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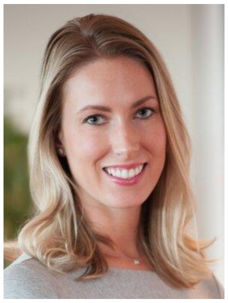
SEC's Final Climate Disclosure Rules: What Cos. Must Know

By **Celia Soehner and Erin Martin** (March 12, 2024, 6:06 PM EDT)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In a historic rulemaking, the U.S. Securities and Exchange Commission on March 6 adopted rules that require public companies to disclose certain climate-related information in registration statements and annual reports.

While the new rules are significant, there were notable revisions and deviations from the proposed rules in the final rules, and the SEC modified its stance articulated in the proposing release that climate-related disclosure was material for all public companies, regardless of industry or size.

The final rules also include a phased compliance runway that is based on a registrant's filer status and the content of the disclosure. The SEC initially proposed rules to require registrants to provide climate-related disclosure in registration statements and periodic reports on March 21, 2022.[1]

The proposed rules marked the first time that the SEC definitively indicated that it viewed climate-related disclosure as material information that all public companies must provide, regardless of industry or size. Additionally, they followed over a decade of increasing focus on climate-related disclosures by the SEC.

For example, the agency published guidance in 2010 that outlined how its existing rules may require narrative climate-related disclosure, including through a discussion of business development, risks, litigation and results of operations.[2] In 2021, the then acting chair released a statement soliciting public input on climate change disclosures.[3]

Later that year, the SEC's Division of Corporation Finance, which is tasked with primary oversight of public issuers' disclosures, published a sample letter to public companies outlining the types of climate-related disclosure issues that public company issuers should consider.[4]

The agency also underscored its stance on the materiality of climate and environmental, social and governance disclosures through the creation of a climate and ESG task force within its Division of Enforcement.[5]

Today's final rules, adopted after a nearly two-year waiting period, reflect a clear desire from the SEC to have public companies provide climate risk disclosure that is consistent, reliable and comparable — although it remains to be seen exactly how comparable such disclosures ultimately will be.

We also saw an acknowledgment from the SEC as to the time and effort that will be incurred in complying with the final rules, as evidenced by scaled-back disclosures and phased-in compliance dates, as well as the elimination of GHG emission disclosure requirements for smaller reporting companies, emerging growth companies and nonaccelerated filers.

Significant Deviations From Proposed Rules

There were a number of significant deviations from the proposed rules that culminated in a scaled-back set of final rules. This approach may result in decreased compliance costs for some public companies, although SEC Commissioner Hester Peirce was quick to note during her dissenting statement that she believed the final rules would increase the cost of being a public company by 21%.[6]

The following are some highlights of the revisions that the SEC made between the proposed rules and the final rules.

No Scope 3 Disclosures

As predicted, the SEC removed the requirement that issuers disclose Scope 3 emissions, which are indirect greenhouse gas emissions from upstream and downstream activities in a company's value chain.

Limitations on Scope 1 and 2 Disclosures

Rather than a universal requirement that all issuers need to disclose Scope 1 and Scope 2 GHG emissions, the final rule requires that only large accelerated filers and accelerated filers provide material Scope 1 and Scope 2 GHG disclosures.

Smaller reporting companies and emerging growth companies will be exempt from any requirement to disclose their GHG emissions or obtain an attestation report, as described in more detail below.

Delays Allowed in Annual GHG Reporting

The final rules will allow affected issuers to provide Scope 1 and Scope 2 GHG emissions disclosures in their second quarterly report to be filed after their fiscal year-end, based on concerns that it would have been too difficult to provide such information by the due date for an annual report.

For U.S. issuers, this can be provided in the second-quarter Form 10-Q, or in an amendment to Form 10-K.

Flexibility on Placement

The final rules leave the placement of climate-related disclosures, other than the new financial statement disclosures, largely up to each registrant. The proposed rules would have required the attestation report and relevant disclosures in a separately captioned "Climate-Related Disclosure" section in the applicable filing.

