissions is individually material, it must disclose that constituent gas disaggregated from others. The specifications related to the disclosures insofar as methodology, significant inputs, and significant assumptions, are unchanged from the Proposed Rule in large measure—albeit with some streamlining of the methodology disclosure provision and streamlining of the description of the calculation approach.

The adopting release notes that the requirement to disclose Scope 3 emissions is not being adopted "at this time." The adopting release notes that foreign and state laws may require such disclosures. Statements by Commissioners also left open the possibility of revisiting the requirement in the future.

Under the Final Rules, a registrant that has not previously disclosed its Scope 1 and Scope 2 emissions in an SEC filing for a particular historical year will not be required to estimate and report those emissions for historical periods prior to the initial compliance date. To address practical concerns relating to measuring and reporting GHG emissions as of fiscal year-end by the same deadline as applicable for a registrant's Exchange Act annual report, the Final Rules provide that GHG emissions metrics required pursuant to Item 1505 to be included in an annual report filed with the SEC on Form 10-K may be incorporated by reference from the registrant's Form 10-Q for the second fiscal quarter in the fiscal year immediately following the year to which the GHG emissions metrics disclosure relate.

Comparable accommodations are made for foreign private issuers by allowing an amendment to their annual report on Form 20-F to be filed no later than 225 days after the end of the fiscal year to which the metrics relate. The Final Rules also address inclusion of the GHG emissions metrics in a Securities Act or Exchange Act registration statement as discussed above.

NEW ITEM 1506 OF REGULATION S-K: ATTESTATION OVER GHG EMISSIONS DISCLOSURE

The SEC had proposed to require a registrant, including a foreign private issuer, that is an AF or an LAF, to include in the relevant filing an attestation report covering the disclosure of its Scope 1 and Scope 2 emissions and to provide certain related disclosures about the service provider providing the attestation report. The proposing release had explained that this was intended to improve accuracy, comparability, and consistency with respect to the proposed GHG emissions disclosures. The SEC further stated that by specifying minimum standards for the attestation, it would provide investors with an enhanced level of reliability against which to evaluate the disclosure. These proposals generated significant comment.

The Final Rules make a number of changes. Item 1506 requires a registrant, including a foreign private issuer, that is required to provide Scope 1 and/or Scope 2 emissions disclosure pursuant to Item 1505 to include an attestation report covering these emissions disclosures in the relevant filing. Both AFs and LAFs are required to obtain limited assurance beginning the third fiscal year after the compliance date for Item 1505; however, only LAFs are required to obtain an attestation report at a reasonable assurance level beginning the seventh fiscal year after the compliance date.

The Final Rules do not require an AF to obtain an attestation report at a reasonable assurance level. The adopting release explains that LAFs are best positioned to bear the increased costs of obtaining reasonable assurance. The adopting release goes on to say that "[s]uch costs are justified for these registrants by the benefits that investors and registrants will receive in the form of positive assurance, which makes it more likely that material errors or omissions are detected and is consistent with the Commission's investor protection mission."

A GHG emissions attestation provider must meet the criteria set out in the rule, including that it be an expert in GHG emissions as a result of its significant experience, and be independent with respect to the registrant and any of its affiliates for which it is providing the attestation report. The independence requirements are set forth in Item 1506(b)(2). The adopting release makes clear that it would be permissible for a registrant to use the auditor of its financial statements to perform the GHG emissions attestation engagement, assuming all of the applicable requirements for assurance providers are met.

The provider is not required to be an entity regulated by the Public Company Accounting Oversight Board (the "PCAOB").

The Final Rules amend Rule 436 to provide that the attestation report will not be considered a part of a registration statement that is prepared or certified by an expert or person whose profession gives authority to the statements with the meaning of sections 7 and 11 of the Securities Act. Therefore, a consent from the attesting firm is not required to be submitted in connection with a Securities Act registration statement or Form 10-K that is incorporated by reference into a Securities Act registration statement. But the Final Rules amend the exhibit requirements to require in connection with certain registration statements or reports on Form 10-K or 10-Q the filing as an exhibit of a letter from the attestation provider acknowledging its awareness of the use of its reports although these are not subject to expert liability.

