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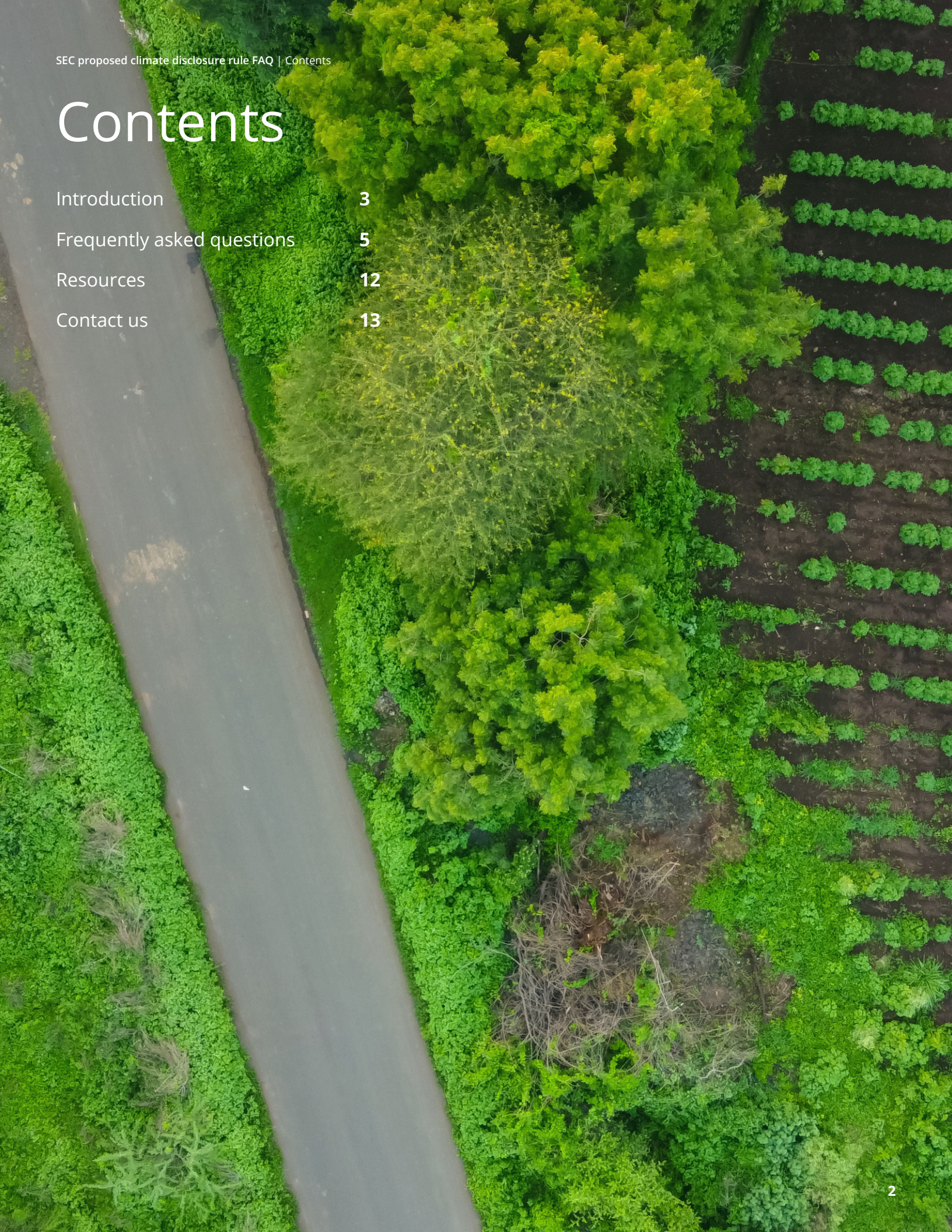
SEC proposed climate disclosure rule FAQ

Your 10 key questions answered

June 2022

Contents



Introduction

On March 21, 2022, the SEC issued a proposed rule that would enhance and standardize the climate-related disclosures provided by public companies. This FAQ provides answers to the most commonly asked questions about the proposal.

First, some background. SEC Chair Gary Gensler's statement at the time the SEC proposed the rule expressed support for the proposal: "If adopted, it would provide investors with consistent, comparable, and decision-useful information for making their investment decisions and would provide consistent and clear reporting obligations for issuers."

