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SEC Chair Addresses Details of Potential New U.S. Climate-Related Disclosure Rules

SEC Chair Gary Gensler Expects Staff Will Propose Mandatory Climate Risk Disclosure Rules to Commission by Year-End

INTRODUCTION

In a speech delivered on July 28, 2021, U.S. Securities and Exchange Commission (SEC) Chair Gary Gensler gave certain insights into the SEC's approach to crafting new rules that would require SEC registrants to disclose information on climate-related risk. The new rules – a draft of which he expects by year-end – will aim to meet what he described as investors' request for "consistent, comparable and decision-useful disclosures."[1] Chair Gensler indicated that the SEC staff would write its own rules to establish a climate risk disclosure regime for U.S. markets, while learning from external standard-setters.

The climate rulemaking follows an SEC request for public input issued in March 2021 on how the SEC could approach climate-related disclosures.[2] Chair Gensler noted that the SEC received more than 550 unique comment letters in response, three quarters of which supported mandatory climate disclosure rules.

The anticipated rules would be a major change from the SEC's existing principles-based approach, set out in its 2010 guidance on climate risk disclosure.[3] The 2010 SEC guidance, which remains in effect, articulates a "principles-based" disclosure framework rooted in the concept of materiality. The 2010 guidance does not mandate disclosure of any specific climate-related metrics and requires companies to disclose information about climate change's potential or actual impacts on the company to the extent material to investors. Chair Gensler's comments suggest that new rules would likely require more specific, prescribed quantitative and qualitative information about climate risk.

SEC CONSIDERATIONS FOR NEW CLIMATE DISCLOSURE RULES

Chair Gensler's comments provide an early indication on how the SEC may approach certain key questions related to what registrants will be required to disclose and how they will be required to do so:

- **Content**: Chair Gensler indicated that disclosures should be mandatory and contain sufficient detail for investors to gain consistent, comparable and decision-useful information. He said the SEC staff should consider both qualitative and quantitative disclosures. Quantitative disclosures could include metrics relating to greenhouse gases, financial impacts of climate change and progress towards climate-related goals. In particular, he has asked the SEC staff to recommend how companies might disclose Scope 1 and Scope 2 greenhouse gas emissions and whether, how and under what circumstances companies could disclose Scope 3 emissions. Scope 1 and Scope 2 cover emissions directly from a company's own operations and emissions from generating electricity purchased by the company, respectively. Scope 3 emissions are more broadly defined and include emissions generated along an issuer's value chain, including emissions linked to use of the company's products and emissions linked to purchased goods and services.[4] For many companies, Scope 3 emissions are the most complicated to calculate and represent the largest category of emissions. He noted that qualitative disclosures could answer key questions such as how the company's leadership manages climate-related risks and opportunities and how these factors feed into the company's strategy.

  Chair Gensler said he had also asked staff to consider whether to include certain metrics for specific industries, such as banking, insurance, or transportation, and whether companies might provide scenario analysis disclosure showing how the company might adapt to different possible climate-related outcomes. In addition, Chair Gensler noted that many companies have made commitments to reduce greenhouse gas emissions or operate in jurisdictions that have made commitments to reduce emissions, which may lead to regulatory or economic changes in those jurisdictions. He has asked SEC staff to consider which data or metrics those companies might use to inform investors about how they are meeting those requirements.

- **Location of Disclosure**: Chair Gensler said that he has asked SEC staff to consider whether climate disclosures should be filed in a registrant's annual report on Form 10-K alongside other information that investors use to make their investment decisions. Any requirement to include the disclosure in a company's annual report filed with the SEC would have implications for issuers' liability for the disclosure under U.S. securities laws. Many issuers now prepare publicly available sustainability reports, often including information on climate risk – two-thirds of companies in the Russell 1000 Index published sustainability reports in 2019, according to data cited by Chair Gensler. However, these reports are very often not filed with the SEC, and issuers would face potentially greater liability for their statements if they are included in SEC filings.

- **Comparability and Consistency**: The SEC in its March solicitation for comment on climate disclosure sought input on incorporating existing climate disclosure frameworks, notably the framework developed by the Task Force on Climate-related Financial Disclosures (TCFD), which was recently endorsed by the G-7 and forms the basis for climate disclosure requirements in jurisdictions including the UK. However, Chair Gensler's remarks suggest that the SEC may instead take a more independent approach. Chair Gensler said that, although he has asked SEC staff to learn from these external standard-setters, he believes that "we should move forward to write rules and establish the appropriate climate risk disclosure regime for our markets, as we have in prior generations for other disclosure regimes."

In addition, Chair Gensler noted that the SEC is considering whether to require fund managers to disclose the criteria and underlying data they use for funds that are marketed as having sustainability features, such as being “green” or “low carbon,” as there is currently a range of what different asset managers might mean when using those terms.

NEXT STEPS

Chair Gensler said that he has asked SEC staff to prepare a proposed rulemaking for the Commission’s consideration by the end of the year, and therefore any new rule will not be effective until 2022 at the earliest.

The SEC’s planned rulemaking is part of a global trend towards requiring more detailed mandatory disclosure from companies related to the impact of climate change. The European Union is implementing increased climate-related disclosure requirements as part of its Taxonomy Regulation (including specific metrics for banks, insurers and asset managers) and Sustainable Finance Disclosure Regulation and has proposed additional requirements under a new Corporate Sustainability Reporting Directive.[5] The UK is also expanding climate-related disclosures and plans to make TCFD-aligned disclosures mandatory across the economy by 2025, with disclosure requirements applicable to certain publicly listed entities beginning this year. 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 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 begin to evaluate how developments in this space may impact their disclosures in the future, as well as the controls and procedures supporting those disclosures.

An overview of related developments on environmental, social and governance matters, including discussion of additional new disclosures likely to be required of SEC registrants, is available here.

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ENDNOTES

[1] 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.

[2] *See* our Client Memorandum, dated March 19, 2021, "SEC Focuses on Potential Updates to U.S. Climate Change Disclosure Requirements," *available at* https://www.sullcrom.com/files/upload/SC-Publication-SEC-Updates-Climate-Change-Disclosure-Requirements.pdf.

[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] *See* Greenhouse Gas Protocol, "Corporate Value Chain (Scope 3) Accounting and Reporting Standard," *available at* https://ghgprotocol.org/standards/scope-3-standard.

[5] *See* our Client Memorandum, dated March 19, 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.

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