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Securities Alert

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The SEC ramps up its plans to change climate disclosure

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We outline and analyze the SEC's recently proposed rules intended to enhance and standardize climate-related disclosures

What's the Impact?

- The SEC intends to increase transparency concerning climate-related effects on companies' financial performance and provide investors more consistent and comparable information regarding climate-related risks
- The proposed rules would significantly broaden climate-related disclosure requirements and related compliance obligations

As we discussed in our prior alerts addressing the climate and environmental, social and governance ("ESG") issues that interest investors and influence public company disclosures, the U.S. Securities and Exchange Commission ("SEC") announced over the past year a number of climate and ESG initiatives, including a comprehensive internal SEC review of current disclosure requirements, establishment of a task force in its Division of Enforcement to identify misleading

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climate and ESG related disclosures, and appointment of a Senior Policy Advisor for climate and ESG matters who reports directly to the SEC Chair. Following that initial buzz of activity, the SEC further announced last year a more significant and substantive initiative—it would propose new disclosure rules concerning the climate's impact on companies' businesses and bottom-lines.

Following through on that commitment, the SEC recently released for public comment a comprehensive, watershed-type proposed set of disclosure requirements entitled The Enhancement and Standardization of Climate-Related Disclosures for Investors (the "Proposed Rules"). The Proposed Rules would significantly broaden climate-related disclosure requirements under the Securities Act of 1933 ("Securities Act") and Securities Exchange Act of 1934 ("Exchange Act"). Although changes to the proposed disclosure requirements may occur in the course of the SEC's consideration of comments submitted in response to the proposal and drafting of final rules, we expect that some version of the proposed rules will ultimately be adopted, and, if much of the current proposal remains intact, the new rules will result in a dramatic change in the way companies must disclose climate-related risks and impacts.

Why does the SEC see a need for a climate-related disclosure rule?

Currently, SEC disclosure rules addressing climate-related risks consist of a patchwork of guidelines, including the federal securities laws' general standard mandating the disclosure of material information that alters the "total mix" of information available to investors, and the SEC's 2010 Guidance focusing on the non-financial statement disclosure rules applicable to climate-related disclosures under Regulation S-K. The SEC identified a number of reasons that it now seeks to adopt a more comprehensive and standardized set of rules to govern the disclosure of climate-related impacts. For one, the SEC noted that climate events and effects may have a material impact upon companies' future financial performance, a factor that would be key to investors' decisions in the capital markets. Citing the growing investor demand for climate-related risk disclosure and related information and its concerns that the existing disclosure regime does not adequately protect investors against climate-related risks, the SEC contends that the proposed required disclosures would provide more consistent, comparable, and reliable reporting by companies of decision-useful information than is currently mandated or voluntarily made available. SEC Chair Gary Gensler noted in his support of the proposal that the proposed rules also would benefit issuers by providing consistent and clear reporting obligations. According to the SEC, the expanded disclosure requirements also would make capital allocation more efficient as investors would be better able to price climate-related risks and that greater transparency and comparability in disclosures would foster competition.

In the proposing release, the SEC noted that companies often provide information regarding climate-related risk outside their SEC filings with differing types of content, varying degrees of completeness, and in different documents and formats, and that all information needed to understand these disclosures, such as the methodologies, data sources, assumptions, and other key parameters used to assess climate-related risks, are not always included. To the extent companies primarily provide this information separate from their financial reporting, it may be difficult for investors to determine whether a company's financial disclosures are consistent with its climate-related disclosures. Furthermore, the SEC noted that the information provided

outside of SEC filings is not subject to the full range of liability and other investor protections that help elicit complete and accurate disclosure by public companies.

