Proposed SEC Climate Disclosures: An Overview of the Proposed Rule and What Companies Need to Do Now.

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Proposed SEC Climate Disclosures:
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What Companies Need to Do Now.

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The SEC Climate Disclosure Rule: Proposed Rule Contents and Path Forward

On March 21, 2022, the Securities and Exchange Commission ("SEC" or "the Commission") voted to issue a Proposing Release on mandatory climate disclosures ("Proposed Rule"). If adopted, the Proposed Rule would create new sections of Regulation S-K and Regulation S-X. These new regulatory requirements would add sweeping new climate disclosure obligations for all United States-listed public companies.

The Proposed Rule is based in large part on the requirements of the Task Force on Climate-related Financial Disclosures ("TCFD") and the standards of the Greenhouse Gas Reporting Protocol ("GHG Protocol"), both of which are voluntary disclosure regimes. As a result, many companies that have voluntarily disclosed under TCFD and reported emissions inventories using the methods of the GHG Protocol have typically been able to exercise discretion regarding the scope of their disclosures. In contrast, the Proposed Rule would mandate extensive disclosures of climate risks, including financial impacts, related governance and strategy, and greenhouse gas ("GHG") emissions for all filers, and also has provisions that do not perfectly correspond with TCFD or the GHG Protocol. So even issuers that currently issue voluntary reports following the TCFD would likely have to rework their approach and also disclose significantly more climate-related information.

Like the TCFD, the Proposed Rule would also permit issuers to discuss climate-related opportunities in their filings. These disclosures are permitted rather than required because the Commission has stated that it does not wish to require companies to disclose competitively sensitive information regarding climate-related opportunities.

Background and History

As set forth in the Proposing Release, the SEC interprets the Securities Act of 1933 and the Securities Exchange Act of 1934 as granting it broad legal authority to promulgate disclosure requirements that are necessary to protect investors and in the public interest. The Proposing Release explains:

> ***The Commission has broad authority to promulgate disclosure requirements that are 'necessary or appropriate in the public interest or for the protection of investors.' We have considered this statutory standard and determined that disclosure of information about climate-related risks and metrics would be in the public interest and would protect investors. In making this determination, we have also considered whether the proposed disclosures 'will promote efficiency, competition, and capital formation.'***[1]

[1] The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334, 21335 (Apr. 11, 2022) (to be codified at 17 C.F.R. pts. 210, 229, 232, 239, and 249).

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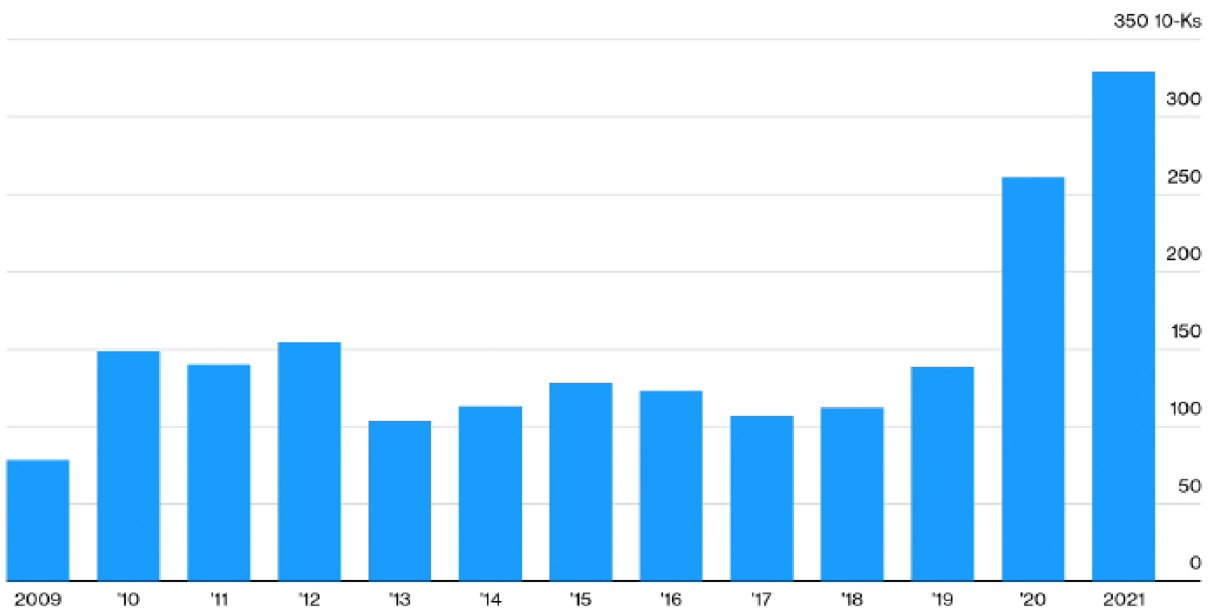
The SEC first addressed environmental issues in disclosures in the early 1970s with an interpretive release encouraging the disclosure of the financial impact of environmental laws if material.[2] In 1982, the Commission issued its first requirements for the disclosure of environmental risks, proposing revisions to Regulation S-K and Regulation S-X to require the disclosure of material environmental liabilities.[3] Under these requirements, public companies must disclose the effects of any environmental laws, regulations, or litigation that may have a material impact as part of its disclosures under Item 101 (description of business), Item 103 (legal claims), and Item 303 (management's discussion and analysis) of Regulation S-K.[4] Generally, with certain exceptions, the SEC's existing disclosure requirements are subject to a materiality standard and the threshold applied to determining whether an item is material for SEC disclosure purposes is whether there is a substantial likelihood that a reasonable investor would consider the information important in deciding how to vote or make an investment decision.

The Commission first squarely addressed disclosing climate risk in a 2010 guidance document.[5] This Climate Change Disclosure Guidance ("Disclosure Guidance") outlined the Commission's views on when climate change impacts could be material and, therefore, would require disclosure under the Commission's current rules. The Disclosure Guidance outlined that companies may be subject to a range of risks from potential legislative and regulatory actions to address climate change, climate change litigation, and the physical impacts of climate change. The Disclosure Guidance emphasized that if any of these risks were material to a company, they should be disclosed in Items 101 (description of business), 103 (legal proceedings), 303 (management's discussion & analysis), and 503(c) (risk factors) of Regulation S-K. While these requirements led to an initial uptick in climate-related disclosures and some initial comments by the Commission, the number of issuers with climate-related disclosures in their annual reports remained relatively stagnant until 2020, as shown in the figure below.



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[2] Interpretative Releases Relating to the Securities Act of 1933 and General Rules and Regulations Thereunder: Disclosures Pertaining to Matters Involving the Environment and Civil Rights, 36 Fed. Reg. 13,989 (July 19, 1971).
[3] Adoption of Integrated Disclosure, 47 Fed. Reg. 11,380 (Mar. 16, 1982).
[4] *See supra* notes 2 and 3.
[5] Commission Guidance Regarding Disclosure Related to Climate Change, 75 Fed. Reg. 6290 (Feb. 8, 2010).

