CLIENT ALERTS & INSIGHTS

SEC Proposed Rule-Making - Part I: SEC Proposal on Enhancement and Standardization of Climate-Related Disclosures

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Authors: Samantha J. Barbara

In sports, the rules of the game allow for consistent guidance in the face of ambiguity on a given call, as well as allow for comparison across teams, leagues, seasons, and years. SEC Chairman Gary Gensler made this analogy when discussing the need for regulation of environmental and climate-related disclosures.[i] In response to investor and other stakeholder interest, there has been an influx in recent years of climate-related disclosure; however, these disclosures are frequently outside of such companies' SEC reporting and appear in sustainability reports or on companies' websites, and do not follow standardized disclosure regimes. Accordingly, the SEC has observed fragmentation around climate-related disclosures that can present "substantial obstacles" to investors' processing and comparing such information.

To provide investors with consistent and comparable information, the SEC has proposed new rules that contemplate disclosure of, among other items, (1) a registrant's governance and oversight process with respect to climate matters; (2) the impact climate matters have on a registrant's business operations and the risks such matters present; (3) the process for identifying and managing climate-related risks and related plans around climate matters/events; (4) certain quantifiable metrics, including GHG emissions; and (5) information around any public climate-related goals or targets. Just as baseball's statistics allow us to compare Babe Ruth to Mike Trout, the SEC intends for its proposed climate-related disclosure rules to allow investors to evaluate public companies' market positions on environmental risks and opportunities.

While these rules are still in the proposal phase, they represent a larger demand for disclosure in this area and public companies should consider reviewing their climate-related disclosures as compared to the proposed rules and consider what updates and revisions may ultimately be needed, both from a process and disclosure perspective. While these proposed rules are pending, interested parties may provide written comments to the SEC with their suggestions and considerations.

Background

The SEC's current framework on environmental disclosure lacks specific mandatory reporting requirements. The SEC's commentary primarily consists of certain interpretive guidance published in 2010 and, more recently, a sample comment letter (and a number of actual comment letters issued to registrants) regarding climate change disclosure.[ii] The guidance generally notes that registrants should consider applicable laws and regulations, including existing disclosure requirements, international accords, and business trends relating to climate matters when preparing their registration statements, annual filing, and quarterly filings ("Filings"). The SEC sought to elicit comments and proposals on climate change disclosures pursuant to a March 2021 request for public input in the face of increasing investor demand for climate change information from public companies.[iii]

Proposed Rules

On March 21, 2022, the SEC proposed a new subpart to Regulation S-K (Subpart 1500) that would require registrants to include certain climate-related disclosures in their Filings (the "Proposal"). The SEC sought to create requirements that would generate consistent, comparable, and reliable metrics and information so that investors can make an informed judgement about the impact of climate-related risks related to their investments.

The proposed rules would require numerous disclosures including, among other matters, the following:[iv]

1. Oversight and Governance Process - Registrants would be required to consider how their board and management teams (a) oversee and govern climate-related risk, (b) the process for evaluating and managing climate-related risk, and (c) whether a strategy or plan is in place as part of climate-related risk management and make disclosures around their oversight and governance processes around climate matters.

2. Climate-Related Risks, Impact on Business, and Risk Management - A central tenet of the Proposal is the identification and disclosure of material climate-related risks. Registrants would be required to identify such risks and consider how such material climate-related risk(s) have impacted - or are likely to impact - the business and financial statements, as well as consider how such risks may impact business models, strategy, or outlook and consider how climate-related events have impacted or may impact the financial position of the business and make appropriate disclosures. The Proposal notes that such risks may manifest over the short, medium, and long term, but does not define those time periods (and instead asks registrants to describe its time horizons). Registrants would be required to confirm whether or not they use scenario analysis to assess the resilience of its business strategy to climate-related risks. Further, the Proposal calls for disclosure of the process by which a registrant identifies, assesses, and manages climate-related risks.

