SEC PROPOSES MANDATORY CLIMATE-RELATED DISCLOSURE, JOINING A GLOBAL EFFORT LED BY THE EUROPEAN UNION AND THE UNITED KINGDOM

On March 21, the Securities and Exchange Commission (SEC) proposed new mandatory climate-related disclosure rules. The proposed rules cover both textual disclosure (Regulation S-K) and financial statement footnote disclosure (Regulation S-X), as well as related attestation requirements. The long-awaited, and recently expected, requirements would apply to both domestic and foreign SEC reporting companies, and are subject to phase-in dates tied to filer status. The proposals, described in the 510-page proposing release, are subject to a 60-day comment period, and broadly would mandate:

- disclosure of climate-related risks and impacts based on the framework set out by the Task Force on Climate-related Financial Disclosures (TCFD), including information about material impacts of climate risk on a reporting company's business, and information about a reporting company's governance, risk management and strategy related to climate risk;
- disclosure in a reporting company's audited financial statements of disaggregated metrics on climate-related impacts, expenditures, and assumptions and estimates; and
- disclosure of greenhouse gas (GHG) emissions, based on the GHG Protocol, including in respect of Scope 1, Scope 2 and, in certain circumstances and except for smaller reporting companies, Scope 3 emissions.

In the words of SEC Commissioner Allison Herren Lee, "[t]his is a watershed moment for investors and the financial markets" in addressing the pressing physical and transition risks posed by climate change. In terms of the capital markets, these risks can crystalize as credit risk, market risk, insurance risk, hedging risk, supply chain risk, operational risk and liquidity risks, among others. Many of these risks were set out in the FSOC Report on climate-related financial risks (see my briefing note: Stability of the Financial System).

The proposed framework borrows heavily from (and is aligned with) the TCFD framework and the GHG Protocol and, therefore, incorporates climate-related metrics, concepts and terms that have been developed over the past decade as part of global efforts to develop consistent, comparable, reliable and decision-useful climate-related corporate disclosure. (See my briefing notes: Climate Change Lexicon and Scope 3 Complexities.)

One element of consistency is *consistency* of location; the rules would mandate disclosure to be set forth in a separately captioned "Climate-Related Disclosure" section in 1934 Act annual reports and 1933 and 1934 Act registration statements (including via incorporation by reference from other parts of a report or registration statement), as well as in accompanying audited financial statements. (Today, to the extent disclosure is being made on a voluntary basis, it largely appears in different locations, often outside of SEC filings.) There are various additional consequences to inclusion in SEC filings, including the applicability of disclosure controls and procedures (DCP) requirements, as well as liability considerations.

Summary of the Proposed Requirements

The SEC is proposing to add to Regulation S-K new Subpart 1500 (Items 1500-1507), which would require disclosure of certain climate-related information, including disclosure about climate-related risks that are reasonably likely to have material impacts on a registrant's business or its financial statements, as well as GHG metrics. The new Subpart would include an attestation requirement (Regulation S-K, Item 1505) for accelerated filers and large accelerated filers in respect of certain GHG emissions metrics disclosure.

The SEC is also proposing to add new Article 14 to Regulation S-X, which would require certain climate-related financial statement metrics and related disclosures to be set out in a note to audited financial statements. These metrics would include disaggregated climate-related impacts on financial statement line items and would be subject to audit as part of the audit of the financial statements and, accordingly, would come within the scope of internal control over financial reporting (ICFR).

In summary, the SEC has proposed disclosure of:

- the oversight and governance of climate-related risks by the registrant's board and management (Regulation S-K, Item 1501);
- how any climate-related risks identified by the registrant 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 (Regulation S-K, Item 1502(a));
- how any identified climate-related risks have affected, or are likely to affect, the registrant's strategy, business model and outlook (Regulation S-K, Item 1502(b));
- the registrant's processes for identifying, assessing and managing climate-related risks and whether any such processes are integrated into the registrant's overall risk management system or processes (Regulation S-K, Item 1503(a) and (b));
- if the registrant has adopted a transition plan as part of its climate-related risk management strategy, a description of the plan, including the relevant metrics and targets used to identify and manage any physical and transition risks (Regulation S-K, Item 1503(c));
- if the registrant uses scenario analysis to assess the resilience of its business strategy to climate-related risks, a description of the scenario used, as well as the parameters, assumptions, analytical choices and projected principal financial impacts (Regulation S-K, Item 1502(f));
- if a registrant uses an internal carbon price (*i.e.*, an estimated cost of emissions used internally within an organization), information about the price, how it is set and the rationale for selecting the internal carbon price (Regulation S-K, Item 1502(e));
- the impact of climate-related events (severe weather events and other natural conditions) and transition activities on financial statement line items (Regulation S-K, Item 1502(d)), as well as the financial estimates and assumptions used in the financial statements (Regulation S-X, Rule 14-02(g) and (h));
- the registrant's direct GHG emissions (Scope 1) and indirect GHG emissions from purchased electricity and other forms of energy (Scope 2), separately disclosed,

expressed both by disaggregated constituent GHGs and in the aggregate, and in absolute terms, not including offsets, and in terms of intensity (per unit of economic value or production) (Regulation S-K, Item 1504(b));

- the registrant's indirect emissions from upstream and downstream activities in its value chain (Scope 3), if material, or if the registrant has set a GHG emissions targets or goals that include Scope 3 emissions, in absolute terms, not including offsets, and in terms of intensity (Regulation S-K, Item 1504(c)); and
- if the registrant has publicly set climate-related targets or goals, information about (Regulation S-K, Item 1506):
    - the scope of activities and emissions included in the target, the defined time horizon by which the target is intended to be achieved, and any interim targets;
    - how the registrant intends to meet its climate-related targets or goals;
    - relevant data to indicate whether the registrant is making progress toward meeting the target or goal and how such progress has been achieved, with updates each fiscal year; and
    - if carbon offsets or renewable energy certificates (RECs) have been used as part of a plan to achieve climate-related targets or goals, information about the carbon offsets or RECs, including the amount of carbon reduction represented by the offsets or the amount of generated renewable energy represented by the RECs.

When responding to any of the proposed requirements concerning governance, strategy and risk management, a registrant may also disclose information concerning any identified climate-related opportunities, arising from climate-related conditions and transition to net zero. The proposed rules would define "climate-related opportunities" to cover the actual or potential positive impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations or value chains, as a whole. The SEC elected to make this disclosure voluntary to allay anti-competitive concerns around disclosure of potential opportunities.

Addition Detail – Physical and Transition Risks (Regulation S-K, Items 1500 and 1502(a))

The key to navigating compliance with the proposed rules first would be to identity "climate-related risks." As noted above, the proposed rules borrow heavily from the TCFD framework, including its definitions, which are key to this first step.

