April 2022
(updated July 2022)

The SEC wants me to disclose *what?*

The SEC's climate disclosure proposal

> Today, investors representing literally tens of trillions of dollars support climate-related disclosures because they recognize that climate risks can pose significant financial risks to companies.
>
> SEC Chair Gary Gensler

The SEC has proposed sweeping new rules to enhance public company disclosures related to the risks and impact of climate change. New disclosures will be required for all public companies and would include certain climate-related financial metrics in the audited financial statements. Companies will also be required to disclose information about carbon emissions, which would be subject to a phased-in assurance requirement.

It is not often that an SEC proposal is covered so broadly in mainstream news. But the SEC's March 21 proposal for dramatic changes in the nature and extent of disclosures about the impact of climate change caught everyone's attention. As well it should.

Although the SEC still needs to consider public input on the proposal and adopt a final rule before any new disclosures would be required, business leaders should pay attention now. An effective date years in the future may create the illusion that this does not require attention from companies today. However, there is much that needs to be done for companies to be ready in time, starting with understanding what's in the proposal. Yes, the final rules may evolve as the SEC considers comments on the proposal, and yes, there are parts of the proposal that will require further interpretation. However, given the scope of the proposal, efforts to understand and start to operationalize the requirements will not be wasted.

Notably, the proposal includes footnote disclosure—which would be subject to the financial statement audit and management's internal control over financial reporting—as well as disclosures outside the financial statements, including a scope 1 and scope 2 greenhouse gas attestation requirement for accelerated and large accelerated filers. If adopted generally as proposed, we expect that all companies—even those with extensive voluntary disclosures—would need to expand their disclosures while also ensuring the information is investor-grade, even as the reporting timeline is accelerated.

Many of the items in the proposal stand out to us. This *In the loop* details some of the themes that may surprise you, too. And while we don't have all of the answers, we've also included a series of FAQs to help you as you prepare for what is likely to be a dramatic change in the nature and extent of climate reporting for SEC registrants.

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Highlights of proposed disclosure requirements

The following summary of the key disclosure provisions of the proposal provides context for the discussion that follows about some of the challenges companies may face if the final rules mirror the proposed requirements.

Regulation S-K climate-related disclosures	
Climate-related impacts on strategy, business model, and outlook	➜ Physical and transition risks reasonably likely to have a material impact over the short, medium, and long term and how they are considered as part of business strategy, financial planning, and capital allocation (see FAQ 2.3) ➜ Zip code level disclosure of nature and location of assets, processes, and operations subject to climate-related risks with additional disclosures required for assets located in flood hazard zones or regions of high or extremely high water stress
Greenhouse gas (GHG) emissions reporting	➜ Scope 1 and scope 2 - disaggregated by type of greenhouse gas and in the aggregate, accompanied by an emissions intensity measure ➜ Scope 3 - if material or included in the registrant's GHG emissions reduction target or goal, accompanied by a scope 3 emissions intensity measure ➜ GHG reduction targets or goals and transition plan, if any
Governance and oversight of climate-related risks	➜ Board of director's oversight of climate-related risks ➜ Whether any member of the board of directors has expertise in climate-related risks, and if so, the nature of the expertise ➜ Management's processes for identifying, assessing, and managing climate-related risks
Regulation S-X financial statement footnote disclosures	
Financial impact metrics	➜ Quantitative disclosure of the impacts of severe weather events and other natural conditions as well as transition activities on individual financial statement line items, if the impact is greater than a bright-line 1% threshold (determined as the sum of the absolute value of positive and negative impacts)
Expenditure metrics	➜ Quantitative disclosure of amounts capitalized and expensed related to severe weather events and other natural conditions as well as transition activities, if the impact is greater than 1% of total capitalized costs or total expenditures expensed, respectively ➜ Capitalized costs and expenditures incurred to reduce GHG emissions
Impact on estimates and assumptions	➜ Qualitative description of the impact of climate-related events and transition activities on estimates and assumptions
Other information	➜ Contextual information about how each specified metric was derived, including a description of significant inputs and assumptions ➜ Description of the impact of physical risks and transition risks (as identified in the Regulation S-K disclosures) on the financial statement metrics

Focus areas

Given the scope and length of the SEC's document discussing its proposed enhancement and standardization of climate-related disclosures, it's tempting to read the summary fact sheet and then wait for the final rules. But we believe that would be a mistake. Given the breadth of proposed disclosures and the limited transition timeline, companies need to start preparing now. The following are some of the provisions generating the most discussion.

