
SEC Issues Groundbreaking Climate Disclosure Proposal

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I. Introduction

Yesterday, the US Securities and Exchange Commission (SEC or Commission) [proposed](#) groundbreaking rules intended to enhance and standardize climate-related disclosure requirements for public companies. The SEC's climate disclosure proposal is the most extensive, comprehensive and complicated disclosure initiative in decades. The rules would require companies to disclose detailed information about the climate risks and opportunities associated with their operations. While many companies have already begun voluntarily reporting climate-related information, and similar disclosures are already required in Europe, the SEC's proposed rules mark the first time American businesses would be required to make these substantial disclosures in mandatory filings.

The proposal has been anticipated for months, after SEC Acting Chair Allison Herren Lee [solicited public comments](#) on potential climate disclosure rules last spring. The Commission received over 600 submissions in response to this request—a process which appears to have informed the current proposal.

II. Summary of Proposed Rule

The proposal would amend SEC regulations governing non-financial disclosures (Regulation S-K) and financial statement disclosures (Regulation S-X), as well as the related SEC forms, to require mandatory disclosures on a number of climate-related metrics, including quantified disclosures of annual greenhouse gas emissions. The proposed requirements are modeled in part on the Task Force on Climate-Related Financial Disclosures and the Greenhouse Gas Protocol frameworks. While the SEC explained in its proposal that the familiar reporting standards should facilitate compliance, the sheer quantity of information proposed to be required in Form 10-K, the proposed requirement that the information be included in filed SEC periodic reports, and the proposed third-party attestation requirements could dramatically increase climate-related disclosure obligations and related costs and time pressures. Other elements of the proposal—such as a phase-in period for the requirements and a liability safe harbor for some greenhouse gas emissions information—may also seek to address requests and concerns raised during last year's request for input, issued

by Acting Chair Lee. Nonetheless, the detailed requirements will require careful review before the potential impacts on corporate financial reporting processes can be understood.

The requirements would apply to domestic SEC reporting companies and to foreign private issuers reporting in the United States. IPO companies would also be required to comply with the proposed rules. The proposed rules would phase in the new disclosure and attestation requirements over the next several years. Compliance dates vary based on a company's size and filing status; the largest companies would be required to start disclosing climate risks under the new rules as soon as fiscal year 2023. Key provisions of the [510-page proposal](#) are briefly summarized below. In subsequent alerts we plan to address in greater detail critical aspects of the proposal, such as the proposed assurance requirements, the contours of the proposed safe harbor and financial statement reporting implications.

A. Greenhouse Gas Emissions

Greenhouse gas emissions must be disclosed under the proposed rule, and, for certain companies and certain emissions, would be subject to third-party assurance requirements. Specifically, the rules would require companies to disclose direct greenhouse gas emissions from operations that they own or control (Scope 1) and indirect greenhouse gas emissions from purchased electricity and other forms of energy that are consumed by operations owned or controlled by a registrant (Scope 2). Additionally, the proposed rules require disclosure of indirect emissions from upstream and downstream activities in a company's value chain (Scope 3) in certain circumstances. Upstream activities may include, for example, purchased goods and services; capital goods; transportation and distribution of purchased goods, raw materials, and other inputs; and waste generated in a registrant's operations. For each Scope, the proposed rules would require companies to disclose the emissions disaggregated by each constituent greenhouse gas, and in the aggregate, to give investors information regarding the relative risks posed by each constituent greenhouse gas. The proposed rules would require companies to disclose greenhouse gas emissions data in gross terms, excluding any use of purchased or generated carbon offsets, and in terms of intensity (per unit of economic value or production).

As to Scope 3, the proposed rules would require disclosure only if those emissions are material or if the registrant has set a carbon reduction target or goal that includes Scope 3 emissions. The proposal notes that Scope 3 emissions information could be material where Scope 3 emissions represent a relatively large source of overall emissions, such as in the car industry, where there is already a transition underway to reduce tailpipe emissions through stricter fuel efficiency regulations and through initiatives to encourage demand for electric vehicles. Due to the unique challenges associated with collecting data for Scope 3 emissions, the SEC proposed

three accommodations: a limited safe harbor for Scope 3 emissions disclosure from certain forms of liability under the federal securities laws, a reporting exemption for “smaller reporting companies” (i.e., public companies with public float less than \$250 million, or with less than \$100 million in annual revenues and either no public float or public float less than \$700 million), and a delayed compliance date of one year for Scope 3 emissions disclosures.