- "Climate-related risks" would cover the actual or potential negative impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations or value chains, as a whole. The term covers both physical risks and transition risks.
- "Value chain" would cover the upstream and downstream activities related to a registrant's operations, where "upstream" covers activities by a party other than the registrant that relate to the initial stages of a registrant's production of a good or service (*e.g.*, materials sourcing, materials processing and supplier activities), and "downstream" covers activities by a party other than the registrant that relate to

processing materials into a finished product and delivering it or providing a service to the end user (*e.g.*, transportation and distribution, processing of sold products, use of sold products, end of life treatment of sold products and investments);

- "Physical risks" would include both acute and chronic risks to a registrant's business operations or the operations of those with whom it does business.
  - "Acute risks" would cover event-driven risks related to shorter-term extreme weather events, such as hurricanes, floods and tornadoes.
  - "Chronic risks" would cover those risks that the business may face as a result of longer-term weather patterns and related effects, such as sustained higher temperatures, sea level rise, drought and increased wildfires, as well as related effects such as decreased arability of farmland, decreased habitability of land and decreased availability of fresh water.

  The SEC notes that, in some instances, chronic risks might give rise to acute risks: for example, drought (a chronic risk) that increases acute risks, such as wildfires, or increased temperatures (a chronic risk) that increases acute risks, such as severe storms. A registrant should provide a clear and consistent description of the nature of the risk and how it may affect a related risk.

- "Transition risks" would cover the actual or potential negative impacts on a registrant's consolidated financial statements, business operations or value chains attributable to regulatory, technological and market changes to address the mitigation of, or adaptation to, climate-related risks.

  Transition risks could include increased costs attributable to climate-related changes in law or policy, reduced market demand for carbon-intensive products leading to decreased sales, prices or profits for such products, the devaluation or abandonment of assets, risk of legal liability and litigation defense costs, competitive pressures associated with the adoption of new technologies, reputational impacts (including those stemming from a registrant's customers or business counterparties) that might trigger changes to market behavior, changes in consumer preferences or behavior, or changes in a registrant's behavior.

The proposed rules would require that climate-related risks be separately identified as physical or transition. For physical risks, the nature of the risk would have to be identified, as well as whether it is acute or chronic.

Physical risks

The proposed rules would require a registrant to include in its description of an identified physical risk the location of the properties, processes or operations subject to the physical risk. The SEC notes that a registrant might be exposed to water-related acute physical risks, such as flooding, which could impair its operations or devalue its property. If flooding presents a material physical risk, the proposed rules would require a registrant to disclose the percentage of buildings, plants or properties (square meters or acres) that are located in flood hazard areas, in addition to their location.

Additional disclosure would be required if a material risk concerns the location of assets in regions of high or extremely high-water stress. For example, some registrants might be impacted by water-related chronic physical risks, such as increased temperatures and changes in weather patterns that result in water scarcity. Others might face regulatory restrictions on water usage, increased expenses to find alternative sources of water or a possible need to curtail operations, with a concomitant financial impact. If the location of assets in regions of high or extremely high-water stress presents a material risk, the proposed rules would require a registrant to disclose the amount of assets (*e.g.*, book value and as a percentage of total assets) located in such regions in addition to their location. The registrant would also be required to disclose the percentage of its total water usage from water withdrawn in those regions.

The SEC notes that increased temperatures could also materially impact a registrant in other ways. For example, a registrant in the construction industry might need to disclose the physical risk of increased heatwaves affecting the ability of personnel to safely work outdoors, which could result in a cessation or delay of operations, and a reduction in current or future earnings. A registrant operating in wildfire-prone areas could be exposed to potential disruption of operations, destruction of property and relocation of personnel in the event of heat-induced wildfires. A registrant in the real estate sector might need to disclose the likelihood that sea levels rise faster than expected and reduce the value of coastal assets.

Transition risks

The proposed rules would require a registrant to describe the nature of transition risks, including whether they relate to regulatory, technological, market (including changing consumer, business counterparty and investor preferences), liability, reputational or other transition-related factors, and how those factors impact the registrant. A registrant with significant operations in a jurisdiction that subjects it to GHG emissions commitments may be exposed to transition risks by reason of those commitments.

Time horizons and impact on materiality

The proposed rules would require a registrant to disclose whether any climate-related risk is reasonably likely to have a material impact on a registrant, including its business or consolidated financial statements, which may manifest over the short, medium and/or long term. The SEC declined to define specific time periods for these disclosures. A registrant would be required to describe how it defines short-, medium- and long-term time horizons, including how it takes into account or reassesses the expected useful life of its assets and the time horizons for its planning processes and goals.

The proposal to require assessments of the materiality of climate-related risks over the short, medium and long term reflects the dynamic nature of climate-related risks.

Additional Detail – Impact of Risks on Strategy, Business Model and Outlook (Regulation S-K, Item 1502(b) and (d))

To elicit decision-useful disclosure of the impact of identified climate-related risks on strategy, business model and outlook, the SEC has proposed requiring, in effect as a second step, disclosure of the potential or actual impacts of those identified risks (as well as the time horizon of each such impact) on:

- business operations, including the types and locations of its operations;
- products or services;

- suppliers and other parties in its value chain;
- activities to mitigate or adapt to climate-related risks, including adoption of new
- technologies or processes;
- expenditure for research and development; and
- any other significant changes or impacts.

A registrant would be required to discuss how it has considered the identified impacts as part of its business strategy, financial planning and capital allocation, including current and forward-looking disclosure that would enable an understanding of whether the identified risks have been integrated into the business model or strategy, as well as how resources are being deployed to mitigate the risks. The discussion would also need to address how the proposed climate-related metrics (Regulation S-X, Rule 14-02 and Regulation S-K, Item 1506) and targets (Regulation S-K, Item 1506) relate to the business model or strategy.

The discussion would cover both physical risks and transition risks. The SEC notes that some of the impacts of transition risks would likely be common across sectors, and may involve reducing Scope 1 and Scope 2 emissions, and incurring expenses to do so. Other impacts of material transition risks may vary by sector (*e.g.*, modification by oil companies of their business model as demand for fossil-fuel products shifts, or an increase in electricity generated by a utility from more sustainable sources to meet changing regulatory requirements). Physical risks will likely vary among registrants based on a range of factors, including sector and location.

A registrant would be required to discuss whether and how identified climate-related risks have affected, or are reasonably likely to affect, the financial statements, including the metrics covered by Regulation S-X, Rule 14-02. Proposed Regulation S-K, Item 1502(d) would call for this disclosure in a form akin to MD&A, and registrants would be able to incorporate such disclosure from their MD&A sections to the extent that it is included there.

As with traditional MD&A practice, the expectation should be that disclosure of the impact of climate-related risks on the financial statements would not duplicate what is, or what will be required to be, included in the financial statements, but rather would provide the necessary explanations and drill down beyond aggregated figures, where material. The SEC also notes that while financial statement disclosure is, by definition, historical (namely the impact on the fiscal years covered by the financial statements) and, therefore, only covers short-term impacts, proposed Item 1502(d) has broader coverage beyond short-term impacts, to medium term and long term. An example of this would be transition plans that trigger short-term capital expenditures but longer-term increases in revenue or reduction of expenses.

Additional Detail – Carbon Offsets (Regulation S-K, Item 1502(c))

The SEC took note of the fact that some registrants may use carbon offsets or RECs as their primary means of meeting their GHG reduction goals, including those formulated in response to law or policy, or customer or investor demands. Other registrants may develop strategies to reduce their GHG emissions to the extent possible through operational changes, such as modifications to their product offerings or the development of solar or other renewable energy sources, and use carbon offsets or RECs to offset the remainder of their emissions that they cannot reduce through operational changes or to meet their GHG reduction goals while they transition to lower carbon operations.