While the period from 2010 to 2022 saw no developments in regulatory requirements for climate disclosure from the SEC,[6] voluntary climate disclosures by U.S.-based companies increased significantly due to the continued evolution of voluntary climate reporting regimes and the development of regulatory requirements in other jurisdictions, particularly in Europe. In 2017, the G-20's Financial Stability Board issued the first report of the TCFD.[7] The TCFD established a voluntary framework for the disclosure of climate risks and opportunities along four major pillars: governance, strategy, risk management, and metrics and targets. The TCFD encouraged the adoption of its framework by public companies first on a voluntary basis and then integrating its disclosures into mandatory reporting over time.[8]

Since its promulgation, the TCFD framework has been adopted by regulatory authorities in Brazil, the European Union, Hong Kong, Japan, New Zealand, Singapore, Switzerland, and the United Kingdom.[9] In addition, the EU has introduced a number of regulations, proposals, directives, and guidelines to standardize the approach to disclosure of ESG topics, such as disclosure of climate-related risks, including the Sustainable Finance Taxonomy,[10] the Non-Financial Reporting Directive,[11] the Corporate Sustainability Reporting Directive,[12] and the Regulation on Sustainability-Related Disclosure in the Financial Services Sector.[13]

In the U.S., public companies have increasingly been subject to pressures from investors and lenders to provide voluntary climate disclosures. For example, the Institutional Shareholder Services group of companies ("ISS") will generally vote against or withhold its vote from the chair of the responsible committee at a company that is a significant GHG emitter[14] that is failing to take the minimum steps needed to understand, assess, and mitigate risks related to climate change. For 2022, ISS has stated that such minimum steps include making detailed disclosure of climate-related risks, such as according to the TCFD framework. Further, Glass Lewis will generally recommend voting against the governance committee chair of a company in the S&P 500 that fails to provide explicit disclosure concerning the board's role in overseeing matters related to climate change.[15] BlackRock asks that companies report in accordance with the TCFD framework and publish certain metrics and targets aligned with Sustainability Accounting

[6] Notwithstanding this, in 2020, the SEC did amend Regulation S-K requiring more general environmental disclosure. Specifically, Item 101(c)(1) which incorporated the material effects of compliance, including environmental regulations, upon capital expenditure, earnings, and the competitive position of the registrant and also included the "estimated capital expenditures for environmental control facilities" for the fiscal year being reported on and any other subsequent, material, period. Additionally, the SEC amended Item 103(c)(3)(iii), which increased the quantitative threshold for disclosure of environmental proceedings in which the government is a party from $100,000 to $300,000 or provided for the selection of a different threshold that a registrant determined was reasonably designed to disclose material environmental proceedings, subject to the limitation that this not exceed the lesser of $1 million or one percent of the current assets of the registrant and its subsidiaries on a consolidated basis. *See* Modernization of Regulation S-K Items, 85 Fed. Reg. 63,726 (Oct. 8, 2020) (codified at 17 C.F.R. 229, 239, and 240).

[7] TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES, FINAL REPORT: RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES (JUNE 2017).

[8] *See id.* at 42.

[9] TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES, 2021 STATUS REPORT at 3 (Oct. 2021) (denoting that this represents 89 countries and jurisdictions and approximately $194 trillion in assets) ["TCFD 2021 Status Report"].

[10] For more information regarding the EU Sustainable Finance Taxonomy, *see EU Sustainable Finance Taxonomy: Will Categorization Bring Clarity?*, V&E (Sept. 11, 2020), https://www.velaw.com/insights/eu-sustainable-finance-taxonomy-will-categorization-bring-clarity/.

[11] For more information regarding the Non-Financial Reporting Directive, *see EU Consultation Process Underway on the Non-Financial Reporting Directive*, V&E (Feb. 25, 2020), https://www.velaw.com/insights/eu-consultation-process-underway-on-the-non-financial-reporting-directive/.

[12] For more information on the Corporate Sustainability Reporting Directive, *see Europe Doubles Down on Sustainability: Proposal for a Corporate Sustainability Reporting Directive*, V&E (June 22, 2021), https://www.velaw.com/insights/europe-doubles-down-on-sustainability-proposal-for-a-corporate-sustainability-reporting-directive/.

[13] For more information on the Regulation on Sustainability-Related Disclosure in the Financial Services Sector, *see EU Sustainable Finance Disclosure Regulation: Another Step Towards an ESG-Driven Economy*, V&E (June 11, 2021), https://www.velaw.com/insights/eu-sustainable-finance-disclosure-regulation-another-step-towards-an-esg-driven-economy/.

[14] A company may be a "significant GHG emitter" through its operations or value chain. For 2022, ISS defines a "significant GHG emitter" as those on the current Climate Action 100+ Focus Group list. For more information regarding ISS' 2022 Voting Guidelines, *see* ISS, UNITED STATES: PROXY VOTING GUIDELINES BENCHMARK POLICY RECOMMENDATIONS (2021), https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf.

[15] For more information regarding Glass Lewis' 2022 Voting Guidelines, *see* GLASS LEWIS, 2022 POLICY GUIDELINES (2022), https://www.glasslewis.com/wp-content/uploads/2021/11/US-Voting-Guidelines-US-GL-2022.pdf.

Standards Board ("SASB") standards, as well as disclose Net Zero-aligned business plans.[16] State Street[17] expects companies to report according to the TCFD framework and has released disclosure expectations for effective climate transition plans, and Vanguard[18] supports companies reporting under the TCFD framework or SASB standards.

In addition, the six largest U.S. banks have all become signatories of the Net-Zero Banking Alliance and are in the process of setting and implementing sector-specific targets for financed emissions.[19] As banks work to implement these pledges, companies may face increasing pressures to enhance their own climate reporting and goal setting in order to maintain access to capital.[20]

Working against this backdrop, the SEC characterizes its Proposing Release as responding to investor demands for transparent, comparable climate information that is "decision useful."

Disclosures Under the Proposed Rules Filed Not Furnished

Disclosures required by the proposal would be included in periodic reports (Forms 10-K, 10-Q and 20-F) and Securities Act or Exchange Act registration statements (Securities Act Forms S-1, F-1, S-3, F-3, S-4, F-4, and S11, and Exchange Act Forms 10 and 20-F). Notably, these disclosure would be required for initial public offerings and merger proxies, among other filings.

The information required by the Proposed Rule will generally be *filed* rather than furnished. In addition, the disclosures required in companies' annual reports and financial statements would be subject to officer certifications required by Rules 13a-14 and 15d-14 under the Exchange Act. This all creates significant additional potential liability for companies and individuals as compared to information that may have been previously provided in sustainability reports or other disclosures that are not filed. The SEC noted this in its adopting release and recognized that it may "cause registrants to prepare and review information filed in the Form 10-K more carefully than information presented outside SEC filings."[21]

Forward-Looking Information and Related Safe Harbor

Before proceeding to discuss the specifics of the Proposing Release, it is worth noting that many of the requirements of the Proposed Rule would entail companies making forward-looking statements as they would be required to project the risk of climate issues, and in some instances estimate the impact of those issues. This applies, in particular, to Proposed Items 1502 (Strategy) and 1503 (Risk Management). In certain instances the SEC asks companies to make these projections over the short, medium, and long term. The forward-looking statements required by the Proposed Rule (including, among others, internal carbon price, scenario analysis, and targets and goals) may be eligible for the Private Securities Litigation Reform Act's ("PSLRA") safe harbor if other PSLRA conditions are met.