Under the proposed rule, a registrant (both domestic and foreign private issuers) would be required to provide certain climate-related disclosures in its registration statements and annual reports (e.g., Form 10-K or Form 20-F). These would include climate-related financial impact and expenditure metrics as well as a discussion of climate-related impacts on financial estimates and assumptions in the financial statements. These disclosures would also be subject to management's internal control over financial reporting and external audit.

Outside of the financial statements, a registrant would be required to provide quantitative and qualitative disclosures in a separately captioned "Climate-Related Disclosure" section to immediately precede the MD&A. These disclosures would address:

- Scope 1, Scope 2, and Scope 3 (if material or a registrant has established a reduction target or goal that includes Scope 3) greenhouse gas (GHG) emissions
- Climate-related risks and opportunities
- Climate risk management processes
- Climate targets and goals
- Governance and oversight of climate-related risks

These disclosures would be subject to management's disclosure controls, procedures, and certifications. In addition, Scopes 1 and 2 GHG emission disclosures would be subject to attestation requirements consisting of limited assurance during a phase-in period, followed by reasonable assurance thereafter.

All disclosure requirements under the proposed rule would be subject to phase-in over several years, depending on the registrant's filing status and the specific disclosures, as illustrated in the table below. (The data assumes the proposed rule is finalized by December 2022 and the registrant has a calendar year end.)

Registrant type	All disclosures (Except Scope 3 GHG emission disclosures)	Scope 3 GHG emission disclosure	Attestation on Scope 1 and Scope 2 GHG emission disclosure
Large accelerated filer	FY 2023 (filed in 2024)	FY 2024 (filed in 2025)	Limited assurance—2024 (filed in 2025) Reasonable assurance—2026 (filed in 2027)
Accelerated filer	FY 2024 (filed in 2025)	FY 2025 (filed in 2026)	Limited assurance—2025 (filed in 2026) Reasonable assurance—2027 (filed in 2028)
Nonaccelerated filer	FY 2024 (filed in 2025)	FY 2025 (filed in 2026)	Not required

This rule marks an inflection point in the United States: If the proposal is finalized, climate reporting would move from being largely voluntary to being regulated for publicly listed companies, with climate information to be disclosed in a consistent format and integrated into SEC filings. Standardized, reliable, and consistent climate disclosure helps investors and other stakeholders understand how climate change might affect the companies they work with, oversee, and allocate capital.

The proposal is open for public comment through June 17, 2022, which is an extension from the original date of May 20, 2022.

In addition to the SEC proposed rule on climate-related disclosure, on March 31, 2022, the International Sustainability Standards Board (ISSB) released two exposure draft standards on sustainability and climate reporting, which have similar objectives as the SEC proposed rule. We have a Heads Up article coming soon, which will summarize the ISSB exposure draft release.

Frequently asked questions

1. What is the anticipated timeline for implementation?

The proposed rule contains an implementation timeline, assuming the rule is adopted by the end of this calendar year. If the SEC meets that goal, and the proposed rule becomes effective before December 31, 2022, the compliance date for disclosure (other than Scope 3 disclosure) for calendar year-end registrants would be:

- For large accelerated filers, 2023 (filed in 2024)
- For accelerated and nonaccelerated filers, 2024 (filed in 2025)
- For SRCs, 2025 (filed in 2026)

