G&A GOVERNANCE & ACCOUNTABILITY INSTITUTE, INC.™

Resource Paper

SEC Releases Draft Rule on Climate-Related Disclosures

G&A GOVERNANCE & ACCOUNTABILITY INSTITUTE, INC.™

April 2022

In brief: An important new SEC rule for corporate ESG-focused disclosures was issued in draft form and is seemingly moving toward adoption by year-end 2022. The impacts on both domestic and foreign corporations that file SEC reports will be significant. G&A is sharing highlights and our perspective with you in this Resource Paper.

Background: On March 21st, the commissioners of the U.S. Securities and Exchange Commission voted to approve a staff-generated, comprehensive draft rule that would mandate periodic reporting of climate-related risks and *material impacts* on a company's *business, strategy, and outlook.*

Important Notes: For the first time, greenhouse gas* (GHG) emissions and a range of climate-related disclosures would be required in mandated financial filings including the 10-K (to be phased in over several years).

* Greenhouse gases are carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, and sulfur, as defined by the Kyoto Protocol.

Key Draft Rule Highlights:

The rule as written would require:

+ **Direct (Scope 1) and Indirect (Scope 2) GHG emissions** for all companies regardless of size or accelerated filer status
+ **Upstream and Downstream (Scope 3) GHG emissions** for all companies except for smaller reporting companies (SRC defined as public float less than $250 million -- OR less than $100 million in annual revenues and public float of less than $700 million) "...if material or the company has set a GHG emissions target or goal that includes Scope 3 emissions".
+ **Independent Assurance ("Attestation") of Scope 1 and 2 GHG emissions** first at a "limited" level (2024 emissions for large accelerated filers, and 2025 emissions for all others except SRCs which are exempted from needing attestation), and then a year later at the higher "reasonable" level.
+ **Climate Targets / Goals Details** If a company has adopted climate-related goals/targets, these would need to be explained in detail (baseline, boundaries, scopes included, and progress towards the goals, etc).
+ **Plan / Strategy to Reach Goals** The company's plans for reaching its goals, including details on any RECs or Offsets being used.
+ **Governance of Climate Risks** Details of the governance and oversight of climate-related risks and related issues.
+ **Climate Risk Plan and Strategy** Identification of climate-related risks that have affected or are likely to affect the company's strategy, business model, and outlook.
+ **Impact of Climate-related Events on Line Items Events** such as severe weather, drought, flooding, and other transition activities on the line items of a registrant's consolidated financial statements, including financial impact metrics, expenditure metrics, and financial estimates and assumptions used.

Brief Takeaways

Climate-related disclosures would be required in annual reports or registration statements in a separately captioned "Climate-Related Disclosure" section and the issuer's financial statements.

This chart published by SEC in a Fact Sheet explains the draft rule approach:

Registrant Type	Disclosure Compliance Date	
	All proposed disclosures, including GHG emissions metrics: Scope 1, Scope 2, and associated intensity metric, but exluding Scope 3	GHG emissions metrics: Scope 3 and associated intensity metric
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)
Accelerated Filer and Non-Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)
SRC	Fiscal year 2025 (filed in 2026)	Exempted

Filer Type	Scopes 1 and 2 GHG Disclosure Compliance Date	Limited Assurance	Reasonable Assurance
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)	Fiscal year 2026 (filed in 2027)
Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Fiscal year 2027 (filed in 2028)

Note the Title: According to the SEC, the rule is intended to "enhance and standardize" corporate disclosures about climate-related risks, opportunities, and steps taken by the reporting company to meet climate change challenges (such as measuring and managing carbon emissions and then publicly reporting on these).

Many companies are already voluntarily reporting on their carbon emissions and other climate-related data, but this draft rule is the first time the SEC is seeking to mandate this reporting and to apply standards.

14 Wall Street, 20th Floor
New York, NY 10005
646.430.8230
info@ga-institute.com
ga-institute.com

Timing: The 500+ page draft rule is subject to 60-day period for public comment; that was recently extended in June 2022 by the agency.

The final rule is expected to be in place by year-end 2022 for the first rounds of mandated reporting a year later, with phasing in over several years for certain companies.

Feedback: It should be expected that a large volume of responses will be provided to SEC. The draft rule includes statements of intent, perspectives shared, and almost 200 questions posed by the agency to obtain public feedback that will aid in the SEC staff's development of the final rule.

TCFD and GHG Protocol: Prominently cited in the draft rule are the TCFD disclosure framework and the Greenhouse Gas Protocol (GHG Protocol). It is apparent in the draft document that these frameworks are favored reporting approaches for the SEC staff. The TCFD framework has four pillars – governance, strategy, risk management, and metrics and targets.