Summary of the Proposed Rules

The Proposed Rules would apply to all companies with Exchange Act reporting obligations pursuant to Exchange Act Section 13(a) or Section 15(d) and to companies filing a Securities Act or Exchange Act registration statement, subject to certain proposed emissions disclosure accommodations discussed below for smaller reporting companies. If the Proposed Rules are adopted as proposed, companies would be required to include in registration statements and annual reports filed with the SEC, in a separately captioned "Climate-Related Disclosure" section, and in the notes to the audited financial statements included or incorporated in those filings, substantially more comprehensive and granular climate-related reporting than is mandated under current disclosure requirements. The Proposed Rules are modeled largely on the disclosure framework developed by the Task Force on Climate-Related Financial Disclosures ("TCFD"), which the SEC notes "has been widely accepted by issuers, investors, and other market participants" and "should help elicit climate-related disclosures that are consistent, comparable, and reliable while also limiting the compliance burden for registrants that are already providing climate-related disclosures based on this framework" as well as the Greenhouse Gas Protocol ("GHG Protocol"). The 500-plus page proposing release is replete with examples of the types of disclosures that the SEC suggests may be required under the Proposed Rules. The compliance burden under these expansive and complex rules—including the cost and challenges of data gathering and analysis, establishment of necessary internal processes and controls, retention of internal expertise and external advisors, and preparation of appropriate and responsive disclosure reporting—will nonetheless be significant for many companies. Public companies (and companies planning to become public) will want to begin early to prepare to meet these potential challenges. A summary of the Proposed Rules follows.

Expanded disclosure requirements under Regulation S-K

Climate-related risks

The proposed climate-related provisions under new subpart 1500 of Regulation S-K would require a company to disclose in relevant filings any climate-related risks reasonably likely to have a material impact on the company's business or consolidated financial statements over short-, medium-, and long-term horizons. Climate-related risks would include both physical risks—encompassing acute risks to property or operations from shorter-term extreme weather events, such as hurricanes, floods, and tornadoes, and chronic risks resulting from longer term weather patterns and related effects, such as temperature increases, sea level rise, drought, and wildfires—and transition risks associated with the potential transition to a less carbon intensive economy.

As proposed, climate-related risks would be defined to mean the actual or potential negative impacts of climate-related conditions and events on a company's consolidated financial statements, business operations, or value chains, as a whole. A company's value chain would

include the upstream activities of other parties that relate to the initial stages of the company's production of a good or service (such as materials sourcing and processing, and other supplier activities) and downstream activities that relate to processing materials into a finished product and delivering that product or providing a service to the end user (such as transportation and distribution, processing, use or end-of-life treatment of sold products, and investments). By including a company's value chain within the proposed definition of climate-related risks, the SEC indicates that its intent is to capture the full extent of the company's potential exposure to climate-related risks.

Under the Proposed Rules, companies would be required to specify whether an identified climate-related risk is a physical risk or a transition risk. For a physical risk, the company would also be required to describe the nature of the risk, including whether it is an acute or chronic risk. For a physical risk that the company has determined has had or is likely to have a material impact on its business or consolidated financial statements, the required disclosure would also include disclosure of the location of the properties, processes, or operations subject to that risk. Additional disclosures also would be required in certain specified circumstances involving, for example, material risks due to flooding or exposure in regions of high or extremely high water stress. For transition risks, companies would be required to describe the nature of those risks, including whether they relate to regulatory, technological, market, liability, reputational, or other transition-related factors, and how those factors impact the company.

In addition to requiring that companies identify and describe the nature of material climate-related risks, proposed Subpart 1500 establishes specific requirements for disclosures in the following areas:

Any climate-related impacts on the company's strategy, business model, and outlook

To "elicit robust and company-specific disclosure"—as opposed to generic or boilerplate discussion—the Proposed Rules would require a company to disclose material actual and potential climate-related impacts on its:

- business operations, including the types and locations of operations (by ZIP codes or similar subnational postal zone or geographic location);
- products or services;
- suppliers and other parties in its value chain;
- activities to mitigate or adapt to climate-related risks, including adoption of new technologies or processes;
- expenditure for research and development; and
- any other significant changes or impacts.