A registrant that purchases offsets or RECs to meet its goals as it makes the transition to lower carbon products would need to reflect this additional set of short and long-term costs and risks in its Item 1502(d) disclosure, including the risk that the availability or value of offsets or RECs might be curtailed by regulation or changes in the market.

Additional Detail – Carbon Price (Regulation S-K, Item 1502(e))

Internal carbon pricing may be used by a registrant as a planning tool to help identify climate-related risks and opportunities, as an incentive to drive energy efficiencies to reduce costs, to quantify the potential costs the registrant would incur should a carbon price be put into effect, and to guide capital investment decisions. If a registrant uses an internal carbon price, the proposed disclosure requirements cited above would apply. In addition, a registrant would need to describe how it uses its price to evaluate and manage climate-related risks. If a registrant uses more than one internal carbon price, it would need to provide disclosures for each internal carbon price, and to disclose its reasons for using different prices.

The proposed rules would not require registrants to maintain an internal carbon price or to mandate a particular carbon pricing methodology for those that do set a price.

Additional Detail – Scenario Analysis (Regulation S-K, Item 1502(f))

A registrant would be required to describe the resilience of its business strategy in light of potential future changes in climate-related risks. The registrant also would be required to describe any analytical tools, such as scenario analysis, that it uses to assess the impact of climate-related risks on its business and consolidated financial statements, or to support the resilience of its strategy and business model in light of foreseeable climate-related risks.

Scenario analysis is a process for identifying and assessing a potential range of outcomes of future events under conditions of uncertainty. As the TCFD set out in its framework, "scenarios are hypothetical constructs and not designed to deliver precise outcomes or forecasts. Instead, scenarios provide a way for organizations to consider how the future might look if certain trends continue or certain conditions are met. In the case of climate change, for example, scenarios allow an organization to explore and develop an understanding of how various combinations of climate-related risks, both transition and physical risks, may affect its businesses, strategies, and financial performance over time." Scenario analysis can be qualitative or quantitative, although for most it is a qualitative exercise. The TCFD believes that all organizations exposed to climate-related risks should consider using scenario analysis to help inform their strategic and financial planning processes and disclosing how resilient their strategies are to a range of plausible climate-related scenarios.

The SEC declined to mandate that registrants conduct scenario analyses. Instead, if a registrant uses scenario analysis or any analytical tools to assess the impact of climate-related risks on its business and consolidated financial statements, and to support the resilience of its strategy and business model, the registrant would be required to disclose certain information about such analysis. If a registrant uses scenario analysis, it would need to disclose the scenarios considered (*e.g.*, an increase of no greater than 3º, 2º or 1.5ºC above preindustrial levels), including parameters, assumptions and analytical choices, and the projected principal financial impacts on the registrant's business strategy under each scenario. The disclosure should include both quantitative and qualitative information.

Additional Detail – Governance (Regulation S-K, Item 1501)

Similar to the TCFD framework, the proposed rules would require a registrant to disclose, as applicable, certain information concerning the board's oversight of climate-related risks, and management's role in assessing and managing those risks. The proposed disclosure requirements are based on specific TCFD recommendations.

Board oversight

Regarding board governance, a registrant would need to:

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

Management oversight

Regarding management's role in assessing and managing climate-related risks, a registrant would need to describe:

- whether certain management positions or committees are responsible for assessing and managing climate-related risks and, if so, would need to identify such positions or committees and disclose the relevant expertise of the position holders or members in such detail as necessary to fully describe the nature of the expertise;
- the processes by which the responsible managers or management committees are informed about and monitor climate-related risks; and
- whether the responsible positions or committees report to the board or board committee on climate-related risks and how frequently this occurs.

The SEC declined to require disclosure of whether any portion of executive compensation is tied to the achievement of climate-related targets or goals.

Additional Detail – Risk Management Disclosure (Regulation S-K, Item 1503)

Processes for identifying, assessing and managing climate-related risks

A registrant would be required to describe any processes it has for identifying, assessing and managing climate-related risks. When describing these processes, the registrant would be required to disclose, as applicable, how it:

- determines the relative significance of climate-related risks compared to other risks;
- considers existing or likely regulatory requirements or policies, such as GHG emissions limits, when identifying climate-related risks;
- considers shifts in customer or counterparty preferences, technological changes, or changes in market prices in assessing potential transition risks; and
- determines the materiality of climate-related risks, including how it assesses the potential size and scope of any identified climate-related risk.

When describing any processes for managing climate-related risks, a registrant would be required to disclose, as applicable, how it:

- decides whether to mitigate, accept or adapt to a particular risk;
- prioritizes addressing climate-related risks; and
- determines how to mitigate a high priority risk.

The proposed rules would also require a registrant to disclose whether and how climate-related risks are integrated into the registrant's overall risk management system or processes.

Transition plan disclosure

If a registrant has adopted a transition plan as part of its climate-related risk management strategy, it would be required to discuss, as applicable, how it plans to mitigate or adapt to any physical risks identified in the filing, including but not limited to those concerning exposure to sea level rise, extreme weather events, wildfires, drought and severe heat. For this purpose, a transition plan would be defined as any strategy and implementation plan to reduce climate-related risks.

If a registrant has adopted a transition plan, it would be required to describe its plan, including the relevant metrics and targets used to identify and manage physical and transition risks. It would also be required to discuss, as applicable, how it plans to mitigate or adapt to any identified transition risks, including, for example:

- laws, regulations or policies that restrict GHG emissions or products with high GHG footprints, including emissions caps or require the protection of high conservation value land or natural assets;
- imposition of a carbon price; and
- changing demands or preferences of consumers, investors, employees and business counterparties.

A registrant that has adopted a transition plan as part of its climate-related management strategy would be required to update its disclosure about its transition plan each fiscal year by describing the actions taken during the year to achieve the plan's targets or goals. It may also describe how it plans to achieve any identified climate-related opportunities.

Additional Detail – Financial Statement Metrics (Regulation S-X, Rule 14-02)

A registrant would be required to disclose in a note to its audited consolidated financial statements (in any filing that is required to include Subpart 1500 disclosure) certain disaggregated climate-related financial statement metrics that are mainly derived from existing financial statement line items. There are three categories of metrics: financial impact; expenditure; and financial estimates and assumptions.

These metrics would involve estimation uncertainties that are driven by the application of judgments and assumptions, similar to other financial statement disclosures (*e.g.*, estimated loss contingencies, fair value measurement of certain assets, etc.). For each type of metric, the registrant would need to disclose contextual information to enable a reader to understand how it derived the metric, including a description of significant inputs and assumptions used and, if applicable, policy decisions made by the registrant to calculate the specified metrics. A registrant would apply the same set of accounting principles used to prepare the rest of the financial statements.

Disclosure would be provided for the most recently completed fiscal year and for prior fiscal years to the extent the filing includes audited income statements for prior fiscal years. The proposed rules would not override 1933 Act Rule 409 or 1934 Act Rule 12b-21 in respect of prior historical periods.

Financial impact metrics

To complement the proposed disclosure requirement in Regulation S-K, Item 1502(d) to discuss the impact of identified climate-related risks that affect financial statements, the SEC proposes to amend Regulation S-X to require disclosure of disaggregated information about the impact of climate-related conditions and events, and transition activities, on the consolidated financial statements included in the relevant filing, unless the impact is below a specified threshold.

