STRADLEY RONON

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Client Alert | Investment Management

SEC Proposes Rule Changes for the Enhancement and Standardization of Climate-Related Disclosure for Public Companies

Introduction

On March 21, 2022, the U.S. Securities and Exchange Commission (SEC), in a 3-1 vote,[1] proposed rule changes to require U.S. public companies and certain foreign private issuers (companies) to disclose more comprehensive and standardized climate-related information in their registration statements and periodic reports.[2] The Proposal would add new reporting requirements for companies such as disclosure of climate-related data, goals and risks in registration statements and periodic reports. It also would require additional financial statement metrics and attestation of the proposed disclosure for certain registrants. Public comments on the Proposal must be received 30 days after publication in the Federal Register or by May 20, 2022, whichever is later.

This Alert provides a brief overview of the Proposal and key takeaways from the perspective of asset managers and funds.

Summary of the Proposed Rule Changes

The Proposal would require companies to include a significant amount of climate-related information in their registration statements and periodic reports. The disclosure framework is modeled in part on the Task Force on Climate-Related Financial Disclosure's recommendations and would require specifically:

- Oversight and governance of climate-related risks by the board and management;
- How identified climate-related risks have or may have an impact on business or financial statements;
- How climate-related risks may affect strategies, business models and outlooks;
- The process for identifying, assessing and managing climate-related risks and whether any such process is integrated into overall risk management systems;
- If applicable, certain details regarding any climate-related transition plan adopted by the registrant, scenario analysis used to assess the resilience of a registrant's business plan and any internal carbon price;
- The impact of climate-related events and transition activities on the line items of a registrant's financial statements;
- Scope 1 (direct) and Scope 2 (indirect) greenhouse gas (GHG) emissions metrics are separately disclosed, disaggregated and aggregated, and in absolute and intensity terms;

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1 Commissioner Pierce dissented, stating that there was a lack of adequate statutory basis for the proposed rule changes, in particular noting that (i) they may not comport with First Amendment limitations on compelled speech; (ii) the current disclosure rules already cover material climate risks; and (iii) the proposed rule changes would place a large financial burden on companies. Hester M. Peirce, Commissioner, SEC, Statement on Proposed Rules to Enhance and Standardize Climate-Related Disclosures for Investors: We are Not the Securities and Environment Commission - At Least Not Yet (March 21, 2022).

2 The Enhancement and Standardization of Climate-Related Disclosures for Investors, Release Nos. 33-11042; 34-94478 (March 21, 2022) (the Proposal).

- For larger companies, Scope 3 (value chain, such as suppliers and distributors) GHG emissions and intensity, if material or if the registrant has Scope 3 GHG emissions targets; and
- If applicable, certain details regarding any publicly set climate-related targets or goals and a transition plan.

The Proposal also includes amendments to Regulation S-X, which would require registrants to include climate-related financial statement metrics and related disclosures in a note to their audited financial statements. Specifically, the note would be required to include information in these categories: financial impact metrics, expenditure metrics, and financial estimates and assumptions. The financial statement metrics would be subject to audit by an independent registered public accounting firm.

Additionally, the Proposal would require large, accelerated filers (a registrant with a public float of at least $700 million) and accelerated filers (a registrant with a public float between $75 and $700 million) to include a third-party attestation report covering its Scope 1 and Scope 2 GHG emissions disclosure. While providers of third-party attestation reports would not be limited to Public Company Accounting Oversight Board accountants, such providers would be required to be independent of the company and to have "significant experience in measuring, analyzing, reporting or attesting to GHG emissions."

The table below summarizes the proposed timeline for phasing in the new climate-related disclosures and requirements.

<table>
<tr><th>Registrant Type</th><th>Compliance Date for Disclosures Other Than Scope 3 Emissions</th><th>Compliance Date for Scope 3 Emissions Disclosures</th><th>Compliance Date for Attestation Requirements</th></tr>
<tr><td rowspan="2">Large Accelerated Filer</td><td rowspan="2">Fiscal Year 2023</td><td rowspan="2">Fiscal Year 2024</td><td>Limited Assurance – Fiscal Year 2024</td></tr>
<tr><td>Reasonable Assurance – Fiscal Year 2026</td></tr>
<tr><td rowspan="2">Accelerated Filer</td><td rowspan="2">Fiscal Year 2024</td><td rowspan="2">Fiscal Year 2025</td><td>Limited Assurance – Fiscal Year 2025</td></tr>
<tr><td>Reasonable Assurance – Fiscal Year 2027</td></tr>
<tr><td>Non-Accelerated Filer</td><td>Fiscal Year 2024</td><td>Fiscal Year 2025</td><td>N/A</td></tr>
<tr><td>Smaller Reporting Company</td><td>Fiscal Year 2025</td><td>N/A</td><td>N/A</td></tr>
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Key Takeaways for Asset Managers and Funds

