

March 19, 2021

SEC Focuses on Potential Updates to U.S. Climate Change Disclosure Requirements

SEC Issues Wide-Ranging Request for Public Input to Inform Potential Rulemaking on Climate Change Disclosure Requirements for U.S. Registrants

INTRODUCTION

Companies subject to U.S. reporting requirements may be required to provide additional information about relevant risks, uncertainties, impacts and opportunities related to climate change, as the U.S. Securities and Exchange Commission (SEC), in the first two months of President Joseph Biden's administration, has begun analyzing whether current disclosures by such companies adequately inform investors about the impacts of the changing climate.

Not since 2010 has the SEC provided specific guidance to U.S. reporting companies on what information concerning climate change they are required to communicate to investors.¹ The 2010 SEC guidance, which remains in effect, articulates a "principles-based" disclosure framework rooted in the concept of materiality and does not mandate disclosure of any specific climate-related metrics. The guidance requires companies to disclose information about climate change's potential or actual impacts on the company to the extent material to investors.

Since 2010, however, global investor demand for information about the impact of climate change on company performance and outlook has increased dramatically. As a result, companies have begun voluntarily disclosing information about sustainability and climate metrics,² and jurisdictions including the European Union, United Kingdom, Hong Kong and Republic of Korea have taken steps towards requiring such disclosures.³

In February of this year, Acting SEC Chair Allison Herren Lee directed the SEC's Division of Corporation Finance "to enhance its focus on climate-related disclosure in public company filings" and stated that the

SULLIVAN & CROMWELL LLP

SEC staff would begin reviewing existing disclosures as part of a process of updating the 2010 guidance.⁴ Acting Chair Lee also appointed Satyam Khanna as the SEC's first-ever senior policy advisor for climate and ESG.

Gary Gensler, President Biden's nominee to chair the SEC, has also signaled support in his Senate confirmation hearing for additional ESG disclosure regulations.⁵ John Coates, acting director of the SEC's Division of Corporation Finance, similarly stated in a recent speech that the "SEC should help lead the creation of an effective ESG disclosure system so companies can provide investors with information they need in a cost effective manner," noting in particular the task of adapting existing rules and standards to the "realities of climate risk".⁶

In early March, the SEC also announced the creation of a Climate and ESG Task Force in the SEC's Division of Enforcement to initially focus on identifying any material gaps or misstatements in issuers' disclosure of climate risks under existing rules. The SEC, in its announcement of the creation of the task force, also noted that it would develop initiatives to proactively identify ESG-related misconduct.⁷ The SEC's Division of Examinations has also included a focus on climate-related risks in its list of examination priorities for 2021. Part of this review, according to a statement by Acting Chair Lee, will include examination of "firms' business continuity plans in light of intensifying physical risks associated with climate change."⁸

SEC SOLICITATION OF PUBLIC INPUT

On March 15, 2021, Acting Chair Lee issued a public statement instructing the SEC staff to evaluate existing "disclosure rules with an eye toward facilitating the disclosure of consistent, comparable, and reliable information on climate change."⁹ As part of this assessment, Acting Chair Lee set forth 15 categories of questions — over 50 questions in total — on which the SEC is soliciting public input.

The questions indicate the wide-ranging nature of the SEC's assessment of climate change disclosure. Key considerations for the SEC as illustrated by the questions include:

- **Content:** A primary focus of the inquiry is determining what information registrants could be required to disclose. Among the SEC's questions include what the advantages and disadvantages would be of sector-specific reporting standards, what quantified and measured information or metrics should be disclosed and what the advantages and disadvantages would be of requiring disclosed metrics to be accompanied by a sustainability disclosure and analysis section, akin to the current SEC requirements that registrants provide Management's Discussion and Analysis of Financial Condition and Results of Operations in annual and quarterly reports. The SEC has also asked what the advantages and disadvantages would be of a "comply or explain" framework for climate change that would permit registrants to either comply with, or, if they do not comply, explain why they have not complied with the disclosure rules.
- **Consistency:** The SEC is soliciting input related to the advantages and disadvantages of rules that incorporate or draw on existing climate disclosure frameworks, such as, for example, those developed by the Task Force on Climate-Related Financial Disclosures, the Sustainability Accounting Standards Board, and the Climate Disclosure Standards Board. The SEC has also signaled that it is considering its actions in the context of the global trend towards increased focus

on climate change disclosure and has asked specifically about the advantages and disadvantages of developing a single set of global standards applicable to companies around the world, including registrants under the SEC's rules, versus multiple standard setters and standards and, if the SEC were to endorse or incorporate a global standard, what would be the advantages and disadvantages of having mandatory compliance.