The attestation report must be provided pursuant to standards established by a body or group that has followed due process procedures, including the broad distribution of the framework for public comment. The adopting release makes clear that the PCAOB, American Institute of Certified Public Accountants ("AICPA") and International Auditing and Assurance Standards Board ("IAASB") standards meet these requirements. In response to comments, the SEC concluded that the ISO standards related to the attestation of GHG emissions standards also would meet these requirements.

The Final Rules require the form and content of the attestation report to follow the requirements set forth by the standard used. The Final Rules (unlike the Proposed Rules) do not prescribe minimum report requirements.

A registrant is required to make certain additional disclosures pursuant to Item 1506(d) relating to the attestation engagement and provider, including whether the engagement is subject to any oversight inspection program and whether a change in a provider is a result of a disagreement.

To the extent that a registrant obtains a voluntary assurance report, Item 1506(e) sets forth certain required disclosures regarding that third-party assurance.

NEW ITEM 1507 OF REGULATION S-K: SAFE HARBOR FOR CLIMATE-RELATED DISCLOSURES

The Final Rules provide a safe harbor for climate-related disclosures that relate to a registrant's transition plans (Item 1502(e)), scenario analysis (Item 1502(f)), the use of an internal carbon price (Item 1502(g)), and targets and goals (Item 1504) that are provided in response to the new Regulation S-K requirements. Information required by these sections, other than historical facts, are considered forward-looking statements for purposes of the Private Securities Litigation Reform Act ("PSLRA") safe harbors for forward-looking statements provided in Section 27A of the Securities Act and Section 21E of the Exchange Act.

NEW ITEM 1508 OF REGULATION S-K INTERACTIVE DATA REQUIREMENT

Under the Final Rules, companies will be required to tag climate-related disclosures in Inline XBRL, with block text tagging and detail tagging of narrative and quantitative disclosures provided pursuant to Subpart 1500 of Regulation S-K and Article 14 of Regulation S-X subject to a phase-in.

CHANGES TO REGULATION S-X (FINANCIAL STATEMENT DISCLOSURES)

The Final Rules expand Regulation S-X to require a company to include certain climate-related financial statement metrics and related disclosures in a note to its audited financial statements. The disclosures will be required for the company's most recently completed fiscal year, and to the extent previously disclosed or required to be disclosed, for the fiscal years included in the consolidated financial statements in the applicable filing.

The company will need to use financial information consistent with the scope of the rest of its consolidated financial statements to calculate the metrics and to apply the same set of accounting principles that it is required to apply in preparation of the rest of its consolidated financial statements. As part of the company's financial statements, the financial statement metrics will be subject to audit by the company's independent registered public accounting firm and come within the scope of the company's internal control over financial reporting.

FINANCIAL IMPACT METRICS

The Proposed Rules would have required a company to include disaggregated information about the impact of climate-related conditions and events and transition activities on the consolidated financial statements ("Financial Impact Metrics"). A company would have been required to determine the impacts of severe weather events, other natural conditions, transition activities and identified climate-related risks on each consolidated financial statement line item. Within each category (*i.e.*, climate-related events or transition activities), Financial Impact Metrics would, at a minimum, have been required to be disclosed on an aggregated, line-by-line basis for all negative impacts and separately, on an aggregated, line-by-line basis for all positive impacts.

The Final Rules omit the proposed Financial Impact Metrics based on the SEC's assessment of the burden and cost associated with companies updating their internal systems and processes. Instead, the Final Rules adopt a narrower set of requirements focused on requiring disclosure of actual expenses that companies incur and can attribute to severe weather events and other natural conditions.

EXPENDITURE METRICS

The Proposed Rules would have required a company to disclose aggregated information about the impact of climate-related conditions and events and transition activities on annual expenditures and capitalized costs. For each category, a company would have been required to disclose separately the amounts incurred during the fiscal years presented toward (i) positive and negative impacts associated with climate-related events and (ii) transition activities, including toward the mitigation of exposures to transition risks (including identified transition risks). This would include expenditures incurred to increase the resilience of assets or operations, retire or shorten the estimated useful lives of impacted assets, relocate assets or operations at risk, or otherwise reduce the future impact of severe weather events and other natural conditions on business operations. It also would include expenditures incurred to research and develop new technologies or to purchase assets, infrastructure or products that are intended to reduce GHG emissions, increase energy efficiency, offset emissions (purchase of energy credits), or improve other resource efficiency.

