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To the Point

SEC — final rules

SEC adopts rules requiring registrants to disclose certain climate-related information

The rules are intended to provide consistent, comparable and reliable information to investors about how a registrant has addressed its climate-related risks.

What you need to know

- The SEC adopted rules requiring registrants to disclose climate-related information in registration statements and annual reports.
- Registrants will be required to disclose, among other things, material climate-related risks, including descriptions of board oversight and risk management activities, the material impacts of these risks on a registrant's strategy, business model and outlook and any material climate-related targets or goals.
- Registrants will need to quantify certain effects of severe weather events and other natural conditions in a note to their audited financial statements.
- Accelerated and large accelerated filers will need to disclose Scope 1 and Scope 2 greenhouse gas (GHG) emissions, if material, which will be subject to third-party assurance.
- In a change from the proposal, the rules will not require disclosure of Scope 3 GHG emissions. They also further incorporate the US Supreme Court's definition of materiality and give companies more time to comply.
- The compliance dates depend on a registrant's filer status and the type of disclosure. The rules will be phased in starting in fiscal year 2025.

Overview

The Securities and Exchange Commission (SEC) adopted final rules to require disclosures about material climate-related risks, how the board of directors and management oversee and manage the risks, and the actual and potential impact of the risks. The rules also require disclosure

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about material climate-related targets and goals and Scope 1 and Scope 2 GHG emissions. These climate-related disclosures will be required in annual reports and registration statements. However, emerging growth companies (EGCs) and smaller reporting companies (SRCs) will be exempt from the requirements to disclose GHG emissions. Registrants will also have to disclose certain effects of severe weather events and other natural conditions and amounts related to carbon offsets and renewable energy credits or certificates (RECs) in their audited financial statements.

SEC Chair Gary Gensler said the rules will provide investors with consistent, comparable and decision-useful information and registrants with clear reporting requirements, adding that the rules are grounded in materiality as defined by the US Supreme Court.

Nonfinancial statement disclosures

Climate-related risks and their impact on a registrant

Registrants will be required to disclose whether any climate-related risks have had or are reasonably likely to have a material impact on their strategy, results of operations or financial condition. In describing a material risk, a registrant will need to explain whether the risk is reasonably likely to manifest in the short term (i.e., the next 12 months) and separately in the long term (i.e., beyond the next 12 months). Registrants will also have to state whether the disclosed climate-related risks are physical or transition risks, as defined in the rules.

Registrants will have to describe the actual and potential material impacts of each disclosed climate-related risk on their strategy, business model and outlook, and how they are considered as part of their strategy, financial planning and capital allocation. Registrants will also need to discuss how material climate-related risks have materially impacted or are reasonably likely to materially impact their business, results of operations or financial condition, and provide a quantitative and qualitative description of material expenditures and material impacts on financial estimates and assumptions that directly result from activities to mitigate or adapt to the climate-related risks.

A registrant that has adopted a plan to manage a material transition risk will have to describe the plan and progress made and disclose the material expenditures and material impacts on financial estimates and assumptions resulting directly from the plan.

Registrants that (1) use scenario analysis to assess the impact of climate-related risks and (2) identify material climate-related risks based on the results of that analysis will be required to describe each scenario used. In addition, if a registrant's use of an internal carbon price is material to how it evaluates and manages a material climate-related risk, it will have to disclose certain information about the price.

How we see it

The requirements to disclose material climate-related risks and the related impacts were changed from the proposal in ways that should lessen the burden on registrants. For example, materiality is used more frequently in the final rules as a threshold for disclosure to prevent the inclusion of immaterial information. In addition, a registrant's value chain (e.g., customers, suppliers) was removed from the definition of a climate-related risk due to potential challenges in obtaining information from entities it does not control.

Governance and risk management

Registrants will be required to describe how the board of directors oversees and is informed about climate-related risks. They will have to identify any board committees or subcommittees responsible for that oversight and need to disclose whether and how the board oversees progress toward climate-related targets or goals or transition plans.

