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SEC Proposes Watershed Climate-Related Disclosure Requirements

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On March 21, 2022, the Securities and Exchange Commission **announced** a long-awaited **proposal** that would require public companies to disclose extensive climate-related information in their registration statements and periodic reports. Among other requirements, the proposed rules would require a company to disclose information about climate-related risks and their impact on the company, as well as information on the company's climate-related governance and risk management processes. The proposed rules also would require disclosure of specified greenhouse gas (GHG) emissions, with a phased-in attestation requirement with respect to some emissions for certain categories of filers, and of climate-related financial statement metrics in the notes to the audited financial statements. Liability safe harbors would be available in some circumstances.

The proposal seeks to "provide consistent, comparable, and reliable – and therefore decision-useful – information to investors to enable them to make informed judgments about the impact of climate-related risks on current and potential investments." The proposed rules were not without opposition, with a dissent from SEC Commissioner Hester Peirce, contending that the proposed rules would "undermine the existing regulatory framework that for many decades has undergirded consistent, comparable, and reliable company disclosures." (For more information on Peirce's dissent and other commissioner statements, refer to our **Cooley PubCo blog post**.)

The SEC is soliciting comments on the proposed rules. The comment period will be open until the later of 30 days after the proposing release is published in the Federal Register or May 20, 2022 (60 days from the date that the rules were proposed). Interested parties can submit comments **here**. The proposing release also provides the compliance dates described below, assuming an effective date of December 2022 for the new rule, which is an optimistic but possible timeline.

Background

While environmental-related issues have been addressed by the SEC since the early 1970s, the SEC did not weigh in on climate-change disclosures until it issued **interpretive guidance in 2010** indicating that climate change disclosure might be required as part of a company's description of its business, risk factors, legal proceedings, and management's discussion and analysis of financial condition and results of operations. The 2010 guidance also identified certain climate-related issues that might necessitate disclosure, including the impact on a company of climate-change related legislation, regulations and international accords, as well as the indirect consequences of regulation or business trends, and the physical impacts of climate change.

Since the publication of the 2010 guidance, investor demand for climate-related information has grown dramatically. As SEC Chair Gary Gensler indicated in his **statement about the March 2022 proposal**, "investors with $130 trillion in assets under management have requested that companies disclose their climate risks." Consistent with the rising investor interest, in February 2021, then-acting SEC Chair Allison Herren Lee **directed** the Division of Corporation Finance to "enhance its focus on climate-related disclosure in public company filings," starting with the extent to which public companies addressed the topics identified in the 2010 guidance. In September 2021, the Division of Corporation Finance posted a **sample letter** containing illustrative comments regarding climate change disclosures, and began to issue more climate-related comments as part of its ongoing disclosure review process. The recent focus on sustainability by companies, investors and regulators is further demonstrated by the increasing trend of companies publishing stand-alone reports with climate-related information and data that is relevant to them, and by the significant increase in the past few years in shareholder proposals for annual meetings relating to environmental, social and governance (ESG) more generally, and the environment in particular.

According to the SEC, while the 2010 guidance may have elicited some valuable climate-related disclosure, "these provisions have not resulted in the consistent and comparable information about climate-related risks that many investors have stated that they need in order to make informed investment or voting decisions." Given the perceived shortcomings of the current regulatory regime and increased investor interest, the SEC has proposed these new rules to "include climate-related disclosure items and metrics to elicit investment decision-useful information that is necessary or appropriate to protect investors" and to "increase the consistency, comparability, and reliability of climate-related information for investors."

Proposed disclosures

The SEC's proposal is modeled in part on the framework recommended by the Task Force on Climate-Related Financial Disclosures, which evaluates "material climate-related risks and opportunities through an assessment of their projected short-, medium-, and long-term financial impacts on a registrant." The widely accepted TCFD framework establishes four core elements that provide a structure for disclosure: governance, strategy, risk management, and metrics and targets. Based largely on these core elements, the proposed rules would add new Subpart 1500 to Regulation S-K that would require a company to disclose certain climate-related information, including:

- Information about climate-related risks that are reasonably likely to have a material impact on the company's business or consolidated financial statements, and the impact of these risks on the company's strategy, business model and outlook.
- The company's climate-related governance and risk management processes.
- Certain data regarding the company's GHG emissions, including a phased-in third-party attestation requirement with respect to Scopes 1 and 2 emissions data for accelerated and large accelerated filers.
- The company's climate-related targets and goals, if any.

When responding to any of the proposed rules' provisions concerning governance, strategy and risk management, a company also may disclose information concerning any identified climate-related opportunities. The information provided pursuant to this new Subpart would be required to be included or incorporated by reference in a separately captioned section of registration statements and annual reports titled "Climate-Related Disclosure."

The proposed rules also would add a new Article 14 to Regulation S-X that would require a company to include certain climate-related financial statement metrics, consisting of disaggregated climate-related impacts on existing financial statement line items and related disclosure, in a note to the company's audited financial statements. As part of a company's financial statements, these metrics would be subject to audit by an independent auditor and would be within the scope of the company's internal control over financial reporting.

