THREADING THE NEEDLE: THE US SECURITIES AND EXCHANGE COMMISSION'S FINAL CLIMATE-RELATED DISCLOSURE RULES

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US Corporate Alert

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On 6 March 2024, by a 3-2 vote of the Commissioners split along party lines, the US Securities and Exchange Commission (SEC) adopted "The Enhancement and Standardization of Climate-Related Disclosures for Investors" final disclosure rules. No other SEC rulemaking in recent history has received as much attention as the climate-related disclosure rules. When preparing the final rules, the SEC had the onerous task of not only reviewing over 24,000 comment letters but crafting the final rules so that they could withstand the inevitable legal challenges while also trying to satisfy growing demands for climate-related disclosures.

The final rules seek to address the question of what climate-related disclosures, including climate-related risks faced by a company, should be publicly disclosed, a question that has been the subject of significant public attention and political controversy. The final rules seek to thread the needle between the two sides of this debate by adopting a pared-down set of final rules, which qualify many of the disclosure requirements by materiality while preserving the foundational idea that material climate-related disclosures are important to investors. Did the SEC successfully thread the needle with the final rules? Only time will tell, depending on the outcome of the legal challenges and whether investors ultimately receive useful information that is "consistent, comparable, and reliable" regarding a company's climate-related disclosures that allows them to make more informed investment decisions.

KEY CHANGES FROM THE PROPOSED RULES

The final rules make several changes from the proposed rules, including:

- Qualifying several disclosure requirements by materiality;
- Eliminating a number of prescriptive disclosure requirements in favor of a more principles-based approach;
- Deleting the requirement to provide a description of board members' climate-related expertise;
- Requiring only larger companies to disclose Scope 1 and Scope 2 GHG emissions and only when material;
- Eliminating the requirement to disclose Scope 3 GHG emissions for all companies;
- Relaxing and extending the requirement to receive third-party assurance for GHG emissions disclosures; and

- Replacing line-item financial statement disclosure of financial impact metrics with disclosure of a discrete set of actual expenses that companies incur and can attribute to severe weather events and other natural conditions.

DISCLOSURES REQUIRED BY THE FINAL RULES

The main thrust of the final rules was adding a new subpart 1500 to Regulation S-K and a new Article 14 to Regulation S-X, which will require public companies to disclose the following information:

Topic	Required Disclosures
Governance (Item 1501 of Regulation S-K)	A description of the board's oversight of climate-related risks, including, if applicable, identifying any board committee or subcommittee responsible for oversight of these risks and the process by which they are informed about such risks. The disclosure should discuss whether and how the board oversees progress related to a target or goal or a transition plan (both as required to be disclosed pursuant to Item 1504 and 1502(e)(2), respectively, of Regulation S-K). A description of management's role in assessing and managing material climate-related risks. The disclosure should discuss, as applicable, the following nonexclusive items: (1) the management positions or committees responsible for assessing and managing climate-related risks and their relevant expertise; (2) the processes by which they assess and manage climate-related risks; and (3) whether they report information to the board or to a committee or subcommittee of the board.
Strategy (Item 1502 of Regulation S-K)	A description of any climate-related risks that have materially impacted or are reasonably likely to have a material impact on the company, including on its strategy, results of operations, or financial condition. The description should include a discussion of whether such risks are reasonably likely to manifest in the next 12 months or beyond the next 12 months; whether the risk is a physical risk or transition risk (including certain aspects about each type of risk); and how such risks have materially impacted or are reasonably likely to materially impact the company's business, results of operations, or financial condition. A company should also discuss the actual and potential material impacts of any climate-related risk on its strategy, business model, and outlook, and whether it considers these impacts as part of its strategy, financial planning, and capital allocation. If the company has adopted a transition plan to manage a material transition risk, it should include a description of the plan. Similarly, a company must describe each scenario if it uses scenario analysis to assess the impact of climate-related risks on its business, results of operations, or financial condition and if it determines that such risk is reasonably likely to have a material impact on its business, results of operations, or financial condition. A company must also provide disclosures regarding internal carbon price to the extent material to how it evaluates and manages a climate-related risk. The safe harbors for forward-looking statements in Section 27A of the Securities Act of