3. GHG Emissions Metrics and Other Disclosure - In addition to disclosures around registrants' governance and risk profiles relating to climate matters, the Proposal calls for disclosure of greenhouse gas (or "GHG") emissions. This disclosure would cover both direct and indirect GSG emissions, using the scope framework developed by the GHG Protocol. Additionally, the Proposal would require disclosure if a registrant uses an internal carbon price and information about the price and how it is set.

4. Targets and Goals - If a registrant discloses climate-related goals and targets, the Proposal calls for additional information to be provided, including time horizons for such goals, how the registrant intends to meet such goals, information to show progress on meeting such goals, and, if applicable, specifics pertaining to how renewable energy certificates or carbon offsets have been used.

The comment period for the Proposal is open until the later of May 20, 2022, or 30 days after the proposing release is published in the Federal Register.

Preparing for the Potential Disclosure Change

While the above are as of yet only proposed rules, they do represent a sea change evidenced by ongoing investor interest that has been emphasized by the SEC's recent spate of climate-related comments to registrants.

Accordingly, public company registrants (including foreign private issuers) should consider their current climate-related disclosures, given this increased focus on comparable and consistent disclosure on climate-related matters. Assuming that the proposed rules are adopted as proposed (or in a substantially similar form), the required disclosure would be mandated in registration statements and annual reports (more specifically, presented or cross-referenced in a separately captioned section, with certain disclosure in the registrant's consolidated financial statements regarding the mandated climate-related financial statement metrics and related disclosure).

Additionally, the Proposal calls for accelerated filers and large accelerated filers to include, in the relevant filing, an attestation report covering, at a minimum, the disclosure of its Scope 1 and Scope 2 emissions and to provide certain related disclosures about the service provider.

Pending the adoption of the proposed rules, a registrant should review its current climate-related disclosures (both those made within its Filings as well as those made in statements or documents other than a registrant's registration statement or annual report) and evaluate such disclosures in light of both the SEC sample comment letter and issued comments, as well as the proposed rules. Registrants should also consider what policies, procedures, and controls it may need to implement should the Proposal be adopted in order to comply with the proposed disclosure regime.

The proposed rules call for transition periods. The disclosure requirements compliance dates would depend on a registrant's status as a large accelerated filer, accelerated/non-accelerated filers, or smaller reporting company, and are further bifurcated between the "general" disclosure requirements and certain of the GHG-related emissions disclosures. Under the proposal, the earliest reporting would be required for large accelerated filers is in 2024, regarding fiscal year 2023 (assuming a 2022 adoption of the rules). Accelerated/non-accelerated filers would be looking at disclosure starting in 2025 and, for smaller reporting companies, in 2026.

Conclusion

The SEC's shift from guidance on disclosing climate-related matters within the existing disclosure framework to specific required disclosures on climate-related matters is a potential game-changer. The Proposal is focused on bringing consistency and comparability to the playing field of climate-related disclosures amongst public companies. As public companies prepare their Filings in the year ahead, it can be beneficial to begin contemplating how the proposed rules would affect Filings if adopted.

This article does not constitute legal advice. If you have any questions regarding the contents of this article or would like to discuss any updates in the securities space, please contact one of Benesch's dedicated securities attorneys listed below.

Sarah M. Hesse at shesse@beneschlaw.com or 312.212.4966.

Samantha J. Barbara at sbarbara@beneschlaw.com or 216.363.6283.

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[i] Prepared Remarks Before the Principles for Responsible Investment "Climate and Global Financial Markets" Webinar, July 28, 2021.

[ii] Commission Guidance Regarding Disclosure Related to Climate Change, February 8, 2010. Under this guidance, the SEC stated that a number of its existing disclosure rules may require disclosure relating to climate change.

[iii] Public Input Welcomed on Climate Change Disclosures, March 15, 2021; *see also* Prepared Remarks Before the Principles for Responsible Investment "Climate and Global Financial Markets" Webinar, July 28, 2021.

[iv] SEC, Proposed Rule, The Enhancement and Standardization of Climate-Related Disclosures for Investors.