The climate-related disclosures detailed in the proposed rules would be required to be **filed** with the SEC for purposes of potential liability under the federal securities laws, as opposed to **furnished**, subject to an exception for information provided by a foreign private issuer on Form 6-K. Further, to the extent that climate-related disclosures constitute forward-looking statements, the SEC has noted that these statements may be covered by existing forward-looking safe harbors under the federal securities laws. However, forward-looking statements made in connection with an initial public offering are excluded from the Private Securities Litigation Reform Act (PSLRA) safe harbor, although the SEC has requested comments as to whether an exception to the PSLRA safe harbor should be adopted that would extend the safe harbor to forward-looking climate-related disclosures in connection with IPOs.

Finally, similar to the treatment of other important business, risk and financial disclosures included in a registration statement or annual report, the proposed rules would require a company to disclose any material change to its previously provided climate-related disclosure in its Form 10-Q (or Form 6-K for a foreign private issuer, if required).

1. Disclosure of climate-related risks and their impacts on strategy, business model and outlook

The proposed rules would require a company to disclose any climate-related risks that have had or are reasonably likely to have a material impact on its business and financial statements, whether over the short, medium or long term, and how those risks have affected or are likely to affect its strategy, business model and outlook.

The SEC based the definitions in the proposed rules on definitions provided by the TCFD in an effort to provide a common terminology for disclosure of climate-related risks and opportunities in a consistent and comparable way, using definitions that are already widely accepted. As proposed, the rules do not include a specific definition of short-, medium- and long-term time horizons, and instead require the company to describe how it defines each of these time horizons, including how it addresses the expected useful life of the company's assets and the time horizons for the company's climate-related planning processes and goals. However, the SEC has requested comment on whether these periods should be defined in the rules.

Climate-related risks

As proposed, "climate-related risks" means the actual or potential negative impacts of climate-related conditions and events on a company's consolidated financial statements, business operations or value chains, as a whole. The SEC included the concept of "value chains" (that is, the "upstream and downstream" activities related to a company's operations) as part of a company's climate-related risks to capture the full extent of its potential risk exposure, which can extend beyond its own operations to those of its suppliers, distributors, and others engaged in upstream or downstream activities. When disclosing these climate-related risks, the proposed rules would require a company to specify whether the risk is a physical or transition risk. Physical risks are related to the physical impacts of the climate, including acute risks such as tornadoes, hurricanes and floods, and chronic risks such as sustained higher temperatures, sea level rise, drought, increased wildfires and decreased arability of farmland, habitability of land, and availability of fresh water. Transition risks are related to the transition to a lower carbon economy, such as increased costs resulting from the adoption or potential adoption of new governmental regulations or policies, technologies to mitigate or adapt to climate-related risks or climate-related litigation, or changing consumer or investor preferences.

For a physical risk, the proposed rules would require a company to describe the nature of the risk, including whether it may be categorized as an acute or chronic risk, and to include in the description of the risk the ZIP code (or a similar subnational postal zone or geographic location, if the location is in a jurisdiction that does not have ZIP codes for the location) of the properties, processes or operations subject to the physical risk. Additional disclosures would be required if the risk relates to flooding, or if the location of assets is subject to water-related acute or chronic physical risks, such as flooding or high-water stress. Disclosure with respect to the company's actions or plans to mitigate or adapt to the risk also would be required.

For a transition risk, the proposed rules would require a company to describe the nature of the risk, including whether it relates to regulatory, technological, market, liability, reputational or other transition-related factors, and how the risk impacts the company. For example, a company 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, such as increased capital expenditures.

Companies also may voluntarily disclose any climate-related opportunities when responding to the proposed disclosure requirements concerning governance, strategy and risk management in connection with climate-related risks. Climate-related opportunities may include actual or potential positive impacts of climate-related conditions and events on the company's consolidated financial statements, business operations or value chains, as a whole, such as cost savings related to the use of renewable energy, increased resource efficiency, the development of new products, services and methods, access to new markets or investors, and increased resilience of supply or distribution chains.

The "materiality" determination for climate-related risks would remain consistent with existing case law – i.e., information is material if there is a substantial likelihood that a reasonable shareholder would consider this information important in making an investment decision, or if the information would have significantly altered the total mix of information made available. Per the proposing release, the materiality analysis should take into consideration quantitative and qualitative factors and, given that companies would be required to assess future impacts at different time horizons, the materiality analysis also would require an assessment of the probability of the event occurring and its potential magnitude, or significance, to the company.