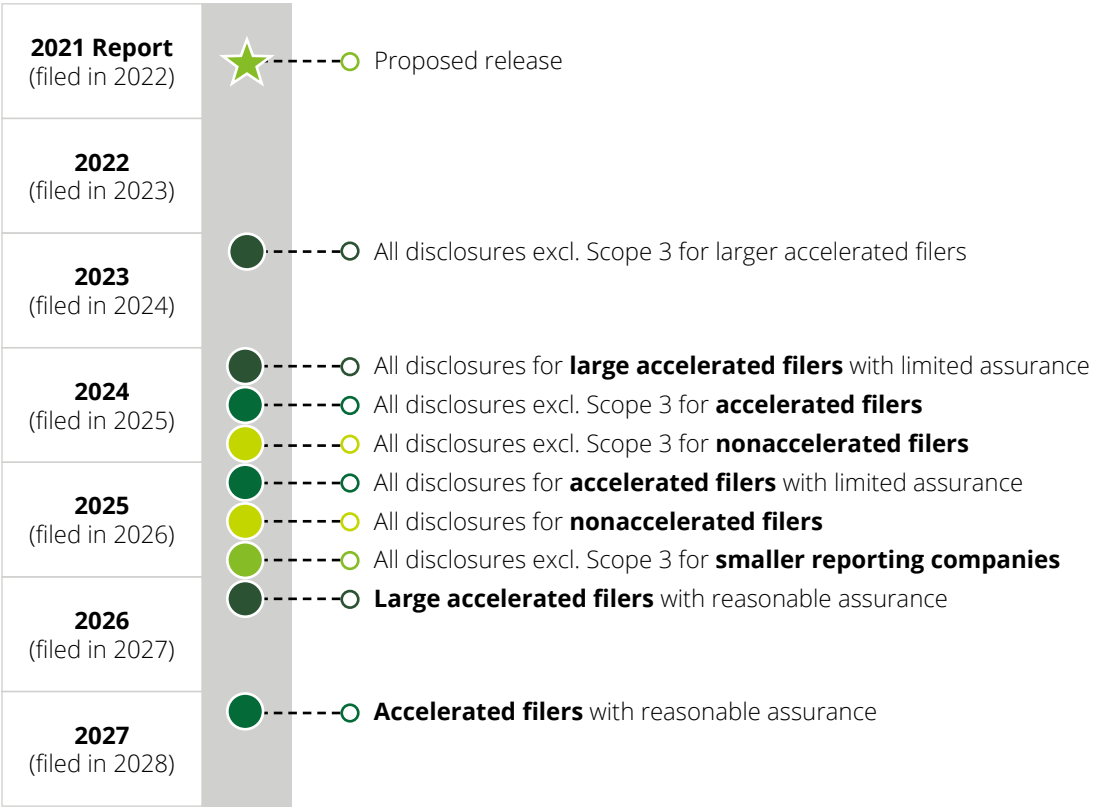
The illustrative timeline in figure 1 is for registrants with a 12/31 fiscal year end. If a company has a different fiscal year-end date that results in their fiscal year 2023 commencing before the effective date of the rules, they would not be required to comply with the requirements until the following fiscal year.

The comment period for the proposal began with the release of the proposal and ends on June 17, 2022, an extension from the original end date of May 20, 2022. The SEC may consider comments that are submitted after the deadline. There is no set time for the SEC to consider comments and develop a final rule after a proposal, and in fact, it is not obliged to move forward with a proposal. The timing of adoption of a final rule will be influenced by the nature and volume of comments received as well as additional stakeholder engagements the SEC may undertake. As noted, the SEC's implementation timeline is based on a final rule being adopted in 2022, and we expect that this is the SEC's goal, although there is no deadline for it to do so.

References

See Proposed Rule pages 1, 45-46, and 290

Figure 1. Timeline for proposed climate rule



2. How does this proposed rule define materiality?

Materiality within the proposed rule is consistent with the Commission's existing definition and the Supreme Court precedent. An item 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" (Proposed Rule, p. 64). A registrant's materiality is determined by quantitative and qualitative considerations, in addition to the probability and potential magnitude of an event occurring over the short, medium, and long term.

However, under the proposal, the Financial Impact Metrics and Expenditure Metrics under Regulation S-X (financial statement requirements), are not required only if material, but rather use a "bright line" 1% threshold to determine whether disclosure of climate impacts on financial statement line items are required. For example, if the impact of an extreme weather event on a company's fixed assets results in the damage and devaluation of those assets, and this value is 1% or greater than the fixed asset line item, a disclosure would be required. Accordingly, a company would need to have appropriate processes, procedures, and internal controls in place for tracking this information and developing the disclosures when preparing financial statements.

The requirements proposed under Regulation S-K do not identify a specific percentage threshold to assess materiality, but rather it requires disclosure of Scopes 1 and 2 GHG emissions, and Scope 3 GHG emissions, if assessed to be material by the company or if a target related to Scope 3 GHG emissions has been set. In assessing materiality of Scope 3 GHG emissions, companies most commonly perform a Scope 3 "relevancy" screening, as outlined by the GHG Protocol, to gain an understanding of the potential materiality, relevance, and sources of GHG emissions across the 15 Scope 3 categories. This may be helpful to perform (or possibly re-perform) an assessment of the materiality of Scope 3 to determine whether it should be disclosed. Further, companies may look to other external guidance relating to Scope 3 materiality, such as the Science Based Targets Initiative (SBTi) target-setting guidance. Through this guidance, a company cannot set a science-based target and exclude Scope 3 GHG emissions from the targets if Scope 3 makes up more than 40% of a company's GHG emission footprint. However, companies ultimately must ground their materiality determination in the Supreme Court definition stated above. As noted, the materiality determination must take multiple factors, both qualitative and quantitative, into account to achieve an accurate assessment. Companies should maintain documentation of their materiality considerations. Additionally, they will need to go through the effort to size and quantify their Scope 3 GHG emissions to effectively evaluate, conclude, and document materiality.

