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SEC Proposes Broad New Climate Change Disclosure Requirements

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In a 500-page release, the SEC has proposed significant new public company climate change disclosure requirements for both domestic companies and foreign private issuers, including the actual and potential impacts of climate change on companies as well as management and governance processes to address those impacts. The proposed disclosure rules among other things would amend Regulation S-K to add a new section to companies' filings, including third-party attestation requirements for greenhouse gas emissions data. The proposals would also amend Regulation S-X to add new financial statement requirements. The proposed disclosures are loosely based on existing metrics that many companies already apply, at least in part, particularly those of the Task Force on Climate-Related Financial Disclosures (TCFD) and the Greenhouse Gas Protocol.

We do not expect the rules to be adopted this year due to their length and complexity, as well the likelihood of significant public comment. In addition, the results of the mid-term elections could result in new hurdles for the SEC in adopting final rules. The timing and scope of the rules remains uncertain, but the earliest that certain companies would need to comply with the rules if adopted would be for fiscal year 2023 as reported in filings made in 2024. If new rules are adopted next year, we expect that they would begin to apply to companies' filings at the earliest for fiscal year 2024 as reported in filings made in 2025.

The new rules would add a new "climate change" section in companies' registration statements and periodic reports on Form 10-K (and corresponding disclosures in Form 20-F for foreign private issuers) to include disclosure regarding:

- Board and management oversight and governance of climate-related risks and related risk management practices;
- Actual or likely material impacts on the company's business, strategy and outlook, and how any climate-related risks have affected or are likely to affect them;
- How any climate-related risks identified by the company have had or are likely to have a material impact on its business and consolidated financial statements,

which may manifest over the short, medium or long-term;

- If the company has adopted a transition plan, a description of the plan, including the relevant metrics and targets used to identify and manage any physical and transition risks;
- If the company uses scenario analysis to assess the resilience of its business strategy to related risks, a description of the approach and the parameters, assumptions, analytical choices and projected principal financial impacts;
- Greenhouse gas emissions data, including direct emissions (Scope 1) and indirect emissions from purchased electricity and other forms of energy (Scope 2), separately disclosed, reported by disaggregated constituent greenhouse gases and in the aggregate and in absolute terms, without regard to offsets, and in terms of intensity (per unit of economic value or production);
- For accelerated or large accelerated filers, an attestation report from an independent attestation service provider covering the company's Scopes 1 and 2 emissions disclosure;
- Indirect emissions from upstream and downstream activities in a company's "value chain" (Scope 3), but only if material, or if the company has set greenhouse gas emissions targets or goals that include Scope 3 emissions, in absolute terms, not including offsets, and in terms of intensity; and
- If the company has publicly announced climate-related targets or goals, the scope of activities and emissions included in the target and related timing expectations, how the company intends to meet the targets, data reflecting progress to date and information about the use of carbon offsets or renewable energy certificates.

The proposed rules would also require some updating disclosure in quarterly reports on Form 10-Q (and Form 6-K for foreign private issuers).

A company's financial statements would also be impacted based on proposed revisions to Regulation S-X addressing climate-related financial statement metrics and related disclosure in a note to the consolidated financial statements, including the impact of climate-related events such as severe weather and transition activities on the line items of a company's consolidated financial statements, as well as the financial estimates and assumptions used in the financial statements. These new financial statement disclosures would be subject in some cases to a one percent reporting threshold, and they will be subject to audit by the company's independent accounting firm, and the related internal processes would be part of the company's required "disclosure controls over financial reporting."

Significantly, the SEC indicates that references in the proposed rules to “materiality” or information that is “material” should be interpreted in the same manner that the SEC and the courts have applied those terms in the past – that is, a matter is material if there is a substantial likelihood that a reasonable investor would consider it important when determining whether to buy or sell securities. However, in some respects the agency appears to expand the scope of the materiality determination as applied to required disclosures by referencing materiality in connection with medium and long-term impacts. Many companies, as well as regulators and the courts, often focus on impacts that could occur in the next 12 months in making materiality assessments, but the proposed rules in some cases appear to require companies to consider the materiality of climate-related risks over longer periods. We believe that the SEC is trying to balance its desire to maintain the traditional definition of materiality while recognizing that many potential impacts of climate change would be expected to materialize over longer periods.

While many of the new required disclosures in the proposed new section on climate change appear to overlap with disclosures that may be required in other sections of the registration statement or annual report, particularly in the management’s discussion and analysis (MD&A) and risk factor sections, the SEC has stated that companies may incorporate by reference from one section to another in order to avoid duplication.

The proposed new disclosures, and the processes used to identify and synthesize relevant information, would be part of the company’s required “disclosure controls and procedures,” so companies may be subject to regulatory scrutiny even if their related disclosures are sufficient. In some cases, the SEC has focused its enforcement scrutiny on companies’ disclosure controls even though it may not believe it has an adequate basis to challenge a company’s end-product disclosures.

The SEC proposes staged phase-in periods beginning as early as the fiscal year after the new rules are adopted by the SEC, with the period depending upon the company’s filer status. There would be separate phase-in periods for Scope 3 greenhouse gas emissions disclosure, and for the assurance requirements. For example, if the SEC adopts new rules in January 2023, then a large accelerated filer would begin to comply for fiscal year 2024 (and the Form 10-K or 20-F filed in 2025), with “limited assurance” for Scope 1 and 2 greenhouse emissions data applying to the following fiscal year, and “reasonable assurance” a year after that.

While we do not recommend that companies begin to voluntarily comply with the new proposed rules generally at this time, in some cases it may be appropriate to tailor existing or planned disclosure practices to reflect or acknowledge the proposed rules as part of a transition to new requirements (if the proposed rules are ultimately adopted in a form substantially similar to the current proposals), and given that the proposals may influence current “best practices” and investor expectations. Many companies have already focused on their disclosure controls and procedures for identifying, gathering and reporting information on climate change, but those companies may consider adjusting their efforts in light of the new proposals, such as to ensure that greenhouse gas emissions are adequately addressed. Companies that have not yet focused on related disclosure controls and procedures may consider an initiative on that subject. The rule proposals would not impact the content of proxy statements, even following adoption.

The SEC set a short deadline for receipt of public comments of the later of 30 days after publication in the Federal Register or May 20, 2022. Given the length and complexity of the proposed rules, we expect that the SEC will ultimately extend the comment period.

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