The amounts of expenditure disclosed pursuant to the proposed metrics would have been a portion, if not all, of the company's total recorded expenditure (expensed or capitalized) as calculated pursuant to the accounting principles applicable to the company's financial statements. The proposed expenditure metrics would not have been required if the sum of the absolute values of all the impacts on the line item was less than one percent of the total line item for the relevant fiscal year. However, a company would have been required to aggregate expenditure related to climate-related events and transition activities within the categories of expenditure (i.e., amount capitalized and amount expensed) when determining if information must be disclosed.

The Final Rules generally follow the structure of the Proposed Rules, but with significant changes.

The Final Rules require the disclosure of aggregate (i) capitalized costs and recognized charges and (ii) expenditures expensed and losses incurred as a result of severe weather events and other natural conditions, with separate disclosure of related recoveries. This is intended to more narrowly focus disclosures on items that already are captured for accounting purposes, instead of speculating as to the mitigating effect of items. Additionally, it looks to the entire amount of an item, instead of requiring a company to allocate portions of an item.

The entire amount of an item will be attributed to severe weather events and other natural conditions if they were a significant contributing factor in incurring the item. Additionally, a company will be required to identify where the items are presented in the income statement and the balance sheet.

The Final Rules retain a one percent disclosure threshold for the aforementioned two categories, but with refence to income or loss before income tax expense or benefit, and stockholders' equity or deficit, instead of specific line items. Additionally, the Final Rules include de minimis thresholds that exempt disclosure of amounts that aggregate to less than $100,000 in the income statement or less than $500,000 in the balance sheet.

The Final Rules also omit the requirement to disclose costs and expenditures related to general transition activities. Instead, companies will be required to disclose capitalized costs, expenditures expensed, and losses related to the purchase and use of carbon offsets and Renewable Energy Certificates ("RECs") in the financial statements. However, the SEC cautions in the preamble that companies may need to disclose material expenditures incurred in furtherance of their transition activities, depending upon the application of current accounting standards.

Under the Final Rules, companies will be required to disclose the aggregate amounts of (i) carbon offsets and RECs expensed, (ii) carbon offsets and RECs capitalized, and (iii) losses incurred on the capitalized carbon offsets and RECs during the fiscal year. This disclosure requirement will not be subject to the one percent disclosure threshold that applies to the disclosure of severe weather events and other natural conditions. Instead, disclosure is required if carbon offsets or RECs have been used as a material component of a company's plan to achieve disclosed climate-related targets or goals. In addition, companies will be required to disclose the beginning and ending balances of capitalized carbon offsets and RECs on the balance sheet for the fiscal year.

FINANCIAL ESTIMATES AND ASSUMPTIONS (RULE 14-02(H))

The Proposed Rules would have required a company to 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. If so, the company would have been required to provide a qualitative description of how such events impacted the development of the estimates and assumptions used by the company in the preparation of such financial statements.

Similar to the other proposed financial statement metrics, the Proposed Rules included a provision that would have required separate disclosure focused on transition activities. If the estimates and assumptions a company used to produce the consolidated financial statements were impacted by risks and uncertainties associated with, or known impacts from, a potential transition to a lower carbon economy or any climate-related targets it had disclosed, the company would have been required to provide a qualitative description of how the development of the estimates and assumptions was impacted by such a potential transition or the company's disclosed climate-related targets.

The proposed estimates and assumptions disclosures would have been subject to the same disclosure threshold as the expenditure metrics discussed above.

The Final Rules generally follow the structure of the Proposed Rules, but with minor changes.

The Final Rules require companies to disclose financial estimates and assumptions related to "any . . . transition plans" disclosed by the company, instead of requiring disclosure of estimates and assumptions related to the broader universe of "a potential transition to a lower carbon economy."

Additionally, the Final Rules include a materiality qualifier that will require companies to disclose whether the estimates and assumptions used to prepare the consolidated financial statements were materially impacted by exposure to risks and uncertainties associated with, or known impacts from, severe weather events and other natural conditions.

