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INSIGHTS

Summary Outline of SEC's Proposed Rule on Climate-Related Disclosure and Accounting

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The SEC's proposed rule on climate-related risks includes amendments to both the financial reporting requirements (Reg S-X) and the narrative disclosure requirements (Reg S-K). The proposal interlinks the new requirements, drawing aspects of the required narrative disclosures into the financial statement. The proposed changes are complex and detailed. The preamble to the proposal offers interpretive guidance, but the proposed regulatory language itself merits close study apart from the preamble. What follows is a *précis* of the key proposed requirements, with hyperlinks to the actual language as found in the pre-publication copy of the proposal.

Part 210 **– Regulation S-X (audited financial statements)**

In Brief – Changes to Reg S-X

The Proposed Rule adds a new Article 14 solely for climate-related disclosure.

Proposed ***210.14-01*** – Climate-related metrics must be reported as a note to the financial statements

Proposed ***210.14-02*** – Climate-related metrics include:

- Financial impacts and expenditures relating to severe weather events and the climate transition (e.g., climate policies and consumer preferences)
- Impacts of material climate-related risks identified under (revised) Reg S-K

Details – Changes to Part 210

210.14-01 **– Climate-related disclosure instructions**

- Must include the metrics of ***210.14-02*** as a note to the financial statements
- Climate disclosure must cover same span of years (historical) as otherwise being reported

210.14-02 **– Climate-related metrics**

- Provide contextual information, including for each metric: how derived, significant inputs, and significant assumptions, and any policy decisions made to calculate the metrics

- Disclose financial impacts of severe weather events and other natural conditions
  - when added to transition activities item, disclosure threshold is 1% of the aggregate line item
  - separately aggregate positive and negative impacts
  - covers changes to revenues, impairment charges; changes in loss contingencies or reserves; change in insured losses

- Disclose financial impacts related to transition activities
  - when added to severe weather impact, disclosure threshold is 1% of the aggregate line item
  - financial impact of efforts to reduce GHG emissions or otherwise mitigate exposure to transition risks
  - separately aggregate positive and negative impacts
  - covers, e.g., changes in revenue/cost from new emissions pricing or from regulations that result in loss of sales contract; changes in cash flow resulting from changes in upstream costs such as transportation of raw materials; changes in carrying amount of assets because of changed useful life or salvage value; changes in interest expense driven by financing instruments that increase the interest rate if you miss climate-related targets

- Disclose expenditures to mitigate risk of severe weather and natural conditions
  - when added to transition mitigation expenditures, disclosure threshold is 1% of the aggregate line item
  - separately aggregate what is expensed and what is capitalized
  - covers expenditures to increase asset resilience, retire assets, shorten asset life, relocate assets, etc.

- Disclose expenditures related to transition activities
  - when added to expenditures for severe weather mitigation, disclosure threshold is 1% of the aggregate line item
  - separately aggregate what is expensed and what is capitalized

- covers expenditures to reduce GHG emissions like R&D, purchases of GHG-mitigating assets, increased energy efficiency, offset emissions, increased resource efficiency

- covers expenditures toward announced GHG emission reduction targets and other climate-related commitments

- Disclose financial estimates/assumptions affected by severe weather and natural conditions
  - requires qualitative discussion if exposure to these risks/uncertainties affected any assumptions or estimates used in the consolidated financial statements

- Disclose financial estimate/assumptions affected by transition activities
  - requires qualitative discussion if exposure to transition risks and uncertainties affected any assumptions or estimates used in the consolidated financial statements

- Disclose impact of climate-related risks identified under (revised) Reg S-K
  - for any physical or transition risks that the registrant identifies per ***229.1502(a)***, disclose the impact on any of the metrics noted above

- May disclose impact of climate-related opportunities
  - if you disclose opportunity for any one item noted above, must do so consistently for all years presented and for each line item

Part 229 **– Regulation S-K**

In Brief – Changes to Reg S-K

The Proposed Rule adds a new Subpart ***229.1500*** solely for climate-related disclosure.

229.1500 – Definitions

- Climate-related risks (physical and transition), Emission factor, Internal carbon price, Scenario analysis, Scopes 1,2, and 3, Transition plan, and Value chain

229.1501 – Governance

- Disclose Board oversight of climate-related risk, including responsibilities, expertise, information flow, climate goals, strategy and risk management
- Disclose Management's role on climate risk, including committees, expertise, information flow, and reporting to Board

229.1502 – Strategy, business model, and outlook

- Describe climate-related risks reasonably likely to have a material impact over short, medium or long term
- Describe related impacts on financial statement, operations, products, services, suppliers, R&D, and discuss related strategy, planning, and capital allocation
- Disclose internal carbon price, scenario analyses, and how they are used
- Describe resilience of business strategy to climate-related risks

229.1503 – Risk management

- Describe processes for identifying, assessing, and managing climate-related risks, including gauging materiality, selecting mitigation, and setting priorities

229.1504 – GHG emissions metrics

- Scope 1 and 2; Scope 3 if material or subject to company target
- Disclose GHG intensity per revenue and per production