- **Climate-related risks**
- **Notes to the audited financial statements**
- **Emissions and emissions reductions**
- **Scope 3 emissions disclosures**
- **Conditional disclosures**
- **Materiality**
- **Governance**
- **Attestation**
- **Transition**

Climate-related risks

The proposed rules would require a registrant to disclose "how climate-related risks have impacted or are likely to impact [its] strategy, business model, and outlook." Risks may include, for example, the need to reduce GHG emissions because the registrant has operations in a jurisdiction that is limiting (or will limit) emissions in support of the Paris Agreement. While this is a common example, it's far from the only one. The potential climate-related risks are broad and include both acute and chronic risks associated with extreme weather and other natural conditions—items like the impact of drought, rising temperatures, floods, and wildfires—as well as transition risks. The SEC proposal avoids debate about what constitutes a "climate-related risk" by specifically defining the physical and transition risks within the scope of the disclosures (see FAQ 2.3).

The climate-related risk disclosures would be included in a new section of the annual report or registration statement entitled "Climate-Related Disclosure," with a requirement to update for material changes on a quarterly basis. This presentation is intended to "facilitate review of the climate-related disclosure by investors alongside other relevant company financial and nonfinancial information." In addition to the qualitative disclosures, this section would include disclosure of the location and nature of assets, processes, and operations at physical risk (including the nature of the risk and whether acute or chronic), disaggregated by zip code location, as well as additional information about assets located in flood zones or regions of high or extremely high water stress.

Notes to the audited financial statements

One of the standout provisions in the SEC proposal is the requirement to include certain climate-related disclosures in the annual financial statements; these disclosures would be subject to both management's internal control over financial reporting as well as audit by the entity's auditor. As discussed in the table above, the proposed disclosures are extensive and include disclosure of financial impact and expenditure metrics, with disclosure determined based on a "bright-line" threshold. The SEC states that the "proposed quantitative threshold could also promote comparability and consistency among a registrant's filings over time and among different registrants compared to a principles-based approach."

Complying with these rules would require a registrant to identify severe weather events, transition activities, and climate-related risks, and determine the impact of these items on individual financial statement line items—at a threshold of 1% of the impacted line item. According to the proposal, the list of potential items that need to be considered is long, including the impact of “flooding, drought, wildfires, extreme temperatures, and sea level rise,” as well as expenditures related to the research and development of new technologies, relocation of assets or operations at risk, and the purchase of assets intended to reduce GHG emissions (see FAQ 2.4).

Companies are likely not capturing information at this low threshold today and may need to enhance their existing reporting systems to accurately capture all of the information that would be required.

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Greenhouse gas emissions in many respects resemble financial statement disclosures, involving as they do significant estimates and assumptions and providing critically important insight into a company’s operations.

SEC Commissioner
Allison Herren Lee

Emissions and emissions reductions

The proposed rules would require all companies to disclose total scope 1 (direct) and total scope 2 (primarily electricity-related) greenhouse gas emissions in the new “Climate-Related Disclosure” section of an annual report or registration statement, as well as disaggregated by seven specified greenhouse gases. In addition, the proposal would specifically require disclosure of emissions *excluding* the impact of any purchased or generated offsets. Any offsets used in a company’s emissions reduction strategy would be disclosed separately. Thus, the proposed disclosures would highlight whether a company intends to reduce emissions through operational changes or whether it will be dependent on the purchase (or generation) of offsets. These requirements will enhance visibility—and potentially scrutiny—of a company’s approach to achieving “net zero” or other similar goals.

Scope 3 emissions disclosures

Many companies already report scope 1 and scope 2 emissions. However, the SEC proposal would bring much more transparency to the emissions resulting from a company’s value chain—which is captured in a company’s scope 3 emissions. Specifically, registrants (except smaller reporting companies) would be required to disclose scope 3 emissions in the new “Climate-Related Disclosure” section of the annual report or registration statement if “those emissions are material, or if the registrant has set a GHG emissions reduction target or goal that includes its scope 3 emissions.” The proposal indicates that this disclosure was included because it may be material to an investor’s assessment of climate-related risk, particularly transition risk, as it may provide clarity on the potential financial impact of transitioning to a lower carbon economy (see FAQ 3.1).