Instead, under the final rules, companies will have the flexibility to either present the new disclosures in a separately captioned section, or place the majority of the new disclosures in applicable, currently existing parts of their registration statement or annual report.

Where appropriate, registrants should consider the use of cross-references within the registration statement or report, to assist in readability. Companies also will be allowed to incorporate by reference some of the climate-related disclosures from previously filed disclosures, as applicable.

Notably, however, registrants will not be able to incorporate by reference disclosures required in annual reports on Form 10-K from the proxy statement, as is currently allowed for Part III of Form 10-K information.

Modified Risk Disclosures

Similar to the removal of Scope 3 disclosures, the final rules modified climate-related risk disclosures to eliminate discussion of negative climate-related impacts on a registrant's value chain. Thus, registrants can independently determine and disclose, as appropriate, whether such negative impacts on its value chain will reasonably materially affect their business, results of operations or financial condition.

The final rules also reflect revisions to disclosure requirements to more closely align with terminology and concepts baked into existing disclosure requirements, such as Item 303 of Regulation S-K.

Scaled-Back Governance Disclosures

In response to concerns raised by commentators, the SEC also scaled back certain corporate governance disclosures, and, similarly to the recent cybersecurity disclosure rules, emphasized that the climate rules are not intended to mandate a specific corporate governance structure or risk-management methodology.

Rather, the final rules focus on the disclosure of a registrant's existing or developing climate-related risk governance practices.

In particular, companies will not need to identify relevant expertise of board members, the specific board members responsible for climate-related risk, the frequency of reporting climate-related risks to the board, or how the board sets climate-related targets or goals.

But registrants will be required to describe whether and how the board oversees progress against disclosed climate-related targets, goals or transition plans.

The Final Rules

Positioned as a continuation of the commission's 2010 guidance, the final rules require the following climate-related disclosures by public companies, as described in the official fact sheet about the rules.[7]

Climate-Related Risk Disclosures

- "Climate-related risks that have had or are reasonably likely to have a material impact on the registrant's business strategy, results of operations, or financial condition";
- "The actual and potential material impacts of any identified climate-related risks on the registrant's strategy, business model, and outlook";

- "If, as part of its strategy, a registrant has undertaken activities to mitigate or adapt to a material climate-related risk, a quantitative and qualitative description of material expenditures incurred and material impacts on financial estimates and assumptions that directly result from such mitigation or adaptation activities"; and

- "Specified disclosures regarding a registrant's activities, if any, to mitigate or adapt to a material climate-related risk including the use, if any, of transition plans, scenario analysis or internal carbon prices."

Risk Management and Oversight of Climate-Related Risk

- "Any processes the registrant has for identifying, assessing, and managing material climate-related risks, and, if the registrant is managing those risks, whether and how any such processes are integrated into the registrant's overall risk management system or processes"; and

- "Any oversight by the board of directors of climate-related risks and any role by management in assessing and managing the registrant's material climate-related risks."

Climate-Related Targets or Goals Disclosure

- "Information about a registrant's climate-related targets or goals, if any, that have materially affected or are reasonably likely to materially affect the registrant's business, results of operations or financial condition. Disclosures would include material expenditures and material impacts on financial estimates and assumptions as a direct result of the target or goal or actions taken to make progress toward meeting such target or goal."

GHG Disclosure

- "For large accelerated filers ... and accelerated filers ... that are not otherwise exempted, information about material Scope 1 and Scope 2 emissions";[8][9] and

- "For those required to disclose Scope 1 and/or Scope 2 emissions, an assurance report at the limited assurance level, which, for an LAF, following an additional transition period, will be at the reasonable assurance level."