References

See Proposed Rule pages 64-65, 121, and 159-168

3. My company is already voluntarily reporting climate/ESG data. What is different now?

If the proposed rule goes into effect, for the first time in the United States, public companies will be required to disclose specific information on governance, risk management, targets, and goals, and report and obtain assurance on their impact on climate through mainstream financial filings. For companies that have been voluntarily reporting climate data, it is likely that one or more of the following third-party climate-related reporting frameworks or standards were used: Global Reporting Initiative (GRI) Standards, Greenhouse Gas (GHG) Protocol Standards, Task Force on Climate-related Financial Disclosures (TCFD) framework, and/or Sustainability Accounting Standards Board (SASB) Standards. The SEC opined in the proposal that historically the use of "multiple voluntary frameworks has failed to produce the consistent, comparable, and reliable information that investors need" (Proposed Rule, p. 29) and has led to fragmentation across reporting. The proposed rule leverages the TCFD framework and the GHG Protocol, though it does not adopt these in their entirety.

Additionally, for companies that have been voluntarily reporting climate data, currently there is no required date by which information must be reported. If the proposed rule comes into effect, the reporting timeline for all climate-related disclosures would have to align with the current SEC filing deadlines for annual reports (i.e., 60 days after fiscal year end for large accelerated filers, 75 days after fiscal year end for accelerated filers, and 90 days after fiscal year end for nonaccelerated filers). The impact of this change in reporting timing may create different methods of determining emissions, such as estimating Q4 GHG emission data.

Furthermore, the reporting boundaries would change if the proposed rule goes into effect. If a company is voluntarily reporting under the GHG Protocol, it is allowed to apply either an equity share approach or a control (financial or operational) approach to its organizational boundaries when determining which GHG emissions will be reported. Under the proposed rule, registrants already reporting under the GHG Protocol would need to revise their reporting boundary and inventory management plan to align with the consolidated financial statements. The proposed rule states that the organizational boundary, as well as any determination of if a registrant "owns or controls a particular source for GHG emissions, must be consistent with the scope of entities, operations, assets, and other holdings within its business organization . . . and [be] based upon the same set of accounting principles applicable to the registrant's consolidated financial statements" (Proposed Rule, p. 472). In other words, the proposed rule would require companies to disclose the GHG emissions of all consolidated subsidiaries as well as their share of GHG emissions for investments for which they apply either proportional consolidation or the equity method of accounting. Any entities not consolidated, proportionally consolidated, or accounted for under the equity method would be reflected in the Scope 3 GHG emission disclosures.

References

See Proposed Rule pages 29 and 472

4. We currently issue our sustainability report several months after our 10-K. How can we align the timing of reporting our Scope 1, Scope 2, and Scope 3 GHG emissions with our annual financial filing?

The proposed rule considers the fact that companies may need to adjust their reporting practices to be able to issue their GHG emissions with their 10-K according to SEC issuance timelines. The proposed rule would permit a "reasonable estimate" for Q4 GHG emission disclosures in the absence of currently available data as long as registrants "describe the assumptions underlying, and their reasons for using, the estimate" (Proposed Rule, p. 197). Additionally, companies must disclose any material differences between the actual versus estimated GHG emission data in their next filing (e.g., subsequent quarter filing). Within their annual report, they would be required to disclose any material changes between the method or significant assumptions used in the current and historical calculations. Information about GHG emissions (including any assumptions, emission factors, etc.) would be required for the most recently completed fiscal year and, if reasonably available, would need to be provided for the historical periods presented within the financial statements. The proposed rule does provide a safe harbor from liability for Scope 3 GHG emission disclosure. The SEC stated that the purpose of this safe harbor is to "alleviate concerns that registrants may have about liability for information that would be derived largely from third parties in a registrant's value chain" (Proposed Rule, p. 210) with the thought that this will encourage registrants to provide more meaningful disclosures. The proposed safe harbor would provide that disclosure of Scope 3 GHG emissions by or on behalf of the registrant would not be a fraudulent statement unless it is shown that such information was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.