It may seem easy enough to determine if the company has goals that encompass scope 3. But assessing materiality? Companies may need to calculate their scope 3 emissions just to determine if they are, indeed, material. Either way, calculating scope 3 emissions is complex and may be reliant on information from suppliers or that requires estimation based on available data and certain assumptions about a company’s value chain: from emissions created through the mining of raw materials, to the eventual disposition of a product by consumers. Many companies are already calculating at least some scope 3 emissions; however, disclosure in an SEC document, even with safe-harbor protection, would likely require enhanced processes and controls.

Conditional disclosures

The proposed disclosures to be included in annual reports and registration statements are extensive and center primarily on the impact climate-related risks could have on a registrant's strategy, business model, and outlook. The proposed rules, however, are not applied to all companies equally. In some cases, the SEC requires companies with more established climate-related programs or processes to provide additional disclosures. For example, as noted above, a company with emission reduction goals that encompass scope 3 emissions would be required to make additional disclosures of scope 3 emissions across all 15 categories—even if scope 3 emissions are immaterial. Companies would also be required to disclose an internal carbon price, if used. Further, companies that use scenario analysis to assess the impact of climate-related risks would be required to provide various disclosures, including qualitative and quantitative information about the scenarios considered as well as the potential financial impact. The SEC believes "scenario analysis could help investors evaluate the resilience of the registrant's business strategy in the face of various climate scenarios that could impose potentially different climate-related risks."

Perhaps the most significant incremental disclosure for ESG-leading companies relates to transition plans, and not just those linked to reducing emissions. A company that has set a climate-related target or goal—whether that plan relates to emissions, water usage, energy usage, or ecosystem restoration—would need to disclose details about the plan, the unit of measure, the defined time horizon, and how progress toward the goal is tracked.

Materiality

As discussed above, some of the footnote disclosures would be based on "bright-line" requirements at a threshold of 1% of the impacted financial statement line item; however, the determination of whether disclosures outside of the financial statements are required—such as climate-related risks and, in some cases, scope 3 emissions—would be based on a materiality assessment. For example, climate-related risks would need to be disclosed if the matter is reasonably likely to have a material impact over the short, medium, or long term. The proposal says that it defines "material" similar to how it's currently applied in areas like MD&A, which in turn is based on securities law and Supreme Court precedent, meaning "a matter is material if there is substantial likelihood that a reasonable investor would consider it important when determining whether to buy or sell securities or how to vote." This approach is different from the proposed requirements in other jurisdictions, like Europe, where the rules are expected to incorporate a concept of "double materiality," an assessment that incorporates the needs of stakeholders beyond investors in the evaluation of what is deemed material. The impact of the different definitions of materiality may become clearer as the SEC and European rules are finalized (see FAQ 1.4).

The SEC has leveraged the definition of materiality used in SEC filings today. But there may be some questions around how it should be applied to some of the disclosures that would be required by the SEC's proposal. Typically, materiality is considered in the context of a company's current financial condition and may or may not explicitly consider future periods, especially periods that extend as far in the future as many potential climate-related impacts. Given the uncertainty around many climate developments, in some cases, this evaluation may be challenging. The proposed rules acknowledge this difficulty, and note that registrants have other requirements to disclose forward-looking information, including in MD&A. In addition, the forward-looking statement safe harbor provisions would generally apply assuming the relevant conditions are met (although it would not apply in an initial public offering).

> Through the SEC's embrace of the TCFD framework, we are that much closer to providing investors with a consistent, comparable view into the financial impacts of climate change so they can make better-informed financial decisions. When markets have the information to accurately price the financial impacts of climate change, capital will shift towards businesses that prioritize climate resilience, transition, and sustainability.
>
> Mary Schapiro, TCFD Vice Chair and Former SEC Chair

Governance

The proposed rules would require disclosure about a board's role in overseeing climate-related risks and management's role in assessing and managing those risks. While not requiring a board expert, the registrant would need to disclose the board members or committee responsible for oversight of climate-related risks and the name of any board member with expertise in the area. This requirement is similar to the existing requirement for a company to disclose whether or not it has at least one audit committee financial expert serving on its audit committee.

Interestingly, this requirement is also similar to the SEC's March 9 proposal related to cybersecurity, which requires a discussion of the oversight process and disclosure of the name of a board member with cybersecurity expertise, if any. However, in that case, the SEC specifies that the information may be disclosed in the proxy. The cyber proposal also includes safe harbor language that is explicit that a director designated as having cyber expertise is not an "expert" for purposes of liability under securities laws. The climate proposal does not discuss any safe harbor for designation as having climate expertise, although a question in the proposal asks if proxy disclosure should be an alternative (SEC proposal, question 7).

