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Client Alert
Commentary

Latham & Watkins Environment, Land & Resources Practice October 8, 2021 | Number 2898

Climate Disclosures and the SEC

What SEC commentary and the influence of existing frameworks could mean for mandatory climate disclosures in the US.

US Securities and Exchange Commission (SEC) Chair Gary Gensler has publicly stated that the SEC will propose a rule to require climate-related disclosures in public filings and that the proposal will likely be made before the end of this year.[1] This anticipated rulemaking represents a critical step forward in the SEC's growing focus on sustainability and climate matters over the past several years. In light of the near-exponential growth in voluntary disclosure frameworks and significant global momentum for mandatory climate and sustainability disclosures, Chair Gensler indicated that he expects such a rule to bring clarity in relation to a number of questions that have been raised by public companies, including the scope of reportable emissions, the appropriate reporting standards, and other relevant benchmarking criteria.[2] In order to prepare for this impending rulemaking, it is advisable to first understand the history of the SEC's review of climate disclosure and to develop a working knowledge of the existing climate disclosure frameworks that have taken root in voluntary disclosures and in jurisdictions outside the US.

This *Client Alert* outlines the SEC's review of the issue since 2010 and evaluates a number of the key existing international and voluntary criteria and methodologies that may inform the SEC's assessment of climate-related disclosures.

Background

In 2010, the SEC issued guidance regarding disclosures related to climate change (2010 guidance), noting that information about climate change-related risks and opportunities might be required in a registrant's disclosures, specifically those sections relating to business description, legal proceedings, risk factors, and management's discussion and analysis of financial condition and operations.[3] The issue remained in focus at the SEC in subsequent years, as reflected in public comments to the SEC 2016 concept release and 2019 proposed rulemaking on modernizing S-K regulations called for the inclusion of environmental, social, and governance (ESG) disclosures, specifically those that are climate-related.[4] In May 2020, the SEC Investor Advisory Committee approved recommendations for the SEC to update reporting requirements to include material, decision-useful ESG factors.[5]

In February 2021, Acting Chair Allison Herren Lee issued a "Statement of Review" directing the SEC staff to review climate-related disclosures in public company filings. On March 15, 2021, Acting Chair Lee formally sought comments on such disclosures to assist the SEC staff in evaluating the SEC's "disclosure rules with an eye toward facilitating the disclosure of consistent, comparable, and reliable information on climate change." Acting Chair Lee also created a Climate and ESG Task Force in the Division of Enforcement to focus on under-reporting of climate risks under the SEC's *existing* rules. The 2010 guidance noted that climate change impacts may trigger reporting requirements under a number of *existing* non-financial statement disclosure rules.[6]

As recently as September 22, 2021, the SEC Division of Corporation Finance reminded companies that it is selectively reviewing SEC filings for climate-related disclosures and provided a sample letter that companies may receive regarding their climate-related disclosures or the absence thereof.[7] The announcement is an important reminder that, regardless of whether the SEC mandates climate-related disclosures, the rapidly evolving and shifting nature of climate change is likely to raise the prominence of climate-related issues for companies.

The Public Response

In response to the SEC's March 2021 request,[8] the SEC received more than 550 comments from a variety of organizations, including trade and environmental advocacy groups, asset managers, and research organizations.[9] Chair Gensler reported that of the comments received, three out of every four letters supported mandatory climate disclosure rules.[10] Those in favor generally agreed that:

- Climate-related disclosures should be required if those disclosures are "material" to operations and would cause a rational investor to alter their investment decision.
- Mandated climate-related disclosures should require the quantification and reporting of direct greenhouse gas (GHG) emissions (Scope 1) and certain indirect GHG emissions (Scope 2).
- Specific applicable metrics are needed for quantifying emissions and consistency with current frameworks such as the Sustainability Accounting Standards Board (SASB), the Climate Disclosure Standards Board, and the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).[11]

Scope Emissions

The existing emissions reporting landscape, including how emission sources are grouped and defined under international standards, is a foundational element of existing disclosure frameworks and something the SEC may likely consider in preparing its proposal. The GHG Protocols are recognized as among the most authoritative international standards for quantifying emissions.[12] Since 2001, the Protocols have helped entities identify the universe of emissions for which they are responsible (their emission inventory), and provided guidance on how those emissions should be quantified, defining emissions in three "Scope" categories:[13]

- ***Scope 1 emissions:*** Direct emissions from sources owned or controlled by the organization (e.g., emissions from an organization's combustion of fuel, vehicles, and process emissions and fugitive emissions).
- ***Scope 2 emissions:*** Indirect emissions associated with a third party's generation of electricity, heat, or steam that is purchased and consumed by the organization.
- ***Scope 3 emissions:*** All other indirect emissions across an organization's value chain. The GHG Protocols define 15 categories of Scope 3 emissions, including purchased goods and services, transportation and distribution, the use of sold products, and the effects of financial investments.