229.1505 – Attestation of emissions

- Sets schedule for limited and, later, reasonable attestation of Scope 1 and 2

229.1506 – GHG targets and goals

- Disclose all GHG or climate-related targets and goals

Details – New Subpart 229.1500

229.1500 – Definitions

- Adds many new definitions, including inter alia Climate-related risks (physical and transition), Emission factor, Internal carbon price, Scenario analysis, Scopes 1,2, and 3, Transition plan, and Value chain

229.1501 – Governance

- Disclose board governance
  - including, as applicable, which board members have responsibility for climate-related risk, who has climate-related expertise, how the board is informed of climate risks and how often, how they consider climate-related risks as part of business strategy, risk management and financial oversight, and whether/how they set climate-related targets/goals and oversees them

- Disclose management governance
  - including, as applicable, any positions, committees or members with responsibility, what expertise they have, how they are informed about and monitor climate-related risks, whether and how often they report to the board on climate-related risks

229.1502 – Strategy, business model, and outlook

- Describe any climate-related risks reasonably likely to have a material impact on the registrant over short, medium or long term
  - separate discussion of physical risks and transition risk
  - for physical risk, special disclosure requirements if there are flooding risks or assets in areas of high water stress
  - for transition risk, it says categorically: "A registrant that has significant operations in a jurisdiction that has made a GHG emissions reduction commitment may be exposed to transition risks related to the implementation of the commitment." (p. 483)

- Describe the impact of these climate-related risks on business operations, products, services, suppliers, mitigation efforts, R&D, etc.

- Discuss whether and how these material impacts are considered in the registrant's business strategy, financial planning, and capital allocation
  - include current and forward-looking discussion

  - include how any Article 14 metrics and any targets in ***229.1506*** relate to business strategy or mode
  - include discussion of offsets and RECs

- Discuss whether and how these material climate-related risks have affected or are reasonably likely to affect the consolidated financial statements
- If registrant maintains an internal carbon price, disclose it and its derivation, rationale, and use
  - if it uses more than one internal carbon price, provide info for each of them and describe why multiple

- Describe resilience of business strategy in light of potential future changes in climate-related risks

229.1503 **– Risk management**

- Describe processes for identifying, assessing, and managing climate-related risks [no materiality qualifier]
  - how it determines relative significance of climate-related risks compared to other risks
  - how it considers existing or likely “regulatory requirements or policies”
  - how it considers shifts in customer or counterparty preferences, technology changes, and market price changes in relation to transition risks
  - how it determines materiality of climate-related risks
  - how it decides whether to mitigate, accept or adapt
  - how it prioritizes whether to address climate-related risks
  - how it selects mitigation

- Disclose whether/how these processes are integrated into overall risk management
- If registrant adopted a transition plan, describe it and annually update its disclosure of actions taken to achieve the plan’s targets or goals

229.1504 **– GHG emissions metrics**

- Disclose GHG emissions as defined

  - disclose by constituent GHG gas and in aggregate as CO2e, without accounting for offsets

- Disclose Scope 1 and 2
  - include everything in the registrant's operational and organizational boundaries, but may exclude emissions from unconsolidated investments

- Disclose Scope 3 if material or if registrant has set a Scope 3 target/goal
  - identify the categories of upstream and downstream activities included
  - if any category is significant, separately disclose for it
  - describe the data sources (actual data, studies, statistics, industry associations, etc.)

- Disclose GHG intensity per revenue and per production

- Describe the methodology, significant inputs and significant assumptions used to calculate GHG emissions
  - can use reasonable estimates for fourth quarter if data is not reasonably available, but must justify and promptly update
  - can use ranges for Scope 3, but must justify
  - must disclose source of any third-party data and how it was obtained
  - must disclose any method changes from prior year
  - must disclose any data gaps, including discussion of proxy data or alternative method
  - must include in Scope 3 any outsourced activities previously done in-house in the years being reported on

- Liability for Scope 3 emission disclosures: a statement is deemed not fraudulent unless shown to have been made or reaffirmed without a reasonable basis or was disclosed other than in good faith

229.1505 **– Attestation of Scope 1 and 2 emissions disclosure**

- Large or accelerated filers must provide attestation
  - covers Scope 1 and 2

    - first three years: a limited assurance level
    - fourth year: reasonable assurance level
    - use public, free reference standard by an organization that used due process (public input)

- Attestation provider must meet all of a list of characteristics, including expertise and independence
- Attestation report has minimum elements, including the criteria for evaluation, level of assurance, etc.
- Specific requirements for voluntary attestations where none is required

229.1506 – Targets and goals

- Disclose any targets or goals related to the reduction of GHG emissions or any other climate-related target or goal
    - examples include energy usage, water usage, conservation, ecosystem restoration, or revenues from low-carbon products

- Disclose as applicable the duration, scope, baseline, interim goals, whether offsets//RECs are relied on, etc.

ALSO: The SEC also proposes to change standard disclosure forms in order to include the new disclosure requirements.