Specifically, disclosure would be required regarding the impact from severe weather events and other natural conditions under Rule 14-02(c), as well as transition activities (under Rule 14-02(d)), which would cover both physical risks and transition risks. Disclosure would also be required under Rule 14-02(i) regarding the impact of any climate-related risks identified pursuant to Regulation S-K, Item 1502(a) – both identified physical risks and identified transition risks – on any financial statement items. Covered physical risks would include flooding, drought, wildfires, extreme temperatures and sea-level rise.

Impacts could be negative or positive. If a registrant makes a policy decision to disclose the impact of a climate-related opportunity on the proposed financial statement metrics, it must do so consistently (*e.g.*, for each fiscal year presented in the consolidated financial statements, for each financial statement line item, for all relevant opportunities identified by the registrant) and must follow the same presentation and disclosure threshold requirements applicable to the required disclosures related to financial impact metrics and expenditure metrics, as discussed below.

The financial impact metric disclosure requirements in proposed Rule 14-02(c), (d) and (i) would require a registrant to disclose the financial impacts of severe weather events, other natural conditions, transition activities and identified climate-related risks on the consolidated financial statements included in the relevant filing unless the aggregated impact of the severe weather events, other natural conditions, transition activities and identified climate-related risks is less than 1% of the total line item for the relevant fiscal year.

A registrant would be required to determine the impacts on each consolidated financial statement line item. Within each category (*i.e.*, climate-related events or transition activities), impacts would, at a minimum, be 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. For purposes of determining whether the 1% disclosure threshold has been met, a registrant would be required to aggregate the absolute value of the positive and negative impacts on a line-by-line basis for the relevant fiscal year.

To provide additional clarity, the proposed rule would include the following examples of disclosures that may be required to reflect the impact of the severe weather events and other natural conditions on each line item of the registrant's consolidated financial statements (e.g., line items of the consolidated income statement, balance sheet or cash flow statement):

- changes to revenue or costs from disruptions to business operations or supply chains;
- impairment charges and changes to the carrying amount of assets (such as inventory, intangibles, and property, plant and equipment) due to the assets being exposed to severe weather, flooding, drought, wildfires, extreme temperatures and sea-level rise;
- changes to loss contingencies or reserves (such as environmental reserves or loan loss allowances) due to impact from severe weather events; and
- changes to total expected insured losses due to flooding or wildfire patterns.

With respect to the financial impacts of transition activities, the proposed rule would include the following examples of potential impacts:

- changes to revenue or cost due to new emissions pricing or regulations resulting in the loss of a sales contract;
- changes to operating, investing, or financing cash flow from changes in upstream costs, such as transportation of raw materials;
- changes to the carrying amount of assets (such as intangibles and property, plant, and equipment), for example, due to a reduction of the asset's useful life or a change in the asset's salvage value by being exposed to transition activities; and
- changes to interest expense driven by financing instruments such as climate-linked bonds issued where the interest rate increases if certain climate-related targets are not met.

Expenditure

The proposed expenditure metrics (Rule 14-02(e), (f) and (i)) would refer to the positive and negative impacts associated with the same climate-related events, transition activities and identified climate-related risks as the proposed financial impact metrics. The expenditure metrics would require a registrant to separately aggregate amounts of expenditure expensed and capitalized costs incurred during the fiscal years presented. For each of those categories, a registrant would be required to disclose separately the amount incurred during the fiscal years presented 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 toward transition activities, specifically, to reduce GHG emissions or otherwise mitigate exposure to transition risks (including identified transition risks). The registrant may also elect to disclose the impact of efforts to pursue climate-related opportunities associated with transitions activities.

The proposed expenditure metrics would be subject to the same 1% disclosure threshold as the financial impact metrics.

The proposed rules would clarify that a registrant may be required to disclose the amount of expenditure expensed or capitalized costs, as applicable, incurred for:

- the climate-related events 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 (Rule 14-02(e)).
- climate-related transition activities related to research and development of new technologies, purchase of 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 (Rule 14-02(f)).

Financial estimates and assumptions

The proposed rules would require a registrant to disclose whether the estimates and assumptions used to produce the consolidated financial statements were impacted by 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) (Rule 14-02(g)). If so, the registrant would be required to provide a qualitative description of how such events have impacted the development of the estimates and assumptions used by the registrant in the preparation of such financial statements. Similar to the other proposed financial statement metrics, separate disclosure focused on transition activities would be required (including identified transition risks) (Rule 14-02(h) and (i)).

If the estimates and assumptions a registrant 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 has disclosed, the registrant would be required to provide a qualitative description of how the development of the estimates and assumptions were impacted (Rule 14-02(h)).

A registrant may also include the impact of 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, including those identified pursuant to S-K Regulation, Item 1502(a), on any of the financial statement metrics disclosed under Rule 14-02. If a registrant makes a policy decision to disclose the impact of an opportunity, it must do so consistently for the fiscal years presented, including for each financial statement line item and all relevant opportunities identified by the registrant. (Rule 14-02(j)).

Additional Detail – Targets and Goals Disclosures (Regulation S-K, Item 1506)

If a registrant has set any climate-related targets or goals, then the proposed rules would require the registrant to provide certain information about those targets or goals. Those goals or targets might, for example, relate to the reduction of GHG emissions (a registrant might disclose that it plans to reduce its Scope 1 and Scope 2 emissions by 50% by a date certain or that it will reduce its Scope 3 emissions by 50% by a date certain, or that it intends to achieve net zero across its operations by 2050, in keeping with the goals of the Paris Agreement). Or it may address energy usage, water usage, conservation or ecosystem restoration. A registrant might also set goals as to revenues from low-carbon products in line with anticipated regulatory requirements, market constraints or other goals established by a climate-related treaty, law, regulation, policy or organization.

If a registrant has set climate-related targets or goals, the proposed rules would require it to disclose them, including, as applicable, a description of:

- the scope of activities and emissions included in the target;
- the unit of measurement, including whether the target is absolute or intensity based;
- the defined time horizon by which the target is intended to be achieved, and whether the time horizon is consistent with one or more goals established by a climate-related treaty, law, regulation, policy or organization;
- the defined baseline time period and baseline emissions against which progress will be tracked with a consistent base year set for multiple targets;
- any interim targets set by the registrant; and
- how the registrant intends to meet its climate-related targets or goals.

A registrant would be required to disclose the baseline year for multiple targets. It would also be required to disclose the unit of measurement, including whether the target is expressed in absolute terms or is intensity-based. If the registrant has set intervening targets, the registrant would be required to disclose these targets as well.

A registrant would be required to discuss how it intends to meet its climate-related targets or goals. For example, for a target or goal regarding net GHG emissions reduction, the discussion might include a strategy to increase energy efficiency, transition to lower carbon products, purchase carbon offsets or RECs, or engage in carbon removal and carbon storage. For a registrant operating in a water-stressed area, with the goal of reducing its freshwater needs, the discussion might include a strategy to increase the water efficiency of its operations, such as by recycling wastewater or, if in agriculture, engaging in bioengineering techniques to make crops more resilient and less water dependent.

A registrant would also be required to disclose relevant data to indicate whether it is making progress toward achieving the target or goal and how such progress has been achieved, and would also be required to update this disclosure each fiscal year by describing the actions taken during the year to achieve its targets or goals.