	1933 and Section 21E of the Securities Exchange Act of 1934 apply to the disclosures provided pursuant to Item 1502(e) (Transition Plans), Item 1502(f) (Scenario Analysis), and Item 1502(g) (Internal Carbon Price).
Risk Management (Item 1503 of Regulation S-K)	A description of any processes for identifying, assessing, and managing material climate-related risks. The disclosure should discuss, as applicable, the following nonexclusive items: (1) how the company identifies whether it has incurred or is reasonably likely to incur a material physical or transition risk; (2) how the company decides whether to mitigate, accept, or adapt to the particular risk; and (3) how the company prioritizes whether to address the climate-related risk. If the company is managing a material climate-related risk, the company must disclose whether and how any processes described above have been integrated into its overall risk management system or processes.
Targets and Goals (Item 1504 of Regulation S-K)	A company must disclose any climate-related target or goal if it has materially affected or is reasonably likely to materially affect its business, results of operations, or financial condition. The disclosure should include a discussion of any progress made towards meeting the target or goal, how such progress has been achieved, and certain information regarding any carbon offsets or renewable energy credits or certificates (RECs) that have been used as a material component to achieve climate-related targets or goals. In the discussion regarding the progress made toward meeting the target or goal, a company should (1) include a discussion of any material impacts to its business, results of operations, or financial condition as a direct result of the target or goal or the actions taken to make progress toward meeting the target or goal, and (2) include quantitative and qualitative disclosure of any 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 the target or goal. The safe harbors for forward-looking statements in Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 apply to the disclosures provided pursuant to Item 1504 of Regulation S-K.
Greenhouse Gas (GHG) Emission Metrics (Item 1505 of Regulation S-K)	Large accelerated filers and accelerated filers are required to disclose, if material, Scope 1 emissions and Scope 2 emissions, each expressed in the aggregate and on a gross basis excluding the impact of purchased or generated offsets. This disclosure should be provided for the most recently completed fiscal year and for any historical years previously disclosed in an SEC filing and describe the methodology, significant inputs, and significant assumptions used to calculate the emissions disclosed. The emissions disclosures are to be included in the annual report but can be incorporated by reference from the second quarter Form 10-Q or included in an amendment to the annual report such that companies generally have until early August of the following year to

	provide this information.
Attestation of Scope 1 and Scope 2 Emissions Disclosures (Item 1506 or Regulation S-K)	Large accelerated filers, beginning in the third fiscal year after the compliance date for providing emission disclosures, must have an attestation report covering Scope 1 and Scope 2 emissions disclosures at a limited assurance level. Beginning in the seventh fiscal year after the compliance date for providing emissions disclosures and thereafter, large accelerated filers must have an attestation report covering Scope 1 and Scope 2 emissions disclosures at a reasonable assurance level. Accelerated filers, beginning in the third fiscal year after the compliance date for emissions disclosures, must have an attestation report covering Scope 1 and Scope 2 emissions disclosures at a limited assurance level. There is no requirement for accelerated filers to provide an attestation report at the reasonable assurance level. The final rules include certain requirements for GHG emissions attestation providers as well as attestation report requirements and certain additional disclosures that must be provided by a company in connection with the attestation report.
Severe Weather Events and Other Information (Article 14 of Regulation S-X)	A company must provide, in the notes to the financial statements, disaggregated financial information resulting from the impact of severe weather events and other natural conditions such as hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures, and sea level rise. ▪ The information must include the amount of expenditures expensed as incurred and losses, excluding recoveries, incurred during the fiscal year if the aggregate amount exceeds 1% of the absolute value of income or loss before income tax expense or benefit for the relevant fiscal year. No disclosure is required if the aggregate amount is less than US$100,000. ▪ The information must also include the amount of capitalized costs and charges, excluding recoveries, incurred in the fiscal year if the aggregate amount exceeds 1% of the absolute value of stockholders' equity or deficit as of the end of the relevant fiscal year. No disclosure is required if the aggregate amount is less than US$500,000. If carbon offsets or RECs are used as a material component of a company's plan to achieve its disclosed climate-related targets or goals, the company must disclose: (1) the aggregate amount of carbon offsets and RECs expensed during the fiscal year; (2) the aggregate amount of capitalized carbon offsets and RECs recognized during the fiscal year; (3) the aggregate amount of losses incurred on the capitalized carbon offsets and RECs during the fiscal year; and (4) the beginning and ending balances of capitalized carbon offsets and RECs for the fiscal year. These disclosures must be included in any filing that requires audited financial statements and the information called for by subpart 1500 of Regulation S-K and must be provided for a company's most recently completed fiscal year and to the extent previously disclosed or