As proposed, the company would also be required to disclose the time horizon for each described impact and discuss how it has considered the identified impacts as part of its business strategy, financial planning, and capital allocation, as well as how any of the proposed required financial metrics under Regulation S-X, required GHG emissions metrics, or any targets requiring disclosure relate to the company's business model or strategy.

Additionally, the company would be required to provide a narrative discussion of whether and how any of its identified material climate-related risks have affected or are reasonably likely to affect the company's consolidated financial statements.

Further, as applicable, the company would be required to describe:

- the role of carbon offsets or renewable energy credits in the company's climate-related business strategy;
- the company's use and determination of an internal carbon price; and
- any analytical tools, such as scenario analysis, that the company uses to assess the impact of climate-related risks on its business and consolidated financial statements, or to support the resilience of its strategy and business model. The required disclosure would include both quantitative and qualitative information about the scenarios considered, including parameters, assumptions, and analytical choices, and the projected principal financial impacts on the company's business strategy under each scenario.

Oversight and governance of climate-related risks by the company's board and management

To provide investors with additional insight into a board's and management's governance of climate-related risks, companies would be required to:

- identify any board members or board committees responsible for the oversight of climate-related risks;
- disclose whether any director has expertise in climate-related risks and to fully describe the nature of the expertise;
- describe the processes and frequency by which the board or board committee discusses climate-related risks;
- describe whether and how the board or board committee considers climate-related risks as part of its business strategy, risk management, and financial oversight;
- disclose whether and how the board sets climate-related targets or goals and how it oversees progress against those targets or goals;
- disclose whether certain management positions or committees are responsible for assessing and managing climate-related risks and, if so, identify those positions or committees and fully describe the nature of the expertise;
- describe the processes by which the responsible managers or management committees are informed about and monitor climate-related risks; and
- disclose whether the responsible positions or committees report to the board or board committee on climate-related risks and how frequently this occurs.

The company's processes for climate-related risk management

Under the Proposed Rules, companies would be required to describe their processes for identifying and assessing climate-related risks, including, as applicable, how the company:

- determines the relative significance of climate-related risks;
- considers existing or likely regulatory requirements or policies, such as GHG emissions limits, when identifying climate-related risks;
- considers shifts in customer or counterparty preferences, technological changes, or changes in market prices in assessing potential transition risks;
- determines the materiality of climate-related risks, including how it assesses the potential size and scope of any identified climate-related risk;
- decides whether to mitigate, accept, or adapt to a particular risk; and
- prioritizes addressing climate-related risks and determines how to mitigate a high priority risk.

The SEC indicates that these disclosures would help investors evaluate whether a company's processes for identifying, assessing, and managing climate-related risks are adequate. Additionally, to help investors assess whether the company has centralized the processes for managing climate-related risks and how the board and management might respond to such risks as they unfold, companies would be required to describe whether and how climate-related risks are integrated into the registrant's overall risk management system or processes.

Climate-related targets or goals established by the company, and transition plans, if any

If a company has adopted a strategy and implementation plan to reduce climate-related risks (a "transition plan"), the Proposed Rules would require the company to:

- describe its plan, including the relevant metrics and targets used to identify and manage physical and transition risks; and
- discuss, as applicable, how it plans to mitigate or adapt to any identified physical or transition risks.

If a company has set climate-related targets or goals (for example, a net zero emissions goal within a specified timeframe), the Proposed Rules would require it to disclose them, including, as applicable, a description of:

- the scope of activities and emissions included in the target;
- the unit of measurement, including whether the target is absolute or intensity based;
- the defined time horizon by which the target is intended to be achieved, and whether the time horizon is consistent with one or more goals established by a climate-related treaty, law, regulation, policy, or organization;
- the defined baseline time period and baseline emissions against which progress will be tracked with a consistent base year set for multiple targets;
- any interim targets set by the company; and

- how the company intends to meet its climate-related targets or goals.