Financial Statement Disclosure

- "The capitalized costs, expenditures expensed, charges, and losses incurred as a result of severe weather events and other natural conditions, such as hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures, and sea level rise, subject to applicable one percent and de minimis disclosure thresholds, disclosed in a note to the financial statements";

- "The capitalized costs, expenditures expensed, and losses related to carbon offsets and renewable energy credits or certificates ... if used as a material component of a registrant's plans to achieve its disclosed climate-related targets or goals, disclosed in a note to the financial statements"; and

- "If the estimates and assumptions a registrant uses to produce the financial statements were materially impacted by risks and uncertainties associated with severe weather events and other natural conditions or any disclosed climate-related targets or transition plans, a qualitative description of how the development of such estimates and assumptions was impacted, disclosed in a note to the financial statements."

Key Compliance Dates

Large Accelerated Filers	**Fiscal Year Beginning in Calendar Year 2025**
	Majority of Regulation S-K and Regulation S-X Disclosure
	Fiscal Year Beginning in Calendar Year 2026
	• Regulation S-K Item 1502(d)(2)[10]
	• Regulation S-K Item 1502(e)(2)[11]
	• Regulation S-K Item 1504(c)[12]
	• Scope 1 and 2 GHG emission information
	• Inline XBRL data tagging for subpart 1500
	Fiscal Year Beginning for Calendar Year 2029
	• Item 1506 limited assurance attestation (if applicable)
	Fiscal Year Beginning for Calendar Year 2033
	• Item 1506 reasonable assurance attestation (if applicable)
Accelerated Filers	**Fiscal Year Beginning in Calendar Year 2026**
	• Majority of Regulation S-K and Regulation S-X disclosure
	• Inline XBRL data tagging for subpart 1500
	Fiscal Year Beginning in Calendar Year 2027
	• Regulation S-K Item 1502(d)(2)
	• Regulation S-K Item 1502(e)(2)
	• Regulation S-K Item 1504(c)
	Fiscal Year Beginning for Calendar Year 2028
	- Scope 1 and 2 GHG emission information
	Fiscal Year Beginning for Calendar Year 2031
	• Item 1506 limited assurance attestation (if applicable)
Smaller reporting companies, emerging growth companies and non-accelerated filers	**Fiscal Year Beginning in Calendar Year 2027**
	• Majority of Regulation S-K and Regulation S-X Disclosure
	• Inline XBRL data tagging for subpart 1500
	Fiscal Year Beginning in Calendar Year 2028
	- Regulation S-K Item 1502(d)(2)
	- Regulation S-K Item 1502(e)(2)
	- Regulation S-K Item 1504(c)

The final rules will become effective 60 days after publication in the Federal Register, and compliance will be phased in gradually based on the size of the issuer and the following specific disclosure requirements.

References to "the fiscal year beginning" mean that the disclosure will need to capture that applicable year. Therefore, for U.S. calendar-year-end issuers that are also large accelerated filers, the first disclosure requirements will be in effect for Forms 10-K for the fiscal year ending Dec. 31, 2025, to be filed in early 2026.

Key Issues to Consider

The SEC's final rules, while significantly deviating from the proposed rules, attempt to reflect a balanced approach that acknowledges the challenges, both structural and financial, faced by public companies in complying with the new requirements.

For example, the decisions to exempt smaller reporting companies and emerging growth companies from emissions disclosure, and only require Scope 1 and 2 emissions based on filer status and materiality to the specific filer, do provide meaningful relief to the former category, and flexibility for the latter in compliance.

The materiality analysis, however, may pose challenges for companies that have voluntarily provided similar disclosure in the past, either in SEC filings or through other media. Companies will have to balance their materiality assessment with other regulatory requirements, including state and international law, that may also be applicable.

For example, recently adopted climate-related regulations in California — which currently require, depending on the resolution of legal challenges, Scope 3 emissions disclosures — have the potential to affect a significant portion of public companies that do business in the state.

Additionally, multinational public companies with operations outside the U.S. may need to comply with the European Union's Corporate Sustainability Reporting Directive, which, similar to the recent California legislation, requires more expansive disclosures.