The proposed rules would require “large accelerated filers” (public companies with public float greater than \$700 million that have been reporting for at least one year and have filed at least one annual report) and “accelerated filers” (public companies with public float between \$75 million and \$700 million that have been reporting for at least one year and filed at least one annual report) to obtain a third-party attestation report covering their Scope 1 and Scope 2 emissions disclosures. The proposed rules include minimum standards for acceptable attestation frameworks, would require an attestation service provider to meet certain minimum qualifications and independence requirements (modeled after existing SEC auditor independence rules), and establish minimum requirements for the contents of the attestation report. The level of assurance to be obtained over these disclosures would increase over time, starting with “limited assurance” after an initial transition period, then expanding over a subsequent transition period to the more extensive “reasonable assurance.” Requirements vary based on a company’s status as a large accelerated filer or accelerated filer, but generally companies must provide limited assurance in fiscal years two and three after the applicable compliance date and provide reasonable assurance in fiscal years four and beyond after the applicable compliance date. The proposing release contemplates that if the proposed rules were adopted with a December 2022 effective date, large accelerated filers would need to obtain a limited assurance attestation report over fiscal year 2024 disclosures (filed in 2025), and accelerated filers would follow for fiscal year 2025 disclosures

(filed in 2026). Any additional attestation reports obtained would be voluntary under the proposed rules, though filers other than large accelerated filers and accelerated filers would be required to disclose information related to any third-party attestation or verification of the company's greenhouse gas emissions disclosures.

B. Other Material Impacts and Disclosures

Under the SEC's existing 2010 climate guidance, climate-related risks and their actual or likely material impacts on business strategy and outlook must be disclosed. The proposal does not alter the definition of "material"—a substantial likelihood that a reasonable investor would consider the information important when determining whether to buy or sell securities or how to vote. This determination is fact specific, requiring quantitative and qualitative considerations.

Unlike under the current framework, the proposal would codify specific, detailed disclosure requirements related to climate change. In addition to the greenhouse gas emissions disclosures discussed above, the proposed rules would require a number of new climate-related disclosures, including with respect to a company's governance; strategy, business model and outlook; risk management; targets and goals; and financial statement metrics, each as described briefly below.

When assessing materiality for purposes of these disclosures, companies will need to analyze the magnitude and probability of climate-related risks. As an example, the proposal notes that wildfires in California are a material risk for wineries, farmers and property owners. The proposal notes that companies may use an internal carbon price or "scenario analysis" process to assess the impact of climate-related risks on the business model or to support future-looking strategies. For instance, scenario analysis may be used to assess how, under various possible future climate scenarios, climate-related risks may impact operations over time. Companies would be required to disclose information about internal carbon pricing or the scenario analysis process, if used. To the extent that proposed climate-related disclosures constitute forward-looking statements, existing safe harbors under the federal securities laws would apply, if satisfied.

1. Strategy, Business Model and Outlook

The proposed rules would require extensive disclosures about how climate-related risks have affected or are reasonably likely to affect a company's strategy, business model and outlook in the short, medium and long term. Starting with the discussion of risks, the proposed rules require a description of climate-related risks based on whether they are physical or transition risks, with further disclosures specified for each type. As an example, the disclosure for physical risks includes the nature of the risk (including classification as acute or chronic) and the location and nature of the properties, processes or operations subject to the risk. Additional disclosures are required specifically for physical risks related to flooding and water stress.

With respect to each of the identified risks, the company must then disclose the actual and potential impacts of such risks on its strategy, business model and outlook, including impacts on, and any

significant changes made to, its business operations (including types of operations and locations), products or services, suppliers and other parties in the value chain, activities to mitigate or adapt to climate-related risks, R&D expenditures, and any other significant impacts or changes. Current and forward-looking disclosures would be required as to the impact of these risks on a company's strategy, financial planning and capital allocation, in addition to a discussion of these risks on the company's financial statements.

2. Targets and Goals Disclosures

For companies that have made public pledges to reduce their carbon footprint or set other environmental goals, the proposed rule would require them to detail how they intend to meet such goals and to share relevant data, including the extent to which they rely on purchased carbon offsets to meet commitments and the progress they have made toward such goals. Companies would be required to disclose the scope of activities and emissions included in the target, the time horizon by which the target is intended to be achieved, and any interim emission reduction targets. Other disclosures about the source, description, authenticity and costs of the offsets or renewable energy credits are also proposed to be required.

3. Governance

The proposed rules would require companies to disclose specific information concerning corporate oversight of climate-related risks. The proposed rules include a number of disclosure prompts with respect to both (i) the board's oversight of climate-related risks and (ii) management's role in assessing and managing climate-related risks. As to the former, among other disclosures, companies would be required to identify the board members or board committees responsible for the oversight of climate-related risks; disclose whether any board members have expertise in climate-related risks; describe how (and how often) the board or board committee discusses climate-related risks; explain whether and how climate-related risks inform the company's business strategy, risk management and financial oversight; and discuss whether the board sets climate-related targets or goals (including any climate-related opportunities) and how progress against those goals (including interim targets and goals) is overseen. Similarly with respect to management's role in assessing and managing climate-related risks, the proposed rules would require disclosure of the management positions or committees responsible for assessing and managing climate-related risks, including the relevant expertise of position holders, the processes by which such positions or committees are informed about and monitor climate-related risks, how frequently management reports to the board or board committee on climate-related risks, and whether management has a role in assessing and managing climate-related opportunities.