Climate Disclosure Frameworks and Metrics[14]

Once scope emissions have been quantified, there are a number of widely recognized and utilized standards and frameworks for disclosing emissions and other climate-related disclosures published by organizations including SASB, the Task Force on Climate-related Financial Disclosures (TCFD), the Global Reporting Initiative (GRI), and the Carbon Disclosure Project (CDP). The SEC recognized the GRI and CDP in its 2010 guidance[15] and SEC officials have recently referenced the TCFD on multiple occasions.[16]

In order to understand the landscape of options that will inform the SEC's anticipated rulemaking, companies may want to consider these foundational metrics:[17]

- ***Task Force on Climate-related Financial Disclosures (TCFD):***[18] The TCFD was formed in 2015 to develop a consistent framework for climate-related financial disclosures. The TCFD issued its recommendations in June 2017, with a focus on four pillars: (i) governance, (ii) strategy, (iii) risk management, and (iv) metrics and targets. Each pillar specifies what organizations should include in their financial filings and contains guidance with suggested implementation approaches across all sectors. The TCFD framework is increasingly the leading framework for climate-related disclosures, and it was supported by the G20 Finance Ministers in July 2021 as the framework of reference for climate-related disclosure standards.

- ***Sustainability Accounting Standards Board (SASB):***[19] The SASB was founded in 2011 and has issued standards that focus on the concept of materiality to facilitate disclosure of ESG (including climate change) information. The SASB Standards are investor-focused and they recommend disclosure of ESG/climate-related information only if that information is reasonably likely to affect the financial condition or operating performance of a company. The SASB Standards provide industry-specific and detailed reporting requirements for nearly 80 industries.

- ***Global Reporting Initiative (GRI):***[20] Companies use these reporting standards, formed in 1997, to report on ESG issues such as climate change, human rights, governance, and social well-being. The GRI Standards, like the SASB Standards, are specific and detailed but unlike SASB Standards are aimed at identifying the broadest range of stakeholders, rather than solely targeting investors. The GRI Standards include both universal topics applicable to all companies as well as specific topics for industries. Organizations that publish annual ESG reports often work to align such reports with GRI Standards. The GRI Standards have frequently been used by organizations alongside the SASB Standards, and they are often seen as complementary, a view that was bolstered on July 13, 2020, when the SASB and GRI announced a collaborative work plan to apply the two standards concurrently.

- ***CDP***:[21] Founded in 2000, the CDP establishes a disclosure system for investors, companies, cities, states, and regions to measure their environmental impacts and manage their risks and opportunities on climate change, water security, and deforestation. Organizations are required to respond to detailed questionnaires addressing all aspects of managing climate-related matters. The CDP uses this information (supplied annually) to score organizations based on its own independent scoring methodology. Participation in the CDP is voluntary, but is supported by some in the investor community.

Given the practical challenges that may result from a governmental regulator such as the SEC utilizing a set of standards administered by a private body, the SEC may seek to create its own framework as opposed to adopting one of the aforementioned frameworks in toto. However, any and all of these standards may inform the SEC's rulemaking and the criteria they ultimately adopt, including the scope of covered emissions and the method(s) for quantifying such emissions. Of the frameworks discussed above, the GRI Standards, GHG Protocol, and TCFD recommendations contemplate Scope 3 emissions reporting. However, although numerous companies make Scope 3 emissions disclosures in public reports, the breadth and complexity of quantifying Scope 3 emissions suggest that any initial rulemaking may only address Scope 1 and 2 emissions reporting.