The Proposed Rules would also require disclosure of relevant data to indicate whether the company is making progress toward achieving the target or goal and how that progress has been achieved.

This disclosure would need to be updated annually to describe the actions taken during the year to achieve the company's targets or goals.

Voluntary disclosures regarding the actual and potential impacts of any climate-related opportunities involving governance, strategy, and risk management in connection with climate-related risks would also be permitted.

Greenhouse gas ("GHG") emissions

The Proposed Rules would require companies to measure and report, based largely on concepts developed by the GHG Protocol, Scope 1, Scope 2, and, in certain cases, Scope 3 emissions for the most recently completed fiscal year and, to the extent available without unreasonable effort or expense, the historical fiscal years included in the audited financial statements in the applicable filing.

As proposed, and consistent with the GHG Protocol and various other international frameworks, "greenhouse gases" would be defined to include carbon dioxide (CO2), methane (CH4), nitrous oxide (N2O), nitrogen trifluoride (NF3), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), and sulfur hexafluoride (SF6).

GHG emissions would mean both direct emissions of greenhouse gases—emissions from sources that are owned or controlled by the company—and indirect emissions of greenhouse gases—emissions that result from the activities of the company, but occur at sources not owned or controlled by the company.

- **Scope 1 emissions** would include direct GHG emissions from operations that are owned or controlled by a company.
- **Scope 2 emissions** would include indirect GHG emissions from the generation of purchased or acquired electricity, steam, heat, or cooling that is consumed by operations owned or controlled by a company.
- **Scope 3 emissions** would include all other indirect GHG emissions which occur in the upstream and downstream activities of a company's value chain. Upstream emissions include emissions attributable to goods and services that the company acquires, the transportation of goods (for example, to the company), and employee business travel and commuting. Downstream emissions include the use of the company's products, transportation of products (for example, to the company's customers), end-of-life treatment of sold products, and investments made by the company. Consistent with the GHG Protocol, the Proposed Rules identify a non-exclusive list of 15 discrete categories of value chain activities that might give rise to Scope 3 emissions, including: purchased goods and services; capital goods; fuel

and energy related activities not included in Scope 1 or Scope 2 emissions; transportation and distribution of purchased goods, raw materials, and other inputs; waste generated in a company's operations; business travel by a company's employees; employee commuting by a company's employees; leased assets related principally to purchased or acquired goods or services; transportation and distribution of a company's sold products, goods, or other outputs; processing by a third party of a company's sold products; use by a third party of a company's sold products; end-of-life treatment by a third party of a company's sold products; leased assets related principally to the sale or disposition of goods or services; franchises; and investments by a company.

Total Scope 1 emissions would be required to be disclosed separately from total Scope 2 emissions after calculating them from all sources that are included in the company's organizational boundaries (using the same scope of entities, operations, assets, and other holdings as those included in, and based upon the same set of accounting principles applicable to, its consolidated financial statements) and operational boundaries (encompassing emissions sources within its plants, offices, and other operational facilities).

As proposed, GHG emissions data would be required to be expressed in terms of carbon dioxide equivalent, or CO2e, and disclosed in gross terms, excluding any use of purchased or generated offsets, both on a disaggregated basis by each greenhouse gas and in the aggregate.

The Proposed Rules would not require companies to calculate GHG emissions under a particular methodology. Instead, each company would have flexibility as to the choice of calculation methodology, so long as the methodology chosen is consistent with the GHG Protocol. Companies would, however, be required to describe the methodology, significant inputs, and significant assumptions used to calculate their GHG emissions.

All reporting companies would be required to provide disclosures regarding Scope 1 and Scope 2 emissions. Total Scope 3 emissions for the fiscal year would also require separate disclosure if (a) those emissions are material or (b) the company has set a GHG emissions reduction target or goal that includes its Scope 3 emissions. Smaller reporting companies, however, would be exempted from Scope 3 emissions reporting in light of the proportionately higher fixed costs smaller reporting companies would otherwise bear for gathering, verifying, and reporting Scope 3 emissions data.