Finally, it remains to be seen how deferential the SEC ultimately will be on the question of materiality for some companies. In recent years, the commission's Division of Corporation Finance has increasingly issued comment letters to issuers relating to climate-related disclosures and materiality.

As companies navigate the phased-in compliance runway, careful consideration will need to be made as to filer status, which may fluctuate year-to-year because companies are required to assess market capitalization for purposes of filer status on the last business day of the most recently completed second fiscal quarter, and loss of emerging growth status.

Although the compliance dates provide a relatively clear timeline for companies to adapt to these changes, companies, their boards and other trusted advisers should begin discussions as soon as possible to develop or revise current policies and procedures to ensure compliance. Companies that have already implemented such policies and procedures should begin stress-testing them now, to preempt any issues once these rules come into force.

Additionally, while the modifications in governance disclosures and risk management requirements in the final rules support the SEC's stated intention to encourage responsible climate-related practices without prescribing a one-size-fits-all approach, the anticipation of publicly disclosed information regarding such practices may also prompt companies to make significant changes to their governance and oversight functions. An early, meaningful and holistic approach to these considerations is necessary.

The implications of these new rules for public companies are vast, and emphasize the increasing significance of ESG considerations and sustainability in the future of corporate governance and investment decision making.

Much attention will be given to legal challenges against this rule, including the coalition of states that, within hours of adoption, filed a petition with the U.S. Court of Appeals for the Eleventh Circuit requesting emergency action. Although we expect the SEC to seek to protect the new rules from successful legal challenges, recent court decisions have not fallen in favor of the SEC.

These include the U.S. Court of Appeals for the Fifth Circuit's December 2023 decision, in Chamber of Commerce v. SEC, to vacate the commission's share repurchase disclosure rule, and the U.S. Court of Appeals for the D.C. Circuit's August 2023 finding, in Grayscale Investments LLC v. SEC, that the commission acted arbitrarily and capriciously when it disapproved the listing of a proposed spot bitcoin exchange-traded product.

But the resolution of any legal challenge is far too difficult to predict at this nascent stage. Thus, it will be prudent for companies to begin preparations, and resist prematurely delaying such actions while any legal challenges are adjudicated.

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[1] See The Enhancement and Standardization of Climate-Related Disclosures for Investors, 33-11042 (March 21, 2022).

[2] See Commission Guidance Regarding Disclosure Related to Climate Change, 33-9106 (Feb. 8, 2010).

[3] See Lee, Allison Herren, Acting Chair, SEC, Statement: Public Input Welcome on Climate Change Disclosures (March 15, 2021).

[4] See SEC Division of Corporation Finance, Sample Letter (Sept. 2021).

[5] See Press Release, SEC, SEC Announces Enforcement Task Force Focused on Climate and ESG Issues (March 4, 2021).

[6] https://www.sec.gov/news/statement/peirce-statement-mandatory-climate-risk-disclosures-030624.

[7] https://www.sec.gov/files/33-11275-fact-sheet.pdf.

[8] Large accelerated filers are public companies with at least $700 million market capitalization.

[9] Accelerated filers are public companies with at least $75 million, but less than $700 million, market capitalization.

[10] Regulation S-K Item 1502(d)(2) will require a registrant to describe quantitatively and qualitatively the material expenditures incurred and material impacts on financial estimates and assumptions that, in management's assessment, directly result from activities to mitigate or adapt to climate-related risks disclosed pursuant to Item 1502(b)(4).

[11] Regulation S-K Item 1502(e)(2) will require a registrant, as part of its updating disclosure under a transition plan, to include quantitative and qualitative disclosure of material expenditures incurred and material impacts on financial estimates and assumptions as a direct result of the disclosed actions taken under the plan.

[12] Regulation S-K Item 1504(c) will require a registrant to disclose any progress toward meeting a climate-related target or goal (if such target or goal is material) and how such progress has been achieved.