If the registrant has used carbon offsets or RECs in its plan to achieve climate-related targets or goals, it would be required to disclose the amount of carbon reduction represented by the offsets or the amount of generated renewable energy represented by the RECS, the source of the offsets or RECs, a description and location of the underlying projects, any registries or other authentication of the offsets or RECs, and the cost of the offsets or RECs.

A registrant may provide the targets and goals disclosures when discussing climate-related impacts on its strategy, business model and outlook (in response to proposed Item 1502) or when discussing its transition plan as part of its risk management disclosure (in response to proposed Item 1503). If so, it need not repeat the disclosure, but should cross-reference the section where the information has been provided.

Additional Detail – GHG Emissions Metrics Disclosures (Regulation S-K, Item 1504)

A registrant would be required to disclose its GHG emissions for its most recently completed fiscal year and for the historical fiscal years included in the consolidated financial statements in the applicable filing, to the extent such historical GHG emissions data is reasonably available. For example, a registrant that is required to include income statements and cash flow statements at the end of its three most recent fiscal years would be required to disclose three years of its Scope 1, Scope 2 and, if material to the registrant or if it has set a GHG emissions target or goal that includes its Scope 3 emissions, its Scope 3 emissions, expressed both in absolute terms and in terms of intensity (discussed below).

The relevant definitions of GHGs and GHG emissions are consistent with the definitions used in the GHG Protocol and the proposed disclosure similarly is modelled on the Scope 1, 2 and 3 concepts set forth in the GHG Protocol. Consistent with the GHG Protocol, the proposed rules would require a registrant to express each scope of its GHG emissions in terms of carbon dioxide equivalent. The SEC notes that because GHG emissions data compiled for the EPA's own GHG emissions reporting program would be consistent with the GHG Protocol's standards, and thus with the proposed rules, a registrant may use that data in partial fulfilment of its GHG emissions disclosure obligations.

A registrant would be required to disclose its total Scope 1 emissions separately from its total Scope 2 emissions after calculating them from all sources that are included in its organizational and operational boundaries. It would also be required to disclose separately its total Scope 3 emissions for the fiscal year if those emissions are material, or if it has set a GHG emissions reduction target or goal that includes its Scope 3 emissions.

For each of its Scope 1, Scope 2 and, if included, Scope 3 emissions, a registrant would be required to disclose the emissions disaggregated by each constituent GHG and in the aggregate, and would disclose GHG emissions data in gross terms, excluding any use of purchased or generated offsets. Because the value of offsets can vary depending on restrictions that are or may be imposed by regulation or market conditions, disclosing GHG emissions data in this manner would allow investors to assess the full magnitude of climate-related risk posed by a registrant's GHG emissions and the registrant's plans for managing such risk. This proposed approach is consistent with the approach taken in the GHG Protocol.

The SEC notes that the methodologies pertaining to the measurement of GHG emissions, particularly Scope 3 emissions, are evolving. While it expects that many registrants would choose to follow the standards and guidance provided by the GHG Protocol when calculating their GHG emissions, the proposed rules would not require registrants to do so.

Treatment of Scope 1 and Scope 2 vs. Scope 3

Perhaps the most fraught element of the proposed rules is the coverage of Scope 3 emissions, as highlighted in the responses to the March 2021 request for input on climate-related disclosures.

The SEC proposes to require all registrants to disclose their Scope 1 and Scope 2 emissions. The SEC recognizes that unlike Scope 1 and Scope 2 emissions, Scope 3 emissions typically result from the activities of third parties in a registrant's value chain and, therefore, collecting the data and calculating the emissions is potentially more cumbersome than the exercise needed for Scope 1 and Scope 2 emissions. In light of this, as noted above, the proposed rules would require disclosure of Scope 3 emissions only if those emissions are material, or if the registrant has set a GHG emissions reduction target or goal that includes its Scope 3 emissions.

The SEC notes that, if a registrant determines that its Scope 3 emissions are not material and, therefore, not subject to disclosure, it may be useful to investors to understand the basis for that determination. If, however, Scope 3 emissions are material, then understanding the extent of a registrant's exposure to Scope 3 emissions, and the choices it makes regarding them, would be important for investors, and registrants should also consider disclosing why other categories are not material.

If required to disclose Scope 3 emissions, a registrant would need to identify the categories of upstream and downstream activities that have been included in the calculation of the Scope 3 emissions. Consistent with the GHG Protocol, the proposed rules identify several categories of activities that can give rise to Scope 3 emissions. Upstream activities from which Scope 3 emissions might result include:

- a registrant's purchased goods and services;
- a registrant's capital goods;
- a registrant's fuel and energy related activities not included in Scope 1 or Scope 2 emissions;
- transportation and distribution of purchased goods, raw materials, and other inputs;
- waste generated in a registrant's operations;
- business travel by a registrant's employees;
- employee commuting by a registrant's employees; and
- a registrant's leased assets related principally to purchased or acquired goods or services.

Downstream activities from which Scope 3 emissions might result include:

- transportation and distribution of a registrant's sold products, goods or other outputs;
- processing by a third party of a registrant's sold products;
- use by a third party of a registrant's sold products;
- end-of-life treatment by a third party of a registrant's sold products;
- a registrant's leased assets related principally to the sale or disposition of goods or services;
- a registrant's franchises; and
- investments by a registrant (which would capture so-called financial emissions).

If required to disclose Scope 3 emissions, a registrant would also be required to describe the data sources used to calculate those emissions, including the use of any of the following:

- emissions reported by parties in the registrant's value chain, and whether such reports were verified by the registrant or a third party, or were unverified;
- data concerning specific activities, as reported by parties in the registrant's value chain; and
- data derived from economic studies, published databases, government statistics, industry associations or other third-party sources outside of a registrant's value chain, including industry averages of emissions, activities or economic data.

GHG Intensity

In addition to requiring the disclosure of GHG emissions in *gross terms*, the proposed rules would also require a registrant to disclose the sum of its Scope 1 and Scope 2 emissions in terms of *GHG intensity*. If required to disclose Scope 3 emissions, a registrant would also be required to separately disclose its Scope 3 emissions in terms of GHG intensity.

The proposed rules would define "GHG intensity" (or "carbon intensity") to mean a ratio that expresses the impact of GHG emissions per unit of economic value (*e.g.*, metric tons of CO_2e per unit of total revenues, using the registrant's reporting currency) or per unit of production (*e.g.*, metric tons of CO_2e per unit of product produced). For purposes of standardizing the disclosure and facilitating its comparability, the SEC proposed to require the disclosure of GHG intensity in terms of metric tons of CO_2e per unit of total revenue and per unit of production for the fiscal year.

If the registrant has no revenue for a fiscal year, it would be required to calculate its GHG intensity with another financial measure (*e.g.*, total assets), with an explanation of why the particular measure was used. Similarly, if the registrant does not have a unit of production, it would be required to calculate its GHG intensity with another measure of economic output, depending on the nature of its business (*e.g.*, data processing capacity, volume of products sold, or number of occupied rooms), again, with an explanation of why the particular measure was used.

GHG emissions methodology and related instructions

The proposed rules would require a registrant to describe the methodology, significant inputs and significant assumptions used to calculate its GHG emissions metrics. The description of the registrant's methodology would include the registrant's organizational boundaries, operational boundaries, calculation approach and any calculation tools used to calculate the registrant's GHG emissions.

