TOPIC

Proposed SEC Climate Disclosure Rule

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With new climate-related disclosure rules in the making, the Securities and Exchange Commission has signaled greater enforcement ahead of environmental, social, and governance disclosures. For public companies, these developments signal the most significant overhaul of ESG reporting requirements in two decades. Even though the proposed rules have yet to be adopted, and face all but certain legal challenges thereafter, the SEC climate-related disclosure rules represent a growing global business push for more consistent, transparent ESG reporting standards by companies.

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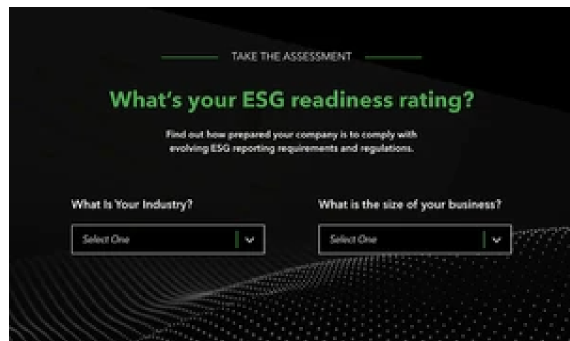
What is the proposed SEC climate disclosure rule?

The SEC has proposed new climate-related disclosure requirements for public companies. In March 2022, with the "issuer rule," the SEC proposed rule amendments that would require public companies to provide certain climate-related financial data, and greenhouse gas emissions insights, in public disclosure filings. As part of the issuer rule, companies would have to disclose emissions they are directly responsible for, as well as emissions from their supply chains and products.

Then in May, with the "investor rule," the SEC proposed ESG-focused funds and firms disclose more specifics about their ESG strategies in materials like fund prospectuses and annual reports.



Take our assessment: Test your ESG preparedness

Are you ready for the SEC climate disclosure rules? Take our assessment and unlock tailored guidance to help in-house counsel develop leading-edge ESG programs.

What implications does the proposed SEC climate disclosure rule hold?

Currently, the SEC does not require extensive line-item disclosure of ESG matters. All that may soon change, as the proposal calls for ESG reporting that goes well beyond current mandates.

To date, companies have largely relied on 2010 guidance, with disclosures based on materiality. This standard, as set forth in the U.S. Supreme Court 1976 decision, *TSC Industries, Inc. v. Northway, Inc.*, and reaffirmed more than a decade later, in *Basic Inc. v. Levinson*, offers companies considerable discretion in determining what constitutes appropriate climate-related disclosures. Beyond specified ESG reporting requirements based on materiality, issuers typically make any other ESG disclosures through voluntary frameworks, like sustainability reports.

In a significant departure, the proposed rule would expand climate-related disclosures beyond the materiality standard. Among other requirements, the new rule would mandate public companies delineate climate-related risks totaling 1% or higher of a total line item in relevant year financial statements. This more detailed disclosure framework would require greater internal resources and time commitments to produce and may inadvertently introduce inconsistent information into public filings like the 10-K, as well as annual reports to shareholders. If not carefully executed, the result could be greater investor confusion and expose organizations to legal risks.

Download: The Essential ESG Toolkit

A free ESG Toolkit with guidance on ESG strategies, preparing ESG reports and disclosures, and engaging with the board of directors on how to identify and manage ESG risks.

What timeline for adoption should in-house counsel expect?

After issuer rule comment periods, the SEC will consider whether to issue further amendments and adopt the proposal. Legal experts predict the SEC will finalize and adopt the issue rule – in some version – before the end of 2022.

However, legal challenges will certainly follow based on assertions the requirements are not necessary or appropriate, and exceed the SEC's rule-making authority. The U.S. Supreme Court's ruling in *West Virginia v. EPA* further calls into question whether the proposed rules could survive a legal challenge.

Despite these variables, the SEC climate disclosure rule is a sign of enforcement changes, considering settled charges by the SEC against an investment company about ESG disclosures, and current charges against a mining company for safety claims made to investors prior to a dam collapse.

See guidance: Comparison of ESG reporting frameworks

To report on ESG issues, many companies implement one or several voluntary reporting frameworks. See a comparison of the leading ESG reporting frameworks.

What considerations should in-house counsel make about the proposed SEC climate disclosure rule?

In-house counsel must consider complications that may arise in executing the more expansive climate-related disclosure requirements. Public companies should first review existing frameworks, such as the Task Force on Climate-Related Financial Disclosures (TCFD) and Greenhouse Gas (GHG) Protocol. If a company is already providing ESG disclosures, they may be in a better position to comply with the proposed rule's requirements.

However, companies cannot simply rely on frameworks like the EPA's 2009 reporting of greenhouse gases rule, because it requires facility-specific reporting, not organizational reporting as mandated by the proposed issuer rule.

Yet frameworks like the TCFD do not provide surefire models for compliance with the proposed climate-related disclosure rules. Companies should anticipate variances – specifically, more narrow disclosure requirements than what is called for by the TCFD, as well as disaggregated financial reporting, and reporting timelines, says Bloomberg Law legal analyst Abigail Gampher.

Learn more: Five Key Takeaways From SEC's Proposal for Climate Disclosures

Read exclusive Bloomberg analysis on the SEC proposal with a focus on timing, global context, scope, and litigation.

What industry pushback has the proposed SEC climate disclosure rule sparked?

There is some consistency in pushback to the rule coming from the energy, financial, and technology sectors. Among areas of contention are the 1% disclosure threshold, reporting requirements greater than TCFD specifications, and Q4 emissions data proposed for inclusion within the 10-K reporting schedule.

The energy sector pushed back on the financial statement threshold, arguing that a disclosure of this nature would include irrelevant information and confuse investors, rather than help them to make informed decisions.

The SEC's proposed rule would create a new disclosure framework with a more detailed disclosure regime than the Task Force on Climate-Related Financial Disclosures framework. Financial institutions are particularly concerned with the SEC's alignment with the TCFD framework and International Sustainability Standards Board.

The technology sector asked the SEC to consider flexibility in the reporting timelines for new and historical climate-related data.

Read more: Sectors Push Back on SEC Climate-Related Disclosures

For a full analysis, check out this breakdown of objections and counterproposals by industry leaders in the technology, financial, and energy sectors.

What role do corporate legal teams play in navigating ESG reporting requirements?

Corporate legal teams play a vital role in helping public companies get compliant ready. In-house counsel leadership should consider establishing a task force to assess their company's ESG preparedness, including current ESG reporting and disclosure practices, and lead efforts to identify ESG issues that could imperil compliance with the SEC's proposed rules on climate disclosure.

With expertise across ESG issues, in-house counsel are already well-poised to advise companies and communicate ESG initiatives to their boards. Yet they will face new challenges, in a more robust ESG reporting age. Among other considerations, in-house counsel must ensure they maintain independent professional judgment in instances where ESG matters place them in a business advisory role.

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