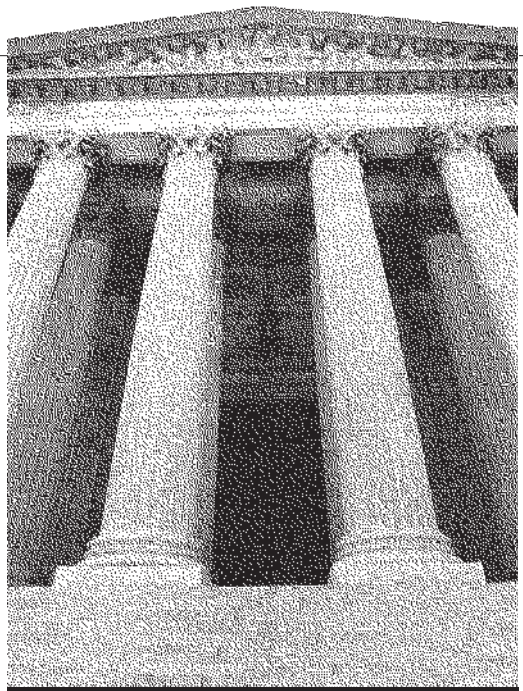

THE DEBATE

Opportunities, Gained and Missed, in the SEC's Proposed Climate Rule

Last year, the Securities & Exchange Commission published a proposed rule on climate disclosure that would require registrants to provide certain climate-related information in their registration statements and annual reports. The proposed rule requires "information about a registrant's climate-related risks that are reasonably likely to have a material impact on its business, results of operations, or financial condition." A final rule is expected later this year.

Certain issues raised in the proposed rule have garnered much attention, such as the disclosure of Scope 3 emissions, which we covered in an earlier debate. But the appearance of this SEC proposal raises a number of other important topics. They relate to ESG disclosure generally (both voluntary and mandatory) and climate risk disclosure (as a subset of ESG or sustainability disclosure). Its possible effects call into question the relationship between the SEC proposal and other pending international proposals from bodies like the International Sustainability Standards Board.

We ask a panel of experts: Was the alignment of the proposal with the TCFD framework (Task Force on Climate-related Disclosure) appropriate? What provisions included in the proposed rule prompt optimism or concern? Should the overall scope of the proposed rule have been broader than climate risk, for example the full scope of ESG or sustainability reporting, as others had proposed in prior petitions to the SEC? And were there other aspects of climate disclosure that were excluded or could have been better addressed?

"The proposed rule will enable investors to make informed decisions based on objective and accurate data"

Andrew Behar
CEO
As You Sow

"The rule largely ignores the adaptation and resilience side of climate action"

Ira Feldman
Founder & Board Chair
Adaptation Leader

"The proposal's financial statement requirements would present significant challenges for companies"

Tiffani Lee
Partner
Holland & Knight LLP

"International guidelines like the forthcoming ISSB climate standards have major advantages over federal rules"

Robert Pojasek
President
Pojasek & Associates

"Improvements in technology are needed to measure and achieve new sustainability benchmarks"

Dottie Schindlinger
Executive Director
Diligent Institute

"Global alignment of climate disclosure rules will reduce reporting fragmentation"

Kristina Wyatt
Deputy General Counsel and Senior Vice President
Persefoni

Building Trust for Better Investments

By Andrew Behar

TODAY'S hyper-connected and data-driven economy means that investors consider many risk factors when making critical decisions in line with their fiduciary duty. Shareholders rely on the SEC to require that companies release this material information. However, many disclosures, including climate emissions, have historically been inaccurate, unverified, often misleading, and released in a variety of formats, making comparisons impossible.

This chaotic reporting process creates inconsistency, which in turn increases risk for individual investors and those who manage trillions of dollars in retirement funds for hardworking Americans. The new climate disclosure rule assures that these material disclosures are accurate, verified, and in a standardized format. It is the manifestation of the most fundamental mission of the SEC: to establish trust between companies and their beneficial owners, and to protect investors and maintain a fair and orderly market.

As shareholder advocates, we at *As You Sow* are all too aware of the urgent need for action on climate change. It is a material issue that affects all companies and therefore all investors. It is one that requires bold and decisive action from governments, businesses, and shareholders around the world. That's why the SEC's recent proposal is so significant. It marks an important step forward in ensuring that investors have access to the information they need to make informed decisions about the risks and opportunities presented by the transition to a low-carbon economy.

As the extractive economy winds down and a new regenerative economy based on justice and sustainability moves to center stage, this new rule—along with the SEC's proposed fund-naming rule, Europe's ESG taxonomy, the International Sustainable Standards Board's global definitions of materiality, and other critical frameworks—is needed to assure a smooth transition to the new economic paradigm.