Notably, the PSLRA does not apply to initial public offerings, and, if the SEC's current proposed rules regarding SPACs are approved in the current form, deSPAC transactions. The PSLRA also does not limit the SEC's authority to bring an enforcement action on any forward-looking statements. It is also interesting that, at a time when the SEC has posed significant concerns regarding the use of projections and forward-looking statements in SPAC transactions, it is asking issuers to make much longer term projections regarding climate risks in the Proposed Rule.

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[16] For more information regarding BlackRock's 2022 Voting Guidelines, *see* BLACKROCK INVESTMENT STEWARDSHIP: PROXY VOTING GUIDELINES FOR U.S. SECURITIES (2022), https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-us.pdf.

[17] For more information regarding State Street's 2022 Voting Guidelines, *see CEO's Letter on Our 2022 Proxy Voting Agenda*, STATE ST. (Jan. 12, 2022), https://www.ssga.com/us/en/intermediary/ic/insights/ceo-letter-2022-proxy-voting-agenda, and for more information on State Street's disclosure expectations for effective climate plans, *see* STATE ST., DISCLOSURE EXPECTATIONS FOR EFFECTIVE CLIMATE TRANSITION PLANS (Jan. 2022), https://www.ssga.com/library-content/pdfs/asset-stewardship/disclosure-expectations-for-effective-climate-transition-plans.pdf.

[18] For more information regarding Vanguard's 2022 Voting Guidelines, *see* VANGUARD, PROXY VOTING POLICY FOR U.S. PORTFOLIO COMPANIES (2022), https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/policies-and-reports/US_Proxy_Voting.pdf.

[19] For more information on the Net-Zero Banking Alliance, *see Net Zero Banking Alliance at One Year: Impactful or Uneventful?* V&E (Mar. 15, 2022), https://www.velaw.com/insights/net-zero-banking-alliance-at-one-year-impactful-or-uneventful/

[20] For more information on enhancing climate reporting and goal setting to maintain access to capital, *see Credit for Climate Action*, HARVARD L. SCH. F. ON CORP. GOVERNANCE (Apr. 8, 2021), https://corpgov.law.harvard.edu/2021/04/08/credit-for-climate-action/

[21] The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. at 21339.

Proposed Amendments to Regulation S-K

The Commission is proposing to add a new Part 1500 to Regulation S-K setting forth requirements for mandatory climate disclosures. These proposed disclosures largely align with the TCFD, while also requiring disclosure of GHG emissions for all reporting companies. Except as detailed below, the SEC's typical materiality threshold is notably absent from the Proposed Rule and the Commission is proposing to require all registrants to make these disclosures on the grounds that they are "decision useful" to investors.

Examples of what most of the potential new Regulation S-K disclosures could look like are available in existing TCFD reports issued by individual companies and in the TCFD's annual implementation report.[22] The TCFD's annual implementation report summarizes the TCFD's annual review of the current state of support for the TCFD, as well as the status of implementation of the 12 core requirements of the TCFD framework.[23] The implementation analysis is based upon an artificial intelligence review of TCFD reports filed by companies globally. In the TCFD 2021 Status Report, the review included 1651 TCFD reports filed by companies around the globe. The statistics provided in this report are important in understanding the degree of implementation of the various TCFD requirements and can provide a view as to the gap between current practice and the Commission's Proposed Rule.

Proposed Item 1501 – Governance

Proposed Item 1501 of Regulation S-K would require all reporting companies to make disclosures on oversight of climate risks by management and the board of directors.

For board oversight of climate risks, Proposed Item 1501(a) would require companies to disclose:

- The identity of board members or committees responsible for oversight of climate-related risks;
- Whether any board member has climate-related expertise;
- The process by which the board or board committees discuss climate-related risks;
- Whether and how the board or board committee considers climate-related risks as part of business strategy, risk management, and financial oversight;
- Whether and how the board sets climate-related targets or goals, and how it oversees progress toward achieving those goals; and
- Oversight of climate-related opportunities, if applicable.

For management's oversight of climate risks, Proposed Item 1501(b) would require companies to disclose:

- Whether management positions or committees are responsible for assessing and managing climate-related risks and relevant expertise of those so charged;
- Processes by which management is informed about and monitors climate-related risks;
- Whether and how frequently management reports to the board on climate-related risks; and
- Management's role in assessing climate opportunities, if applicable.

Although these requirements would appear to be some of the least costly to implement among the complex array of requirements set forth in the SEC's Proposing Release, according to the TCFD 2021 Status Report, governance disclosures — such as those that would be required under Item 1501 — are among the *least* reported elements.

[22] TCFD 2021 Status Report, *supra* note 9, at 38–49.
[23] *Id.* at 2.

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Globally, in 2020, only 25 percent of companies that issued voluntary reports under the TCFD framework included disclosures on the board's oversight of climate risks and 18 percent included disclosures of management's oversight of climate risks.[24] In North America, these numbers are 20 percent and 11 percent, respectively.

The Proposed Item 1501 disclosures will require companies to review their governance structures, ensure that formal assignments of responsibility over climate matters are assigned to identified members of management and board committees, and modify charters and policies to reflect such changes.

Of particular note is the proposal that would require identification of any director with expertise in climate-related risks, which is similar to the SEC's recent proposal on cyber-security disclosures, each of which, if implemented, will have the likely effect of motivating companies to appoint experts in the field of climate risks and cyber security to their boards.

Proposed Item 1502 – Strategy

Proposed Item 1502 would require all companies to disclose climate-related risks reasonably likely to have a material impact on their business or consolidated financial statements. Such disclosures would include delineation of these climate-related risks as physical or transition and their manifestation over the short-, medium-, or long-term. The Proposed Rule does not define these periods, but rather asks each issuer to describe how it defines short, medium, and long-term, 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 SEC Proposing Release also notes that the Proposed Rule serves to emphasize that, when assessing the materiality of a particular risk, management should consider its magnitude and probability over the short-, medium-, and long-term.

Item 1502 specifically calls for disclosure of both physical and transition risks.