A key consideration for the SEC will be the extent to which assurance, in line with internationally recognized standards, will be required in relation to mandatory climate disclosures in the US. Specifically, the SEC will have to address whether climate-related disclosures will need to be evaluated and assured by third parties in some manner similar to the assurances made for corporate financial reporting. In any event, assurance may come to be considered a preferred/recommended practice.

While it is too early to determine exactly what may be included in the SEC's new rule, statements made by Chair Gensler on July 28, 2021 to the UN Principles for Responsible Investment may hold some insight. Chair Gensler noted that, among other topics, required disclosures will likely contain a combination of qualitative and quantitative information, including specific information to support any climate-related pledges or commitments.

Public companies in the US may consider assessing their GHG emissions and the methodologies they use to quantify such emissions. Moreover, the sample letter regarding climate-related disclosures released by SEC staff on September 22, 2021, is a useful resource to consult when preparing upcoming Form 10-K annual reports. Beyond climate-related disclosures, a broader assessment of ESG issues and the supporting documentation for any ESG disclosures is advised given the potential for SEC rulemaking to encompass broader ESG issues now or in the future.

Timeline for SEC Rulemaking

Chair Gensler has made clear that climate disclosures are a top priority for the agency[22] and indeed broader ESG reporting requirements could be coming as well. While some reports suggest that the SEC could propose a rule this month, in line with the October 2021 date from the SEC rulemaking agenda,[23] it appears likely that the rule will be issued some time before the end of this year[24] or early next.

Latham & Watkins will continue to monitor developments in this area.

The SEC's Steps Toward Mandated Disclosure

Date	Action
February 2010	The SEC issues the 2010 Guidance, which notes that, depending on the circumstances, information about climate change-related risks and opportunities might be required in a registrant's disclosures related to its description of business, legal proceedings, risk factors, and management's discussion and analysis of financial condition and results of operations.[25]
April 13, 2016	The SEC publishes a concept release discussing and seeking public comment on modernizing certain business and financial disclosure requirements in Regulation S-K.

Date	Action
	The Commission seeks public input on whether the disclosure requirements continue to elicit the information that investors need.
August 2019	The SEC issues a proposed rule to modernize Regulation S-K and Commissioners Robert J. Jackson, Jr. and Allison Herren Lee release a statement noting the proposed rule does not address climate risk and calling on commenters to provide data and analysis to help guide the SEC as it considers "whether and how additional rules should be updated to provide more transparency on climate risk."[26]
May 2020	The SEC Investor Advisory Committee approved recommendations for the SEC to begin an effort to update reporting requirements for issuers so that they include material, decision-useful ESG factors.[27] The recommendations follow a series of sessions on ESG disclosures in 2016, 2018, and 2019.[28]
December 2020	The ESG Subcommittee of the SEC Asset Management Advisory Committee issued a preliminary recommendation that the Commission require the adoption of standards by which corporate issuers disclose material ESG risks.[29]
February 24, 2021	Acting Chair Lee issues a "Statement of Review" directing the SEC staff to review climate-related disclosures in public company filings.[30]
March 4, 2021	Acting Chair Lee announces the creation of a Climate and ESG Task Force in the Division of Enforcement[31] to identify any material gaps or misstatements in disclosures of climate risks under existing rules.
March 15, 2021	Acting Chair Lee seeks comments on climate-related disclosures to assist the SEC staff in the evaluating of the SEC's "disclosure rules with an eye toward facilitating the disclosure of consistent, comparable, and reliable information on climate change."[32]
May 20, 2021	President Biden releases an Executive Order to incorporate climate risk and other ESG considerations into financial regulations and virtually all aspects of government spending.[33]
June 14, 2021	The comment period for the SEC's climate-related disclosures inquiry ends.

Date	Action
July 7, 2021	The SEC Asset Management Advisory Committee recommends that the SEC (1) accelerate research on third-party ESG disclosure frameworks and (2) consider establishing an ESG standards-setting body that would operate like the Financial Accounting Standards Board.
July 28, 2021	Chair Gensler and the UN Principles for Responsible Investment host a webinar titled "Climate and Global Financial Markets".[34] Chair Gensler reiterates that he has requested a proposal for mandatory climate risk disclosures by the end of the year.
September 1, 2021	Chair Gensler states that he has instructed his staff to prepare a "proposal for climate risk disclosure requirements" and that the proposal should be informed by other frameworks including the TCFD.[35]
September 14, 2021	Chair Gensler reiterates that "[t]oday's investors are looking for consistent, comparable, and decision-useful disclosures around climate risk," and that the SEC should "step in" when there is high demand for relevant information. Chair Gensler further notes that proposals developed by the SEC will be "informed by economic analysis" and will be available for public comment.[36]
September 22, 2021	SEC Division of Corporation Finance reminds companies that provides a sample letter that companies may receive regarding their climate-related disclosures in connection with the Division's disclosure review program.