Material impacts of climate-related risks on the company's strategy, business model and outlook

As proposed, a company would be required to disclose material impacts of any identified climate-related risks on its strategy, business model, and outlook in the short, medium or long term. This disclosure may include material impacts on the company's business operations, products or services, suppliers and other parties in its value chain, activities to mitigate or adapt to climate-related risks, expenditures for research and development, and other significant changes or effects. Disclosures would need to be current and forward-looking – and include how the company has considered the identified impacts as part of its business strategy, financial planning and capital allocation – in order to convey whether the climate-related risks have been integrated into the company's business model or strategy. In addition, disclosures with respect to any metrics or targets utilized by the company, and how they relate to the company's business model and strategy, would be required.

The proposed rules would require an in-depth narrative discussion, similar to MD&A, of the likely impacts on the company's consolidated financial statements. Under the proposal, the company would need to discuss whether and how any of the identified impacts are considered as part of the company's business strategy, financial planning and capital allocation, including current and forward-looking disclosures. Additional disclosures also would be required if a company uses carbon offsets or renewable energy credits or certificates (RECs) as part of its net emissions reduction strategy, or if a company uses an internal carbon price (that is, an estimated cost of carbon emissions used internally as, for example, a planning tool or incentive) to evaluate and manage climate-related risks.

In addition, the proposal requires a company to describe any analytical tools, such as scenario analyses, that it uses to "assess the impact of climate-related risks on its business and consolidated financial statements, or to support the resilience of its strategy and business model in light of foreseeable climate-related risks." If a company uses scenario analysis for this latter purpose, the proposed amendments would require quantitative and qualitative disclosure regarding the scenarios considered, including the parameters, assumptions, analytical choices and projected financial impacts under each scenario considered. The proposed rules do not mandate the use of an internal carbon price, analytical tools or scenario analyses; rather, these disclosures are required only if a company actually uses these tools.

2. Disclosure of climate-related governance

The proposed rules would require a company to disclose information concerning the board of directors' oversight of climate-related risks, and management's role in assessing and managing those risks. For example, the company would be required to disclose the identity of directors or board committees responsible for the oversight of climate-related risks, the nature of their expertise, processes for keeping the board informed about climate risks, how the directors consider climate risks as part of the board's financial, strategic and risk oversight, and how the directors set and oversee climate goals.

Similarly, the company also would need to identify any management positions or committees responsible for assessing and managing climate-related risks, and describe the nature of the individuals' expertise, their processes for keeping informed and monitoring climate risks, and the frequency of their reporting to the board about climate risks.

3. Disclosure of climate-related risk management

Disclosure of processes for identifying, assessing and managing climate-related risks

Under the proposed rules, a company would be required to describe any processes used for identifying, assessing and managing climate-related risks. When describing any processes for **identifying** and **assessing** climate-related risks, a company would be required to disclose, as applicable, how it:

- Determines the relative significance of climate-related risks compared to other risks.
- Considers existing or likely regulatory requirements or policies, such as GHG emissions limits, when identifying climate-related risks.
- Considers shifts in customer or counterparty preferences, technological changes or changes in market prices in assessing potential transition risks.
- Determines the materiality of climate-related risks, including how it assesses the potential size and scope of any identified climate-related risk.

When describing any processes for **managing** climate-related risks, a company would be required to disclose, as applicable, how it:

- Decides whether to mitigate, accept or adapt to a particular risk.
- Prioritizes addressing climate-related risks.
- Determines how to mitigate a high-priority risk.

The proposed rules also would require a company to disclose whether and how any of these identified processes is integrated into its overall risk management system or processes. If a separate board or management committee is responsible for assessing and managing climate-related risks, a company would be required to disclose how that committee interacts with its board or management committee governing risks.

Disclosure of a transition plan

Adoption of a transition plan to mitigate or adapt to climate-related risks may be an important part of a company's climate-related risk management strategy, particularly if it operates in a jurisdiction that has made commitments to reduce its GHG emissions. If a company has adopted a transition plan, the proposed rules would require it to describe the plan, including the relevant metrics and targets used to identify and manage physical and transition risks. A company also would be required to update the disclosure about its transition plan each year by describing the actions taken during the year to achieve the plan's targets or goals.

The proposed rules would require a company that has adopted a transition plan to discuss how it plans to mitigate or adapt to any physical risks identified in the filing, including risks concerning exposure to sea level rise, extreme weather events, wildfires, drought and severe heat. In addition, the proposed rules would require a company that has adopted a transition plan to discuss how it plans to mitigate or adapt to any identified transition risks.

A company that has adopted a transition plan may voluntarily describe how it plans to achieve any identified climate-related opportunities.