- "**Physical risks**" are those risks that result from the experienced impacts of climate change, such as the potential for increasing severity or frequency of extreme weather events, changes in precipitation patterns (including drought), and sea level rise. The Proposed Rule uses "extreme weather" as a proxy for acute physical risks in many of the disclosure requirements without specifically discussing the influence of climate change on extreme weather events. Based on this presentation, it appears that the Commission intends for companies to treat all extreme weather exposure as physical climate risk exposure rather than asking companies to wade into attempting to discern which extreme weather events are climate-driven (or perhaps implicitly drawing the conclusion that all extreme weather events have at least some degree of climate influence).
- In contrast, "**transition risks**" are those risks that a company faces from the transition to a lower carbon economy. Transition risks can include more traditional legal risks that have long been recognized as part of the Commission's required environmental disclosures — such as increased costs associated with regulatory compliance and costs resulting from litigation — as well as costs that are associated with shifting consumer demand towards lower-carbon products.

Proposed Item 1502(a) would require disclosure of climate risks "reasonably likely to have a material impact on the registrant," including the following information:

- Categorization of the risks as either physical or transition and the nature of the risks;
- For physical risks, a description of the nature of the risk, categorization as an acute or chronic risk, and additional information regarding the location and nature of the properties, processes, or operations subject to the risk;[25]

[24] *Id.* at 30 (Fig. B2).
[25] The Proposed Item 1502 would also require specific disclosure for physical risks concerning flooding or those locating in regions of high or extremely high water stress.

- For transition risks, a description of the nature of the risk to include whether the risk relates to regulatory, technological, market, liability, reputational, or other transition related factors and how this impacts the company;
- Details as to the actual and potential impacts of the climate-related risks to include impacts on: business operations, products or services, suppliers and other parties in its value chain, activities to mitigate or adapt to climate-related risks, expenditure for research and development, and any other significant changes or impacts;
- Whether and how the impacts are considered in the company's business strategy, financial planning, and capital allocation;
- A narrative discussion of whether and how the climate-related risks detailed have affected or are reasonably likely to affect the company's consolidated financial statement; and
- A description as to the resilience of the company's business strategy in light of the potential changes in climate-related risks to include, if used by the company, additional details regarding analytical tools, such as scenario analysis.[26]

Per the TCFD 2021 Status Report, the strategy disclosures, like those required under Item 1502, are among the most reported elements, particularly disclosure regarding climate-related risks and opportunities and their impact on the organization. Globally, in 2020, 52 percent of those who reported under the TCFD included disclosure on risks and opportunities and 39 percent included disclosure on impact upon the organization. For North America, these numbers were 48 percent and 35 percent, respectively. However, disclosure pertaining to an organization's resilience of strategy was the least reported element out of all disclosures required under the TCFD. In 2020, only 13 percent of global reporters included disclosure on resilience of strategy, and in North America, this number reduced to just 7 percent.

Proposed Item 1502 requires disclosure with a high degree of specificity, even where the information is clearly not material. For example, a company must provide the location by Zip code of properties subject to flooding risk and must provide such location and book value of assets located in regions of high water stress.

Proposed Item 1503 – Risk Management

Proposed Item 1503 would require all companies to disclose the identification and management of climate-related risks, including disclosing the processes surrounding identifying risks and the management and integration of climate risks into the company's overall risk management system.

Proposed Item 1503 would require companies to disclose:

- The processes used for identification, assessment, and management of climate-related risks:
    - This includes disclosing how the company determines: (i) the relative significance of the climate-related risks compared to other risks; (ii) consideration of regulatory requirements or policies in identification of climate-related risks; (iii) consideration of shifts in customer or counterparty preferences, technological changes, or market price changes in assessment of climate-related transition risks; and (iv) the materiality of climate-related risks;
    - This also includes disclosing how the company: (i) determines whether to mitigate, adapt, or accept a particular risk; (ii) prioritizes whether to address climate-related risks; and (iii) determines how to mitigate high priority risks; and
- Whether and how such processes are integrated into the company's overall risk management system.

The TCFD 2021 Status Report indicates that in 2020, for risk management disclosures — such as those in Item 1503 of the Proposed Rule — 30 percent of global reporters included disclosure on risk identification and assessment, 29 percent included disclosure on risk management processes, and 27 percent included disclosure on the integration of

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[26] For further discussion on scenario analysis, *see infra* "'Disclose it if you have it' requirements."

these risks into the company's overall risk management. In North America, these figures were 17 percent, 19 percent, and 18 percent, respectively.

In order to prepare for Proposed Items 1502 and 1503 disclosures, companies (potentially working with third-party consultants) will want to refine, and in some instances design and implement, their formal risk assessment processes around climate-related risks.

Proposed Items 1504 & 1505 – GHG Emissions

The Proposed Rule would require all issuers to disclose certain GHG emissions on the premise that they are quantifiable and comparable across all industries and that investors have stated that emissions disclosures are useful in conducting transition risk analysis.[27]

Before going into the requirements in detail, it is helpful to explain several key definitions used in the Proposed Rule that are relevant to the Commission's proposed GHG disclosure requirements:

- **Scope 1 Emissions** are direct GHG emissions from operations that are owned or controlled by a registrant;[28]
- **Scope 2 Emissions** are indirect GHG emissions from the generation of purchased or acquired electricity, steam, heat, or cooling that is consumed by operations owned or controlled by a registrant;
- **Scope 3 Emissions** are indirect GHG emissions from all upstream and downstream activities in a registrant's value chain.
    - According to the Proposing Release, "upstream" emissions may include:
        - Purchased goods and services,
        - Capital goods,
        - Fuel and energy related activities not included in Scope 1 or Scope 2,
        - Transportation and distribution of purchased goods, raw materials, and other inputs,
        - Wastes generated by a company's operations,
        - Business travel by a company's employees, and
        - Leased assets related principally to purchased or acquired good and services.
    - According to the Proposing Release, "downstream" emissions may include:
        - Transportation and distribution of a company's sold products, goods, or other outputs,
        - Processing by a third party of a company's sold products,
        - Use by a third party of a registrant's sold products,
        - Leased assets related principally to the sale or disposition of goods and services,
        - Franchises of the company, and
        - Investments by the company.
- **Greenhouse Gases** are carbon dioxide (CO_2), methane (CH_4), nitrous oxide (N_2O), nitrogen trifluoride (NF_3), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), and sulfur hexafluoride (SF_6). The Proposed Rule

[27] The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. at 21373.

[28] Note that while these definitions are based upon those in the GHG Protocol, the Commission explains that the activities to which emissions reporting requirements apply may differ from those in the GHG Protocol because it intends for the GHG reporting requirements to cover the same operations that are included in a company's financial statements. *Id.* at 166.

would require all disclosures to be made both by individual GHG and aggregated as CO_2 equivalent (CO_2e) emissions;[29]

- **Absolute emissions** are the total quantity of GHGs emitted for each of the scopes described above; and
- **Emissions intensity** is a measure of GHG emission per unit of output. Under the proposed rule, companies would be required to report emissions intensity based upon both units of production and total revenue.