Organizational boundaries. The proposed rules would require a registrant to disclose its Scope 1 and Scope 2 emissions separately after calculating them from all sources that are included in the registrant's organizational and operational boundaries. An initial step for many registrants may be to determine their organizational boundaries. Those boundaries determine the business operations owned or controlled by a registrant to be included in the calculation of its GHG emissions, which define the Scope 1 and Scope 2 emissions coverage.

The proposed rules require a registrant to set the organizational boundaries using the same scope of entities, operations, assets and other holdings within its business organization as those included in, and based upon the same set of accounting principles applicable to, its consolidated financial statements. This represents a departure from the GHG Protocol, which calls for basing organizational boundaries on either an equity share approach or a control approach.

A registrant would use the same organizational boundaries when calculating its Scope 1 emissions and Scope 2 emissions. If required to disclose its Scope 3 emissions, a registrant would also be required to apply the same organizational boundaries used when determining its Scope 1 and Scope 2 emissions as an initial step in identifying the sources of indirect emissions from activities in its value chain over which it lacks ownership and control and which must, therefore, be included in the calculation of Scope 3 emissions.

Operational boundaries. When describing the methodology, significant inputs and significant assumptions used to calculate its GHG emissions metrics, a registrant would be required to describe its operational boundaries (*i.e.*, the boundaries that determine the direct and indirect emissions associated with the business operations owned or controlled by a registrant). This would entail identifying emissions sources within plants, offices and other operational facilities that fall within the organizational boundaries, and then categorizing the emissions as either direct or indirect emissions. For example, a registrant might have direct emissions from one or more of the following sources that it owns or controls:

- stationary equipment (from the combustion of fuels in boilers, furnaces, burners, turbines, heaters and incinerators);
- transportation (from the combustion of fuels in automobiles, trucks, buses, trains, airplanes, boats, ships and other vessels);
- manufacturing processes (from physical or chemical processes, such as CO_2 from the calcination process in cement manufacturing or from catalytic cracking in petrochemical processing and PFC emissions from aluminum smelting); and
- fugitive emission sources (equipment leaks from joints, seals, packing, gaskets, coal piles, wastewater treatment, pits, cooling towers and gas processing facilities, and other unintentional releases).

A registrant would be required to include its approach to categorizing its emissions and emissions sources when describing its methodology to determine its operational boundaries, and could use the foregoing list of emissions sources or other categories of emissions sources as long as it describes how it determined the emissions to include as direct emissions, for the purpose of calculating its Scope 1 emissions, and indirect emissions, for the purpose of calculating its Scope 2 emissions.

Once a registrant has determined its organizational and operational boundaries, it must consistently use those boundaries when calculating its GHG emissions.

GHG emissions calculation approach, including emission factors

A registrant would need to select a GHG emissions calculation approach. While the direct measurement of GHG emissions from a source by monitoring concentration and flow rate is likely to yield the most accurate calculations, due to the expense of the direct monitoring of emissions, an acceptable and common method for calculating emissions involves the application of published emission factors to the total amount of purchased fuel consumed by a particular source.

After a registrant has selected a calculation approach (*i.e.*, direct measurement or application of emissions factors), it would determine what data must be collected and how to conduct the relevant calculations, including whether to use any publicly available calculation tools. In this regard, the SEC notes that there are a number of publicly available calculation tools a registrant may decide to use in determining its GHG emissions. Finally, a registrant would gather and report GHG emissions up to the corporate level.

As part of the roll-up process for a registrant with multiple entities and emission sources, once it has determined the amount of CO_2e for each type of direct emissions source and for each facility within its organizational and operational boundaries, the registrant would add them together to derive the total amount of Scope 1 emissions for the fiscal year. It would undergo a similar process when calculating its Scope 2 emissions for its most recently completed fiscal year. There are two common methods for calculating Scope 2 emissions for purchased electricity: the market-based method and the location-based method.

In all instances a registrant would be required to describe its methodology, including its organizational and operational boundaries, calculation approach (including any emission factors used and the source of the emission factors), and any calculation tools used to calculate the GHG emissions.

Financial institutions

A financial registrant's Scope 3 emissions disclosures, if required, would likely include the emissions from issuers to which the registrant provides debt or equity financing (financed emissions). While financial registrants may use any appropriate methodology to calculate Scope 3 emissions, the Global GHG Accounting & Reporting Standard of the Partnership for Carbon Accounting Financials (the PCAF Standard) provides one methodology that complements the GHG Protocol. The PCAF Standard covers six asset classes: listed equity and corporate bonds; business loans and unlisted equity; project finance; commercial real estate; mortgages; and motor vehicle loans. Financial institutions are free to use other methodologies.

Additional rules related to methodology disclosure

A registrant:

- may use reasonable estimates when disclosing its GHG emissions as long as it also describes the assumptions underlying, and its reasons for using, the estimates;
- would be required to disclose, to the extent material and as applicable, any use of third-party data when calculating its GHG emissions, regardless of the particular scope of emissions;
- would be required to disclose any material change to the methodology or assumptions underlying its GHG emissions disclosure from the previous fiscal year; and

- would be required to disclose, to the extent material and as applicable, any gaps in the data required to calculate its GHG emissions. This would be particularly relevant to Scope 3 emissions.

When determining whether its Scope 3 emissions are material, and when disclosing those emissions, in addition to emissions from activities in its value chain, a registrant would be required to include GHG emissions from outsourced activities that it previously conducted as part of its own operations, as reflected in the financial statements for the periods covered in the filing. If a registrant is required to disclose Scope 3 emissions, and if there were any significant overlap in the categories of activities producing the Scope 3 emissions, the registrant would be required to describe the overlap, how it accounted for the overlap and its disclosed total Scope 3 emissions.

A registrant may present estimated Scope 3 emissions in terms of a range as long as it discloses its reasons for using the range and the underlying assumptions. This reflects the SEC's acknowledgement that, because a registrant may encounter more difficulties obtaining all of the data required for determining its Scope 3 emissions compared to determining Scopes 1 and 2 emissions, presenting Scope 3 emissions in terms of a range may be a reasonable means of estimating these emissions when faced with gaps in the data.

Attestation of Scope 1 and Scope 2 Emissions Disclosure (Regulation S-K, Item 1505)

Attestation

The proposed rules would require accelerated filers and large accelerated filers to include, in the relevant filing, an attestation report covering, at a minimum, the disclosure of their Scope 1 and Scope 2 emissions and to provide certain related disclosures about the service provider. The attestation engagement would be required to provide, at a minimum, "limited assurance" for fiscal years 2 and 3 after the Scope 1/Scope 2 emissions disclosure compliance date, and "reasonable assurance" for fiscal year 4 and beyond after such compliance date.

At its option, an accelerated filer or a large accelerated filer would be able to obtain any level of assurance over its climate-related disclosures that are not required to be assured pursuant to proposed Item 1505(a). For example, an accelerated filer or a large accelerated filer could voluntarily include an attestation report at the limited assurance level for its GHG intensity metrics or its Scope 3 emissions disclosure. To avoid potential confusion, however, the voluntary assurance obtained by such filer would be required to follow the requirements of proposed Item 1505(b)–(d), including using the same attestation standard as the required assurance over Scope 1 and Scope 2.