Attestation

Under the proposal, large accelerated and accelerated filers would need to engage a third party to attest to their disclosure of scope 1 and scope 2 GHG emissions. This requirement would be phased in. For example, a company that initially discloses emissions under the proposed rules for 2023 would need limited assurance for 2024 and 2025, and reasonable assurance for 2026 and beyond. The SEC believes that doing so will provide investors with "an additional degree of reliability regarding not only the figures that are disclosed, but also the key assumptions, methodologies, and data sources the registrant used to arrive at those figures." It's unusual for the SEC to require assurance over disclosures outside the financial statements, in part because most other quantitative disclosures in SEC filings are derived from the same books and records that support the audited financial statements.

According to the Center for Audit Quality, more than half of the S&P 500 obtain some type of assurance over their GHG emission data. Given the proposed attestation provider requirements, current service providers may no longer be qualified to do the work. While the service provider would not need to be the financial statement auditor, they would need to be independent of the registrant and perform the engagement in accordance with professional standards. Further, the registrant would need to disclose (among other things) if the provider has a license to provide assurance from a licensing or accreditation body and if the GHG emission attest engagement is subject to any oversight inspection program.

Transition

The disclosure requirements are phased. This phased approach is intended to provide registrants with “time to establish necessary systems, controls, and procedures” and is based on registrant type (dates assume a calendar year-end filer).

	Disclosure compliance date		Scope 1 and Scope 2 attestation	
Registrant type	All proposed disclosures, excluding Scope 3	Scope 3	Limited assurance	Reasonable assurance
Large accelerated	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	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	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

Comparative disclosures are required for all periods presented, with provisions to exclude the information for historical periods if it is not “reasonably available to the registrant without unreasonable effort and expenses.” This would mean some registrants may need to disclose information for 2022 or 2021. In addition, even without this requirement, the proposed adoption timeline may be challenging for companies, especially those with less mature processes.

What should companies do now?

Although some of the proposed requirements will undoubtedly evolve as a result of the rule-making process, we expect the final rules to generally reflect the same key focus areas. Given the size of the proposal, assessing the impact on an individual company will not be an easy task. In preparation, there are several actions companies can, and should, take now to prepare for adoption:

- Review the proposal, evaluate current climate-related disclosures within SEC filings and corporate sustainability reports, and identify significant gaps with the proposed requirements
- Establish a cross-functional team (including representatives from Finance, Operations, IT, Risk and Compliance, Internal Audit, and Legal) to develop a comprehensive strategy on climate disclosures and risk management
- Review the company's current voluntary disclosures to consider what information and processes can be leveraged in support of the SEC's proposed disclosures
- Inventory climate-related data, including internal and external sources, and develop processes to define key climate metrics and methodologies and to capture relevant data in a timely manner
- Establish a framework for controls and identify where controls, business processes, and IT general controls need to be established, enhanced, and monitored
- Discuss attestation requirements with service providers to understand requirements and limitations
- Develop training to ensure the board understands the extent of the proposed governance disclosures and encourage directors to assess whether any changes are warranted in the board's processes related to oversight of climate-related risks

Understanding the proposed rules and preparing to comply with the requirements will likely require effort by all companies, even those that provide some level of climate-related disclosure today. Even the most advanced voluntary reporting processes will likely require some enhancement to produce investor-grade climate information in compliance with the proposed rules and accelerated reporting timeline.

Companies may find that continuing to provide voluntary climate information in advance of any required compliance date will be time well spent. Information used in voluntary reports can be a good starting point to identify gaps in current processes compared to what will be needed to comply with the proposed requirements. Further, the SEC proposal reflects current demand among retail and institutional investors for more information about climate risk and response. These groups will continue to assess companies based on climate-related metrics (whether in annual reports, on websites, or in press releases) even prior to any final rules.

The SEC often emphasizes the importance of companies "telling their stories." That's how you convey to investors a view of the company through the eyes of management, a view beyond what the numbers say. Now is no different. As the focus of investors continues to evolve, companies should continue to be transparent, continue to work toward their ESG goals, and continue to be environmental leaders. The importance of mitigating the impact of climate change is as important leading up to adoption of the proposed rules as it will be when the rules are finalized.

The key, though, is to get started now. The timing is tight. And, the proposed requirements are expansive; it's almost certain that compliance will require new data, new processes, and new controls. Companies should form a cross functional team and begin dissecting the proposed requirements now, before the rules are finalized. Identify the right resources and start to strategize, engaging not only the financial reporting teams, but all who may be called on to help with adoption.