4. Risk Management

Closely connected to governance, the proposed rules would require a number of disclosures regarding the company's processes for identifying, assessing and managing climate-related risks and, if applicable, climate-related opportunities. Disclosures would include—among other things, and to the extent applicable—how the company determines the significance of climate-related risks relative to other risks; considers existing or likely regulatory requirements (e.g., greenhouse gas

emissions limits); considers shifts in customer, counterparty preferences, or other market changes in assessing transition risks; and determines the materiality of climate-related risks. As to the management of such risks, the proposed rules would require disclosures regarding how the company decides to mitigate, accept or adapt to a risk; how the company prioritizes whether to address climate-related risks; and how the company determines how to mitigate high-priority risks. Disclosures would also be required with respect to transition plans, including whether such a plan has been adopted and how the company is progressing against such plan.

5. Financial Statement Impacts and Disclosures

The proposal also expands Regulation S-X and would require that companies disclose in their financial statement footnotes the impact of climate-related events and transition activities on the line items of consolidated financial statements and related expenditures, in addition to financial estimates and assumptions impacted by such climate-related events and transition activities. By requiring that these disclosures be included in a company's financial statement footnotes, the disclosures would be included within the scope of any audit of the company's financial statements, subject to audit by a registered independent public accounting firm and within the scope of the company's internal control over financial reporting. If the rules are adopted as proposed, this would result in a significant expansion of a company's financial statement disclosures, dramatically extending companies' climate-related disclosure obligations from the current accounting literature.

More specifically as to the nature of the disclosures, with regard to financial impact metrics, companies would be required to disclose disaggregated information about the impact of climate-related conditions and events and transition activities on affected line items in its consolidated financial statements. Such climate-related conditions and events would include severe weather events, other natural conditions and physical risks, in addition to the impacts of any other climate-related risks identified by the company pursuant to other disclosures required by the proposal. As an example of the type of event to be considered, the proposal contemplates evaluating that the "[c]ost of revenue was impacted negatively by Events A and B by \$300,000, driven by increased input costs impacted by severe weather events that strained the registrant's main supplier." The actual disclosure could be provided in a tabular format, limited to the dollar amounts involved, without the added contextual information. Some disclosures would not be required if the aggregated absolute value impact of the severe weather events, other natural conditions, transition activities and identified climate-related risks, on a line-by-line basis, was less than 1 percent of the total line item for the relevant fiscal year.

Similarly, disclosure of expenditure metrics would include expenditures expensed and capitalized in response to severe weather events and physical risk and toward transition activities specifically to reduce greenhouse gas emissions or otherwise mitigate exposure to transition risks (including identified transition risks). Disclosure of the proposed expenditure metrics would also be subject to the same 1 percent materiality threshold described above in relation to the proposed financial impact metrics.

C . Presentation of Proposed Disclosures

The proposal would require companies to provide new climate-related disclosures in registration statements and annual reports, for example on Form 10-K or Form 20-F. Disclosures would be presented in a separate “Climate-Related Disclosure” section of these reports and in the financial statement notes, as described above. Moreover, domestic issuers would need to monitor for and report any material changes to these disclosures in their quarterly filings on Form 10-Q.

The proposed presentation mechanism runs counter to concerns voiced in public comments last spring about liability risks. Many commenters argued that requiring climate disclosures to be included in SEC filings—rather than in separate, climate-specific furnished reports—would create undue liability given the uncertainty of estimates and assumptions underlying the disclosures. The SEC’s proposal rejects these requests and instead treats the new climate disclosures the same as any other information that SEC rules require companies to include in filed SEC registration statements (including for IPO companies) and reports. The SEC’s proposal attempts to respond to liability concerns by creating a targeted safe harbor for Scope 3 emissions disclosures. The proposed safe harbor would protect those disclosures from claims of fraud “unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.”

III. Next Steps

While three out of the four commissioners expressed support for the proposal during yesterday’s public meeting, the final rule faces a long road to approval. The SEC will accept public comments until the later of May 20, 2022, and 30 days after publication in the Federal Register and will consider those comments in crafting the final requirements. A final rule may not be released until late 2022, and litigation over the final rule is likely.

The WilmerHale team is tracking this long-anticipated proposal and is helping companies engage in the SEC rulemaking process and prepare to comply with climate-related disclosure requirements. The authors of this alert, and other WilmerHale lawyers, are available to discuss the SEC’s proposal, its implications and how to participate in this process.

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