SEC ISSUES CLIMATE-RELATED RISK DISCLOSURE RULE PROPOSAL

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U.S. Policy and Regulatory Alert

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The Biden administration has prioritized environmental, social, and governance (ESG) risks to capital markets, particularly climate-related financial risks (discussed in our previous alert, Biden Administration ESG Activity Accelerates). Building on that focus, the Securities and Exchange Commission (SEC) has issued a proposed rule on "The Enhancement and Standardization of Climate-Related Disclosures for Investors." The SEC published a press release and fact sheet to accompany the proposed rule. Those wishing to comment on the proposed rule have 30 days after publication in the Federal Register, or until 20 May 2022 (60 days after the date of issuance and publication on SEC.gov), whichever period is longer.

The SEC's proposed rule not only will directly impact publicly traded companies regulated by the SEC, but given the scope of coverage, will have profound impacts across the business community in how companies consider, approach and potentially address climate change impacts.

PROPOSED RULEMAKING ON CLIMATE-RELATED DISCLOSURES

On 21 March 2022, the SEC issued a proposed rule that would require domestic and foreign issuers to include numerous climate-related disclosures in various filings. This proposed rule was approved by a vote of 3-1, with SEC Commissioner Hester Peirce as the lone dissent. The SEC's press release states that the proposed rule is "intended to enhance and standardize climate-related disclosures to address these investor needs." The SEC noted that "many issuers currently seek to provide this information to meet investor demand, but current disclosure practices are fragmented and inconsistent. The proposed rules would help issuers more efficiently and effectively disclose these risks, which would benefit both investors and issuers."

The proposed rule contains various provisions that would require registrants (other than small reporting companies) to disclose information about their Scope 1 (direct emissions) and Scope 2 (indirect emissions from purchased electricity or other forms of energy) emissions, as well as require large accelerated and accelerated filers to disclose Scope 3 emissions (upstream and downstream activities in its value chain) if they are (1) material or (2) if the registrant has included Scope 3 emissions in their overall greenhouse gas (GHG) emissions targets. The proposed rule would require accelerated and large accelerated filers to obtain an attestation report from an independent attestation service provider for Scope 1 and Scope 2 emissions disclosures.

Registrants would also be required to disclose information about their climate-related risk governance and relevant risk management processes and to discuss whether and to what extent any climate-related risks identified by the registrant have had or are likely to have a material impact on its business and consolidated financial statements. If a registrant has developed transition plans or scenario analyses, they would be required to

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disclose the relevant chosen metrics, parameters, assumptions, analytical choices, and projected principal financial impacts involved. Similarly, if a registrant has publicly announced climate-related targets or goals, the registrant would need to disclose the scope of activities and emissions included; the time by which the target is to be met; any interim target; a strategy for meeting the target; relevant data to demonstrate the registrant's progress; and whether carbon offsets or renewable energy certificates are used to achieve the goals.

Registrants would need to disclose the required climate-related information in the registration statement and any annual reports required by the Securities Exchange Act of 1934. Any information required by Regulation S-K must be disclosed in a separate section of the registration statement or annual report (appropriately titled) and disclosed under Regulation S-X in a note to the consolidated financial statements. Such data must be tagged via Inline XBRL.

Additional information on the specific parameters and requirements of the SEC's proposed rule on climate-related disclosures can be found here.

In support of this proposed rule, SEC Chairman Gary Gensler stated, “Companies and investors alike would benefit from the clear rules of the road proposed in this release. I believe the SEC has a role to play when there's this level of demand for consistent and comparable information that may affect financial performance. Today's proposal thus is driven by the needs of investors and issuers.”

Conversely, Commissioner Peirce wrote in her dissent, “We are here laying the cornerstone of a new disclosure framework that will eventually rival our existing securities disclosure framework in magnitude and cost and probably outpace it in complexity. The building project upon which we are embarking will consume our attention and enrich many, as any massive building project does. The placard at the door of this hulking green structure will trumpet our revised mission: 'protection of stakeholders, facilitating the growth of the climate-industrial complex, and fostering unfair, disorderly, and inefficient markets.' This new edifice will cast a long shadow on investors, the economy, and this agency. Accordingly, I will vote no on laying the cornerstone.”

NEXT STEPS

This proposed rule will accelerate discussions both within the Biden administration and on Capitol Hill surrounding the role of the SEC in promoting sustainability, and the extent to which registrants are, or should be, required to disclose climate-related risks and risk management. There will likely be a significant number of comment letters submitted, which the SEC will need to review and consider ahead of issuing a final rule, potentially later this year. The prospects of litigation and congressional oversight, particularly if Republicans win one or both chambers of Congress, are quite high given the breadth and substance of the rule.

While the SEC reviews comments, President Biden could nominate two commissioners to fill the currently vacant spot and to replace outgoing Commissioner Allison Herren Lee. It is possible these nominees may be confirmed in time to vote on the final rule.

To assist our clients in staying abreast of important ESG developments, K&L Gates has established a dedicated ESG webpage to synergize robust ESG services in an integrated, multidisciplinary structure.

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