The Proposed Rule would require all reporting companies to disclose their Scope 1 and Scope 2 GHG emissions, with reporting and attestation requirements phasing in over time. Notably, while the Proposed Rule calls for registrants to set organizational and operational boundaries to help identify sources for emissions accounting, the SEC does not adopt the GHG Protocol's "equity versus control" approach.[30] Rather, the Proposed Rule would require registrants to use "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" when calculating Scope 1 and 2 emissions.[31]

The Proposing Release notes that companies may be able to use GHG data already reported to the U.S. Environmental Protection Agency (EPA) under the agency's Mandatory Greenhouse Gas Reporting Program (MGHGRP) in "partial fulfillment" of the disclosure requirements here. However, there are a number of important differences that suggest companies will need to take care in assessing how useful their existing inventories under the MGHGRP may be. First, the MGHGRP only requires reporting if emissions at a facility are above 25,000 metric tons CO_2e/year.[32] The SEC's Proposed Rule operates at the company, rather than the facility, level and does not propose a similar *de minimis* threshold, meaning that facilities that are currently excluded from the EPA's reporting requirements would need to be included in a GHG inventory for SEC reporting purposes. Second, the EPA Rule does not necessarily align with Scopes 1, 2, and 3 emissions for all covered source categories, meaning that companies may need to consider how their current GHG data collected for the MGHGRP aligns with the requirements in the SEC's Proposed Rule. Existing voluntary emission reporting frameworks, such as the GHG Protocol, are more closely aligned with what the SEC proposes regarding emissions reporting. Those companies that are already providing voluntary disclosures of GHG emissions aligned with the GHG Protocol may already have procedures in place to address these differences.

Accelerated filers and large accelerated filers will be required to include an attestation report form covering the disclosure of their Scope 1 and Scope 2 emissions alongside related disclosures about the independent "GHG emissions attestation provider." As set forth more fully in the table below,[33] the Proposed Rule provides an initial transition period for a "limited assurance"[34] attestation report followed by a subsequent transition period for a "reasonable assurance"[35] attestation report. The SEC explains that this requirement provides investors with an enhanced level of reliability not just with respect to the figures disclosed but also regarding "the key assumptions, methodologies, and data sources" used to arrive at those figures.[36] Although the attestation requirements may contribute to greater investor confidence, there is a concern regarding the current number of sufficiently qualified attestation providers to deliver this assurance. The Proposed Rule notes that the provider must be "an expert in GHG emissions by virtue of having significant experience in measuring, analyzing, reporting, or attesting to GHG

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[29] "CO_2e" essentially means translating the other GHGs into the number of metric tons of CO_2 emissions with the same global warming potential as one metric ton of another GHG.

[30] Under an "equity" approach, a company accounts for GHG emissions from operations reflective of its share of equity in an operation. By contrast, under the "control" approach, a company accounts for all GHG emissions (*i.e.*, 100 percent) from operations over which it exerts control. *See* THE GREENHOUSE GAS PROTOCOL: A CORPORATE ACCOUNTING AND REPORTING STANDARD (n.d.), https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf.

[31] The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. at 21384.

[32] 40 C.F.R. § 98.2. *See also Learn about the Greenhouse Gas Reporting Program*, EPA (n.d.), https://www.epa.gov/ghgreporting/learn-about-greenhouse-gas-reporting-program-ghgrp.

[33] *See supra* page 15.

[34] "Limited assurance is equivalent to the level of assurance (commonly referred to as a "review") provided over a registrant's interim financial statements included in a Form 10-Q." The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. at 21392 n. 564.

[35] "Reasonable assurance is equivalent to the level of assurance provided in an audit of a registrant's consolidated financial statements included in a Form 10-K." *Id.*

[36] *Id.* at 21393.

emissions"[37]—and the specifics of these qualifications are one of many issues the SEC has asked for public comment and feedback. Depending on the ultimate requirements, a company may have difficulty in identifying an independent GHG emissions attestation provider that meets the SEC's definition or may face delays if those providers handle increased engagements to supply the requisite attestation reports.

The Commission proposes two circumstances in which a company would also be required to disclose its Scope 3 emissions:

1. When the company has made an emissions goal that includes Scope 3 emissions; or
2. If they are material to the company.

Goals that may include Scope 3 emissions and would draw companies into this reporting requirement could include net-zero targets or quantitative emission reductions goals that apply to all emissions in a company's value chain.

The more difficult question with respect to required Scope 3 disclosures is determining when Scope 3 emissions may be material. It is important to note that the Scope 3 disclosure requirements are the only place in the Proposing Release where the SEC seems to invoke more traditional concepts of materiality. However, even here, the Commission's Proposing Release suggests that they are considering materiality in a more quantitative way that departs from past practice. The Proposing Release indicates that the Commission would consider Scope 3 emissions to be material when they make up "a relatively significant portion of [a company's] overall GHG emissions."[38] To illustrate this concept, the Proposing Release gives the example of a vehicle manufacturer, noting that most of the emissions associated with automobiles result from the end-users' driving activities, and suggesting that the emissions from consumers' driving activities are material Scope 3 emissions that should be disclosed.[39] The Proposing Release also addresses Scope 3 emissions in the oil and gas industry, stating:

> ***For oil and gas product manufacturers, for example, Scope 3 emissions are likely to be material and thus necessary to understanding a registrant's climate-related risks.***[40]

To the extent that a company is required to disclose Scope 3 emissions under the Proposed Rule, it would also be required to describe the sources of data used, including any data reported to the company by third parties and any instances where the company is relying on published estimates of GHG emissions from a particular activity.

The Commission focuses on Scope 3 emissions as an indicator of sensitivity to energy transition risks, likely in the hopes of side-stepping concerns that reporting of Scope 3 emissions can lead to double-counting emissions across companies' value chains. The basis for this argument is that companies with large Scope 3 emissions are more likely to be impacted by a transition to a low carbon economy, either by disrupting carbon intensive supply chains or shifting consumer focus away from carbon-intensive products. The ultimate value of Scope 3 emissions data to an investor, however, is heavily dependent on the quality and the ability of companies to gather emissions data from both upstream and downstream points in the value chain. Moreover, concerns surrounding the accuracy of Scope 3 emissions are increased when companies are required to disclose this data in public filings because of risks of potential claims from investors.

The SEC notes its recognition that the calculation and disclosure of Scope 3 emissions may prove more difficult than Scope 1 and Scope 2 emissions due to the problems in obtaining and verifying data from third parties — essentially, the lack of direct control a company has over Scope 3 emissions data. The SEC explains that, in some cases, a company may need to rely heavily on estimates and assumptions to generate Scope 3 emissions data. However, notwithstanding this, elsewhere in the Proposing Release, the SEC explains that Scope 3 emissions may account for a "relatively significant portion" of a company's overall GHG emissions, which could impact the materiality of such emissions. And if the Scope 3 emissions are material, a company would be required to disclose Scope 3 emissions irrespective of the difficulties in obtaining the data. Even if Scope 3 emissions are not material, however, a company

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[37] *Id.* at 21398.
[38] *Id.* at 21378.
[39] *Id.*
[40] *Id.* at 21378–79.

would still be required to make this determination, thereby undertaking a significant amount of work to reach such an assessment.