- **Reliability:** A separate focus of the questions addresses the steps that may be required of issuers to ensure that the information provided is reliable. Among the questions posed by the SEC include how, if at all, registrants should disclose internal governance and oversight of climate-related risks, whether management's annual report on internal control over financial reporting and related requirements should be updated to ensure sufficient analysis of controls around climate reporting, and what the advantages and disadvantages are of making disclosures subject to audit or another form of assurance.
- **Liability:** The SEC has also solicited comment as to where and how such disclosures should be provided, and whether any such disclosures be included in annual reports, other periodic filings, or otherwise be furnished. The location of any such disclosures — and particularly whether the information must be filed with the SEC or furnished to it — can affect issuers' potential liability for the disclosure under U.S. securities laws.

NEXT STEPS

Comments have been requested within 90 days of the statement (June 13, 2021). All written comments submitted will be made public. The SEC has also invited the public to meet with Division of Corporation Finance staff to discuss these and other related matters.

The breadth and depth of the questions released for public input highlight the complexity of regulating climate-related disclosures by SEC registrants and the wide-ranging nature of the SEC's ongoing analysis of the matter. While the SEC has clearly signaled it is considering revising or replacing the 2010 guidance, drafting new rules could be a complex and lengthy process involving multiple stakeholders, including issuers, investors, researchers and existing standard setters from both the U.S. and other nations.

The SEC has indicated it is looking at the possibilities of international coordination on climate-related disclosure issues, and the EU is currently considering updates to its Non-Financial Reporting Directive, which may include increased climate-related disclosure requirements. There are also several bills related to climate change disclosure under consideration in the U.S. House and Senate, as well as in certain states.

In light of all of these developments, SEC registrants are advised to consider the adequacy of their existing disclosure related to climate change under existing applicable law and regulatory guidance and track developments in this space closely in the coming year.

* * *

ENDNOTES

- 1 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>.
- 2 See our Client Memorandum, dated June 8, 2020, “The Rise of Standardized ESG Disclosure Frameworks in the United States,” *available at* <https://www.sullcrom.com/files/upload/SC-Publication-Rise-Standardized-ESG-Disclosure-Frameworks.pdf>.
- 3 See our Client Memorandum, dated March 18, 2021, “EU Authorities Propose Mandatory Sustainability-Related Key Performance Indicator (KPI) Reporting for EU Companies,” *available at* <https://www.sullcrom.com/files/upload/sc-publication-eu-mandatory-reporting-on-sustainability-kpis-under-eu-taxonomy-update.pdf>, and our Client Memorandum, dated April 30, 2020, “Sustainable Finance Update,” *available at* <https://www.sullcrom.com/files/upload/SC-Publication-Sustainable-Finance-Update-4-30-2020.pdf>.
- 4 SEC Statement, Review of Climate-Related Disclosure (Feb. 24, 2021), *available at* <https://www.sec.gov/news/public-statement/lee-statement-review-climate-related-disclosure>.
- 5 See Nomination Hearing, U.S. Senate Committee on Banking, Housing, and Urban Affairs (Mar. 2, 2021), *available at* <https://www.banking.senate.gov/hearings/02/22/2021/nomination-hearing>.
- 6 Statement by John Coates, Acting Director, Division of Corporation Finance, “ESG Disclosure – Keeping Pace with Developments Affecting Investors, Public Companies and the Capital Markets, Statement Published in Connection with Remarks at the 33rd Annual Tulane Corporate Law Institute” (Mar. 11, 2021), *available at* https://www.sec.gov/news/public-statement/coates-esg-disclosure-keeping-pace-031121?utm_medium=email&utm_source=govdelivery.
- 7 SEC Statement, SEC Announces Enforcement Task Force Focused on Climate and ESG Issues (Mar. 4, 2021), *available at* <https://www.sec.gov/news/press-release/2021-42>.
- 8 See SEC Press Release, SEC Divisions of Examinations Announces 2021 Examination Priorities, No. 2021-39 (Mar. 3 2021), *available at* <https://www.sec.gov/news/press-release/2021-39>.
- 9 SEC Statement, Public Input Welcomed on Climate Change Disclosures (Mar. 15, 2021), *available at* <https://www.sec.gov/news/public-statement/lee-climate-change-disclosures>.

SULLIVAN & CROMWELL LLP

ABOUT SULLIVAN & CROMWELL LLP

Sullivan & Cromwell LLP is a global law firm that advises on major domestic and cross-border M&A, finance, corporate and real estate transactions, significant litigation and corporate investigations, and complex restructuring, regulatory, tax and estate planning matters. Founded in 1879, Sullivan & Cromwell LLP has more than 875 lawyers on four continents, with four offices in the United States, including its headquarters in New York, four offices in Europe, two in Australia and three in Asia.

CONTACTING SULLIVAN & CROMWELL LLP

This publication is provided by Sullivan & Cromwell LLP as a service to clients and colleagues. The information contained in this publication should not be construed as legal advice. Questions regarding the matters discussed in this publication may be directed to any of our lawyers or to any other Sullivan & Cromwell LLP lawyer with whom you have consulted in the past on similar matters. If you have not received this publication directly from us, you may obtain a copy of any past or future publications by sending an e-mail to SCPublications@sullcrom.com.