CONTEXTUAL INFORMATION (RULE 14-02(A))

The Proposed Rules would have required companies to provide contextual information about Financial Impact Metrics and estimates and assumptions. The Proposed Rules noted that contextual information could include disclosure of specific climate-related events and transition activities that were aggregated for purposes of determining the impacts on the capitalized or expensed expenditure amounts and, if applicable, policy decisions made by a company to determine the amount of climate-related events or transition activities that are categorized as expenditure capitalized versus expenditure expensed or whether impact from pursuing any climate-related opportunities are included in the analysis.

The Final Rules largely follow the proposal (except for omitting Financial Impact Metric-related content) and require a company to provide "contextual information, describing how each specified financial statement effect . . . was derived, including a description of significant inputs and assumptions used, significant judgments made, [and] other information that is important to understand the financial statement effect and, if applicable, policy decisions made by the registrant to calculate the specified disclosures."

OPPORTUNITIES

The Proposed Rules would have permitted a company, at its option, to disclose the impact of any opportunities arising from severe weather events and other natural conditions, any impact of efforts to pursue climate-related opportunities associated with transition activities, and the impact of any other climate-related opportunities on any of the financial statement metrics.

The Final Rules omit any discussion of the disclosure of such opportunities. This is based on the removal of related disclosure requirements, as well as the SEC's determination that even voluntary disclosure is unnecessary.

CONSEQUENCES OF INCLUSION IN FINANCIAL STATEMENTS (RULE 14-01(A))

As with the Proposed Rules, a company will be required to include the metrics and disclosures discussed above in its financial statements. This means that the metrics and disclosures will be subject to audit by the company's independent registered public accounting firm and within the scope of the company's internal control over financial reporting.

Under the Final Rules, the PCAOB auditing standards will apply to the financial statement metrics included in the audited financial statements. Companies filing in accordance with IFRS must include the financial statement metrics in the scope of their audit.

COMPLIANCE DATE

The Final Rules will be phased in for all registrants, with the compliance date dependent upon the status of the registrant as a LAF, AF, non-accelerated filer, SRC or EGC, and the content of the item of disclosure. The table below, which is reprinted from the SEC's factsheet, sets forth the compliance dates under the Final Rules:

Compliance Dates under the Final Rules[1]						
Registrant Type	**Disclosure and Financial Statement Effects Audit**		**GHG Emissions/Assurance**			**Electronic Tagging**
	All Reg S-K and S-X disclosures, other than as noted in this table	*Item 1502(d)(2), Item 1502(e)(2), and Item 1504(c)(2)*	*Item 1505 (Scope 1 and Scope 2 GHG emissions)*	*Item 1506 – Limited Assurance*	*Item 1506 – Reasonable Assurance*	*Item 1508 – Inline XBRL tagging for subpart 1500*[2]
LAFs	FYB 2025	FYB 2026	FYB 2026	FYB 2029	FYB 2033	FYB 2026
AFs (other than SRCs and EGCs)	FYB 2026	FYB 2027	FYB 2028	FYB 2031	N/A	FYB 2026
SRCs, EGCs, and NAFs	FYB 2027	FYB 2028	N/A	N/A	N/A	FYB 2027
	[1] As used in this chart, "FYB" refers to any fiscal year beginning in the calendar year listed. [2] Financial to the tagging of financial statements. See Rule 405(b)(1)(i) of Regulation S-T.					

SEC AUTHORITY AND LITIGATION CHALLENGES

Perhaps anticipating challenges to its Final Rules, the adopting release addresses concerns raised by commenters regarding the SEC's authority to promulgate such requirements. The SEC notes that it is adopting the Final Rules based on its determination that they will elicit information that investors have indicated is important to their investment and voting decisions.

As widely expected, legal challenges have already been filed.

Shortly after the Final Rules were released, Liberty Energy Inc. and Nomad Proppant Services LLC filed a petition in the Federal Court of Appeals for the Fifth Circuit, with a district court filing also planned if certain parts of the rule are deemed ineligible for an initial challenge at the appellate level. Liberty Energy, an oilfield services firm, submitted a comment letter in response to the Proposed Rules noting that the domestic oil and gas production industry was uniquely and adversely affected by the Proposed Rules.