4. Climate-related financial statement metrics

As noted above, a new article to be added to Regulation S-X would require certain climate-related financial statement metrics and related disclosure to be included in a note to a company's audited financial statements. The required disclosure would fall under the following three categories of information:

- **Financial impact metrics**, which would show, on a disaggregated basis, the impact on any relevant line item in the company's consolidated financial statements of physical risks identified by the company, and any other severe weather events and natural conditions, such as floods, drought, wildfires, extreme temperatures and sea level rise, as well as any transition risks, unless the sum of the absolute values of all the impacts on a line item is less than 1% of the total line item for the relevant fiscal year. Disclosure of these impacts would, at a minimum, be required on an aggregated, line-by-line basis for all negative impacts and, separately, all positive impacts.
- **Expenditure metrics**,which would show expenditures expensed and capitalized costs incurred to mitigate the same climate-related events and identified risks, as well as transition activities, unless the amount is less than 1% of the total expenditures expensed or total capitalized costs incurred, respectively, for the relevant fiscal year. The proposed rules would require separate disclosure of the positive and negative impacts associated with each of these items.
- **Financial estimates and assumptions**, which would disclose whether the estimates and assumptions used to produce the consolidated financial statements were impacted by exposures to risks and uncertainties associated with, or known impacts from, climate-related events and transition activities. If applicable, a company would need to provide a qualitative description of how the development of these estimates and assumptions was impacted by these events and transition activities.

As part of a company's financial statements, the proposed financial statement metrics would be subject to audit by an independent auditor and within the scope of a company's internal control over financial reporting. The proposed rules would require disclosure for the company's most recently completed fiscal year and the historical fiscal year(s) included in the company's consolidated financial statements in the applicable filing (with some exceptions).

When calculating these metrics, a company would be required use financial information that is consistent with the scope of the rest of its consolidated financial statements included in the filing, and, whenever applicable, apply the same accounting principles – for example, generally accepted accounting principles (GAAP) or International Financial Reporting Standards (IFRS) – that are used in preparing the rest of its consolidated financial statements. Accordingly, the calculations of these metrics must include financial information from a company's consolidated subsidiaries.

Similar to other financial statement disclosures, the proposed financial statement metrics disclosures would involve estimations and uncertainties driven by the application of judgments and assumptions. Therefore, a company would need to disclose contextual information for each type of metric to enable a reader to understand how it derived each metric, including a description of significant inputs and assumptions used and, if applicable, policy decisions made by the company to calculate the specified metrics.

5. GHG emissions

Disclosure requirements

Overview

The proposed rules would require a company to disclose, under the separate section captioned "Climate-Related Disclosure," its direct and indirect GHG emissions based primarily on concepts and definitions provided by the GHG Protocol, a widely used global GHG accounting and reporting standard. GHG emissions would be categorized based on the well-accepted concept of scopes, as follows:

- **Scope 1 emissions:** Direct GHG emissions from operations that are owned or controlled by a company.
- **Scope 2 emissions:** 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 company.
- **Scope 3 emissions:** All indirect GHG emissions not otherwise included in a company's Scope 2 emissions, which occur in the upstream and downstream activities of the company's value chain.

Consistent with the GHG Protocol, the proposed rules define "greenhouse gases" as carbon dioxide (CO_2); methane (CH_4); nitrous oxide (N_2O); nitrogen trifluoride (NF_3); hydrofluorocarbons (HFCs); perfluorocarbons (PFCs); and sulfur hexafluoride (SF_6).

For each of the Scopes 1, 2 and 3 emissions, a company would need to disclose the emissions disaggregated by each constituent greenhouse gas and in the aggregate. The GHG emissions disclosure would be made in terms of carbon dioxide equivalents, CO_2e, which is the common unit of measurement used to indicate the global warming potential of each GHG, expressed in terms of the global warming potential of one unit of CO_2. Further, a company would be required to disclose its GHG emissions data in gross terms, excluding any use of purchased or generated offsets.

The GHG emissions disclosure would need to be provided for the company's most recently completed fiscal year and, if reasonably available, for the historical fiscal years included in the company's consolidated financial statements in the applicable filing. With respect to all required GHG emissions disclosure for the most recent fiscal year, the proposed rules would allow a company to use a reasonable estimate of its GHG emissions for its fourth fiscal quarter, if actual reported data is not reasonably available, together with actual, determined GHG emissions data for the first three fiscal quarters. If a company avails itself of this accommodation, it would be required to promptly disclose in a subsequent filing any material difference between the estimate used and the actual, determined GHG emissions data for the fourth fiscal quarter, when it becomes available.

Scopes 1 and 2 disclosure requirements

The proposed rules would require all companies to separately disclose their total Scope 1 emissions and total Scope 2 emissions from all sources that are included in their organizational and operational boundaries.

Scope 3 disclosure requirements

A company also would be required to disclose separately its total Scope 3 emissions if those emissions were material, or if the company had set a GHG emissions reduction target or goal that included its Scope 3 emissions.

A smaller reporting company (SRC) would be exempt from this requirement, and disclosures made pursuant to the proposed rules would be afforded a safe harbor unless made or reaffirmed by the company without a reasonable basis, or disclosed by the company other than in good faith.

A company's Scope 3 emissions would be considered "material" if there's a substantial likelihood that a reasonable investor would consider the company's Scope 3 emissions important in making an investment or voting decision. When conducting this materiality assessment, companies should consider whether Scope 3 emissions constitute a relatively significant portion of their overall GHG emissions, although a quantitative analysis alone would not be dispositive as to whether Scope 3 emissions are material and required to be disclosed.