Climate-Related Impacts: The registrant would be required to disclose climate-related impacts on:

+ Business operations
+ Products and services
+ Suppliers – others in the value chain
+ Activities to mitigate or adapt to climate-related risks
+ Expenditures for R&D
+ Any other significant changes or impacts

Disclosure of Risk: The proposed rule would include these examples of disclosures that could be required:

+ Changes to revenues or cost from disruption of operations, or supply chain impact.
+ Impairment charges (inventory, intangibles, property, plant & equipment) due to severe weather or sea-level rise.
+ Changes to reserves or loss contingencies.
+ Changes to expected insured losses due to floods & wildfires).

Carbon Offsets or RECs: The use of carbon offsets or RECs would have to be disclosed if these are used as part of an emissions reduction strategy.

14 Wall Street, 20th Floor
New York, NY 10005
646.430.8230
info@ga-institute.com
ga-institute.com

Price of Carbon: If a company has an internal carbon price established to assess climate-related factors, this would have to be disclosed (i.e., rationale, assumptions, boundaries, pricing, nature of pricing tool).

Scenario Analysis: If a company uses scenario analysis, it would have to describe the resiliency of its business strategy in terms of potential future changes in climate-related risks – and identify what analytical tools are used (in the scenario analysis).

Scope 3 Disclosures: Scope 3 will be required for all companies except for smaller reporting companies (SRC) "...if material or the company has set a GHG emissions target or goal that includes Scope 3 emissions".

The SEC provides a perspective in the draft saying that many companies have adopted "ambitious" Scope 3 targets but have not disclosed much on transition activities including large expenditures that may be needed to reach these goals.

The agency recognizes (saying in the draft) that Scope 3 emissions are a new type of metric (largely based on third-party data, assumptions, and estimations).

Without Scope 3 disclosures, says the SEC, Scopes 1 and 2 disclosures could be misleading and incomplete.

The SEC has included an initial safe harbor for Scope 3 disclosures given the complexity of calculations.

"Attestation" / Assurance of Scope 1 and 2 Disclosures: The SEC will require domestic and foreign filers to provide an "attestation report" that covers Scope 1 and 2 emissions disclosures, first at a "limited" level (2024 emissions for large accelerated filers, and 2025 emissions for all others except SRCs which are exempted from needing attestation), and then a year later at the higher "reasonable" level.

The required disclosures would include information about the service provider involved in the attestation. According to the SEC, this validation is intended to promote the "reliability of GHG emissions disclosures for investors."

Attestation reports would be prepared and signed by a GHG emissions attestation provider, with these characteristics as identified by the SEC:

+ Expert in analyzing, reporting, and attesting to GHG emissions.
+ Performing engagements in accordance with professional and applicable legal and regulatory requirements.
+ Be independent with respect to the registrant during the attestation and professional engagement period.
+ Expected to have policies and procedures in place to provide reasonable assurance that the personnel involved have significant experience in both GHG disclosure and attestation engagements.

14 Wall Street, 20th Floor
New York, NY 10005
646.430.8230
info@ga-institute.com
ga-institute.com

Materiality: The rule as now drafted would require that filers provide information about the registrant's climate-related risks that are "reasonably likely" to have a "material impact on its business, results of operations, or financial condition."

"Certain" climate-related financial metrics, "which have become a commonly-used metric" to assess a registrant's exposure to these risks, would be required in a company's audited financial statements.

G&A Institute Perspective

The SEC's draft rule on climate-change disclosure was widely expected and covers many issues that G&A has been tracking in recent years.

We were pleased to see citations from research conducted by our G&A Institute team included in the SEC draft rule. SEC Chair Gary Gensler, in his speech launching the draft rule, said:

"Today's proposal would help issuers more efficiently and effectively disclose these risks and meet investor demand, as many issuers already seek to do.

One Report found that nearly two-thirds of companies in the Russell 1000 Index, and 90 percent of the 500 largest companies in that index, published sustainability reports in 2019 using various third-party standards, which include information about climate risks. "

– SEC Chair Gary Gensler

Chair Gensler's reference was to findings in G&A's "2020 Russell 1000 Flash Report." Our annual research on sustainability reporting trends, which we launched in 2011, shows that voluntary corporate sustainability reporting has been adopted as a best practice by the largest U.S. public companies.

The G&A Institute team will continue to monitor the progress of the draft rule through the comment period, adoption, and subsequent enforcement and we look forward to sharing additional news and perspectives going forward.

14 Wall Street, 20th Floor
New York, NY 10005
646.430.8230
info@ga-institute.com
ga-institute.com

GOVERNANCE & ACCOUNTABILITY INSTITUTE, INC.™

Want to know more? Let's Talk!

For information on how the G&A Institute team can help you please visit our site and view our services sections and / or contact us at the info below:

Governance & Accountability Institute, Inc.
14 Wall Street, 20th Floor, New York, New York 10005

646.430.8230
info@ga-institute.com
ga-institute.com