	required to be disclosed for the historical years for which audited financial statements are included in the filing.

COMPLIANCE DATES

The compliance dates for the disclosures set forth in the final rules are as follows:

Registrant Type	Disclosure and Financial Statement Effects Audit		GHG Emissions / Assurance			Electronic Tagging
	All Reg. S-K and S-X disclosures, other than as noted in this table	Item 1502(d)(2), Item 1502(e)(2), and Item 1504(c)(2) of Reg. S-K*	Item 1505 (Scopes 1 and 2 GHG emissions)	Item 1506 – Limited Assurance	Item 1506 – Reasonable Assurance	Item 1508 – Inline XBRL tagging for subpart 1500
Large Accelerated Filers	Fiscal Year Beginning (FYB) 2025	FYB 2026	FYB 2026	FYB 2029	FYB 2033	FYB 2026
Accelerated Filers	FYB 2026	FYB 2027	FYB 2028	FYB 2031	N/A	FYB 2026
Smaller Reporting Companies, Emerging Growth Companies, and Non-Accelerated Filers	FYB 2027	FYB 2028	N/A	N/A	N/A	FYB 2027

** Item 1502(d)(2) of Regulation S-K requires a company 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, including the adoption of new technologies or processes. Item 1502(e)(2) requires a company to include quantitative and qualitative disclosure of material expenditures incurred and material impacts on financial estimates and assumptions as a direct result of any disclosed transition plan. Item 1504(c)(2) requires a company to include quantitative and qualitative disclosure of any material expenditures and material impacts on financial estimates and assumptions as a direct result of the target or goal or the actions taken to make progress toward meeting the target or goal.*

LEGAL CHALLENGES

As noted above, the final rules are not without controversy. It will be expensive for companies to comply with the disclosures required under the final rules, and the SEC's own estimates of the cost to comply with the final rules is in the hundreds of thousands of US dollars for a company. In addition, the final rules raise certain legal questions relating to the authority of the SEC to adopt the final rules, the process by which the final rules were adopted, and whether the proposed disclosure requirements are impermissible compelled speech under the First Amendment to the US Constitution.

The final rules are already subject to legal challenges. On 6 March (the day the final rules were adopted), 10 state attorneys general (AGs) from Alabama, Alaska, Georgia, Indiana, New Hampshire, Oklahoma, South Carolina, Virginia, West Virginia, and Wyoming filed a petition for review of the final rules in the US Court of Appeals for the Eleventh Circuit. As stated in the petition, the AGs argue that the final rules exceed the SEC's authority and are "arbitrary, capricious, an abuse of discretion, and not in accordance with law." Additionally, on 8 March, three AGs from Louisiana, Mississippi, and Texas challenged the final rules in the US Court of Appeals for the Fifth Circuit. It is likely that other industry groups representing a variety of stances with respect to the rule, such as the US Chamber of Commerce and the Sierra Club, may also file suit against the rule.