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IOSCO Consults on Regulation of ESG Data and Ratings Providers

FCA Seeks to Extend Climate-Related Disclosures for Listed Companies

SEC Creates Enforcement Task Force to Assess ESG-Related Disclosure

Endnotes

[1] Gary Gensler, Chair, Prepared Remarks Before the Principles for Responsible Investment "Climate and Global Financial Markets" Webinar (Jul. 28, 2021) https://www.sec.gov/news/speech/gensler-pri-2021-07-28

[2] *See* endnote 1.

[3] Commission Guidance Regarding Disclosure Related to Climate Change, Exchange Act Release No. 33-9106 (Feb. 2, 2010) [75 Fed. Reg. 6290 (Feb 8, 2010)] (2010 Climate Change Guidance). (Noting that disclosure obligations under the SEC's rules could result from legislation and regulations governing climate change, international accords, changes in market demand for goods or services, and physical risks associated with climate change.

[4] Comments on Concept Release: Business and Financial Disclosure Required by Regulation S-K, Exchange Act Release No. 33-10064, https://www.sec.gov/comments/s7-06-16/s70616.htm

[5] *See* Recommendation from the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee Relating to ESG Disclosure (as of May 14, 2020), https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf.

[6] *See* endnote 3 at 12, 21.

[7] Sample Letter to Companies Regarding Climate Change Disclosures (modified Sept. 22, 2021) https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures

[8] These comments were in addition to the numerous comments received in response to the SEC's concept release and rulemaking for modernizing S-K Regulations, which also called for climate-related disclosures. *See e.g.,* endnote 3.

[9] *See* endnote 1.

[10] *See* endnote 1.

[11] In June 2017, the Task Force on Climate-related Financial Disclosures (TCFD) issued its final recommendations for producing consistent, comparable, clear, and reliable corporate disclosures of climate-related information that would support informed decision-making and capital allocation by investors, lenders, and insurance underwriters. https://www.sasb.org/knowledge-hub/tcfd-implementation-guide/

[12] GPP Webinar: Measuring Emissions from Purchased Electricity: A Primer on GHG Protocol's New Scope 2 Guidance (Oct. 7, 2015) https://www.epa.gov/greenpower/gpp-webinar-measuring-emissions-purchased-electricity-primer-ghg-protocols-new-scope-2; Environmental Reporting Guidelines: Including streamlined energy and carbon reporting guidance (Mar. 2019) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/850130/Env-reporting-guidance_inc_SECR_31March.pdf

[13] Definitions taken from GHG Protocol Corporate Accounting and Reporting Standard https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf

[14] This *Client Alert* focuses on climate-related disclosures. There are a wide number of disclosure frameworks that are already connected to climate change topics and that concern broader sustainability objectives. This includes the UN Sustainable Development Goals (SDGs) and nature-related metrics like land use and ecological sensitivities, and fresh water consumption in stressed areas. For example, the Taskforce on Nature-related Financial Disclosures (TNFD) is a global initiative which aims to release a framework for reporting on evolving nature-related risks in 2023. It strives to address financial institutions and companies' low understanding of how their operations or investments impact or depend on nature, and to what extent they are exposed to nature-related financial risks. TNFD builds on the framework provided by TCFD.

[15] *See* endnote 3 at 2, 9.

[16] *SEC Chairman Gensler's Senate Testimony Reaffirms focus on ESG Disclosures*, The Nat'l Law Review, Sept. 15, 2021, https://www.natlawreview.com/article/sec-chairman-gensler-s-senate-testimony-reaffirms-focus-esg-disclosures

[17] Note that this list is not exhaustive and there are other standards, frameworks, and initiatives such as the Climate Disclosure Standards Board and the Science Based Targets (SBTi) that provide recommendations regarding climate-related disclosures and emissions targets.

