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ESG Alert

Three Takeaways from the SEC's New Proposed Rules on Climate Disclosures

Written by Matthew E. Miller

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Today, the Securities & Exchange Commission voted 3 to 1 in favor of adopting a long-awaited set of proposed revisions to SEC regulations concerning the disclosure of climate risks and related financial impacts, as well as data on greenhouse gas emissions in certain SEC filings. The recommendation to adopt the new set of rules was not unanimous, with Commissioner Hester Peirce voting against the measure, arguing that the new set of rules is at best unnecessary, and at worst improperly exceeds the SEC's mandate to only regulate statements that are material to investors. The SEC also issued a "Fact Sheet" to summarize the new proposal.

Here are three key takeaways from the SEC's new set of proposed climate disclosure rules.

Climate Disclosures in Financial Statements

First, the SEC has proposed amendments to Regulation S-X – which governs financial statements included in documents filed with the SEC – to require climate-related metrics in existing financial statement line items with further explanation of those issues in the notes to the issuer's financial statements. To respond to investors' calls for a uniform set of disclosure rules, the SEC explained that it adopted portions of the framework and vocabulary employed by the Task Force on Climate-Related Financial Disclosures (TCFD). The SEC believes that incorporating the TCFD disclosure framework will mitigate the cost of implementation of the new rules on companies, since many companies already report climate disclosures based on TCFD guidelines. Paul Munter, the SEC's Chief Accountant, noted that the new climate rules would build on existing financial statement disclosure requirements and would be subject to already existing audit requirements.

Importantly, the revisions to Regulation S-X incorporate a materiality threshold, requiring registrants to disclose:

> the financial impacts of severe weather events, other natural conditions, transition activities, and identified climate-related risks on the consolidated financial statements included in the relevant filing *unless the aggregated impact* of the severe weather events, other natural conditions, transition activities, and identified climate-related risks *is less than one percent* of the total line item for the relevant fiscal year.

GHG Emissions Disclosures

Second, the SEC's new proposal amends Regulation S-K – which proscribes detailed disclosure requirements (other than financial statements) applicable to several required filings including registration statements, periodic reports, and proxy statements – to require disclosure on greenhouse gas emissions (GHG), with varying requirements based on the "scope" of GHG involved. If the new rule is adopted, registrants will have to disclose their direct GHG emissions (Scope 1) and indirect GHG emissions from purchased electricity and other forms of energy (Scope 2). Some registrants will need to disclose their Scope 3 GHG emissions – meaning those generated "from upstream and downstream activities in a registrant's value chain" – if material, or if the registrant has set a GHG target that includes its Scope 3 GHG emissions. Smaller reporting companies will be exempt from the Scope 3 reporting requirement. The SEC also included a "safe harbor" that would shield registrants from liability under the securities laws for disclosures on Scope 3 GHG emissions.

The proposed amendment would also require registrants who classify as "large accelerated" or "accelerated" filers to obtain an attestation report from an independent attestation service provider. The rule does not require the attestation service provider to be registered with the Public Company Accounting Oversight Board (PCAOB), but the provider must satisfy independence and expertise requirements.

The requirement for GHG emissions disclosures has been a hot topic of debate, not only among SEC filers and stakeholders, but among the SEC Commissioners themselves. In her statement opposing adoption of the new rules, Commissioner Hester Peirce noted that the amendments would require registrants to disclose Scope 1 and Scope 2 GHG emissions regardless of whether they are material to the registrant's overall financial condition. Foreshadowing the likely legal challenges to come, Commissioner Peirce argued that regulating statements that are not material may violate companies' First Amendment rights, and extend beyond the SEC's Congressional mandate.

Phased Approach

Third, these rules do not go into effect today. The SEC has announced a 60-day public comment period. If, at the end of that period, the SEC adopts the new rules as proposed, there will be a phased implementation approach tied to the registrant's filer status. For example, assuming the rules go into effect in December 2022, large accelerated filers would have until 2024 (pertaining to fiscal year 2023) to incorporate the new required climate-related disclosures, including Scope 1 and Scope 2 GHG emissions, into their SEC filings. Accelerated and non-accelerated filers will have until 2025 (pertaining to fiscal 2024) to comply with the new climate disclosure requirements, and smaller reporting companies will have until 2026 (pertaining to fiscal 2025). Additional phase periods will apply to disclosures of Scope 3 GHG emissions and third-party attestations.

We will continue to review proposed revisions addressing climate disclosures and will post additional updates and analysis moving forward.

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