References

See Proposed Rule pages 197-198 and 210-212

5. Will the new proposed rule require quarterly updates on climate disclosures?

The proposed financial statement disclosures would only be required in the annual audited financial statements (Forms 10-K or 20-F) and thus would not be included in interim financial statements filed on Form 10-Q (for domestic registrants) or Form 6-K (for foreign registrants). Specifically, under Regulation S-X, registrants would not be required to include the climate-related note to the financial statements in their Form 10-Q filing. Under Regulation S-K, they would not need to disclose GHG emissions in their Form 10-Q as they would be disclosed in the annual report.

However, the proposed rule would require companies to provide disclosure in their quarterly reports on Form 10-Q or a Form 6-K if material changes occurred since the disclosures provided within the last annual report. This may include, for example, material changes in Q4 GHG emissions if the company utilized estimates for disclosures in the annual report. The SEC posed several questions in its request for comments numbers 125 and 177 directly asking if it should be required of registrants to disclose material changes in their quarterly filings.

References

See Proposed Rule pages 205, 275, 278, and 433

6. Is there any comparative reporting that will be required in the proposed disclosures?

For Regulation S-K, the proposed rule would require "disclosure to be provided for the registrant's most recently completed fiscal year and for the historical fiscal years included in the registrant's consolidated financial statements in the applicable filing, to the extent such historical GHG emission data is reasonably available" (Proposed Rule, p. 183). Historical data may be helpful for investors to analyze a company's exposure to climate-related impacts over time as represented by the annual GHG emission data and to assess how a company is managing the climate-related risks associated with those impacts. Historical GHG emission data may be particularly helpful if a company has announced a target or goal to reduce their overall GHG emissions (i.e., decarbonization goals) by a certain date, as an investor could track the progress toward meeting this target or goal over time.

Under Regulation S-X, similar to other disclosures in the notes to the financial statements, the proposed rule states "disclosure must be provided for the registrant's most recently completed fiscal year, and for the historical fiscal year(s) included in the financial statements in the filing" (Proposed Rule, p. 452). For example, a registrant required to provide balance sheets as of the end of its two most recent fiscal years and income statements and cash flows as of the end of its three most recent fiscal years would be required to disclose two years of climate-related metrics that correspond to balance sheet line items and three years of climate-related metrics that correspond to income statement and/or cash flow statement line items.

References

See Proposed Rule pages 183 and 452

7. Are there any accommodations for a "smaller reporting company," "'emerging growth company," or private companies undertaking an IPO?

At this time, private companies are not subject to the proposed rule. However, private companies that undertake an IPO or SPAC merger, or are the target of a public company in a merger that requires the filing of a proxy statement or registration statement, would be required to comply with the proposed rule. Therefore, private companies may consider standardizing their ESG processes to the steps outlined below (see question 14). Private companies will need to consider the implications of the proposed rule on their business for the following reasons: (1) climate-related data may be requested if they do business with a public company or need access to capital (e.g., debt) and (2) there could be an expectation for companies outside of the coverage of the proposed rule to provide information to customers that are public companies or subject to disclosure.

For emerging growth companies (EGC) or small reporting companies (SRC), the proposed rules would require disclosure to be provided for the registrant's most recently completed fiscal year and for periods included in the consolidated financial statements. The SEC is not proposing to exempt EGCs, SRCs, or registrants that are foreign private issuers from the entire scope of the proposed climate-related disclosure rules "because [it] agrees with commenters who stated that, because of their broad impact across industries and jurisdictions, climate-related risks may pose a significant risk to the operations and financial condition of domestic and foreign issuers, both large and small" (Proposed Rule, p. 277). For SRCs specifically, the SEC is proposing to exempt them from the proposed Scope 3 GHG emission disclosure requirement. For ECGs and companies that were recently acquired or are targets of a possible acquisition, the SEC has posed several questions in the request for comments numbers 134, 175, 180, and 200.