WHAT COMPANIES SHOULD DO NOW

While it is still uncertain if and when the final rules will become effective given the current and anticipated legal challenges, particularly in light of the success of recent challenges to the "Share Repurchase Disclosure Modernization" rules, companies should still prepare to provide the disclosures required by the final rules. Given the sheer magnitude of the disclosures required by the final rules, they will require significant data-gathering and preparation. Even though the final rules qualify many of the disclosures by materiality, companies will nonetheless need to undertake a materiality analysis which may be complex and uncertain given that these are new disclosure rules with no history or precedent that can be considered.

Create a timeline and responsibilities checklist for new disclosures required by the final rules

In order for a company to prepare to make disclosures under the final rules, it should prepare a timeline and responsibilities checklist for the new disclosures. By mapping out which disclosures a company is required to provide, the timeline for making those disclosures and the persons or management committees responsible for preparing those disclosures, it will begin to create the road map it needs to be ready to comply with the final rules if and when they become effective.

Review previous climate-related disclosures

If it has not already done so, a company should inventory its previous climate-related disclosures, both in and outside of its SEC filings. Given that several disclosure requirements in the final rules require a company to provide such disclosures if it has previously done so in an SEC filing, a company needs to understand what climate-related disclosures it has previously made in such filings. Additionally, given the qualification of many of the disclosures in the final rules by materiality, having a full inventory of all climate-related disclosures previously made can help a company as it performs a materiality assessment of its climate-related risks.

Review disclosure controls and procedures and internal controls over financial reporting

Given the new disclosures required by subpart 1500 of Regulation S-K and Article 14 of Regulation S-X, companies should begin to review their disclosure controls and procedures and their internal controls over financial reporting with respect to these new requirements.

Board oversight of and management's role in assessing and managing climate-related risks

Given the new disclosure requirements regarding the board's oversight of and management's role in assessing and managing climate-related risks, a company should review its climate-related governance and consider what changes, if any, need to be made in the allocation of oversight responsibilities by the board and in its management's roles and committees.

For large accelerated filers and accelerated filers, determine whether Scope 1 and Scope 2 emissions will be material

As noted above, Scope 1 and Scope 2 emissions disclosures are required for large accelerated filers and accelerated filers, if material. A critical step for these companies will be to perform their own assessment of their Scope 1 and Scope 2 emissions against their overall operations, which may require gathering information that companies currently do not collect. The process of considering materiality, which is based on the established standards of whether information is material to a voting or investment decision or significantly alters the total mix of information, may be deceptively complex and subject to further guidance and interpretation.

Attestation providers

To the extent a company that is a large accelerated filer or an accelerated filer does not already have an attestation provider or has not previously sought to engage an attestation provider, it should begin a search. While the assurance requirements may seem far off, it will take time to hire an attestation provider, understand what information it needs to be able to provide the attestation, and prepare for such attestation. Considering the number of companies that will need to hire an attestation provider for their emissions disclosures, certain attestation providers may not be able to take on a new client as the compliance dates for the attestation requirements become closer.

Continue focusing on other climate-related disclosures

The final rules did not preempt any other climate-related disclosures such as those required by other states (e.g., California) or countries, including the European Union's Corporate Sustainability Reporting Directive (CSRD). To the extent there is overlap in the disclosures required by these other rules, a company will be better situated to be able to provide the disclosures required under the final rules. However, companies subject to both the final rules and other climate-related disclosure requirements, such as those required by CSRD, should continue to prepare to comply with the disclosure requirements under both regulatory regimes.

CONCLUSION

Although it is uncertain if and when the final rules will go into effect given the current and future legal challenges to those rules, compliance with the final rules will require a significant investment of time and resources by companies. Companies should review the final rules and begin making their initial assessments on how best to

comply with these new requirements and how these new requirements will impact their current and future disclosures.

Our Capital Markets and Asset Management and Investment Funds lawyers will be pleased to discuss how the final rules impact our clients as they consider their own next steps.

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