If required to disclose Scope 3 emissions, a company would need to identify the categories of upstream and downstream activities in the calculation of its Scope 3 emissions. Furthermore, if any of these categories were significant to the company, the proposed rules would require the company to identify these categories and separately disclose Scope 3 emissions data for each category. For example, Scope 3 emissions might result from upstream activities, such as a company's purchased goods and services, a company's capital goods, waste generated by a company's operations, and business travel by a company's employees, among others. Similarly, Scope 3 emissions might be generated from downstream activities, such as transportation and distribution of a company's sold products, goods or other outputs, processing by a third party of a company's sold products, investments by a company (which would capture emissions from third parties that the company provides debt or equity financing to, commonly referred to as "financed emissions"), and use by a third party of a company's sold products, among others. If required to disclose Scope 3 emissions, a company also would be required to describe the data sources used to calculate its Scope 3 emissions.

GHG intensity

In addition to requiring the disclosure of its GHG emissions in gross terms, the proposed rules also would require a company to separately disclose the sum of its Scope 1 and 2 emissions, and separately disclose its Scope 3 emissions (if applicable) in terms of GHG intensity. GHG intensity disclosure is intended to provide context to a company's emissions in relation to its business scale, demonstrating the level of emissions efficiency.

The proposed rules would define "GHG intensity" as "a ratio that expresses the impact of GHG emissions per unit of economic value (*e.g.*, metric tons of CO_2e per unit of total revenues, using the registrant's reporting currency) or per unit of production (*e.g.,* metric tons of CO_2e per unit of product produced)." The proposal would require the disclosure of GHG intensity in terms of metric tons of CO_2e per unit of total revenue and per unit of production for the applicable fiscal year.

GHG emissions methodology

In addition, the proposed rules would require a company to describe the methodology, significant inputs and significant assumptions used to calculate its GHG emissions metrics. The description of a company's methodology would need to include the company's organizational boundaries, operational boundaries, calculation approach and any calculation tools used to calculate its GHG emissions.

- **Organizational boundaries** refer to the company's determination, based upon the same set of accounting principles applicable to its consolidated financial statements, of the operations that it owns or controls, for purposes of calculating its GHG emissions, which must be the same for Scopes 1, 2 and 3. The proposal would therefore require a company to include all the GHG emissions from an entity that it consolidated for purposes of its financial statements. Because the same set of accounting principles apply to GHG emissions disclosure, domestic companies will generally set their organizational boundaries by applying GAAP. A company also would be required to include its share of emissions based on its percentage ownership of an equity method investee or an operation that is proportionally consolidated into its financial statements. The proposal would, however, allow a company to exclude emissions from investments that are not fully or proportionally consolidated, or that do not qualify for the equity method of accounting in its financial statements. A company required to disclose Scope 3 emissions would apply the same organizational boundaries in identifying the sources of indirect emissions from its value chain over which it lacks ownership and control.
- **Operational boundaries** refer to the "boundaries that determine the direct and indirect emissions associated with the business operations owned or controlled by a registrant." In order to set its operational boundaries, a company would identify emissions sources from its operational facilities that fall within its organizational boundaries and then categorize the emissions as either direct or indirect emissions. As part of describing the methodology for setting its operational boundary, a company would be required to disclose its approach to categorizing its emissions and emissions sources. This description must detail how the company determines the emissions to include as direct emissions (Scope 1) and indirect emissions (Scope 2 and Scope 3, if applicable). For most companies, purchased electricity would likely constitute a large percentage of their Scope 2 emissions.

Once a company has determined its organizational and operational boundaries, it must consistently use those boundaries when calculating its GHG emissions.

In addition to setting its organizational and operational boundaries, a company would need to select and disclose a GHG emissions calculation approach. The proposal does not prescribe a specific method of calculation and instead allows companies to make this determination and disclose the methods used. The proposal suggests that "an acceptable and common method for calculating emissions involves the application of published emission factors." An "emission factor" is a multiplication factor that allows actual GHG emissions to be calculated from available activity or economic data. For example, to calculate GHG emissions, the company might multiply a level of activity data (e.g., kWh of electricity consumed facility) by an emission factor (e.g., grams of CO_2 per kWh). Examples of activity data might include "kilowatt-hours of electricity used, quantity of fuel used, output of a process, hours of operation of equipment, distance travelled, and floor area of a building." In the absence of activity data, a company may use an emission factor based on economic data – for example, the economic value of purchased goods or services. The proposal also includes additional rules related to the calculation and disclosure of GHG emissions, including rules relating to the use of estimates, third-party data, changes in assumptions or methodology, gaps in data, emissions from certain outsourced activities, and overlapping Scope 3 emissions.