The SEC considered whether to require management teams to assess and disclose the effectiveness of controls over GHG emissions disclosure (apart from the existing requirements with respect to the assessment and effectiveness of DCP). More specifically, in addition to the requirement to assess such controls, the SEC considered whether to require management to include a statement in their annual reports regarding their responsibility for the design and evaluation of controls over GHG emissions disclosures, as well as to disclose their conclusion regarding the effectiveness of such controls. It also considered proposing to require a GHG emissions attestation provider's attestation of the effectiveness of controls over GHG emissions disclosure in addition to the proposed attestation over the Scope 1 and Scope 2 GHG emissions disclosure. The SEC is not currently proposing any of these.

Attestation provider

The proposed rules would require the GHG emissions attestation to be prepared and signed by a GHG emissions attestation provider. A GHG emissions attestation provider would mean a person or a firm that has all of the following characteristics:

- Is an expert in GHG emissions by virtue of having significant experience in measuring, analyzing, reporting or attesting to GHG emissions. Significant experience means having sufficient competence and capabilities necessary to: perform engagements in accordance with professional standards and applicable legal and regulatory requirements, and enable the service provider to issue reports that are appropriate under the circumstances.
- Is independent with respect to the registrant, and any of its affiliates, during the attestation and professional engagement period.

Attestation engagement and report requirements

The attestation report would be included in the separately-captioned "Climate-Related Disclosure" section in the relevant filing and would 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, including the broad distribution of the framework for public comment. This requirement would be similar to the requirements for determining a suitable, recognized control framework for use in management's evaluation of ICFR. In the SEC's view, the attestation standards, for example, of the PCAOB (AT Section 101, Attest Engagements), AICPA (SSEA 18 (general attestation standard)) and IAASB (ISAE 3000 (Revised); Assurance Engagements Other than Audits or Reviews of Historical Financial Information) would meet this due process requirement.

The proposed rules would not include any requirement for a registrant to obtain an attestation report covering the effectiveness of internal control over GHG emissions disclosure, and therefore such a report would not be required even when the GHG emissions attestation engagement is performed at a reasonable assurance level. The SEC notes that, given the current evolving state of GHG emissions reporting and assurance, it believes that existing DCP obligations, and the proposed requirement that accelerated filers and large accelerated filers initially obtain at least limited assurance of such disclosure, are appropriate first steps toward enhancing the reliability of GHG emissions disclosure.

The GHG emissions attestation report would be required to include an identification or description of the subject matter or assertion on which the attestation provider is reporting, as well as the point in time or period of time to which the measurement or evaluation of the subject matter or assertion relates. This means that the attestation provider would be required to identify the time period to which the Scope 1 and Scope 2 emissions disclosure (or other additional disclosure) relates, which would be the registrant's most recently completed fiscal year or some other 12-month period if permitted under the applicable climate-related disclosure rules as well as any relevant historical period disclosure included within the filing.

The proposed rules would also require the attestation report to identify the criteria against which the subject matter was measured or evaluated. For an attestation report solely covering Scope 1 and Scope 2 emissions disclosure, the identified criteria would include the requirements in proposed Regulation S-K, Item 1504 and, in particular, Item 1504(a), which includes presentation requirements such as disaggregation by each constituent GHG. The identified criteria would also include Item 1504(b) and the applicable instructions in Item 1504(e) regarding methodology, organizational boundary and operational boundary.

The attestation report would need to include statements that:

- identify the level of assurance provided and describe the nature of the attestation engagement. An attestation report providing "limited assurance" would need to include not only a statement that limited assurance is the provided level of assurance, but also would describe the scope of work performed in a limited assurance engagement, which typically would indicate that the procedures performed vary in nature, timing and extent compared to a "reasonable assurance" engagement.
- identify the attestation standard(s) used;
- describe the registrant's responsibility to report on the subject matter or assertion being reported on in order to make it clear to investors who is ultimately responsible for the disclosure. At a minimum, this would require a statement that the registrant is responsible for the subject matter, or its assertion on the subject matter, as well as a statement that describes the attestation provider's responsibilities in connection with the preparation of the attestation report;
- the attestation provider is independent; and
- describe any significant inherent limitations associated with the measurement or evaluation of the subject matter (at a minimum, Scope 1 and Scope 2 emissions) against the criteria (*i.e.*, the applicable requirements in proposed Item 1504).

The attestation report would also need to include a description of the work performed as a basis for the attestation provider's conclusion, if it is a limited assurance engagement, and the attestation provider's conclusion or opinion, as applicable, based on the attestation standard(s) used.

Registrant disclosure relating to the attestation report

In the separately captioned "Climate-Related Disclosure" section, where the GHG emissions disclosure would be provided, a registrant would need, with respect to the Scope 1 and Scope 2 emissions attestation, to disclose whether:

- the attestation provider has a license from any licensing or accreditation body to provide assurance, and if so, the identity of the licensing or accreditation body, and whether the attestation provider is a member in good standing of that body;
- the GHG emissions attestation engagement is subject to any oversight inspection program, and if so, which program (or programs); and
- the attestation provider is subject to record-keeping requirements with respect to the work performed for the GHG emissions attestation engagement and, if so, identify the record-keeping requirements and the duration of those requirements.

A registrant, other than a large accelerated filer or an accelerated filer that is required to include a GHG emissions attestation report pursuant to proposed Item 1505(a), would need to disclose within the separately captioned "Climate-Related Disclosure" section in the filing the following information if the registrant's voluntary GHG emissions disclosures were subject to third-party attestation or verification:

- the identity of the provider of such assurance or verification;
- the assurance or verification standard used;
- the level and scope of assurance or verification provided;
- the results of the assurance or verification;
- whether the third-party service provider has any other business relationships with or has provided any other professional services to the registrant that may lead to an impairment of the service provider's independence with respect to the registrant; and
- any oversight inspection program to which the service provider is subject (e.g., the AICPA's peer review program)

Location of Disclosure; Applicability

The proposed rules would require a registrant to:

- provide the climate-related disclosure in 1933 Act registration statements (Forms S/F-1, S/F-3, S/F-4 and S-11), 1934 Act registration statements (Form 10 and Form 20-F) and 1934 Act annual reports (10-K or 20-F), and appropriate updates of material changes (on Form 10-Q or Form 6-K);
- provide the Regulation S-K mandated climate-related disclosure in a separate, appropriately captioned section ("Climate-Related Disclosure") of its registration statement or annual report, or alternatively to incorporate that information in the separate, appropriately captioned section by reference from another section, such as Risk Factors, Description of Business or MD&A;
- provide the Regulation S-X mandated climate-related financial statement metrics and related disclosure in a note to the registrant's audited financial statements;
- tag narrative/quantitative climate-related disclosures in Inline XBRL; and
- "file" rather than "furnish" the climate-related disclosure (except in the case of disclosures included in a Form 6-K).