Registrants will be required to disclose management's role in assessing and managing material climate-related risks, including whether and which management positions or committees are responsible for assessing and managing the risks, the relevant expertise of such position holders or committee members, the processes to assess and manage the risks, and whether management reports information about the risks to the board and its committees or subcommittees.

A registrant also will have to describe how it determines whether it has incurred or is reasonably likely to incur a material physical or transition risk, how it decides whether to mitigate, accept or adapt to the risk, and how it prioritizes addressing the risk. A registrant will also be required to disclose whether and how these processes have been integrated in its overall risk management systems or processes.

Targets and goals

Registrants will be required to disclose any climate-related targets or goals that have materially affected or are reasonably likely to materially affect their business, results of operations or financial condition. They will have to disclose the scope of activities included in the target, the unit of measurement, the defined time horizon by which the target is intended to be achieved, any established baselines and how related progress will be tracked, and a description of how they intend to meet their targets or goals. Registrants will need to state whether the time horizon is based on one or more goals established by a climate-related treaty, law, regulation, policy or organization.

Registrants will have to describe any progress made toward meeting their targets or goals and how it was achieved. They will have to discuss the material impacts of the target or goal or the related actions taken on their business, results of operations or financial condition. In addition, they will have to provide quantitative and qualitative disclosure of material expenditures and material impacts on financial estimates and assumptions resulting directly from the target or goal. Registrants will also be required to make additional disclosures if carbon offsets or RECs are a material component of their plan to achieve their targets or goals.

How we see it

Disclosure of a target or goal won't depend on whether it has been publicly announced, so registrants will need to include nonpublic targets and goals in the scope of those they consider when determining what to disclose.

Safe harbor

The rules provide stronger safe harbors from private liability for climate-related disclosures (excluding historical facts) about transition plans, scenario analysis, the use of an internal carbon prices and climate-related targets and goals than initially proposed.

GHG emission metrics

Accelerated and large accelerated filers will be required to disclose gross direct GHG emissions from operations they own or control (Scope 1) and/or indirect emissions from purchased electricity and other forms of energy their operations consume (Scope 2), if material. Scope 1 and Scope 2 emissions will need to be reported separately and each expressed in the aggregate

in terms of carbon dioxide equivalents. If any of the seven greenhouse gases defined in the rule (i.e., carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, sulfur hexafluoride and nitrogen trifluoride) is individually material, it will need to be disaggregated from the other gases.

These disclosures will be required for the most recently completed fiscal year and, to the extent previously disclosed or required to be disclosed, for the historical fiscal year(s) for which audited consolidated financial statements are included in the filing. This means that registrants will not need to provide comparative emissions data until the second year of reporting.

Registrants will also be required to describe the methodology, significant inputs and assumptions used to calculate their GHG emissions, including the protocol or standards used and the organizational boundaries. If the boundaries materially differ from the entities and operations included in the consolidated financial statements, a brief explanation of the difference will need to be provided. The SEC had initially proposed requiring registrants to use the same boundaries for emissions that are used for the consolidated financial statements.

In a change from the proposal, domestic registrants will be allowed to delay filing the GHG emissions disclosures for the most recent year as part of their Form 10-Q for the second quarter or in an amendment to their annual report on Form 10-K. A company filing a registration statement will need to file the information for the most recent year that is at least 225 days before the date of effectiveness of the registration statement.

In another change from the proposal, registrants will not be required to disclose indirect emissions from upstream and downstream activities in their value chain (Scope 3). In addition, the rule will not require disclosure of GHG intensity metrics and will exempt EGCs and SRCs from the emissions disclosure requirements entirely.

How we see it

Compared to the proposal, some of the requirements, such as those related to organizational boundaries, are better aligned with those required or allowed by other reporting regulations and standards (e.g., the European Union's Corporate Sustainability Reporting Directive, California's climate disclosure laws, the International Sustainability Standards Board's standards). However, significant differences remain, such as the treatment of Scope 3 emissions.