Frequently asked questions

To supplement the discussion of focus areas, we've addressed some of the questions that may be top of mind to help assess how the SEC's proposal may impact your company:

Scope and timing

1.1 Will the final rules really be adopted in 2022?

After a May 9 extension, comments on the proposal were due June 17. The SEC staff is reviewing all comments and will draft final rules for vote by the Commissioners. Based on the compliance dates noted in the proposal, the SEC is targeting to adopt the final rules before the end of the year.

As highlighted in Commissioner Peirce's dissenting statement, there could be legal challenges raised against the proposed rules. Some stakeholders believe the proposal exceeds the SEC's statutory authority and, in particular, that the proposed disclosure requirements do not align with protections under the First Amendment's freedom of speech clause. Some argue that the First Amendment's compelled- speech doctrine means that the SEC cannot force companies to express specific beliefs. While there is some precedent for SEC rules being delayed by legal proceedings, we expect new climate-related disclosures to be adopted in some form.

In addition, the SEC proposal reflects:

> increased [investor] demand for more detailed information about the effects of the climate on a registrant's business and for more information about how a registrant has addressed climate-related risks and opportunities when conducting its operations and developing its business strategy and financial plan.

While investor demand has inspired many companies to voluntarily disclose more information about climate risks and impact, the proposed requirements formalize the need to give investors more. The SEC proposal is also consistent with developments in Europe and more broadly (see FAQ 1.4). With these motivations, finalizing the rule is among the Commission's top priorities.

As such, companies that delay in hopes of a legal reprieve or other operational delay in issuing the final rule may be scrambling if the rules are adopted later this year.

1.2 Will all SEC registrants need to provide the new climate-related disclosures?

Generally, yes. The proposed rules would amend Regulation S-X and Regulation S-K (as well as other regulations), resulting in new requirements for most companies with publicly traded securities. The SEC has not proposed relief for emerging growth companies or foreign private issuers (FPIs), although the rules as proposed do not apply to asset-backed issuers or certain Canadian registrants (see discussion of Canadian issuers below).

The proposed disclosures would also be required in registration statements (e.g., Forms S-1, F-1, S-4, F-4) following the same timeline as the overall phase in.

The proposal does offer limited relief to smaller reporting companies (SRCs) by providing a longer transition period and exempting them from the scope 3 emissions disclosure requirements. The proposal indicates the accommodations for SRCs are intended to mitigate the compliance burden for these registrants that may be less able to afford the fixed costs associated with GHG emissions reporting.

Canadian registrants

The rules as proposed do not amend Form 40-F, thus excluding Canadian companies that are eligible to report under the Multijurisdictional Disclosure System (MJDS). However, question 181 of the proposal asks various questions around this exemption, including whether Form 40-F filers should be required to comply with the proposal, the Canadian climate-related requirements under certain conditions, or to provide other disclosures.

1.3 Private companies can ignore the new rules, right?

Although not directly subject to the rules, the proposed GHG disclosure requirements could sweep in private companies that have relationships with a public company—whether as customers, suppliers, investees, borrowers, or otherwise. Private companies considering an initial public offering would also need to be prepared to make these disclosures in their S-1 registration statements (with phase-in requirements based on issuer size).

Public companies would be required to include their proportionate amount of scope 1 and scope 2 emissions of equity method investments in their overall emissions disclosures, thus imposing this disclosure requirement on their investees. Further, public companies would need information from entities upstream (e.g., materials sourcing, materials processing, supplier activities) and downstream (e.g., transportation and distribution, processing of sold products, end of life treatment of sold products) in their value chain to accurately report their scope 3 emissions, consistent with the requirements of the Greenhouse Gas Protocol (see FAQ 3.1).

ESG information, including climate-related data, may also impact investment in and lending activities to both public and private companies. Like other companies, financial institutions are being asked to take action on the impacts of climate change. Through the Glasgow Financial Alliance for Net-Zero (GFANZ), over 450 financial institutions totalling over $130 trillion in assets have committed to net-zero initiatives. To reach these goals, financial institutions will need to measure their financed emissions and assess their level of risk related to climate change. This means they will be asking current and prospective investees for climate-related information, including scope 1, scope 2, and scope 3 emissions, transition plans, and climate risk exposures.

In addition, once investors start receiving climate-related information from public companies, they may press private companies to provide similar disclosures. This trend has already begun with voluntary reporting, and the proposal will continue to put pressure on private companies to provide more climate-related information.