Note that, while disclosure provided in other sections of a filing may be incorporated into the new "Climate-Related Disclosure" section, the proposed rules do not supplant existing 1933 and 1934 Act disclosure requirements, including the guidance provided by the SEC in 2010. As the SEC noted, registrants should "continue to evaluate the climate-related risks they face and assess whether disclosures related to those climate-related risks must be disclosed" in their business descriptions, risk factors, legal proceedings and MD&A as described in the 2010 guidance. "While climate risks impact many issuers across industries, the impacts of those risks on a particular registrant and how the registrant addresses those risks are fact-specific and may vary significantly by registrant." (See my briefing note: Recent SEC Staff Comments on Climate-Related Disclosure.)

The proposed rules would apply to domestic registrants as well as foreign private issuers. Emerging growth companies would not be exempt, and small reporting companies would only be exempt from the Scope 3 emissions disclosure requirement and would benefit from a longer transition period, but otherwise would be subject to the proposed rules.

The SEC acknowledged the creation of the International Sustainability Standards Board (see my briefing note: ISSB Moves Forward) and, as part of the request for comment, asked whether SEC rules, which admittedly would be an alternative reporting regime, should accommodate reporting that complies with criteria developed by global sustainability standards bodies, such as the ISSB. If so, should the accommodations apply only to foreign private issuers?

Phase-In

The proposed rules would include a phase-in period:

- for all registrants, with the compliance date dependent on the registrant's filer status, and an additional phase-in period for Scope 3 emissions disclosure; and
- for the assurance requirement and the level of assurance required for accelerated filers and large accelerated filers

Illustrative dates based on an effective date of December 2022, for filers with year-end fiscal years:

Disclosure compliance dates:

Registrant status	Proposed disclosures, x-Scope 3	Scope 3
Large accelerated	FY 2023 (filed in 2024)	FY 2024 (filed in 2025)
Accelerated and non-accelerated	FY 2024 (filed in 2025)	FY 2025 (filed in 2026)
Smaller reporting company	FY 2025 (filed in 2026)	Exempt

Attestation requirement:

Registrant status	Scope 1/2 GHG Disclosure	Limited Assurance	Reasonable Assurance
Large accelerated	FY 2023 (filed in 2024)	FY 2024 (filed in 2025)	FY 2026 (filed in 2027)
Accelerated	FY 2024 (filed in 2025)	FY 2025 (filed in 2026)	FY 2027 (filed in 2028)

Scope 3 Safe Harbors

The SEC recognizes that the calculation and disclosure of Scope 3 emissions may pose difficulties compared to Scope 1 and Scope 2 emissions and, depending on the size of a company and its value chain, may be challenging. In particular, it may be difficult to obtain activity data from suppliers and other third parties in the value chain, or verify the accuracy of that information, and may be necessary to rely heavily on estimates and assumptions to generate Scope 3 emissions data.

In light of the unique challenges for Scope 3 emissions disclosure, the proposed rules would include in respect of Scope 3 emissions disclosure only:

- a targeted safe harbor (Regulation S-K, Item 1504(f));
- an exemption for smaller reporting companies; and

- a delayed compliance date (all registrants, regardless of their size, would have an additional year to comply initially with the Scope 3 disclosure requirement beyond the compliance date for the other proposed rules).

The proposed safe harbor would provide that disclosure of Scope 3 emissions by or on behalf of the registrant would be deemed not to be a fraudulent statement unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith. The safe harbor would extend to any statement regarding Scope 3 emissions made pursuant to Regulation S-K, Items 1500-1506 in a document filed with the SEC. 1933 Act Rule 409 and 1934 Rule 12b-21, which provide accommodations for information that is unknown and not reasonably available, would be available for the proposed Scope 3 emissions disclosures.

For purposes of the safe harbor, "fraudulent statement" would mean a statement that is an untrue statement of material fact, a statement false or misleading with respect to any material fact, an omission to state a material fact necessary to make a statement not misleading, or that constitutes the employment of a manipulative, deceptive, or fraudulent device, contrivance, scheme, transaction, act, practice, course of business, or an artifice to defraud as those terms are used in the 1933 Act or the 1934 Act or the rules or regulations thereunder.

With respect to the additional year, the SEC notes that, because a registrant's Scope 3 emissions consist of Scope 1 and Scope 2 emissions of its suppliers, distributors and other third parties in the registrant's value chain, to the extent those parties become subject to the proposed rules, the increased availability of Scope 1 and Scope 2 emissions data following the rules' effectiveness should help ease the burden of complying with the Scope 3 emissions disclosure requirement.

Safe Harbors for Forward-Looking Statements

In various sections of the proposing release, the SEC has set out its views regarding the applicability of the forward-looking safe harbors available under the Private Securities Litigation Reform Act, subject to the other statutory conditions of the safe harbors being met. In its request for comment, the SEC does ask whether additional specific safe harbor protection would be warranted, for example along the lines of Regulation S-K, Item 305(d) (Quantitative and qualitative disclosures about market risk).

In the proposing release, the SEC notes that:

- just as MD&A traditionally has had a forward-looking view, so too would a registrant's assessment of the materiality of climate-related risks over the short, medium and long term, and that the forward-looking safe harbors remain available (although they would not cover disclosures, for example, in an IPO registration statement);
- the disclosure of an internal carbon price should not be viewed as a promise or guarantee with regard to the future costs to the registrant of GHG emissions and, to the extent that internal carbon pricing information would be forward-looking, the forward-looking safe harbors would be available;
- because scenario analysis disclosure would necessarily include predictions and other forward-looking statements based on assumptions concerning future events, the SEC

believes that the forward-looking safe harbor would apply to much of the disclosure concerning scenario analysis;

- because transition planning inherently requires judgments and predictions about the future, forward-looking statements made as part of a registrant's discussion of its transition plan would be eligible for the forward-looking statement safe harbors; and
- to the extent that information regarding a registrant's climate-related targets or goals would constitute forward-looking statements, which the SEC would expect, for example, with respect to how a registrant intends to achieve its climate-related targets or goals and expected progress regarding those targets and goals, the forward-looking safe harbors would apply to such statements.

Concluding Thoughts

The direction of travel on climate-related disclosure, from a global perspective, is clear. The European Union and, following its withdrawal from the European Union, Britain have committed to mandating disclosures that are based on the same frameworks, namely the TCFD framework and the GHG Protocol, on which the SEC has based its proposed rules. While it is unlikely that the SEC will relinquish its role in setting disclosure standards for the US capital markets by combining forces with the ISSB (after all, after decades of effort the FASB and the IASB never managed to replace IFRS and US GAAP with a single global accounting standard), the clearest benefit to the global capital markets is for public companies to be subject to largely similar rules (created in parallel processes) that, in turn, generate consistent, comparable, reliable and decision-useful climate-related information across geographies, scale and industries.

Notwithstanding the significant volume of comments received following the March 2021 request for input on climate-related disclosures (reportedly approximately 600 unique letters), these proposed requirements will likely generate an equally significant volume of comments (both for and against) on different aspects of the proposals. As I set out in my recent briefing note (IPCC warnings), addressing the effects of climate change is both urgent and critical (the already elevated threats having been made potentially even worse by the impact of the Russian invasion of Ukraine on global energy policy), and in that context meeting the demands of investors and other stakeholders for comparable, consistent, reliable and decision-useful disclosure to better understand the potential impacts of climate-related risks on companies (and the related opportunities) is equally critical.

The SEC chose December 2022 as an indicative effective date for the proposed rules to illustrate the phased compliance dates – that effective date is a worthy goal we should all strive to achieve.

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