Attestation requirements

Overview

The proposed rules would require accelerated filers and large accelerated filers to obtain and attach to their filings an attestation report regarding Scopes 1 and 2 emissions, and to provide certain related disclosures about the attestation provider. Although the attestation provider need not be a registered public accounting firm, the proposal imposes “minimum attestation report requirements, minimum standards for acceptable attestation frameworks, and would require an attestation service provider to meet certain minimum qualifications.”

Additional disclosure and requirements with respect to the provider of the attestation, and the attestation report itself, would be required and are discussed below. Initially, a company would be required to provide only limited assurance comparable to a “review’’ of interim financial statements included in a Form 10-Q, where the conclusion is expressed in the form of negative assurance regarding whether any material misstatements have been identified. In contrast, “reasonable assurance” is the same level of assurance provided in an audit of a company’s consolidated financial statements, where the conclusion “provides positive assurance that the subject matter is free from material misstatement.”

The minimum level of assurance required from the third-party attestor would be phased in, with limited assurance required for the second and third fiscal years after the Scopes 1 and 2 emissions disclosure compliance date, and reasonable assurance required for the fourth fiscal year and beyond.

Attestation provider requirements

The attestation report required under the proposed rules would need to be signed by a GHG emissions attestation provider. Under the proposed rules, a “GHG emissions attestation provider” would be defined as a person or firm that is an “expert in GHG emissions” with “significant experience,” as defined, in “measuring, analyzing, reporting, or attesting to GHG emissions,” and is independent with respect to the company and its affiliates during the attestation and professional engagement period.

The independence requirement for the GHG emissions attestation provider is modeled after the independence requirements for a company’s independent registered public accounting firm. Specifically, the proposed rules would provide that a GHG emissions attestation provider is not independent “if during the attestation and professional engagement period such attestation provider is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that such attestation provider is not, capable of exercising objective and impartial judgment on all issues encompassed within the attestation provider’s engagement.” The SEC notes that, if a company’s independent auditor also would serve as its GHG emissions attestation provider, then the fees associated with the GHG emissions attestation engagement would be considered “Audit-Related Fees” for purposes of the applicable disclosure requirements in a company’s proxy statement or annual report.

As with the consent of the auditors of the financial statements, a company would be required to obtain and file a written consent from the GHG emissions attestation provider with any registration statement or report filed under the Securities Exchange Act of 1934 that includes or incorporates by reference the attestation report. Given its status as an expert, the GHG emissions attestation provider also would be subject to liability under the federal securities laws for the assurance provided.

Attestation report requirements

Under the proposed rule, the attestation report would be required to be included in the separately captioned “Climate-Related Disclosure” section in the applicable filing. Moreover, the proposed rules would require the attestation report to be provided “pursuant to standards that are publicly available at no cost and are established by a body or group that has followed due process procedures, including the broad distribution of the framework for public comment.” As nonexclusive examples of standards that meet the due process requirement, the proposal lists the attestation standards of the Public Company Accounting Oversight Board, the American Institute of Certified Public Accountants, and the International Auditing and Assurance Standards Board. While not prescribing a standard to use, the proposed rules would require a GHG emissions attestation provider to follow the specific requirements regarding form and content of the reports of the attestation standard (or standards) used. The proposed rules also prescribe certain additional requirements relating to the contents of the attestation report.

Company attestation-related disclosures

In addition to these minimum requirements for the attestation provider and report, the proposal would require disclosure by the company of certain additional matters related to the attestation to be included in the separately titled "Climate-Related Disclosure" section of the applicable filing but not in the attestation report itself. These disclosures would include information about the attestation provider's license, if any, any oversight inspection program to which the engagement is subject and any record-keeping requirements applicable to the attestation provider.

6. Disclosure of climate-related targets or goals

Under the proposed rules, if a company has set any climate-related targets or goals, whether on its own initiative or to meet actual or anticipated regulatory requirements, market constraints, or other goals established by a climate-related treaty, law, regulation, policy or organization, then certain information about those targets or goals would be required to be disclosed. Common examples of climate-related goals or targets a company may set include reduction of GHG emissions, energy usage, water usage, conservation or ecosystem restoration, and revenue goals from low-carbon products, among many others. The proposed rules would require a company that has set targets or goals to include a description of:

- The scope of activities and emissions included in the target.
- The unit of measurement, including whether the target is absolute or intensity based.
- The defined time horizon by which the target is intended to be achieved, and whether the time horizon is consistent with one or more goals established by a climate-related treaty, law, regulation policy or organization.
- The defined baseline time period and baseline emissions against which progress will be tracked, with a consistent base year set for multiple targets.
- Any interim targets set by the company.
- How the company intends to meet its climate-related targets or goals.

The proposed rules also would require disclosure of relevant data to indicate whether the company is making progress toward achieving the target or goal, and how this progress has been achieved, which would have to be updated each year with a description of the actions taken during the year to achieve the target or goal.

In addition, if a company has used carbon offsets or RECs as part of its strategy to achieve targets or goals, the company would be required to disclose the amount of carbon reduction represented by the offsets or the amount of generated renewable energy represented by the RECS, the source of the offsets or RECs, a description and location of the underlying projects, any registries or other authentication of the offsets or RECs, and the cost of the offsets or RECs.