Also shortly following the Final Rules' release, ten states (West Virginia, Georgia, Alabama, Alaska, Indiana, New Hampshire, Oklahoma, South Carolina, Wyoming, and the Commonwealth of Virginia) filed a petition for review in the Eleventh Circuit challenging the Final Rules. The states' filing argues that the Final Rule exceeds the SEC's statutory authority and is otherwise "arbitrary, capricious, an abuse of discretion, and not in accordance with law" under the Administrative Procedure Act. These arguments are not dissimilar to statements made by the dissenting Commissioners, some of which cite to comment letters raising such concerns.

Several other state attorneys general joined letters in opposition to the rule at the proposal stage, so additional state challenges may be coming. A variety of trade associations that opposed the Proposed Rules have indicated they are assessing the Final Rules and may also consider legal challenges. On the other side, environmental groups that supported the Proposed Rules have indicated they are considering their own challenges to the removal of key provisions that were in the Proposed Rules, particularly Scope 3 disclosures, although it is not obvious that such groups would have standing to assert such claims.[4]

Finally, several Republican Members of Congress have publicly announced that they are considering introducing a disapproval resolution under the Congressional Review Act. For such an effort to succeed in abrogating Final Rules would require the resolution to pass both houses of Congress and it would have to be signed by the President. All such steps are, of course, uncertain at best.

PRACTICAL CONSIDERATIONS

The Final Rules are more flexible and require less detailed disclosure than the Proposed Rules, but the required information is still substantial and costly to gather and produce. The Final Rules also exempt SRCs and EGCs from certain requirements where the costs would exceed the benefits, a clear indication that the costs for larger and seasoned companies are likely to be substantial.

Expected Challenges. As noted above, despite the reduction in scope of the Final Rules from the Proposed Rules, continued criticism, litigation, and congressional attempts to enjoin or rescind the Final Rules should be anticipated. The timeline of litigation and how the Final Rules will be treated during the pendency of litigation is uncertain and likely to be affected by changes in administrations. Accordingly, affected companies should start preparing to comply.

Gap Analysis. Companies should perform a gap analysis to assess the differences between their current disclosures, anticipated disclosure requirements under various regulatory regimes and the requirements of the Final Rules. If they have done such an analysis in the past, they should update it to reflect the new requirements.

Phase-In Preparation. The Final Rules impose substantial costs and steps for companies to upgrade and align their reporting processes, data processing and disclosure controls and procedures, as well as their internal control over financial reporting. Companies should use the phase-in periods to establish working groups that can develop processes for gathering and evaluating the required information and preparing drafts of the new disclosures, starting now, even though they are not mandatory until later dates. Some companies may find it helpful to adapt the transition methods they have used for previous significant reporting or accounting changes, or to prepare draft disclosures for internal review. Drafts of various sections of the new disclosures would benefit from a cross-functional approach that may involve input from various technical, legal, financial, accounting, climate specialists, investor relations and public relations functions, as well as outside counsel, accountants, and consultants. Because these new disclosures will likely garner a great deal of attention from investors, the media and other stakeholders, it would be useful to circulate drafts to the company's team well in advance of the compliance date to allow adequate time for careful review, comment and revision.

Disclosure Controls and Procedures. Disclosures outside the financial statements must comply with management's disclosure controls and procedures, which are required to be certified by a company's CEO and CFO. Companies should therefore consider the changes that are necessary to their disclosure controls and procedures in addition to internal control over financial reporting. For example, companies should enhance disclosure committees and processes to include officers or other employees with climate change expertise or with sufficient knowledge to assist with required disclosure. For instance, the Final Rules include reduced market demand for carbon-intensive products leading to decreased prices or profits for such products, the devaluation or abandonment of assets as a non-exclusive example of the "transition risk" component of climate risk. This could mean that the marketing department may need to be brought into the disclosure controls and procedures process. Companies should also establish a system for documenting their climate disclosures and related methodology, particularly with respect to GHG emissions, including whether such emissions would be considered material and subject to disclosure.