Assurance requirements

The disclosure of Scope 1 and Scope 2 emissions of accelerated and large accelerated filers will be subject to limited assurance by an independent provider beginning with the third fiscal year after the compliance date for emissions. These disclosures by large accelerated filers will subsequently be subject to reasonable assurance, beginning with the seventh fiscal year after the compliance date for emissions. Assurance providers will need to be independent and have significant experience in measuring, analyzing, reporting or attesting to GHG emissions. The rules do not specify the attestation standards that will need to be used but establish criteria for the standards that will be acceptable (e.g., publicly available for no cost, widely used).

Registrants will also be required to make additional disclosures about the current assurance provider (e.g., whether the provider is subject to an oversight inspection program and whether the engagement is in the scope of that program) and any previously engaged providers who resigned, declined to stand for reappointment or were dismissed. Registrants that voluntarily obtain assurance on GHG emissions when it is not required will also need to provide certain disclosures about the engagement and the provider.

Financial statement disclosures

Registrants will be required to disclose in a note to the audited financial statements the following effects of severe weather events and other natural conditions (e.g., hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures, sea level rise), including the aggregate amounts and where in the financial statements they are presented:

- Incurred expenses and losses, excluding any recoveries, resulting from severe weather events and other natural conditions, if the amount equals or exceeds 1% of the absolute value of pre-tax income or loss (unless it is less than $100,000) for the relevant fiscal year
- Capitalized costs and charges, excluding recoveries, resulting from severe weather events and other natural conditions, if the amount equals or exceeds 1% of the absolute value of stockholders' equity or deficit (unless it is less than $500,000) for the relevant fiscal year
- Any recoveries recognized during the fiscal year as a result of severe weather events and other natural conditions, if a registrant is required to provide disclosures on incurred expenses, capitalized costs and charges, and losses

If carbon offsets or RECs are deemed a material component of the registrant's plans to achieve its disclosed climate-related targets, registrants will be required to disclose:

The rules require registrants to quantify and disclose certain climate-related effects.

- The aggregate amounts, and where in the financial statements they are presented, of (1) carbon offsets and RECs expensed, (2) carbon offsets and RECs capitalized and (3) losses incurred on the capitalized carbon offsets and RECs during the fiscal year
- The beginning and ending balances of the capitalized carbon offsets and RECs for the fiscal year
- The registrant's accounting policy for carbon offsets and RECs

Registrants will also be required to disclose whether and how (1) exposures to risks and uncertainties associated with, or known impacts from, severe weather events and other natural conditions and (2) any disclosed climate-related targets or transition plans materially impacted the estimates and assumptions used in preparing the financial statements.

Finally, registrants will be required to disclose additional contextual information about the above disclosures, including how each financial statement effect was derived and the policy decisions made to calculate the effects, for the most recently completed fiscal year and, if previously disclosed or required to be disclosed, for the historical fiscal year(s) for which audited consolidated financial statements are included in the filing.

How we see it

While the rules provide examples of severe weather events and other natural conditions, they do not define the terms. As part of their implementation activities, companies will likely need to develop accounting policies to guide their disclosures in a manner consistent with the rules, facts and circumstances.

Transition period

The rules will become effective 60 days after publication in the Federal Register, and companies will be required to comply with them in the fiscal years beginning (FYB) in the calendar years shown below:

Registrant type	Compliance dates				
	All disclosures, other than as noted in this table and end note[1]	Scope 1 and Scope 2 GHG emissions	Limited assurance	Reasonable assurance	Electronic tagging
Large accelerated filers	FYB 2025	FYB 2026	FYB 2029	FYB 2033	FYB 2026
Accelerated filers (other than SRCs and EGCs)	FYB 2026	FYB 2028	FYB 2031	N/A	FYB 2026
SRCs, EGCs and non-accelerated filers	FYB 2027	N/A	N/A	N/A	FYB 2027

Endnote:

[1] Compliance with quantitative and qualitative disclosure requirements for material expenditures and material impacts on financial estimates and assumptions that directly result from (1) activities to mitigate or adapt to the climate-related risks, (2) targets or goals and (3) transition plans will be required one year later (i.e., FYB 2026 for large accelerated filers, FYB 2027 for accelerated filers other than SRCs and EGCs, and FYB 2028 for SRCs, EGCs and non-accelerated filers).

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