The SEC Proposed Rule on Climate-Related Disclosures for Investors

What It Means for You

green strategies, inc.

Helping Clients Create Value through "Climate Capitalism" for More than Two Decades

Green Strategies, Inc.

"We help our clients out-compete their peers and be more profitable by reducing their environmental impact and turning environmental challenges and risks into opportunities. If we are successful, our clients make more money, and the world is a better place."

– **Roger Ballentine**

- Climate and ESG Strategy
- Development and Goal Setting
- Climate Risk Management
- GHG Mitigation and Accounting
- Sustainability Governance
- Supply Chain Decarbonization
- The Built Environment
- Waste Management and Circularity
- Public Reporting & Communication
- Stakeholder Engagement and Capital
- Energy and Environmental Markets

Topics

- The Big Shift: Global and US Stakeholder & Investor Trends
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The Big Shift

Global and US Stakeholder & Investor Trends

The SEC is Not Out on a Limb; the Trend Toward Mandatory Climate Disclosure is Global

Enacted: UK, Switzerland, New Zealand, Singapore

Pending: EU, Hong Kong, Japan

Recommended: Canada, Australia, Brazil, South Africa, Mexico, and many others.

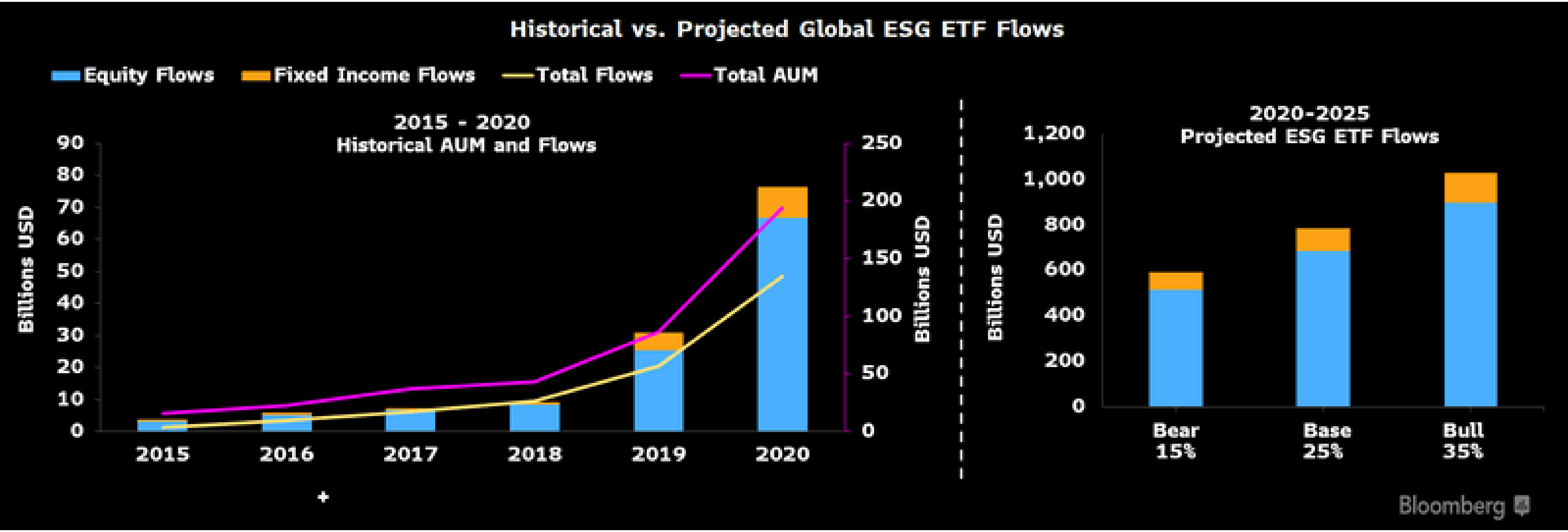
The Task Force on Climate-related Financial Disclosure (TCFD) is the leading global framework supported by more than 3,000 companies and 90 jurisdictions. Many mandatory climate disclosure rules, including that proposed by the SEC, largely align with TCFD recommendations.

Capital Markets Increasingly Care About Climate Change

"Climate change has become a defining factor in companies' long-term prospects."

– Larry Fink, CEO, Blackrock

BlackRock expects that by 2030, 75% of the corporate and government assets it manages will come with science-based targets or equivalent. Right now, that number is about 25%.