References

See Proposed Rule pages 215, 277-279, and 292
See SEC Filer Size Definitions

8. What is the role of the board and governance under the proposed rule?

The proposed rule would require companies to disclose the following information about how their board of directors oversees climate-related risks:

- The specific board member(s) or board committee(s) responsible for overseeing climate-related risks.
- Whether any board member has expertise in climate-related risks and, if so, the nature of such expertise.
- The processes undertaken by the board of directors or board committee(s) to discuss climate-related risks, how those groups are informed of such risks, and how frequently such discussions occur.
- How climate-related risks are considered by the board of directors or board committee(s) "as part of its business strategy, risk management, and financial oversight."
- How the board of directors establishes climate-related targets or goals or oversees the registrant's progress toward such targets or goals.

The proposed rule emphasizes the increasing importance of the audit committee having oversight over climate-related topics, such climate related-topics being built in board charters, and the board itself having a regular cadence for discussing ESG matters. Note that the proposed rule does not indicate a requirement to appoint a chief sustainability officer.

References

See Proposed Rule pages 96-102

9. What are the obligations to disclose targets and goals?

Under the proposed rule, once a company publicly states its net-zero plans, it would be required to disclose the data, modeling, rationale, and assumptions. A company with public climate targets or goals will be required to disclose data regarding its progress toward achieving them. Perhaps more significantly, the disclosure obligation would be increased if the company's targets included Scope 3 GHG emissions. The company would then be required to disclose those GHG emissions (though it can utilize the safe harbor).

References

See Proposed Rule pages 95-96

10. How might the role of the finance organization evolve if the proposal is adopted?

As ESG disclosures continue to move from voluntary to required, the role of the finance organization (including the CFO, treasury, internal audit, accounting and reporting, and investor relations functions) will become increasingly important. Companies will need to adapt quickly to advance their high-quality ESG measurement and reporting and to drive decision-making regarding the allocation of resources. The finance organization will play a critical role in driving the enhanced rigor of a control environment. Companies that take immediate action will be better positioned to comply with any rule that is ultimately adopted, address increased investor expectation, integrate the role of assurance, and seize emerging market opportunities.

Companies should focus on governance, data processes and controls, and reporting agility to disclose data on accelerated timelines relative to historical voluntary reporting, which often lags financial filing deadlines.

For governance, the board and management oversight should be established for climate-related matters, with defined roles, responsibilities, and charters (figure 2). Having a cadence for climate-focused discussions and implementing recurring educational sessions can assist in increasing overall knowledge. For data processes and controls, the strength of processes and controls over climate-related data should be assessed, and existing financial reporting controls should be leveraged where possible. Clearly documented process flows and control matrices are crucial to be prepared for regulatory disclosure timelines. To build reporting agility, companies should standardize governance and controls by enhancing data quality, timeliness, automation, and relevance. Disclosing ESG data in a regulated matter would require applying the structure and timeliness associated with reporting financial data, which the finance organization is accustomed to.

References

SEC Climate Placemat

Figure 2.

Climate-related governance

- Establish **board oversight and top-down accountability** mechanisms to support robust control environment
- Clearly define **data owners' roles, responsibilities, and competencies**
- **Build organization capacity and train** board and management
- Incorporate climate-disclosure considerations into **data management policies and procedures**