Compliance dates

The proposed rules include phased-in dates for compliance. The initial compliance phase-in would be based on filer status, with additional phase-ins for disclosure of Scope 3 emissions, as well as for the attestation requirement and the level of assurance required in the attestation report. The tables below summarize the proposed phase-ins for compliance, assuming that the proposed rules would be adopted with an effective date of December 2022, an optimistic but possible timeline, and that the company has a December 31 fiscal year-end. If the final rule is instead adopted in 2023, each of the dates in the table would be moved back by one year. A company with a different fiscal year-end date that results in its fiscal year 2023 commencing before the effective date of the rules would not be required to comply with the disclosure requirements until the following fiscal year.

Disclosure compliance dates

Registrant type	Disclosure 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)
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

Attestation compliance dates

Filer type	Scopes 1 and 2 GHG	Limited assurance	Reasonable assurance
Large accelerated filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)	Fiscal year 2026 (filed in 2027)
Accelerated filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Fiscal year 2027 (filed in 2028)

Foreign private issuers

The proposed rules would apply similarly to foreign private issuers (other than Canadian issuers using Form 40-F), with some modifications to address differences in accounting standards used. If a foreign private issuer files consolidated financial statements under IFRS as issued by the International Accounting Standards Board, then the company would apply IFRS as the basis for calculating and disclosing the proposed climate-related financial statement metrics, and setting its organizational boundaries for the purpose of providing the proposed GHG emissions disclosure. By contrast, foreign private issuers that file consolidated financial statements under home country GAAP and reconcile to US GAAP would be required to use US GAAP as the basis for calculating and disclosing the proposed climate-related financial statement metrics, and setting its organizational boundaries for the purpose of providing the proposed GHG emissions disclosure.

Separately, when determining whether information is required to be provided on a Form 6-K, the instructions to Form 6-K that dictate when information is required to be furnished on a Form 6-K would apply. In addition, while the proposal generally requires that all information be filed and not furnished, any information provided on Form 6-K may be furnished, per the terms of the form itself, which would exclude it from certain liability provisions under the Exchange Act.

Observations and commentary

- **Prepare to spend time and capital on climate-related disclosures.** It is difficult to overstate the potential effect of the proposed rules on a company's personnel who are responsible for SEC reporting, particularly for smaller companies with limited numbers of employees. In some cases, companies may find that they will need to hire new personnel with expertise in climate risk identification and analysis. Among others, anticipated impacts include that:
  - Legal teams will have to be involved to ensure compliance with the disclosure requirements within the body of relevant filings.
  - Finance teams will have to calculate the financial statement metrics and help prepare the required narrative disclosures.
  - Auditors will require company employees to provide visibility into the climate-related financial metrics as they would any other metrics within the financial statements.
  - GHG emissions will have to be calculated and, for accelerated filers and large accelerated filers, third-party attestation providers will need access to company employees, data, and records to be able to provide the required assurance.

In addition to potentially driving compliance costs through increased human resource requirements, the rule may also increase costs directly, such as through increased outside legal, auditor, attestation and other third-party service provider fees. Companies may decide to engage outside consultants with climate expertise to assist with the calculation of GHG emissions, or they may use a publicly available tool to help calculate GHG emissions. For accelerated filers and large accelerated filers, the retention of a third party to attest to the GHG emissions disclosure will add to the costs, in some cases, significantly. In sum, companies should begin to plan for and think about how to allocate the significant resources that these proposed rules would require. Given the scope and complexity of the proposed rules, and the potentially short time horizon before the proposed effective date, companies should analyze their particular circumstances and consider what steps they would need to take if the rules were adopted largely as proposed.

Keep in mind that the final rules could differ substantially from the proposal. The SEC likely will receive a huge volume of comments conveying strongly held views on both sides. Moreover, reportedly, several aspects of the proposal, including disclosure of Scope 3 GHG emissions and the attestation requirements, were hotly debated among the commissioners – even among the three Democratic commissioners – and two new SEC commissioners are expected to join the SEC before the final rules come up for a vote, all of which could make a difference in the ultimate outcome.