Board Oversight. The Final Rules rejected proposals that would have required disclosure of board expertise in climate matters and information about board discussions of the topic and instead adopt more open-ended disclosures about board oversight. The Final Rules emphasize that it is not the SEC's intention, nor within its authority, to prescribe board actions or preempt board judgments. Boards should therefore exercise their own judgment about their company's views and management of climate risks and exercise their oversight accordingly. The Final Rules only require that such oversight that may follow from such judgment be described. Nevertheless, boards should consider whether any charters, policies or guidelines should be expanded or clarified to address board oversight of climate risk oversight.

As noted above, certain board oversight disclosure requirements will apply only to companies that have information responsive to them, meaning that companies whose boards do not exercise oversight of climate-related risks or do not have any climate-related targets, goals, or transition plans will not have to disclose anything under these rules, including a lack of board oversight or targets, goals or transition plans. As a practical matter, we would expect companies that do not provide some disclosure under new Item 1501 to receive negative attention from proxy advisory firms and possibly some institutional investors.

Board Committees. The board audit committee should exercise its oversight role for any required disclosures made in accordance with Regulation S-X or as part of a company's financial statements. For example, NYSE-listed companies' audit committees must meet to review and discuss the annual audited and quarterly financial statements with management and the independent auditor. Companies should assess whether their committee charters need or warrant any revisions. Where a company has a board committee responsible for climate-related matters, the company may want to consider adding to the committee's responsibilities specified in its charter the review of climate-related disclosures in the company's SEC filings.

Internal Control over Financial Reporting. Because the Final Rules impact financial statement disclosures, they will be subject to standard audit requirements, including internal control over financial reporting. Companies need to start examining their current internal control over financial reporting to assess what changes will be needed to comply with the new requirements. Companies must then develop and test new procedures to assure that they will have adequate levels of control in place for financial reporting purposes.

Attestation. The new emissions disclosures will be subject to varying levels of assurance phased in over time for different types of filers. Companies should assess whether they will seek attestation services for GHG emissions data from a certified public accounting firm that handles public company audits, or whether they would prefer to engage a different attestation service provider allowed by the rules. They may want to interview various service providers as part of this process. Regardless, companies should consider the expertise of any firm they select and their familiarity with the Final Rules. Companies are also well advised to identify and, if appropriate, engage an attestation firm sooner than later as it is unclear the capacity of firms to handle all of the attestation work that may be coming.

Liability Risks. Climate-related disclosure in SEC reports will be "filed," rather than "furnished" under the Final Rules and entails heightened liability risks for registrants. Companies may face litigation over claims that the new disclosures contain materially misleading statements or omissions. Therefore, it will be essential for companies to carefully draft climate-related disclosures responsive to these rules. To the extent the disclosures contain forward-looking statements, including on goals or commitments, such statements should be clearly identified as such, with appropriate cautionary language and should be referenced in the cautionary statement regarding forward-looking statements.

Materiality Assessments. LAFs and AFs should assess whether their Scope 1 and/or Scope 2 GHG emissions are material for the purposes of the Final Rules, even if they are currently disclosing those emissions. There may be reasons, such as investor relations, for such a company to disclose such emissions even if it determines they are not material. However, if the company decides it will disclose emissions that it determines are not material, it may prefer to do so outside of its SEC filings.

Sustainability Reports. The SEC staff has been questioning climate-related disclosures in sustainability reports or on company websites that exceed the scope of SEC filings. Companies should harmonize any such sustainability reports with their SEC filings, considering the disclosures required by the Final Rules. Some companies may also want to rethink whether to publish separate sustainability reports that are not part of their SEC filings. Companies should also consider how the new rules affect their disclosures related to “green bonds” or “sustainability-linked bonds.”

The Final Rules Do Not Prescribe Company Policy. The SEC's approach to company policy, management and board oversight in the Final Rules reflects its approach to these topics taken in last year's rulemaking concerning cybersecurity risks and incidents. In both cases, the SEC had proposed but withdrawn prescriptive and intrusive rules on governance and management matters, emphasizing in the SEC's final rules that it is not prescribing company policies or even trying to influence them. The SEC instead reiterates that companies must set their own policies in these areas, and not view the SEC's disclosure rules as policy guidance or requirements.