To increase comparability and utility to investors, companies required to disclose Scope 3 emissions would also be required to:

- identify the categories of upstream and downstream activities included in the calculation of the Scope 3 emissions; and
- describe the data sources used to calculate the Scope 3 emissions.

In addition to requiring reporting gross data on GHG emissions for the fiscal year, to further enhance both comparability and the ability to track a company's progress over time, the Proposed Rules would require a company to disclose the sum of its Scopes 1 and 2 emissions,

and, if required to disclose Scope 3 emissions, to separately disclose its Scope 3 emissions, in each case in terms of GHG intensity through a ratio of metric tons of CO2e per unit of total revenue and per unit of production.

Recognizing that the calculation and disclosure of Scope 3 emissions may "pose particular difficulties" and "could be challenging" for many companies, particularly given the reliance on third-party data, the Proposed Rules include, in addition to the exemption for smaller reporting companies from the Scope 3 emissions disclosure requirement as noted above, a limited safe harbor for Scope 3 emissions disclosure from certain forms of liability under the federal securities laws and a delayed compliance date for Scope 3 emissions disclosure required of accelerated filers and large accelerated filers. According to the SEC, these accommodations balance the reporting challenges and potential liability associated with Scope 3 emissions reporting with investors' need for decision-useful emissions disclosure that is complete and not misleading.

To avoid repetition and duplication, the company would be able to incorporate by reference in the Climate-Related Disclosure section relevant disclosure from other parts of the registration statement or annual report (for example, from Risk Factors, Description of Business, Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A), or the financial statements) or, in certain cases, from other reports filed with or submitted to the SEC.

Expanded Disclosure Requirements under Regulation S-X

The proposed climate-related provisions under new Article 14 of Regulation S-X would require companies to disclose in a note to their audited financial statements certain disaggregated climate-related financial statement metrics which the SEC indicates are intended to increase consistency and comparability, as well as transparency about how climate-related risks impact the company's financial statements. The required disclosures, which are characterized by the SEC as being mainly derived from existing financial statement line items, would include certain specified financial impact metrics, expenditure metrics, and financial estimates and assumptions. In calculating the financial metrics, companies would be required to include financial information from consolidated subsidiaries. These financial statement metrics would be included in the scope of any required audit of the financial statements in the relevant filing, subject to audit by the company's independent registered public accounting firm, and within the scope of the company's internal control over financial reporting.

Financial Impact Metrics

Under the Proposed Rules, companies would be required to disclose, on a line item basis, the financial impacts—negative and positive—of severe weather events and other natural conditions (such as flooding, drought, wildfires, extreme temperatures, and sea level rise), transition activities (meaning any efforts to reduce GHG emissions or otherwise mitigate exposure to transition risks), and any identified climate-related physical risks on the consolidated financial statements included in the relevant filing, unless the aggregated impact of such items is less than 1% of the total line item for the relevant fiscal year.

Expenditure Metrics

Under the Proposed Rules, companies would be required to aggregate amounts of expenditures expensed and capitalized costs incurred during the fiscal years presented in the consolidated financial statements and disclose separately the amount incurred for each of those categories in respect of positive and negative impacts associated with climate-related events and transition activities, subject to a 1% threshold.

Financial Estimates and Assumptions

Under the Proposed Rules, companies would be required to disclose whether the estimates and assumptions used to produce the consolidated financial statements were impacted by exposures to risks and uncertainties associated with, or known impacts from, climate-related events (including identified physical risks and severe weather events and other natural conditions) and, if so, to provide a qualitative description of how such events have impacted the development of the estimates and assumptions used by the company in the preparation of its financial statements.

Additionally, if the estimates and assumptions a registrant used to produce the consolidated financial statements were impacted by risks and uncertainties associated with, or known impacts from, a potential transition to a lower carbon economy or any climate-related targets it has disclosed, the company would be required to provide a qualitative description of how the development of the estimates and assumptions was impacted.