The Proposed Rule incorporates a safe harbor for the disclosure of Scope 3 emissions as an attempt to strike a "balance" between the concerns regarding reporting with the need for decision-useful disclosure.[41] The safe harbor provides protection for Scope 3 emissions disclosure from certain forms of liability under federal securities law; namely, that statements would not be deemed as fraudulent unless it is shown "that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith."[42] Additionally, smaller reporting companies would be exempted from Scope 3 emissions disclosure. Finally, for those companies which are required to report Scope 3 emissions, the rule provides a delayed compliance date for such disclosure.

This safe harbor could be welcome protection for any companies that may be required to disclose Scope 3 emissions under a final rule. However, companies may wish to submit comments seeking clarification as to how the "good faith" requirements of the proposed safe harbor can be met. Developing a reasonable basis for Scope 3 emissions disclosures will likely require companies to make significant investments in enhanced supply chain diligence and contracting in order to gain comfort with the quality of the data being reported to them by upstream suppliers and downstream service providers. It may also require companies to develop more robust estimation methodologies for the estimation of scope 3 emissions from the end use of their products.

"Disclose it if you have it" requirements

Throughout the proposed revisions to Regulation S-K are a number of requirements that we think are best characterized as "disclose it if you have it." Rather than imposing substantive requirements on companies to adopt particular climate risk management tools or targets, the proposed provisions would require the disclosure of particular climate analyses and targets if a company chooses to use them. The four major strategy and risk management tools that fall into this category are (1) internal carbon pricing, (2) use of climate scenario analysis, (3) climate transition plans, and (4) climate targets and goals.

If a company maintains an internal carbon price, Proposed Item 1502(e) would require the company to disclose specific information about the use of internal carbon pricing. A company would be required to disclose the carbon price being used, the emissions to which it is applied, the rationale for selecting the internal carbon price, and how the carbon price is used to evaluate and manage climate-related risks. Though not discussed in detail in the proposal, carbon pricing is most often used as a tool to assess the transition risks associated with the imposition of new regulations limiting GHG emissions or imposing a price on carbon.

Proposed Item 1502(f) would require disclosures regarding any climate scenario analysis a company may be using. Climate scenario analyses are often pursued as part of the assessment of strategy under the TCFD framework. Typically, a climate scenario analysis will involve an assessment of a company's transition risks in a low-carbon economy,[43] as well as an assessment of physical climate risks, including hazard exposures in a world where average global temperatures are much higher than they are today. Proposed Item 1502(f) would require the disclosure of "any analytical tools" used to assess the impacts of climate-related risks on financial statements or to support the resilience of a company's strategy and business model. If a company has undertaken climate scenario analysis, the Proposed Rule would require disclosure of the scenarios considered, including all parameters, assumptions and analytical choices. A company would also be required to disclose the outcomes of its scenario analysis, including the projected principal financial impacts on a registrant's business strategy under each scenario. The Commission expects that any disclosures under Proposed Item 1502(f) would include both qualitative and quantitative information.

These proposed climate scenario analysis disclosures go far beyond what is typically included in voluntary climate reporting today. The Commission notes this fact in the Proposing Release, stating that investors have expressed

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[41] *Id.* at 21390.
[42] *Id.* at 21391.
[43] A typical scenario analysis will consider transition risks in a 1.5 ºC or 2 ºC scenario, which is a set of assumptions deigned to achieve a concentration of GHG emissions in the atmosphere that is considered reasonably likely to stabilize average global warming at 1.5 ºC or 2 ºC. Limiting temperature rise to a value in this range is recognized by the Intergovernmental Panel on Climate Change as necessary to avoid the most dangerous impacts of climate change. *See generally* INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE, CLIMATE CHANGE 2022: MITIGATION OF CLIMATE CHANGE (April 2022), https://report.ipcc.ch/ar6wg3/pdf/IPCC_AR6_WGIII_FinalDraft_FullReport.pdf.

frustration with the lack of detail in current disclosures regarding climate scenario analysis, which can make these disclosures difficult to compare across companies.[44] To date, disclosure of climate scenario analysis has been limited even in the voluntary context: the TCFD 2021 Status Report finds that only 13 percent of TCFD reporters included a scenario analysis in their 2020 reports.[45]

Proposed Item 1503(c) would require a company to disclose any climate transition plan it has created as part of its risk management disclosures. The disclosures of a company's transition plan would include a description of any metrics and targets used to identify and manage climate risks, and a description of how the company plans to mitigate or adapt to those risks. Importantly, the risks assessed in a transition plan are broader than just GHG emissions and may also include physical risks such as water use and management. Proposed Item 1503(c) would further require a company to update disclosure on its transition plan annually, including describing any actions the company took in the prior year to achieve the plan's targets or goals.

Proposed Item 1506 specifically addresses disclosure requirements around any climate targets and goals a company has set. The Proposed Rule would require disclosure of any targets related to emissions, energy use, water use, conservation, ecosystem restoration or revenues for low-carbon products. Proposed Item 1506 would require that the disclosure of goals should include: a description of the scope of activities and emissions included in the target; the units of measurement for any target, including whether the target is absolute or intensity-based; the time horizon by which a goal is to be achieved and whether it is aligned with the Paris Agreement or another international climate treaty; the baseline period for the targets; and interim goals; and a description of how the company intends to meet its targets or goals. These disclosures would need to be updated annually and include data to demonstrate whether the company is making progress towards its goals. To the extent that the company will use renewable energy credits ("RECs") or carbon offsets as part of a strategy to meet its goals, Proposed Item 1506 would require additional disclosures regarding the carbon offsets or RECs. The required disclosures for offsets and RECs include disclosure of the amount of emissions they represent, the source of the RECs or offsets, the location of the underlying projects, and costs associated with obtaining the RECs or offsets.

Given that the disclosures outlined above would only be required if a company has elected to use a particular tool or target, it is important to consider whether these proposed requirements will have a chilling effect on the use of climate risk assessment and management tools. While many companies in carbon-intensive sectors are likely already using one or more of these tools in response to shareholder demands for scenario analysis, transition planning, or climate target setting, these practices are far from widespread. In fact, per the TCFD 2021 Status Report and as noted above, only 13 percent of TCFD reports incorporated scenario analyses in their 2020 reports, reducing to just 7 percent for North America companies. Disclosure of climate-related metrics fared a little better, with 44 percent of TCFD reporters including this in their 2020 reports, although again reducing to just 23 percent in North America. Climate-related targets stood at 34 percent for TCFD reporters and just 25 percent for North America. The potential chilling effect as a consequence of the SEC's Proposed Rule is an area where we may see a number of comments urging the Commission to mitigate this impact.

