September 23, 2021

SEC Staff Highlights Review of Climate Change Disclosure

SEC Division of Corporation Finance Publishes Sample Comment Letter Regarding Compliance with Existing Climate Change Disclosure Guidance

INTRODUCTION

While the SEC is in the midst of crafting new rules on climate change-related disclosures,[1] it is also stepping up its review of companies' compliance with existing SEC climate change guidance that may require disclosures related to climate risk and opportunities. The SEC has reportedly issued in recent weeks several comment letters exclusively related to climate change disclosures in Form 10-K filings, and then, on September 22, 2021, the SEC's Division of Corporation Finance published a sample letter highlighting comments that it may issue to companies regarding their climate change disclosures—or the absence of such disclosures—in SEC filings.[2]

Consistent with the SEC's existing disclosure framework, in particular the SEC's 2010 Guidance Regarding Disclosure Related to Climate Change (2010 Guidance),[3] the sample comments take a principles- and materiality-based approach. Issuers are called on to confirm whether additional climate change disclosure, whether in the form of risk factor, litigation or MD&A disclosure, would be material to investors.

Notably, one of the comments in the SEC's sample letter asks the issuer to advise the Staff as to what consideration was given to including the same type of climate-related disclosure in the issuer's SEC filings as is included in the issuer's corporate social responsibility report. With the SEC focused on public disclosures outside of issuers' SEC filings, issuers should be prepared to explain why disclosure on climate change they provide elsewhere is not material to investors, or, in the alternative, be prepared to include the additional information in their filings, with the potential for increased liability and the need for enhanced controls around those statements.

SEC SAMPLE COMMENTS FOR COMPANIES

The sample comments are based on the SEC's existing 2010 Guidance, which does not mandate disclosure of any specific climate-related metrics but requires companies to disclose information about climate change's potential or actual impacts on the company to the extent material to investors.

The SEC's Division of Corporation Finance, in explaining the sample letter, noted that, depending on the particular facts and circumstances, information related to climate change-related risks and opportunities may be required in disclosures related to a company's description of business, legal proceedings, risk factors, and management's discussion and analysis of financial condition and results of operations (MD&A). Disclosure matters discussed in the 2010 Guidance include, for example, the impact of pending or existing climate change-related legislation, regulations, and international accords, the indirect consequences of regulation or business trends, and the physical impacts of climate change. In addition, the Division of Corporation Finance reminded issuers that disclosure of further material information may be necessary beyond required disclosures in order to make those statements, in light of the circumstances in which they are made, not misleading.

The illustrative sample comments focus on three parts of a company's disclosure — general disclosure, risk factors, and MD&A.

- **General**: The SEC notes that it might ask companies to explain the consideration they gave to providing the same type of climate-related disclosure in their SEC filings as provided in a parallel corporate social responsibility (CSR) report when the CSR report contains more expansive disclosure than a company's SEC filings.
- **Risk Factors**: The SEC notes that it might ask companies to disclose the material impact of "transition risks" related to climate change, consistent with the terminology used by the Task Force on Climate-related Financial Disclosures (TCFD) framework (which was published after the 2010 Guidance). Transition risks highlighted by the SEC include policy and regulatory changes that could impose operational and compliance burdens, market trends that may alter business opportunities, credit risks and technological changes. The SEC indicates that it may also ask companies to disclose any material litigation risks related to climate change and explain the potential impact to the company.
- **MD&A:** The SEC lists multiple areas where it may request enhanced disclosure, to the extent material, including:
  - the physical effects of climate change on operations and results, including severe weather such as floods and fires, indirect weather-related impacts on major customers or suppliers and weather-related impacts on the cost or availability of insurance;
  - pending or existing climate change-related legislation, regulations, and international accords, including describing any material effect on the company's business, financial condition, and results of operations;
  - indirect consequences of climate-related regulation or business trends, such as decreased demand for goods producing significant greenhouse gas (GHG) emissions, increased competition to develop innovative new products that result in lower emissions, or any

anticipated reputational risks resulting from operations or products that produce material GHG emissions; and

- disclosure about purchase or sale of carbon credits or offsets.

Companies should also anticipate receiving other queries from the SEC, depending on the types of risks and concerns specific to their industry. The Division of Corporation Finance noted that the sample letter is illustrative and does not constitute an exhaustive list of the issues that companies should consider.

NEXT STEPS

In light of the reported and illustrative SEC comments, as well as the anticipated release of proposed SEC rules on climate change disclosures in late 2021,[4] public companies should evaluate carefully their existing climate-related disclosures, whether in SEC filings or otherwise. In particular, companies should ensure that all climate-related disclosures, including newly announced initiatives or commitments, whether currently mandated or voluntarily provided, are subject to their disclosure controls and procedures. Robust disclosure controls and procedures will not only serve to ensure that climate-related disclosures are shared with appropriate decision-makers to evaluate whether climate-related information may be material to investors and required to be disclosed, but will also provide other benefits such as risk mitigation and enhancing the reliability and accuracy of the information.

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ENDNOTES

1 For prior Client Memoranda on the SEC's proposed rulemaking agenda on climate change disclosures, *see*:

- "SEC Chair Addresses Details of Potential New U.S. Climate-Related Disclosure Rules," dated July 29, 2021, *available at* https://www.sullcrom.com/files/upload/sc-publication-SEC-Chair-Discusses-Potential-New-US-Climate-Disclosure-Rules.pdf
- "SEC Focuses on Potential Updates to U.S. Climate Change Disclosure Requirements," dated March 19, 2021, *available at* https://www.sullcrom.com/files/upload/SC-Publication-SEC-Updates-Climate-Change-Disclosure-Requirements.pdf

Our overview of related legal developments on environmental, social and governance matters is available here.

2 SEC Division of Corporation Finance, "Sample Letter to Companies Regarding Climate Change Disclosures," *available at* https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures?utm_medium=email&utm_source=govdelivery

3 Commission Guidance Regarding Disclosure Related to Climate Change, Rel. No. 33-9106 (Feb. 8, 2010), *available at* https://www.sec.gov/rules/interp/2010/33-9106.pdf.

4 SEC Chair Gary Gensler, "Prepared Remarks Before the Principles for Responsible Investment 'Climate and Global Financial Markets' Webinar," dated July 28, 2021, *available at* https://www.sec.gov/news/speech/gensler-pri-2021-07-28. Our firm's memo on Chair Gensler's comments on the upcoming rulemaking is available here.

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