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SEC Issues Final Rule on Climate-Related Disclosures to Investors

On March 21, 2022, the Securities and Exchange Commission proposed a rule requiring registrants to disclose information relating to climate risk that is "reasonably likely to have material impacts on its business or consolidated financial statements," and (ii) "GHG emissions metrics that could help investors assess those risks."[1] Two years and 24,000 comment letters later, on March 6, 2024, the SEC issued its final rules "to enhance and standardize climate-related disclosures by public companies and in public offerings."[2]

The 886-page final rules will require disclosures relating to (i) climate-related risks that have, or are reasonably likely to, materially impact a registrant's business strategy, results of operations, or financial condition and (ii) severe weather events and other natural conditions.[3] According to SEC Chair Gary Gensler, the final rules are issued in the spirit of a basic bargain: "Investors get to decide which risks they want to take so long as companies raising money from the public make what President Franklin Roosevelt called 'complete and truthful disclosure'…. The rules will provide investors with consistent, comparable, and decision-useful information… [and] specificity on what companies must disclose, which will produce more useful information than what investors see today."[4]

What to Disclose:

The final rules will require a registrant to disclose, among other information:

- Climate-related risks that have had or are reasonably likely to have a material impact on the registrant's business strategy, results of operations, or financial condition;
- If, as part of its strategy, a registrant has undertaken activities to mitigate or adapt to a material climate-related risk, a quantitative and qualitative description of material expenditures incurred and material impacts on financial estimates and assumptions that directly result from such mitigation or adaptation activities;
- Specified disclosures regarding a registrant's activities, if any, to mitigate or adapt to a material climate-related risk including the use, if any, of transition plans, scenario analysis, or internal carbon prices;
- Any oversight by the board of directors of climate-related risks and any role by management in assessing and managing the registrant's material climate-related risks;

[1] Proposed Rule: The Enhancement and Standardization of Climate-Related Disclosures for Investors (sec.gov) at p. 42-43.
[2] SEC.gov | SEC Adopts Rules to Enhance and Standardize Climate-Related Disclosures for Investors
[3] Final rule: The Enhancement and Standardization of Climate-Related Disclosures for Investors AGENCY: Securities and Exchange Commission at p. 1. The SEC has also published a fact sheet explaining the final rules at 33-11275-fact-sheet.pdf (sec.gov).
[4] *Supra* n. 2.

- Any processes the registrant has for identifying, assessing, and managing material climate-related risks and, if the registrant is managing those risks, whether and how any such processes are integrated into the registrant's overall risk management system or processes;

- For large accelerated filers and accelerated filers[5], (i) information about material Scope 1 emissions and/or Scope 2 emissions and (ii) an assurance report at the limited assurance level;

- Capitalized costs, expenditures, charges, and losses incurred as a result of severe weather events and other natural conditions, subject to applicable one percent and de minimis disclosure thresholds, disclosed in a note to the financial statements; and

- Capitalized costs, expenditures, and losses related to carbon offsets and renewable energy credits or certificates (RECs) if part of a registrant's climate-related targets or goals, disclosed in a note to the financial statements.[6]

Materiality

The final rules mostly require the disclosure of material information only. Regarding how materiality is to be determined under the final rules, the SEC appears to have weighed the benefits of a prescriptive (or rules-based) materiality approach against the traditional principles-based approach. Principles-based materiality favors issuer judgment, convenience and efficiency, while prescriptive materiality favors measurability and reliability of investor knowledge. The former is more tailored and less burdensome to issuers while the latter is meant to yield more consistent and comparable information. The SEC appears to have mostly (but not exclusively) opted for a prescriptive approach to determining materiality.[7]

Who, When and How to Disclose:

The final rules apply to all registrants, both U.S. and foreign private issuers.[8] They become effective on May 5, 2024. Compliance will be phased-in based on a company's registrant status. Large accelerated filers must begin reporting information pertaining to FY2025 in FY2026.[9]

A registrant must provide climate-related disclosures in its registration statements and its annual reports filed with the SEC. Disclosures must be set out in a separate, appropriately captioned section of the registration statement or annual report or in another appropriate section of the filing, such as Risk Factors,

[5] Categories of publicly traded companies with respective public floats of (i) $700 million or more, and (ii) $75 million or more but less than $700 million.
[6] *See* Fact Sheet, *supra* n. 3.
[7] "In the final rules, we elected to include prescriptive disclosure requirements (with certain modifications to address commenter concerns) to avoid such cherry-picking of information and to ensure that investors are provided with more consistent and comparable information about climate-related risks." Final Rules, Part IV, Section F, p. 797.
[8] A registrant is (i) a company (whether US or foreign) that issue securities for which registration with, or reporting to, the SEC is required under the Securities Act of 1933 (the "Securities Act") and/or the Securities Exchange Act of 1934 (the "Exchange Act"), and/or (ii) an investment company required to register with the SEC under the Investment Company Act of 1940.
[9] *See* the SEC's chart on Compliance Dates under the Final Rules in Fact Sheet, *supra* n. 3.

Description of Business, or Management's Discussion and Analysis (MD&A), or, alternatively, by incorporating such disclosure by reference from another SEC filing.[10]

Disclosure Exemptions and Safe Harbors:

- Smaller reporting companies[11] and emerging growth companies[12] are exempt from reporting on greenhouse gas emissions.

- A new safe harbor from private liability is provided to all registrants for certain climate-related forward-looking statements regarding transition plans, scenario analysis, the use of an internal carbon price, and targets and goals.[13] This safe harbor does not apply to historic statements.

Challenges and Uncertainty:

The final rules have been adopted at a time of significant challenges to the global ESG movement and to U.S. federal agencies like the SEC. Thirteen state attorneys general have challenged the final rules in the Fifth and Eleventh Circuits. Energy companies have also challenged the final rules. These challenges arise amidst recent restrictions placed on the authority of the Environmental Protection Agency by the U.S. Supreme Court.[14] Additionally, there is anticipation of the Court overturning the "Chevron Deference" doctrine, of judicial deference to federal agencies in interpreting the laws which such agencies administer.[15] The U.S. presidential election in 2024 may also affect the eventual scope and survival of the final rules.

Conclusion:

Companies should carefully consider if and to what extent they may be affected by the final rules. While reporting companies will have direct disclosure requirements to the SEC, private contractors and companies in the supply chains of reporting companies may be indirectly affected by changes in reporting company operations, policies, procedures, and strategies, which ripple through said contractors and supply chains.

[10] *See* Fact Sheet, supra n. 3. Disclosures must also be electronically tagged in Inline XBRL, which is the data filing language used in the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system.
[11] Issuers *inter alia* with (i) a public float under $250 million, or (ii) annual revenue under $100 million and no public float or a public float under $700 million. Regulation S-K, Item 10(f)(1).
[12] A company *inter alia* with annual gross revenues under $1.235 billion during its most recent fiscal year. Securities Act, Section 2(a)(19).
[13] Forward-looking statements are generally protected from private claims under the Private Securities Litigation Reform Act (PSLRA).
[14] *See* Sackett v. EPA, 566 U.S. 120 (2023).
[15] *See* Loper Bright v. Raimundo (Docket No. 22-451) and Relentless, Inc. v. Department of Commerce (Docket No. 22-1219).

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PierFerd attorneys are available to assist you with ESG disclosures and other matters. For additional information, please contact any of the following or your regular PierFerd contact for assistance:

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