Proposed Amendments to Regulation S-X

In addition to the proposed amendments to Regulation S-K, the Commission is also proposing to add a new Article 14 to Regulation S-X (Article 14) which would require the inclusion of certain climate-related financial statement metrics and related disclosure in a note to a company's audited financial statements. The financial statement metrics would be comprised of disaggregated climate-related impacts on existing financial statement lines and be subject to audit by an independent

[44] The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. at 21357.
[45] TCFD 2021 Status Report, *supra* note 9, at 30 (Fig. B2).

registered public accounting firm. Additionally, the financial statement metrics would come within the scope of a company's internal control over financial reporting ("ICFR"). As set forth below, the proposed amendments to Regulation S-X would require disclosure under three categories of information: (1) financial impact metrics; (2) expenditure metrics; and (3) financial estimates and assumptions.

Importantly, disclosure of financial impact metrics would not be required if the sum of the absolute values of all the impacts on the line item totaled **less than one percent** of the total line item for the relevant fiscal year. Likewise, disclosure of expenditure metrics — specifically, the aggregate amount of expenditure expensed or the aggregate amount of capitalized costs — would not be required if the amount was less than one percent of the total expenditure expensed or total capitalized costs incurred for the relevant fiscal year. However, it is worth noting that making this determination will require a substantial amount of work. Although a company may think that it does not have to quantitatively track climate-related impacts on its existing financial statement lines because it will be below the threshold, this is not necessarily the case. Companies will have to "show their work," tracking climate-related impacts to make this determination.

Proposed Article 14-01

Proposed Article 14-01 outlines the instructions with respect to climate-related disclosure in its audited financial statements. The Proposed Article 14-01 would require a Company to include, in a footnote to its audited financial statements, the climate-related disclosure outlined in Proposed Article 14-02. Such disclosure would be required to be included in any filing that includes audited financial statements and to cover the years included in such audited financial statements. With respect to the scope and accounting principles of such disclosure, Proposed Article 14-01 requires reporting companies to (i) use financial information consistent with the scope of its other consolidated financial statements in the same filing and (ii) apply the same accounting principles, wherever applicable, as it is required to apply in preparing the remainder of its consolidated financial statements.

Proposed Article 14-02

Under Proposed Article 14-02, the new climate-related note to the audited financial statements would be required to include certain disaggregated climate-related financial statement metrics that are mainly derived from existing financial statement line items, as well as contextual information for each specified metric to include how each metric was derived, details pertaining to significant inputs and assumptions used, and, if applicable, policy decisions used to calculate the specified metric.

Financial Impact Metrics

The financial impact metrics required to be included in the climate-related note to a company's audited financial statements would cover severe weather events (and other natural conditions) and transition activities. For the former, under the proposed amendments, a company would be required to disclose the impact of severe weather events and other natural conditions — flooding, droughts, wildfires, extreme temperature, and sea level rise — on any relevant line items in its consolidated financial statements during the fiscal years including in the filing. At a minimum, the disclosure would be required to be presented separately on an aggregated line-by-line basis for all negative impacts and on an aggregated line-by-line basis for all positive impacts. The SEC Proposing Release notes the following examples of impacts that a company may consider including:

- Any changes in revenue or costs as a result of disruptions to business operations or supply chains;
- Impairment charges and changes to the carrying amount of assets from exposure to severe weather;
- Changes to loss contingencies or reserves due to the impacts of severe weather; and
- Changes to total expected insurance losses as a result of flooding or wildfire patterns.

As noted, a company would also be required to disclose, in the climate-related footnote to the financial statements, the impact of transition activities on relevant line items in its consolidated financial statements for the fiscal years included in the filing; specifically, the impacts of efforts to reduce GHG emissions or mitigate exposure to transition climate-related risks. At a minimum, disclosure must be presented separately on an aggregated line-by-line basis for all negative impacts and on an aggregated line-by-line basis for all positive impacts. Again, the SEC's Proposing Release includes examples which a company may consider including:

- Any changes in revenue or costs resulting from new emissions pricing or regulations that could lead to the loss of a sales contract;
- Changes in operating, investing, or financing cash flows from changes in upstream costs;
- Changes to the carrying amount of assets resulting from, for example, a reduction in the asset's useful life; and
- Changes to interest expense driven by financing instruments (*e.g.*, climate-linked bonds) where the interest rate increases if climate-related targets are not met.

Expenditure Metrics

Under Proposed Article 14-02, a company will also be required to disclose the aggregate expenditures and the aggregate amount of capitalized costs incurred (i) to mitigate the risks of severe weather events and other natural conditions, and (ii) to reduce GHG emissions or mitigate exposure to transition risks. Such disclosures would also include disclosure of expenditures and costs to meet a company's GHG emissions reductions targets or other climate-related commitments, as disclosed.

Financial Estimates and Assumptions

Proposed Article 14-02 would also require a company to disclose whether the estimates and assumptions it used in producing its consolidated financial statements were impacted by exposures to risks and uncertainties related to, or known impacts from, severe weather events and other natural conditions and, separately, by risks and uncertainties related to, or known impacts from, a potential transition to a low-carbon economy or the company's (disclosed) climate-related targets. If the response is "yes" to either of these, then the company would be required to provide a qualitative description detailing how such events, or the potential transition to a low-carbon economy, or the company's disclosed climate-related targets, impacted the development of the estimates and assumptions.

Identified Climate-Related Risks and Climate-Related Opportunities

A company would also be required to disclose the impact of any climate-related risks, separately for physical and transition risks, on any of its financial statement metrics disclosed under the Proposed Article 14-02.

Finally, although not required, a company may, under the proposed amendments to Regulation S-X, include the impacts of climate-related opportunities arising from severe weather events, transition activities, or other, on its financial statement metrics. However, once a company has disclosed the impact of an opportunity, it must do so consistently for each of the fiscal years included in the filing.

Who Does this Rule Apply to and When Will These Requirements Take Effect?

The SEC's Proposed Rule would apply to all domestic issuers and foreign private issuers ("FPI")[46] pursuant to the phased-in approach depicted in the tables below. While the proposed regulations currently exclude Multijurisdictional system

[46] An FPI is defined as a company incorporated outside of the U.S. and more than half of its voting securities are owned or recorded by non-U.S. residents or (i) the majority of the company's executive officers/directors are U.S. citizens or residents; (ii) more than 50% of the company's assets are located in the United States, and (iii) the company's business is principally administered in the U.S.

(“MJDS”) filers,[47] they would become applicable upon loss of FPI or MJDS status. Notably, the SEC has requested comment on whether the rules should be applied to MJDS filers. Furthermore, as the Proposed Rule indicates, there are scaled back disclosures applicable to Smaller Reporting Companies (“SRCs”), to include a delayed phased-in compliance approach for required disclosures and exemption from disclosure of Scope 3 emissions.

Phased-In Compliance

Filer Type	Scopes 1 and 2 GHG Disclosure Compliance Date	Scope 3 Emissions (if applicable)	Limited Assurance	Reasonable Assurance
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)	Fiscal year 2024 (filed in 2025)	Fiscal year 2026 (filed in 2027)
Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Fiscal year 2025 (filed in 2026)	Fiscal year 2027 (filed in 2028)
Non-Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Exempted*	Exempted*
Smaller Reporting Company	Fiscal year 2025 (filed in 2026)	Exempted	Exempted	Exempted

* Non-accelerated filers are only required only to state whether any of their GHG emissions disclosures were subject to third-party assurance, and if so, at what level.