Attestation requirements for Scope 1 and Scope 2 emissions disclosures

The Proposed Rules would require companies that are accelerated filers or large accelerated filers (including foreign private issuers) to (i) include in the "Climate-Related Disclosure" section of relevant filings an attestation report from a qualified third-party "GHG emissions attestation provider" covering the disclosure of their Scope 1 and Scope 2 emissions and (ii) provide certain disclosures about the qualifications and practices of the attestation provider. As defined in the Proposed Rules, a "GHG emissions attestation provider" would be required to be independent and meet certain specified criteria as to expertise. The Proposed Rules specify certain minimum attestation engagement and report requirements which are based largely on existing AICPA attestation standards.

Third-party attestation over Scope 1 and 2 emissions disclosures would, according to the proposing release, improve accuracy, comparability, and consistency with respect to those disclosures and also provide investors with an additional degree of reliability regarding the numbers that are disclosed, as well as the key assumptions, methodologies, and data sources used to calculate the reported numbers. Moreover, the SEC indicates that requiring third-party attestation is appropriate to enhance the reliability of GHG emissions disclosure because, unlike other quantitative disclosure outside of the financial statements that typically is derived, at least in part, from the same books and records used to generate a company's audited financial statements and accompanying notes, that disclosure would generally not be developed from information included in a company's books and records and therefore not be within the scope of the company's internal control over financial reporting or subjected to audit procedures.

The Proposed Rules provide an initial transition period for attestation at the limited assurance level in the first two years after the year in which Scopes 1 and 2 emissions disclosure is initially required and a subsequent one-year transition period for attestation at the reasonable assurance level.

Additionally, under the Proposed Rules, a company that is not a large accelerated filer or an accelerated filer, but that voluntarily obtains a third-party attestation or verification of its GHG emissions disclosures, would be required to provide in the "Climate-Related Disclosure" section in the relevant filing certain specified information regarding the service provider engaged to provide those services and the nature, scope, and results of that engagement.

Materiality

The proposing release clarifies that the materiality standard to be applied to the required disclosure is the long-standing test applied by the SEC and the Supreme Court: a matter is material if there is a substantial likelihood that a reasonable investor would consider it important when determining whether to buy or sell securities or how to vote. The materiality determination is largely fact specific and requires consideration of both quantitative and qualitative factors. In the context of the Proposed Rules, the SEC indicates that, similar to materiality determinations currently required in the context of known trends and uncertainties reporting in the company's MD&A, the materiality determination with regard to potential future climate-related events requires an assessment of both the probability of the event occurring and its potential magnitude, or significance to the company. The SEC also emphasized that, under the Proposed Rules, materiality of a climate-related risk should be assessed over the short-, medium-, and long-term in order "[t]o help ensure that management considers the dynamic nature of climate-related risks" and reinforced that doubts as to materiality are best resolved in favor of disclosure.

Safe harbor for forward-looking statements

If adopted as proposed, the rules would require companies to address future events and expectations in a number of areas. To the extent the company's climate-related disclosures constitute forward-looking statements, the forward-looking statement safe harbors under the Private Securities Litigation Reform Act ("PSLRA") would be available, subject to compliance with the conditions applicable to and limitations of those safe harbors. For example, climate-related disclosures made in registration statements for initial public offerings would not be covered by the PSLRA safe harbors.

To mitigate potential liability concerns associated with providing emissions disclosure based on third-party information, the Proposed Rules also provide a safe harbor for Scope 3 emission disclosures under which any statement regarding Scope 3 emissions would be deemed not to be a fraudulent statement unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.

Interactive data requirement

Under the Proposed Rules, companies would be required to tag the proposed climate-related disclosures in Inline XBRL, including block text tagging and detail tagging of narrative and quantitative disclosures provided pursuant to Subpart 1500 of Regulation S-K and Article 14 of Regulation S-X.