Companies May Be Subject to Different Reporting Requirements Across Jurisdictions. By way of international comparison, the EU's Corporate Sustainability Reporting Directive ("CSRD") and associated European Sustainability Reporting Standards ("ESRS") cover detailed sustainability reporting requirements for in-scope EU and non-EU companies that go far beyond climate reporting to include disclosures on wider ESG matters (such as water and marine resources, biodiversity, workers in the value chain and business conduct).[5] The CSRD and ESRS also cover the due diligence processes implemented by a company in relation to sustainability matters, as well as the actual and potential adverse sustainability impacts of an in-scope company's operations and value chain. Together with other proposed EU legislation, including the Corporate Sustainability Due Diligence Directive (if enacted),[6] the EU rules look to change corporate behaviours at all levels of an in-scope company's operations, including at the board level. Similar to the Final Rules, the EU laws have been adjusted to include several phase-ins, including for Scope 3 GHG emissions and value chain reporting requirements, and the requirement to disclose against the majority of reporting standards and data points required by the ESRS have been made subject to a materiality assessment. By way of domestic comparisons, California's "Climate Accountability Package" requires certain companies doing business in California to make disclosures about their emissions, including Scope 3 and climate-related financial risks.

Similar to the EU laws, the International Financial Reporting Standards' ("IFRS") International Sustainability Standards Board has created two sustainability reporting standards (IFRS S1 and IFRS S2) that go beyond climate reporting to include disclosures on wider ESG matters.[7] Although IFRS S1 and IFRS S2 are voluntary reporting standards, governments across the world – including the UK and Brazil[8] – are considering mandating these standards, further demonstrating that disclosure regimes are moving to a place that goes beyond requiring companies to simply consider climate change but to also consider a broad range of ESG matters.

REITs. The new climate-related disclosures raise considerations that are particular for real estate investment trusts ("REITs"). REITs will need to disclose the impact that adverse climate-related events, such as hurricanes, wildfires and other extreme weather events, have had or could have on their property holdings and the properties underlying their mortgage holdings. For instance, tenants may need to vacate properties or evacuate regional areas for prolonged periods of time resulting in a material decline in rental income to the REIT or in the inability of a borrower to repay amounts owed under a mortgage that is held by a REIT. Property values may be significantly reduced as a result of property damage, increased maintenance costs and/or increased insurance costs associated with climate-related risks. REITs will also need to address transition risks associated with climate change such as its impact on inflation and resulting Federal Reserve action, costs of capital to the REIT and changes to tenant preferences that impact overall real estate values.

For additional discussion of climate-related disclosure rulemaking in other jurisdictions, you may be interested in our related publications:

- New "Climate Reporting" Laws in California – Emissions and Climate-Related Financial Risk Disclosure Required
- The EU Corporate Sustainability Reporting Directive is upon us – what non-EU companies should know and do
- Global Climate Change Disclosure Initiatives and Board Corporate Governance Considerations

Subscribe to Mayer Brown's Eye on ESG blog, which provides insights and analysis to help navigate the ESG landscape on a global scale. We cover a range of timely ESG updates and issues, including regulatory, policy, political and industry-related developments, as well as judicial developments and case law. Visit: https://www.eyeonesg.com/.

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ENDNOTES

[1] *See* SEC Proposed Rules, available at: https://www.sec.gov/rules/proposed/2022/33-11042.pdf.
[2] *See* TCFD Recommendations, available at https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf.
[3] *See* GHP Protocol Corporate Accounting and Reporting Standard (Revised Edition), available at https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf.
[4] *See, e.g.*, https://www.sierraclub.org/press-releases/2024/03/sec-climate-disclosure-rule-represents-important-progress-falls-short-key.
[5] *See* EU Corporate Sustainability Reporting Directive – new sustainability disclosure obligations for EU and non-EU companies; European Commission adopts the European Sustainability Reporting Standards; and The EU Corporate Sustainability Reporting Directive is upon us – what non-EU companies should know and do.
[6] *See* Human Rights and the Environment – EU Institutions Reach Political Agreement On Corporate Sustainability Due Diligence Directive.
[7] *See* ISSB Issues Inaugural Global Sustainability Disclosure Standards.
[8] *See* Brazil Sets Global Precedent: First Nation to Embrace ISSB Sustainability Financial Reports.