- **Assess disclosure controls and procedures as they may apply to climate-related disclosures.** Companies should plan to review their existing disclosure controls and procedures to verify that the appropriate communication channels will be in place to ensure that the climate-related information contemplated by the proposal will be accumulated, processed and reported to appropriate personnel responsible for disclosures. Because of the scope of the proposed rules, the changes to disclosure controls and procedures may be significant and should involve financial and non-financial personnel. Companies with a disclosure committee should include the committee in this review and in implementing a control structure for the disclosure of climate-related information. Companies should also review any disclosure committee charter for necessary changes. In addition, companies should consider putting in place procedures for the identification, gathering and verification of climate-related data, including the responsible parties for each step. Companies may want to begin identifying third parties that would need to be engaged. For instance, companies that do not have climate expertise on staff may need to engage outside consultants who can provide the expertise necessary to help companies collect, calculate and analyze climate-related data in preparation for disclosure. Organizing, identifying, and engaging various third parties in order to support appropriate disclosure controls and procedures in addition to the required attestation report will take time.
- **Late-stage private companies should plan accordingly.** The proposed rules would require climate-related disclosures in IPO registration statements. As a result, should the rules be adopted as proposed, late-stage private companies will need to plan

accordingly to ensure they have the internal and external resources in place to enable compliance. Failure to build in appropriate lead time could delay a proposed IPO or cause a company to miss a window for an IPO entirely. In addition, private companies with registered debt securities would fall within the scope of the proposed rules.

- **Evaluate and enhance climate-related policies and procedures and governance structure.** Given the requirements to disclose climate-related governance and risk management processes, companies should plan to adopt and/or build out existing processes and procedures in the future. Companies will have to ensure that board and management oversight and governance processes are put in place, including the allocation of oversight of climate-related matters to the board or an appropriate board committee. Companies should also ensure that management and the board are educated about climate risk and have the ability to respond to it. Companies will have to review their existing risk management frameworks to incorporate climate-related risks into their policies and procedures, keeping in mind that climate-related risks must be addressed for a longer time horizon than traditional risks companies face. If a company sets a climate target or goal, the board should also oversee progress towards meeting that goal or target. In addition, management should put in place a structure for managing climate-related matters and for reporting climate-related risks to the board. While the race to report on climate and other ESG issues had already begun prior to the proposed rules, and will continue on the disclosure side, the proposed rules can be expected to accelerate the establishment and enhancement of internal governance functions as they relate to climate and other ESG-related risks.
- **Evaluate and enhance board and management expertise.** Similar to the SEC's recent proposed rules regarding cybersecurity risks, the climate-related proposed rules do not mandate specific board expertise; however, we expect that the disclosure requirements to discuss climate-related board expertise potentially will have the effect of companies seeking to add board seats to expand climate-related board expertise. Companies that do not have climate-related expertise on their boards may want to consider prioritizing this expertise in searches for new director candidates, as the proposes rules may create competition for directors with climate-related expertise. Management also should consider whether employees with climate-related expertise would be needed to manage climate-related matters and to position the company to comply with any adopted rules.
- **Companies may be wary of pursuing certain climate-related actions.** Ironically, some provisions of the rules might actually discourage some companies from pursuing actions that might otherwise be promoted by climate advocates. For example, if companies adopt transition plans or use scenario analyses, the proposed rules require extensive disclosure about them. Similarly, a company that adopts climate-related targets or goals would be required to provide extensive disclosure about them and periodically update with relevant data to demonstrate its progress toward these goals, potentially exposing the company to liability. In the absence of institutional investors and market forces that advocate for these practices, these rules might actually dampen some companies' enthusiasm for adopting these plans and processes, but investors and markets have already made their voices heard in many cases, and those calls are expected to continue. For companies that have already publicly disclosed targets or goals, they would now be required to make additional, perhaps unexpected, disclosures, requiring them to take a hard look at those targets and goals, and how they actually plan to achieve them. Importantly, companies should note the proposal does not appear to limit the requirement to targets or goals that have been publicly disclosed and, as a result, it's possible that even targets used only internally to measure progress could ultimately be implicated by this requirement.
- **Note the proposal's treatment of carbon offsets.** Interestingly, the proposal puts a minor spotlight on carbon offsets, the use of which has been somewhat controversial. The proposed rules would require a company to disclose GHG emissions data in gross terms, excluding any use of purchased or generated offsets. In addition, a company that uses carbon offsets as part its plan to meet GHG reduction goals must disclose the amount of carbon reduction represented by the offsets, the source of the offsets, their cost and any authentication. In some cases, the SEC notes, companies "might plan to use carbon offsets […] as their primary means of meeting their GHG reduction goals, including those formulated in response to government law or policy or customer or investor demands." The SEC observes that a "reasonable investor could well assess differently the effectiveness and value to a registrant of the use of carbon offsets where the underlying projects resulted in authenticated reductions in GHG emissions compared to the use of offsets where the underlying projects resulted in the avoidance, but not the reduction, in GHG emissions or otherwise lacked verification. As some commenters have indicated, mandated detailed disclosure about the nature of a purchased carbon offset could also help to mitigate instances of greenwashing."
- **Expect legal challenges to the proposed rule.** We can expect there to be legal challenges to the proposed rules, particularly given the expected compliance costs. Peirce's dissent may elucidate some of the arguments that challengers could make, including reservations as to whether the SEC has the authority to propose these rules, and whether the proposed rules may be overbroad, particularly with respect to Scope 3 emissions. Some also contend that the proposed rules violate the First

Amendment by impermissibly compelling speech. The effects of anticipated legal challenges on the rules or their adoption remain to be seen.

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