[18] TCFD Recommandations, https://www.fsb-tcfd.org/recommendations/

[19] *SASB Implementation Supplement: Greenhouse Gas Emissions and SASB Standards*, Sustainability Accounting Standards Board, https://www.sasb.org/wp-content/uploads/2020/10/GHG-Emissions-100520.pdf; *Proposed Changes to the SASB Conceptual Framework & Rules of Procedure: Bases for Conclusions & Invitation to Comment on Exposure Drafts*, Sustainability Accounting Standards Board, https://www.sasb.org/wp-content/uploads/2021/07/PCP-package_vF.pdf

[20] Resource Center, Global Reporting Initiative, https://www.globalreporting.org/how-to-use-the-gri-standards/resource-center/?g=109b134f-72ba-469c-8273-cfc866b23146&id=2853

[21] CDP Climate Change 2018 Scoring Methodology, CDP, https://guidance.cdp.net/en/guidance?cid=2&ctype=theme&idtype=ThemeID&incchild=1&microsite=%201&otype=ScoringMethodology&tags=TAG-646%2CTAG-605%2CTAG-600

[22] *Gensler Says Climate Disclosure Rules Among 'Top Priorities',* Law360, May 13, 2021

https://www.law360.com/articles/1384626.

[23] *SEC Plans Rules on Climate Disclosures, Cyber Risks This Fall (1)*, Bloomberg Law, Jun. 11, 2021 https://news.bloomberglaw.com/esg/sec-proposals-on-climate-esg-disclosures-planned-for-october; https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202104&RIN=3235-AM87.

[24] *See* endnote 1.

[25] *See* endnote 3 (Noting that disclosure obligations under the SEC's rules could result from legislation and regulations governing climate change, international accords, changes in market demand for goods or services, and physical risks associated with climate change.)

[26] https://www.sec.gov/rules/proposed/2019/33-10668.pdf; Joint Statement of Commissioners Robert J. Jackson, Jr. and Allison Herren Lee on Proposed Changes to Regulation S-K (Aug. 27, 2019) https://www.sec.gov/news/public-statement/statement-jackson-lee-082719.

[27] *See* endnote 4.

[28] Discussion of the State of Sustainability Reporting, Agenda: July 14, 2016, Meeting of the Securities and Exchange Commission Investor Advisory Committee, https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac071416-agenda.htm; Discussion Regarding Disclosures on Sustainability and Environmental, Social, and Governance (ESG) Topics, Agenda: December 13, 2018, Meeting of the Securities and Exchange Commission Investor Advisory Committee, https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac121318-agenda.htm; and Discussion Regarding Whether Investors Use Environmental, Social, and Governance (ESG) Data in Investment/Capital Allocation Decisions, November 7, 2019 Meeting of the Securities and Exchange Commission Investor Advisory Committee Agenda, https://www.sec.gov/spotlight/investor-advisory-committee-2012/iac110719-agenda.htm

[29] *See* U.S. Securities and Exchange Commission Asset Management Advisory Committee Potential Recommendation of ESG Subcommittee, Potential Recommendations of the ESG Subcommittee of the SEC Asset Management Advisory Committee (Dec. 1, 2020).

[30] Allison Herren Lee, Acting Chair, Statement on the Review of Climate-Related Disclosure (Feb. 24, 2021) https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure

[31] SEC Announces Enforcement Task Force Focused on Climate and ESG Issues (Mar. 4, 2021) https://www.sec.gov/news/press-release/2021-42

[32] Allison Herren Lee, Acting Chair, Public Input Welcomed on Climate Change Disclosures (Mar. 15, 2021) https://www.sec.gov/news/public-statement/lee-climate-change-disclosures

[33] Executive Order on Climate-Related Financial Risks (May 20, 2021) https://www.whitehouse.gov/briefing-room/presidential-actions/2021/05/20/executive-order-on-climate-related-financial-risk/

[34] *See* endnote 1.

[35] Gary Gensler, Chair, Remarks before the European Parliament Committee on Economic and Monetary Affairs (Sept. 1, 2021) https://www.sec.gov/news/speech/gensler-remarks-european-parliament-090121

[36] Gary Gensler, Chair, Testimony Before the United States Senate Committee on Baking, Housing, and Urban Affairs (Sept. 14, 2021) https://www.sec.gov/news/testimony/gensler-2021-09-14