1.4 Now that the SEC has weighed in, should I still follow the Corporate Sustainability Reporting Directive (CSRD) and other global climate-related disclosure initiatives?

As proposed in April 2021, the European Union's (EU's) CSRD would require ESG disclosures for all large companies (as defined) in the EU as well as all companies listed on EU-regulated markets (with certain limited exceptions). Unlike the SEC's proposal, the CSRD would require companies to use "double materiality" and consider the impacts the entity has on sustainability matters (an inside-out perspective) in addition to how sustainability matters impact the entity's performance, position, and development (an outside-in perspective) in identifying required disclosures. Key points of the CSRD continue to be debated and whether the SEC reporting requirements will be deemed equivalent (thus potentially allowing US companies to satisfy their CSRD requirements with SEC reporting) is unknown. In addition, the proposed assurance requirements may differ. Given the wide swath of companies potentially in the scope of the CSRD requirements, companies potentially impacted should not ignore ongoing developments. See our In the loop *Why US companies should not ignore Europe's ESG proposals* for more information.

Developments at the International Sustainability Standards Board (ISSB) should also be monitored. The ISSB was formed by the IFRS Foundation in 2021 as a global sustainability disclosure standard-setter. The ISSB issued its first two exposure drafts covering general disclosure requirements and climate-related disclosures on March

31, 2022 and expects to finalize the standards near the end of 2022. Although these rules are not expected to directly impact US registrants, because all of these standard setters are proceeding with similar timing, global developments may also influence the final SEC rules.

Overall framework

2.1 What is TCFD and why did the SEC leverage it in developing its proposed climate-related disclosure rules?

TCFD refers to the Financial Stability Board's Task Force on Climate-Related Financial Disclosures. The TCFD framework establishes eleven disclosure topics and provides a structure for the assessment, management, and disclosure of climate-related financial risks within four pillars: governance, strategy, risk management, and metrics and targets.

The SEC's proposal is modeled in part on the TCFD recommendations as they have been widely accepted by issuers, investors, and other market participants. The TCFD's recommendations have been incorporated into other voluntary climate reporting frameworks, including the Global Reporting Initiative (GRI) and Sustainability Accounting Standards Board (SASB). Further, in June 2021, the G7 group of countries agreed on mandatory disclosure based on TCFD and countries including New Zealand, Switzerland, and the United Kingdom have adopted some form of TCFD-aligned disclosures. As discussed in the proposing release, the SEC believes that "proposing rules based on the TCFD framework may facilitate achieving … balance between eliciting better disclosures and limiting compliance costs."

2.2 Climate-related risks are not material to our company. Will I still be required to make disclosures under the proposed rules?

Overall, the proposed disclosures are based on a concept of materiality that will be familiar to financial statement preparers and users. However, the release introduces the concept of materiality over the short, medium, and long term and further states that the materiality determination "is similar to what is required when preparing the MD&A section in a registration statement or annual report." Commissioner Peirce specifically calls out this "similarity" and the time horizons in her rebuttal as potentially difficult and inconsistent to apply in practice.

In addition, the proposal provides a prescriptive approach to disclosure in certain places:	
No materiality threshold	• All companies would be required to disclose scope 1 and scope 2 emissions disaggregated by the seven specified types of greenhouse gas, as well as in the aggregate, in gross terms, without regard to any purchased or generated offsets. • Companies would be required to disclose "GHG intensity" ("carbon intensity"), a ratio that expresses GHG emissions—combined for scope 1 and scope 2—in terms of metric tons of CO_2e per unit of total revenue and per unit of total production for the fiscal year.
Mixed materiality threshold	• All filers, except smaller reporting companies, would be required to disclose scope 3 emissions, by category, if (1) material or (2) if they have set an emissions reduction target or goal that includes its scope 3 emissions. If scope 3 disclosures are required, the registrant would also be required to disclose scope 3 intensity.
Bright-line threshold	• In the footnotes, registrants would be required to disclose financial impact metrics based on the absolute value of both positive and negative impacts of severe weather events, other natural conditions, transition activities, and identified climate-related risks that exceed 1% of relevant financial statement line items, either individually or in the aggregate. • In the footnotes, registrants would be required to disclose expenditure metrics based on the total amount of expenses and capitalized costs related to climate events or transition activities if those amounts exceed 1% of total expenses or total capitalized costs.