Disclosures to be "filed" rather than furnished

As proposed, the required climate-related disclosures, other than disclosures furnished on Form 6-K, would be considered "filed" and therefore subject to potential liability under Section 18 of Exchange Act and Section 11 under the Securities Act.

Phase-in periods for compliance

Recognizing that many companies, and particularly smaller companies, may need time to establish the necessary systems, controls, and procedures to comply with the proposed climate-related disclosure requirements, the SEC proposed phased-in compliance dates as summarized in the table below. This table assumes that the Proposed Rules will be adopted with an effective date in December 2022, and that the company has a December 31 fiscal year-end.

REGISTRANT TYPE	DISCLOSURE COMPLIANCE DATE		SCOPE 1 AND SCOPE 2 GHG EMISSIONS ATTESTATION REPORT COMPLIANCE DATE	
	All proposed disclosures, but excluding Scope 3 GHG emissions metrics and associated intensity metric.	Scope 3 GHG emissions metrics and associated intensity metric.	Limited Assurance Level	Reasonable Assurance Level
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)	Fiscal year 2024 (filed in 2025)	Fiscal year 2026 (filed in 2027)
Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Fiscal year 2025 (filed in 2026)	Fiscal year 2027 (filed in 2028)
Non-Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Exempted	Exempted
Smaller Reporting Company	Fiscal year 2025 (filed in 2026)	Exempted	Exempted	Exempted

A company with a different fiscal year-end date that results in its fiscal year commencing before the effective date of the rules would not be required to comply with the newly adopted climate-related disclosure rules until the following fiscal year.

The Proposed Rules are subject to a public comment period ending May 20, 2022.

What should companies be doing now?

If the Proposed Rules are adopted substantially as proposed, preparations for compliance will likely be a significant undertaking for most public companies and will require coordination with internal and external resources. While it is likely that it will take some time after the comment period ends for the SEC to review and consider the comments submitted before issuing final rules, it is not too soon to begin preliminary preparations in anticipation that rules requiring more uniform and detailed climate-related risk disclosures may be adopted as soon as this year. In particular, companies should begin to consider the following in light of the Proposed Rules:

Review current reporting concerning climate-related matters

To the extent a company is currently gathering and processing relevant data and reporting on climate risk and climate change matters, in its sustainability reports or elsewhere, this would be a good time to review those processes and disclosures to identify any gaps or misalignments in information collection, processing, verification, or reporting that would need to be addressed if the rules were adopted substantially as proposed. Additionally, companies that have announced climate-related targets or goals will want to begin to consider how they will address the proposed additional disclosure requirements relating to targets and goals, including progress made toward meeting those objectives. Companies that have not previously established and disclosed targets or goals but are contemplating doing so should weigh the potential disclosure implications under the Proposed Rules and may want to consider waiting to establish new targets or goals until after final rules are adopted. For a company that is not currently reporting climate-related information using the TFCD framework or GHG Protocol, it may be useful, at a minimum, to take time now to become familiar with those standards and the related vocabulary as incorporated in the Proposed Rules.

Evaluate board and management oversight responsibilities

Companies that have not already delineated board and management responsibilities for climate-related risk management and oversight should begin to consider how and where to allocate those responsibilities in light of the expectations underlying the proposed disclosure requirements relating to governance and risk management and the company's particular facts and circumstances vis-à-vis climate-related risks. Similarly, companies should begin to consider the nature and scope of any new policies and procedures, or changes to existing policies and procedures, that may be necessary to address changes in climate-related risk management and oversight responsibilities, as well as potential implications for committee responsibilities and director qualifications.

Assess and anticipate resource requirements

Companies will want to assess the adequacy of their existing operational and management resources, processes, and controls to meet the disclosure requirements of the Proposed Rules, and begin to identify additional resources they may be required and processes that may need to be established and/or supplemented for compliance, including internal cross-functional teams and external advisers with relevant expertise in data collection, analysis, and verification.