Bloomberg Intelligence estimates ESG-labelled assets will reach $41 trillion by the end of 2022.

A 2021 study by Swiss Re found that G7 economies could see annual average losses of up to 8.5% by 2050 if current emissions levels continue. Total losses could amount to $4.8 trillion/year (double the GDP loss caused by the pandemic).

Brief Review

Proposed Rule on Climate-Related Disclosures

The Foundation of the Rule is Disclosing Risk

- The SEC has a **mandate to protect investors** and shareholders from risk.
- **Two types of climate risk:** physical (weather, sea level, fires, drought, etc.) and transition (stranded assets, fossil fuel price instability, regulation, stakeholder expectations, etc.).
- Unchecked **climate change is** growing risk for the US economy.
- Mandatory climate disclosure provides **information to the marketplace** (not regulation of behavior or outcomes).

Strengthening climate-related risk reporting would allow investors to bring new information into the investment decision-making process and, ideally, avoid disrupting financial markets down the line.

Rule Highlights

- Modeled in part on the GHG Protocol and TCFD frameworks, proposed disclosures include:
  - **Climate-related risks** and their actual or likely material impacts on the registrant's business, strategy, and outlook;
  - **Governance of climate-related risks** and relevant risk management processes of registrant;
  - **Greenhouse gas (GHG) emissions** which, for accelerated and large accelerated filers and with respect to certain emissions, would be subject to assurance;
  - **Climate-related targets, goals, and transition plan**, if a registrant has developed;
  - **Climate-related financial statement metrics** and material impacts on financial statements (material defined as 1% of any line item).

Proposed Rule Expands 10K and Financial Statement Disclosures

- Proposal to add two new regulation components: Subpart 1500 to Regulation S-K and Article 14 to Regulation S-X.
  - **New Subpart 1500 to Regulation S-K** would "require a registrant to disclose certain climate-related information, including its climate-related risks that are reasonably likely to have a material impact on the registrant's business or consolidated financial statements, as well as GHG emissions metrics to help investors assess such risks."
  - **New Article 14 to Regulation S-X** would "require certain climate-related financial statement metrics and related disclosures to be included in a note to a registrant's audited financial statements. The proposed financial statement metrics would consist of disaggregated climate-related impacts on existing financial statement line items. [T]he financial statement metrics would be subject to an audit by an independent registered public accounting firm and fall within the scope of the registrant's internal control over financial reporting (ICFR)."

Reporting Phase-In

Registrant Type	Disclosure Compliance Date		Financial Statement Metrics Audit Compliance Date
	All proposed disclosures, including GHG emissions metrics: **Scope 1, Scope 2**, and associated intensity metric, but excluding Scope 3.	GHG emissions metrics: **Scope 3** and associated intensity metric	
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)	Same as disclosure compliance date
Accelerated Filer and Non-Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	
SRC	Fiscal year 2025 (filed in 2026)	Exempted	

Latest you'll be reporting depending on size: 2025.

Scope 3 Reporting

"A registrant would be required to disclose its Scope 3 emissions if there is a substantial likelihood that a reasonable investor would consider them important when making an investment or voting decision" – SEC

- Under the draft rule, requirements to disclose Scope 1 and 2 emissions apply to all companies. But the SEC would require disclosure of Scope 3 emissions only if companies have already set climate targets *or* where those emissions are "material".
- Because the SEC has stopped short of defining a uniform materiality threshold for Scope 3, there are two potential pathways the threshold could take:
  - Establish a number-based threshold to determine materiality (not currently in the proposal and likely to be suggested by commentors), or
  - Companies determine for themselves if their indirect emissions are truly material to their business (currently what the draft rule appears to favor).
- Additionally, the SEC recognizes that Scope 3 accounting methodologies are not mature, and registrants may need to rely heavily on assumptions and estimates for Scope 3 calculation. Therefore, the SEC is proposing a safe harbor from certain liability related to Scope 3.