The SEC has indicated that it hopes to release a final rule by the end of this year, December 2022. The timing and contents of the final rule will be shaped by the public comments received on the proposal between now and May 20, 2022.

The Administrative Procedure Act requires the Commission, to accept and respond to public comments on proposed rules *before* it can publish a final rule. Comments can be submitted by anybody — the “public” — to include individual companies affected by the Proposed Rule, trade groups, non-government organizations, and private citizens. The comment period is often disparaged with many believing that public comments will have little to no impact on the final rule; however, this is not the case. Public comments matter: they have the potential to improve the rule by raising issues with the proposal that the Commission may not have fully considered.

Public comments also preserve legal arguments as part of the “administrative record.” Litigation over the final rule is all but certain: commenters responding to the SEC’s initial request for information on climate disclosure in 2021 indicated that they intended to sue the SEC when any final rule on climate disclosures issued. When a court does review the rule, it will consider the extent to which the SEC responded to comments and how well the “administrative record”---including the comments---support the SEC’s final decision. Generally arguments must be raised in comments or they cannot later be raised in court.

Public comments and litigation may also influence the timing of the final rule. As noted in the charts above, the *earliest* date that the Proposed Rule is likely to go into effect will be 2024 assuming the final rule is finalized prior to yearend. Courts have the power to stop a rule from going into effect, either during the lawsuit, or following a successful challenge to a rule, meaning that any litigation over the rule could delay the rule’s effective date. Furthermore, given

[47] An MJDS is an eligible Canadian company which can register and offer securities in the U.S. utilizing their Canadian disclosure documents, subject to certain additional U.S. requirements.

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the Commission's federal requirement to respond to public comments before finalizing a rule, finalizing the rule could take longer than the Commission currently anticipates if it receives a substantial number of comments.

What Can Companies do Now?

The Proposed Rule would significantly augment the climate-related disclosure requirements for public companies. As summarized in more detail below, there are a number of actions that companies should be considering today to engage with the SEC and prepare to comply with the climate disclosure rules when they are finalized.

- **Consider Commenting on the SEC's proposal**:
  - The Proposed Rule will require significant new processes, data collection, and disclosures for many companies. Commenting on the Proposing Release will be essential to educating the Commission regarding the potential impacts to companies.

The Proposed Rule is the first step in a rulemaking under the Administrative Procedure Act. To meet the procedural requirements of this law, the Commission must take public comment on the proposal and *respond to* public comments in any final rule. This does not mean that the Commission must change its proposal to address every comment, but rather that the Commission must demonstrate it has considered issues raised by commenters and provided a response to the comments.

Comments may be submitted by individual companies or through their trade associations by May 20, 2022. Providing comments is a valuable way to help to shape the final rule by raising practical concerns that the Commission may have overlooked or under-appreciated. They also play an important role in any legal challenges to the final rule, which may only be made on the basis of issues raised during the public comment period. Public comments are also part of the "administrative record" which essentially acts as the evidence that a court will consider when reviewing the final rule and determining whether to uphold it under the Administrative Procedure Act. Issues companies may wish to raise in their comments include:

  - Seeking clarification that the requirements of Item 1501(a) can be met through board education on climate;
  - Explaining the potential chilling impacts of "disclose it if you have it" requirements on companies' use of climate risk assessment tools, such as scenario analysis, and suggesting ways this chilling effect could be mitigated through implementation of protections, such as additional safe harbors;
  - Explaining how applying the rule's extensive requirements to registration statements could impact capital formation;
  - Seeking clarification on the application of safe harbors; and
  - Seeking clarification on the Commission's approach to materiality.

Beginning the assessments outlined below will likely be necessary for companies to fully assess the Proposed Rule and determine where to focus their comments.

- **Evaluate Current Capabilities and Reassess Your Climate Risk Strategy, Governance and Reporting**:
  - Assess the current state of your climate disclosures in both SEC reporting and voluntary disclosures against the required disclosures in the Proposing Release. Review current climate-related disclosures that may be transferrable to SEC filings, and what additional processes or controls may be needed to verify these disclosures. Identify the areas where you would need additional disclosures if the rule is finalized as proposed, including whether you have any particular climate risk management tools or targets that would trigger "disclose it if you have it" disclosures or are contemplating implementing the same.

- Assess your Scope 1, 2 and 3 GHG emissions, including evaluating the materiality of the Scope 3 emissions for the organization, and any gaps in that data. As part of this effort, evaluate your current processes and controls around emissions and other climate data. For Scope 3 emissions, assess what additional diligence, contracting, or methodology development steps may be necessary to meet the good faith requirements of the proposed safe harbor.
- Evaluate your current governance and risk management of climate risks and opportunities by management and the board. Are there areas for additional improvement? Revisit and improve your processes for monitoring and tracking of commitments, targets, and progress. Assess whether additional committees or reporting structures are needed to provide adequate oversight of climate risks and opportunities.
- Assess what resources (*e.g.*, people, processes, technologies) your company would need to meet the proposed reporting deadlines. Companies will need to determine organizational talent gaps around expertise with climate data and also assess their ability to produce climate information on a compressed time frame. Many companies that currently engage in voluntary climate or sustainability reporting issue those reports in the second or third quarter, after annual reporting is completed. The Proposed Rule would compress climate reporting into annual reporting season. Companies should assess whether they have sufficient reporting resources to meet these disclosure requirements and time frames.

- **Educate Your Management Team and Directors**: The Proposed Rule has a significant focus on board and management oversight of climate risks. A good first step is to engage in board education regarding the proposed disclosure requirements, key climate risks to the company, and any issues identified in your gap analysis. Over time, develop a process to document director education on and oversight of climate risks.
- **Assess Goals and Progress on Your Current Targets**: The Proposed Rule would require your company to disclose any climate-related targets and annual reporting on progress towards this targets. To get started, companies should assess what targets they have announced that may fall under this requirement and where they stand in relation to these targets. This process may involve developing methods and internal controls to determine where a company is with respect to its targets and what steps it needs to take to make and report on progress towards achieving them.
- **Establish Enhanced Disclosure Controls and Procedures that will Apply to ANY Climate Risk or Opportunities Disclosures Made Going Forward**: Even before a rule is finalized, companies should establish enhanced disclosure controls and policies related to any climate-related disclosures. As noted earlier, under the Proposed Rule any voluntary disclosures ultimately will be in large part transferrable to SEC filings. In addition, the SEC staff has already been issuing comments regarding climate-related disclosures that companies made in sustainability reports or on company websites, and there will likely be an increase in claims that companies are “greenwashing” around climate or emission pledges and related disclosures.

The Commission has signaled that it intends to finalize the Proposed Rule by the end of the year. Given the time that will be required to implement the sweeping changes outlined in the Proposing Release, it is prudent for companies to begin assessing these items and consulting with their internal team and external advisers immediately.

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