Certain of the disclosures require significant granularity, including: zip code location of properties, processes, and operations in areas of physical risk (including the type of risk and nature of the property); the location and percentage of assets located in flood hazard zones; and the amount and location of assets in regions of high or extremely high water stress, as well as the percentage of water usage from water withdrawn in those regions. These disclosures would only be required if the related risks are material to the registrant.

So, in some cases, the determination of whether disclosure is required will be based on a familiar materiality assessment while in others, disclosure requirements are strictly prescribed. As a result, while some disclosures may be mitigated by immateriality, some would be required by all. Thus, it's likely that all registrants will be impacted by the new disclosure requirements.

2.3 What does the SEC mean by "climate-related risks"?

The SEC proposal would require disclosure of climate-related risks in annual reports and registration statements in a separately captioned "Climate-Related Disclosure" section. The SEC avoids debate about what constitutes a "climate-related risk" by specifically defining it to include two types of risk: physical and transition. Among other disclosures, the proposed rules require disclosure about these risks at a 1% threshold (see FAQ 2.2). The SEC's description of climate-related risks includes the following:

Physical risks

Physical risks primarily relate to "extreme" (or "severe") weather events and other natural conditions including flooding, drought, wildfires, extreme temperatures, and sea level rise. In addition, the definition of physical risks specifically includes the following two types of risks:

- "Acute risks" are "event-driven risks related to shorter-term extreme weather events, such as hurricanes, floods, and tornadoes."
- "Chronic risks" are risks arising from "longer term weather patterns and related effects, such as sustained higher temperatures, sea level rise, drought, and increased wildfires, as well as related effects such as decreased arability of farmland, decreased habitability of land, and decreased availability of fresh water."

Registrants would be required to identify the nature of the physical risk and whether it is acute or chronic. The SEC asks several questions about "severe weather events and other natural conditions," including whether it is clear what is required, whether they should further specify what is included, and further inquiring if additional examples are required (SEC proposal questions 61 and 63). However, by explicitly defining the items expected to be disclosed as physical risks, the SEC is sidestepping debate about whether certain items are caused by climate change, and instead is simply decreeing that disclosure is required.

Transition risks

Transition risks involve risks related to the potential transition to a lower carbon economy. As defined, transition risks cast a wide net:

> Transition risks would include, but are not limited to, increased costs attributable to climate-related changes in law or policy, reduced market demand for carbon-intensive products leading to decreased sales, prices, or profits for such products, the devaluation or abandonment of assets, risk of legal liability and litigation defense costs, competitive pressures associated with the adoption of new technologies, reputational impacts (including those stemming from a registrant's customers or business counterparties) that might trigger changes to market behavior, changes in consumer preferences or behavior, or changes in a registrant's behavior.

The SEC provides an example that a company located in a jurisdiction with a GHG reduction requirement would likely be exposed to transition risk associated with implementation of these reductions. Given the proposed scope of transition risks, a company would need to think broadly about how its business may be impacted over the short, medium, and long term by these risks. This may be challenging given the evolving regulatory environment and the inherent uncertainty associated with the impact of climate change.

2.4 *What's the relationship between the climate-related risk disclosures and the financial impact and expenditure metrics required to be disclosed in the footnotes?*

Registrants would be required to provide a narrative discussion of climate-related risks in a separately-captioned "Climate-Related Disclosure" section of annual reports and registration statements (see FAQs 1.2 and 2.3).

The proposed rules would also require quantitative disclosure of the impact of identified climate-related risks—including physical risks, such as severe weather events and other natural conditions, as well as transition risks—in the notes to the financial statements. Specifically, companies would be required to disclose financial impact metrics if the aggregate absolute value of positive and negative impacts arising from (1) severe weather events, and other natural conditions, (2) transition activities, and (3) identified climate-related risks is greater than 1% of the impacted line item. The proposed rules provide examples of potential impacts, such as changes to revenue or costs from disruptions to business operations, impairment charges, and changes to loss contingencies.

For all financial statement line items for which the threshold is met, a company would be required to separately disclose the following:

- Positive impacts of severe weather and other natural conditions
- Negative impacts of severe weather and other natural conditions
- Positive impacts of transition activities
- Negative impacts of transition activities

Similarly, registrants would be required to provide separate disclosure of expenditures (expensed or capitalized) to mitigate risks of severe weather events and other natural conditions as well as expenditures related to transition activities, following the same 1% threshold. Further, the proposal's description of the footnote disclosure of expenditure metrics indicates that these disclosures would include amounts incurred:

> to increase the resilience of assets or operations, retire or shorten the estimated useful lives of impacted assets, relocate assets or operations at risk, or otherwise reduce the future impact of severe weather events and other natural conditions on business operations.