1. *The Proposal would provide consistent and comparable climate-related data.*

   The Proposal is a significant step toward addressing long-standing requests from the asset management industry for consistent and comparable climate-related disclosures.[3] While many companies currently voluntarily disclose information on their emissions, climate-related risks and transition plans, such data is often incomplete and may not be reliable. Asset managers and funds will need to consider the best way to process the data and how such data may impact investment and voting decisions.

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3 *See, e.g.*, Gary Gensler, Chair, SEC, Statement on Proposed Mandatory Climate Risk Disclosures (March 21, 2022) (Chair Gensler stated, "[I]nvestors with $130 trillion in assets under management have requested that companies disclose their climate risks."). *See also* Letter from Eric J. Pan, President and CEO, ICI, to Vanessa Countryman, Secretary, SEC (June 4, 2021), *available at* https://www.ici.org/system/files/2021-06/21_ltr_rfi.pdf (ICI letter).

2. *The Proposal acknowledges liability concerns for companies, and the SEC should provide comparable treatment to asset managers in any future rulemaking.*

   The Proposal acknowledges the challenges with reporting Scope 3 emissions data and the corresponding liability concerns by including a safe harbor and exempting smaller reporting companies from Scope 3 disclosure requirements.[4] The SEC has indicated that it will propose ESG-related rules specific to asset managers and fund products. Asset managers should pay close attention to whether and how such rulemaking takes the Proposal into account. For example, we would anticipate comments if the SEC were to propose that asset managers be subject to disclosure liability related to data that companies are not required to provide or for which companies enjoy safe harbors from liability.[5]

3. *The SEC should appropriately sequence implementation of the Proposal and any rules for asset managers and funds.*

   Under the Proposal, companies would be afforded a transition period to provide disclosure and additional time to meet the attestation requirements. Asset managers should be mindful of how the implementation period for companies impacts their ability to satisfy disclosure requirements related to any ESG-related rules specific to asset managers and funds.[6]

4. *While the Proposal is focused on operating companies, there is some impact on certain funds and asset managers.*

   The Proposal would apply to annual reports of business development companies (BDCs) on Form 10-K. The Proposal requests comment on whether BDCs should be excluded from some or all of the proposed climate-related disclosures rules. As the SEC is planning to propose ESG-related rules specific to asset managers and funds, we anticipate commenters would support such an exclusion.

   In addition, public parents of asset managers generally would fall within the scope of the Proposal and would be subject to the disclosure and, depending on size, attestation requirements of the proposed rules.

5. *The Proposal may be a signal of what is to come for asset managers that have agreed to emissions targets and goals.*

   Many asset managers have agreed to climate-related targets and goals, such as the Net Zero Asset Managers Initiative.[7] Under the Proposal, if a company has set climate-related targets or goals, it would be required to disclose them, along with the unit of measure of the target, the timeline for achieving the target, any interim targets and how the company intends to reach the target, as well as other relevant data. Asset managers that have set emissions targets and goals could face similar disclosure requirements in the anticipated rules for asset managers and fund products.

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4 Along with the Scope 3 GHG emissions disclosure safe harbor, the Proposal notes that the existing safe harbors for forward-looking statements under the Securities Act of 1933 and Securities Exchange Act of 1934 would be available for aspects of the climate-related disclosures.

5 In addition, the Proposal is limited to climate-related disclosure. To the extent that rulemaking for asset managers and funds requires disclosures covering other aspects of ESG, asset managers should assess whether existing data is sufficient to allow asset managers to satisfy proposed disclosure requirements.

6 "The European Union required certain asset managers to disclose sustainability-related information about their investments before requiring companies in which the managers invested to provide sustainability-related disclosure. This approach put asset managers in the position of having to provide information to which they did not have access through public disclosures (and even if they were to obtain it in other ways, methodologies on evaluating and reporting the data were inconsistent)." ICI Letter, *supra* note 3.

7 The Net Zero Asset Managers Initiative includes over 230 signatories representing over $57 trillion in global assets under management. https://www.netzeroassetmanagers.org/

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