Internal controls over climate-related data

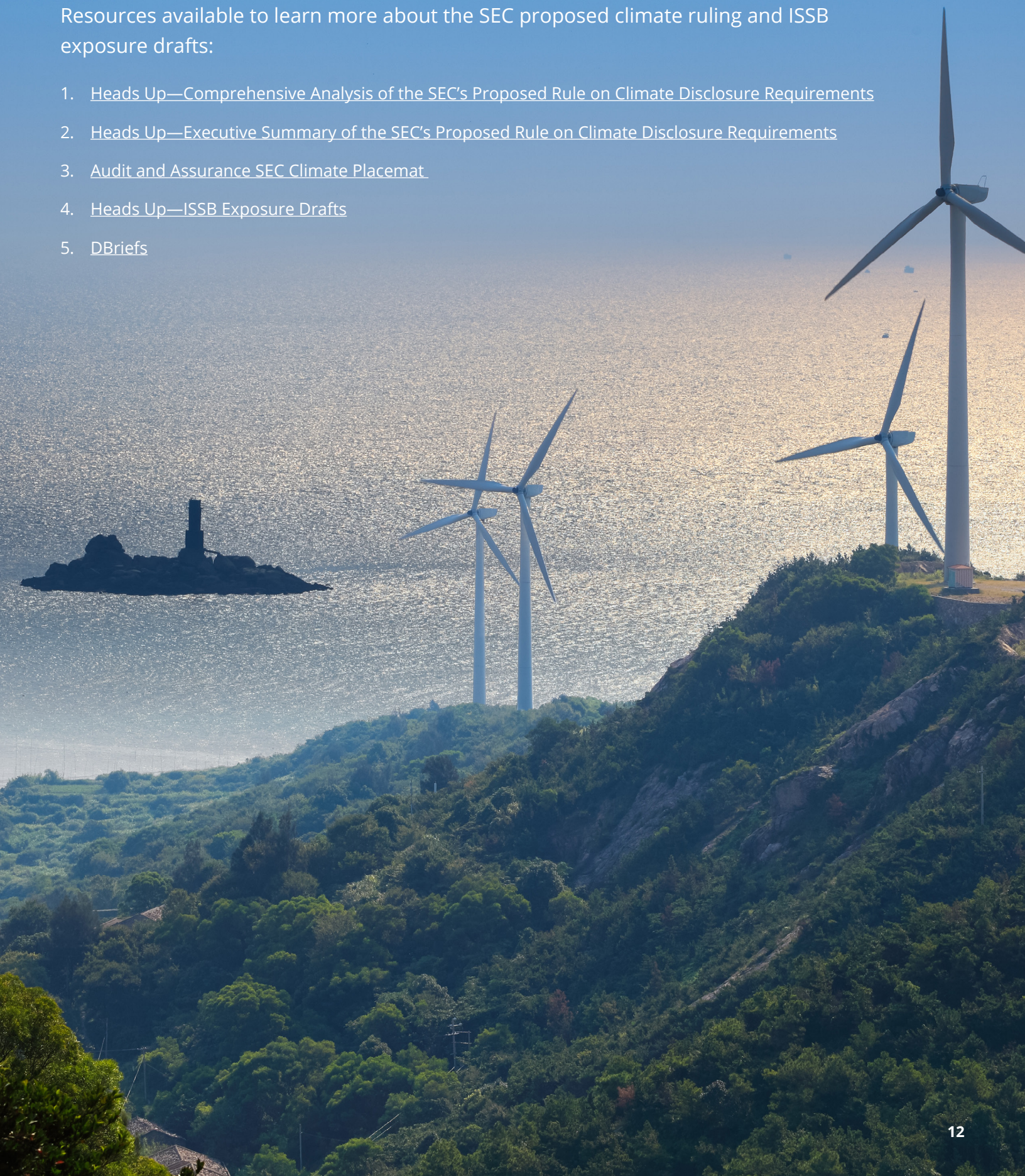
Define disclosure objectives	Assess disclosure risks	Identify controls	Evaluate effectiveness
• Establish, document, and communicate internal and external climate-related data times, aligned with financial reporting • Review current-state processes and controls around existing climate disclosure • Understand existing quantitative and qualitative data governance structures to identify gaps and meet near- and long-term reporting requirements	• Identify potential risks that could impact climate-related reporting objectives • Determine relevant data sources, systems, and process owners • Document end-to-end climate processes through narratives and flowcharts • Identify and document data and IT system limitations, assumptions, and estimates	• Evaluate maturity of existing controls to enhance data accuracy and completeness • Define internal process controls and general IT controls (GITCs) to mitigate identified climate-related risks • Document methodologies for data collection, measurement, and/or estimation (i.e., disparate data sources, varying units, conversion factors, etc.)	• Regularly assess design, implementation, and operating effectiveness of controls • Remediate control gaps and deficiencies timely, and implement ongoing process improvements • Integrate controls over climate disclosure into enterprise risk management processes and internal audit plans • Engage with external assurance provider

The SEC proposed rule calls for disclosure of GHG emissions. Scopes 1 and 2 (and Scope 3 phased in if material or if registrant has Scope 3 target) as well as certain financial statement disclosures, and qualitative and governance disclosures. The Scope 1 and Scope 2 GCG emission disclosures would be subject to limited assurance during a phase-in period, followed by reasonable assurance.

Resources

Resources available to learn more about the SEC proposed climate ruling and ISSB exposure drafts:

1. Heads Up—Comprehensive Analysis of the SEC's Proposed Rule on Climate Disclosure Requirements
2. Heads Up—Executive Summary of the SEC's Proposed Rule on Climate Disclosure Requirements
3. Audit and Assurance SEC Climate Placemat
4. Heads Up—ISSB Exposure Drafts
5. DBriefs



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