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Will SEC Become The 'Securities And Environment Commission?'

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Richard E. Glaze Jr.
Partner

The Securities and Exchange Commission (SEC) has issued a proposed rule that one of its commissioners, Hester Peirce, fears will turn the agency into the "Securities and Environmental Commission." In this comprehensive proposal, the SEC has recommended far-reaching new requirements for publicly traded companies to disclose the impacts of climate change on business operations and governance.

The long-awaited proposed rule, for which Peirce was the lone and vocal dissenter, would amend SEC Regulations S-K and SX to require detailed new disclosure requirements for "climate-related risks" that have had or are likely to have a material impact on a company's business and finances over the short, medium and long terms. The risks to be disclosed would include:

- How climate-related risk will affect the registrant's "strategy, business model and outlook"
- The company's processes for identifying, assessing, and managing climate-related risks
- Board and management oversight of climate-related issues
- The impacts of climate-related events and risks on line items of a registrant's consolidated financial statements.

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The comment period for the rule will be open until May 20, 2022. Given the deadlines that require reporting as early as 2024 (for fiscal year 2023), all companies would be well advised to begin the time-consuming process of identifying and reviewing their climate-related risks, impacts, and representations to be ready for the looming deadlines.

In a major departure from its current materiality-based requirements, the SEC's proposal would, for many registrants, require disclosure of up to three "scopes" of GHG emissions by 2026:

- Scope 1 emissions are "direct" GHG emissions from company sources, such as company facilities and vehicles
- Scope 2 emissions are "indirect" emissions from purchased electricity or other energy sources
- Scope 3 emissions are emissions from "upstream" and "downstream" activities in a company's value chain. Although qualifying registrants must disclose Scope 3 emissions only if they are "material" or if the company has set emissions targets that include Scope 3 emissions, there is no apparent materiality requirement that limits the disclosures of Scopes 1 and 2.

All companies will be required to report Scope 1 and 2 emissions and there is no apparent materiality requirement that limits the disclosures of Scopes 1 and 2. Perhaps the most challenging emissions to calculate are Scope 3 emissions, which require companies to capture emissions generated by sources such as employee commuting, leased assets and the use of and disposal of products sold to customers. This burden would be attenuated somewhat by exempting "smaller reporting companies" from this requirement, as is defined in SEC regulations.

Climate-related goals

In addition to disclosures of current GHG levels, the proposal would require accountability for a company's climate-related targets or goals, a commitment many companies are beginning to publicize to stakeholders with varying degrees of substantiation. Companies would be required to make climate target disclosures more transparent by reporting, in addition to the targets, verifiable information on how the company will attain its targets.

The proposal also would require an accounting of the company's progress toward the attainment of emissions targets, including "certain climate-related financial statement metrics and related disclosures to be included in a note to a registrant's audited financial statements."

Peirce's lengthy critique argues the requirements would be too costly and are a misguided attempt "to direct capital to favored businesses to advance political and social goals." Peirce also notes they are unnecessary because existing regulations already require disclosure of material climate risks.

Additionally, Peirce stated that the proposal exceeds the SEC's authority because it would require the disclosure of non-material risks and could even mandate disclosures of information protected by the First Amendment. Peirce, who other critics will echo, objects to the proposed disclosure requirements as a departure from the SEC's commitment to materiality as the lodestar for disclosures.

The SEC disclosure requirements are said to be based “in large part” on the Task Force on Climate-Related Financial Disclosures (TCFD) framework and the Greenhouse Gas Protocol, and companies who have been using these metrics would have a head start on complying with the rule.

The new requirements would also impact regulated companies’ suppliers whose emissions must be factored into the companies’ GHG calculations. Thus, suppliers also should begin preparing to collect the information to share with their customers.

The many companies who are already voluntarily disclosing climate-related information should be mindful their reports may face greater scrutiny when the rules become mandatory. These firms should consider consulting with counsel to ensure the transition does not create greenwashing risks for previous disclosures.

Given the numerous comments the SEC received on its March 2021 request for public input on climate change disclosures and the controversial nature of this new proposal, it is expected that the agency will receive a mountain of comments. If the rule is approved, Peirce’s fears may be realized when the SEC becomes your favorite new environmental agency.