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SEC Issues New Proposed Rules for Climate Change Disclosures

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At the urging of investors and in accordance with the Biden Administration's climate agenda, the United States Securities and Exchange Commission ("*SEC*") yesterday issued long-awaited new proposed rules to increase climate-related disclosures. The *Enhancement and Standardization of Climate-Related Disclosures for Investors* (the "*Proposed Rule*"), if finalized, would amend the SEC's rules under the Securities Act of 1933 and Securities Act of 1934 to require that registrants provide robust climate related information in their registration statements and annual reports. Although the rule would apply to domestic and foreign companies required to be registered with the SEC, it would also be likely to indirectly affect non-registrants who are in the supply chain of a disclosing company.

This rulemaking represents a significant step for the SEC as growth in Environmental, Social, and Governance ("*ESG*") investing has skyrocketed in recent years with little to no oversight or structure. Through its proposal, the SEC aims to provide "[c]onsistent, comparable and reliable disclosures" on climate-related risks and metrics to serve both investors and capital markets.

The proposed rule is available here. A summary is below.

Background

The SEC first provided guidance on climate-related disclosures in 2010. That guidance suggested that registrants under certain circumstances include information about climate change-related risks and opportunities in disclosures related to the registrant's business description, risk factors, legal proceedings, and management discussion. The SEC recognizes that while many companies currently disclose climate-related risks pursuant to the 2010 guidance and voluntarily through third-party frameworks, those disclosures are fragmented and inconsistent. Further, the SEC expressed concern that much of the climate-related information being provided to investors appears outside of securities filings, including in sustainability reports and on corporate websites.

Proposed Rule

The Proposed Rule, which is modeled in part on the Task Force on Climate-Related Financial Disclosure ("*TCFD*") recommendations, includes significant new climate-related disclosure requirements. The rule would require registrants to disclose information on the oversight and governance of climate-related risks, how such risks could have a material impact on the registrant's business, how climate risk has affected or may affect the registrant's strategy, how climate-related risks are managed, and the impact of climate-related events and transition activities on the registrant's financial statements.

The Proposed Rule would also for the first time require that registrants disclose greenhouse gas ("*GHG*") emission metrics that could help investors assess climate risks. Such disclosures must include metrics for measuring these risks, including the registrants' direct GHG emissions (Scope 1), indirect GHG emissions from purchased energy sources (Scope 2), and GHG emissions from upstream or downstream in a registrant's value chain (Scope 3) if such emissions are material or where the registrant has set goals related to Scope 3 emissions. Further, registrants with publicized goals or targets related to climate risks would be required to provide information detailing the scope, strategies, and timelines for meeting and measuring those goals. The SEC is also proposing to add a new article to Regulation S-X that would require certain climate-related financial statement metrics and related disclosures to be included in a note to a registrant's audited financial statements.

Under the Proposed Rule, registrants would file mandated climate-related disclosures in dedicated sections of the registration statement or annual report and in a note to its consolidated financial statements. In addition, an attestation report from an independent provider would be required for large or accelerated filers covering the disclosure of its Scope 1 and Scope 2 emissions. The attestation service provider need not be a registered public accounting firm.

In an attempt to mitigate the disclosure burden on registrants, the Proposed Rule includes a liability safe harbor for Scope 3 emission disclosures and a Scope 3 exemption for smaller reporting companies. The safe harbor under the Securities Act and Exchange Act would also remain to the extent such disclosures include forward looking statements.

What's Next

The requirements of the Proposed Rule would phase-in with the applicable compliance date depending on the registrant's filer status beginning in fiscal year 2023. An additional phase-in period is provided for Scope 3 emissions.

The Proposed Rule is subject to public comment for the longer of thirty (30) days after publication in the Federal Register or May 20, 2022. The SEC may further revise the rule upon receipt of comments before finalizing it. Once finalized, the rule could then be subject to legal challenges in court. Some registrants had voiced particular concern about any rulemaking that would require them to disclose Scope 3 emissions prior to the rulemaking. It remains to be seen whether the safe harbor protections set forth in the Proposed Rule are sufficient to alleviate those concerns.

For More Information

Please contact Kristin Parker or the Chapman attorney with whom you regularly work, or visit our ESG Counsel and Sustainable Finance resources at chapman.com.

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