Understanding Offsets & RECs in the Rule

"If, as part of its net emissions reduction strategy, a registrant uses carbon offsets or renewable energy credits or certificates ("RECs"), the proposed rules would require it to disclose the role that carbon offsets or RECs play in the registrant's climate-related business strategy." – SEC

- Understanding the role that carbon offsets or RECs play in a registrant's climate-related business strategy can help investors gain useful information about the registrant's strategy, including the potential risks and financial impacts.
- A registrant that relies on carbon offsets or RECs to meet its goals might incur lower expenses in the short term but could expect to continue to incur the expense of purchasing offsets or RECs over the long term. It also could bear the risk of increased costs of offsets or RECs if increased demand for offsets or RECs creates scarcity and higher costs to acquire them over time.
- Accordingly, under the proposed rules, a registrant that purchases offsets or RECs to meet its goals as it makes the transition to lower carbon products would need to reflect this additional set of short and long-term costs and risks in its Item 1502 disclosure, including the risk that the availability or value of offsets or RECs might be curtailed by regulation or changes in the market."

References in the proposed rule to RECs and offsets are vague. How the rule will impact how companies can and should use RECs and offsets should be watched closely.

Listen to the Lawyers

(But Don’t Stop There)

The Compliance Floor

At a minimum, how should companies be preparing?

1. Presume disclosure will be required. At least financial statement footnote and 10-K.

2. Coordinate with auditors, attestation firms, then begin collecting data.

3. Many of the disclosures being asked for are things you are already doing – scenario analysis, targets, etc. Take stock of this and figure out how to explain in disclosures.

4. Don’t try to front-run SEC proposal. Details may change. Look at what you are already doing that the SEC will care about.

From Climate Reaction to Climate Strategy

A Business Opportunity

The Economic Toll of Inaction

“New risks do not emerge during times of crisis alone. To regularly profile and think through new or changing risks, and their associated uncertainties, helps build societal preparedness for the future.”

– Patrick Raaflaub (*Group Chief Risk Officer, Swiss Re)*

Above all else, the SEC is doing this because it is necessary.

Climate change is a critical business issue that when managed well creates value. This is Climate Capitalism. Mandatory disclosure will put Climate Capitalism on steroids.

Beyond Compliance

How You Can Leverage the New Mandatory Disclosure

Above and Beyond the Compliance Floor

Impending mandatory disclosure is an opportunity to assess and address climate-related risks and opportunities.

- **Assess whether anything in your business model or offerings are misaligned with climate trends and risks**. (*Not the same as determining what information must be disclosed; "risks" here are physical, regulatory, reputational, customer-related, employee-related, investor or other stakeholder-related*).
- **Assess whether and how you have integrated climate into current business strategies**.
- If you haven't already, **conduct Scope 1 and Scope 2 footprinting, and begin the process of mapping Scope 3**. If you have already calculated your footprint, review it, scrutinize it, and make it better.
- **Conduct peer review analysis** of public climate goals, commitments, and statements to benchmark yourself against. No goals? Begin to develop, finalize, and announce.
- If a registrant, **take S-K opportunity to tell your story** (*e.g.,* climate *opportunities*).

The Rule’s Impacts Will Be Broad

But Many Questions Remain

Ripple Effects of the Rule

- Disclosure of targets and transition plans are an area of increasing focus by investors and NGOs. What the SEC is asking for both in terms of degree of specificity and breadth of disclosure goes beyond what most companies are already voluntarily disclosing pursuant to TCFD and/or other voluntary disclosure frameworks.
- Another effect, despite the previous point, will likely be to create more pressure for companies who have not adopted goals to do so and for others to keep pace with peers ("race to the top").
- Inevitably, information disclosed on targets (or lack thereof) will be used to compare and maybe rank peers in each sector.
- Will increase awareness and focus on other companies' climate goals (customers for example) and provide more visibility into how a supplier can align with their customer's objectives.

We will continue to see further bifurcation between companies that are developing strong commitments and making progress, and companies that are not.

Many Uncertainties/Questions Remain

Unclear whether enough proven and consistent tools out there for full compliance

Level of detail in reporting may be overwhelming (mostly S-X)

Companies that are the leaders given the most burden. Is that fair?

1%-line item on materiality may be too low

“Double Materiality” confusion: ESG materiality vs. financial materiality

Claims/statements in sustainability/ESG reports will now be held up against S-K and S-X disclosures

What/who constitutes “assurance” for S1 & 2 GHG emissions reporting?

How will mandatory disclosure impact what is considered best practices (*e.g.,* use of RECs and offsets)?

Information needed for Scope 3 disclosure may be controlled by third parties

What will final rule say about disclosing “opportunities”?

Will SEC disclosure rules force changes and transparency on ESG ratings agencies?

Companies must carefully stay attuned and anticipate change.

Thank You

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