As well as amounts related to:

> research and development of new technologies, purchase of assets, infrastructure, or products that are intended to reduce GHG emissions, increase energy efficiency, offset emissions (purchase of energy credits), or improve other resource efficiency.

The list of items captured in these disclosures is broad and may require process and other changes to accurately report these amounts at the prescribed level of detail. Companies would also need to disclose how other estimates and assumptions in the financial statements are impacted by the identified climate-related risks, for example, changes in useful lives of long-lived assets and the related impact on depreciation and asset retirement obligations.

Additionally, companies would be required to disclose the impact of the identified climate-related risks (separately for physical risks and transition risks) on any of the financial statement metrics disclosed in the footnotes.

GHG disclosures

3.1 Am I the only one who doesn't understand the difference among scope 1, scope 2, and scope 3 emissions?

The most common global framework used to measure and manage greenhouse gas emissions is the Greenhouse Gas Protocol (the GHG Protocol). The GHG Protocol was jointly developed in 1998 by the World Business Council for Sustainable Development and the World Resources Institute and, as noted by the SEC, its greenhouse gas accounting standards have been widely incorporated into sustainability reporting frameworks. Specifically, its Corporate Accounting and Reporting Standard provides a uniform framework for measuring and reporting the seven greenhouse gases covered by the Kyoto Protocol—and the subject of the SEC's proposed GHG reporting rules. The GHG Protocol divides greenhouse gases into "scopes" (see below) to provide distinctions between a company's direct and indirect emissions.

The SEC's proposed reporting "draws upon" the GHG Protocol; the proposed rules include definitions of scope 1, scope 2, and scope 3 emissions that are substantially similar to the GHG Protocol discussion. The SEC's intent is to reduce compliance costs and aid investors by sharing concepts and basic vocabulary with this well known standard. However, companies should ensure they familiarize themselves with the SEC's definitions, as follows:

Scope 1
Direct

"direct GHG emissions from operations that are owned or controlled by a registrant"

Scope 2
Indirect, from utilities used

"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
Indirect, from upstream and downstream value chain

"all indirect GHG emissions not otherwise included in a registrant's Scope 2 emissions, which occur in the upstream and downstream activities of a registrant's value chain. Upstream emissions include emissions attributable to goods and services that the registrant acquires, the transportation of goods (for example, to the registrant), and employee business travel and commuting. Downstream emissions include the use of the registrant's products, transportation of products (for example, to the registrant's customers), end of life treatment of sold products, and investments made by the registrant."

The proposed rules reflect some key differences from the GHG Protocol, including how organizational boundaries are determined, as well as the required methodology for calculation of GHG emissions. Specifically, the proposed SEC rules would not require registrants to use the GHG Protocol standards and guidance when calculating GHG emissions, although they expect many registrants will.

Determination of organizational boundaries is one of the key factors in measuring GHG emissions. Unlike the options provided by the GHG Protocol, the SEC would require registrants to use the same organizational boundaries as the consolidated financial statements. That is, financial data and GHG data would use the same scope of consolidation and reporting thus providing “investors a consistent view of the registrant’s business across its financial and GHG emissions disclosures.” The SEC cites multiple benefits for using this approach, including ease for registrants and enhanced comparability across companies. The same organizational boundaries would be used in calculating scope 1, scope 2, and scope 3 emissions.

These requirements may result in a change for some registrants that are already calculating and disclosing their GHG emissions. Companies should start focusing on these calculations now as there may be some challenges in working through application of this guidance.

Attestation

4.1 Large accelerated and accelerated filers will be required to obtain limited assurance on scope 1 and scope 2 emissions, followed by reasonable assurance in subsequent years. What’s the difference?

Limited assurance is also known in the US as negative assurance or may be referred to as a review engagement. In contrast, reasonable assurance is also known as an examination engagement. Limited assurance provides a lower level of assurance than reasonable assurance, and thus the required procedures are narrower in scope. In a limited assurance engagement, the auditor’s report provides a conclusion as to whether any material modifications should be made to the subject matter to be in accordance with specified criteria. In this type of engagement, the auditor may identify significant matters affecting the information; however, all significant matters may not be identified.

Reasonable assurance will be familiar to users as the level of assurance provided in an audit of the annual financial statements. This type of engagement provides positive assurance that the information is in accordance with the relevant standards in all material respects and that it is free of material misstatement.

To have a deeper discussion, contact:

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