Engage with auditors

Companies will also want to begin early to discuss the implications of the proposed financial statement disclosures with their auditors and to identify and begin to prepare for additional audit procedures relating to the climate-related metrics and related information required under the proposed Rules. Companies will also want to consider whether and what internal control changes or additions may be necessary or desirable in light of the expanded disclosure requirements.

Prepare to address Scope 3 emissions reporting challenges

Scope 3 emissions represent one of the most challenging aspects of the GHG emissions disclosures proposed by the SEC. The primary challenges associated with providing Scope 3 emissions disclosures involve data availability, calculation methodologies, scoping, and organizational barriers which collectively can result in significant data gaps and obstacles, as well as double counting of emissions.

- ***Data Availability***—While Scope 1 emissions data for certain sources is already reported to the EPA, and the GHG Protocol requires disclosure of Scope 1 and 2 emissions (albeit with scoping differences relative to those proposed by the SEC), Scope 3 emissions reporting is not broadly required under existing frameworks, and therefore is not broadly available. Additionally, there can be discord between the very high effort involved in primary, or actual, data collection in the supply chain and the lower quality of data collected through more practical secondary data (i.e., industry averages, or spend based) calculations. Companies may struggle to collect relevant and sufficiently granular primary data and to manage the amount of data needed to determine Scope 3 emissions, which may require establishment of formal data management plans and additional internal and external resources.
- ***Calculation Methodologies***—Methodological challenges to obtaining accurate Scope 3 emissions data for reporting purposes include estimating emissions for suppliers that do not calculate their own emissions, defining an appropriate calculation approach for each Scope 3 category, and recognizing double counting when emissions could fit within more than one category. Different calculation approaches and estimation methodologies may need to be chosen and applied to every Scope 3 category because each one involves its own calculation approach. Because methodologies are often based on assumptions about business operations, peers, and industry averages rather than actual data, they can be imperfect and inconsistent.

- ***Boundary and Scoping***—Establishing value chain boundaries when calculating Scope 3 emissions presents another challenge. While the Scope 3 categories identified in the Proposed Rules are each designed to be discrete, applying the categories in practice may cause an overlap in reporting boundaries due to companies' involvement at multiple points in the life cycle of products, as well as confusion when sources fit within more than one category. Additionally, the more complex a company's organizational structure is, the more challenging the data collection and calculation of emissions arising from the Scope 3 categories may become.

  The process of gathering, verifying, analyzing, and reporting Scope 3 emissions data will require cooperation with, and assistance from, third parties in the company's value chain, external advisers, and internal resources with relevant expertise. To address these challenges, companies may want to begin by taking an accounting of internal resources available to dedicate to the collection and management of Scope 3 emissions data, and identifying the additional training and resources that will be needed to facilitate a smooth adoption of appropriate disclosure policies and procedures. Companies may also want to begin engaging with industry groups engaged in finding common solutions to shared challenges in the data collection and verification processes.

Monitor potential challenges and litigation

Almost immediately after the SEC began testing the waters on a new disclosure rule, a number of constituencies and groups raised the specter of legal challenges. Some in the investment community welcome the SEC's proposal to provide comprehensive climate-related disclosure rules, however, while others express concerns over the significant costs and additional liability that companies will incur as a result of such a rule. While the form and number of legal challenges remain to be seen, we expect that challengers will most certainly question the SEC's authority to promulgate such a rule within its current grant of rule-making authority. Those threatening litigation, including a group of sixteen state attorneys general, have already suggested that while they believe the SEC is authorized to act within its Congressional mandate to protect investors, the new rule goes beyond such protection and wades into other policy issues. Those same voices argue that only Congress can legislate requirements for the scope of disclosures described in the Proposed Rules. In addition to what we see as the central question of scope of authority, others have also questioned whether the requirement that companies affirmatively disclose the type of information required in the Proposed Rules would violate companies' First Amendment rights. We expect that legal challenges on these and other grounds will be launched, which may delay implementation of final rules.

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