Although companies have already begun to address climate risk, progress has been uneven and slow, and disclosures continue to be disparate, non-comparable, and lacking in critical information necessary for investors to make prudent capital-allocation decisions. Similarly, while many companies are taking climate-related action, most are not planning sufficiently for the risks of warming—putting shareholder investments in jeopardy.

One of the most notable aspects of the SEC's proposed rule is its alignment with the recommendations of the Task Force on Climate-related Disclosure. The TCFD is a globally recognized framework providing guidance on how companies should assess and report their climate-related risks and opportunities. It was established in 2015 by the Financial Stability Board, a body that promotes international financial steadiness.

For example, the proposed rule includes a requirement for companies to report on the physical and transition risks they face as a result of climate change. These risks can include the impact of extreme weather events on a company's operations and the potential for regulatory changes or market shifts to affect demand for products or services. By requiring companies to report on these risks, the SEC is helping investors understand the full range of challenges and opportunities they may encounter as the world moves to a low-carbon future.

The proposed rule includes a number of provisions that will be particularly beneficial to investors. One of the most significant is the requirement for third-party attestation of a company's greenhouse gas emissions. This will provide a valuable check on the self-reported data that companies currently provide, which have often been found to be incomplete or inconsistent. It will also give investors greater confidence in the accuracy and reliability of climate-related disclosures.

While many aspects of the SEC's proposed rule are cause for optimism, some areas fall short. One of the most notable omissions is the relatively limited coverage of adaptation and resilience. These are crucial considerations for companies operating in a rapidly changing climate, and investors need to understand how well companies are prepared to cope with the physical and transition risks they face. Firms should also be required to disclose their plans for adapting to and mitigating these risks, as well as the resources they have allocated to these efforts.

We are hopeful that the SEC's proposed rule on climate disclosure will be adopted. We strongly believe that it will have a positive impact on the quality and consistency of climate-related reporting and help ensure a more fair, orderly, and efficient market. The accuracy and reliability of climate-related and other material disclosures is a critical function of the SEC, and it is essential to building and maintaining trust between investors and the companies they own. The proposed rule will enable investors to make informed decisions based on objective and accurate data—a goal that every investor should support.

Andrew Behar is CEO of As You Sow, a nonprofit practitioner of shareholder advocacy and engagement.

The Missing Half of Disclosures: Adaptation

By Ira Feldman

MY nonprofit organization, Adaptation Leader, has tracked the SEC's proposed rule on climate-related disclosures with great interest. Admittedly, we were disappointed the agency opted to limit its rule to climate disclosures rather than a broader environmental, social, and governance or sustainability framing. Climate change is an essential consideration within ESG and sustainability reporting, but it does not present the complete picture for disclosure purposes.

Within the narrow climate focus presented in the proposed rule, we believe the SEC has done an excellent job of outlining disclosure requirements for greenhouse gas reduction, or mitigation. Unfortunately, the rule largely ignores the adaptation and resilience side of climate action. This is a critical mistake.

The brief mentions of adaptation and resilience in the proposed rule are superficial and not actionable. While multiple sections explain the rationale for several mitigation-related provisions, like attestation, metrics, scenarios, and others, there is not one analogous section offering rationale or guidance for adaptation. The result is an incomplete, imbalanced scope of material climate considerations that will result in a far less robust disclosure rule than needed. But not all hope is lost; the agency can remedy this.

In comments Adaptation Leader submitted to the SEC, we urged the agency to correct this imbalance and incorporate adaptation considerations. The agency should pay equal attention to mitigation and adaptation.

The SEC's emphasis on mitigation stems from the agency's over-reliance on the Task Force on Climate-related Financial Disclosures framework, known as the TCFD. The proposed rule is so focused on GHG reduction that it virtually excludes substance on the other half of climate action: adaptation and resilience.

We have no gripe with the TCFD; it is an influential framework that has effectively advanced climate disclosure. The TCFD drafters have readily acknowledged that adaptation was not in their remit. So, while TCFD is an excellent base for GHG-related disclosures, it should not be the sole base for all climate disclosure.

The fact that the adaptation and resilience field is less developed than the mitigation space does not justify the SEC's inattention to their inclusion in the proposed rule. On the contrary, the agency should lead on this issue. It should strongly acknowledge the importance of adaptation in the climate risk equation and urge greater corporate attention to developing and implementing adaptation strategies.

Recent attention on adaptation and resilience, most notably in the Intergovernmental Panel on Climate Change report released last year and news coverage of climate-induced extreme weather events, only underscores the importance of looking beyond mitigation for climate disclosures.

We hope the SEC takes our plea seriously. As we stated in our comments on the rule:

"Should adaptation reporting requirements and/or guidance be added to this proposed rule, the SEC will enormously contribute to overall U.S. climate action by drawing attention to adaptation and resilience through disclosure. Any delay in incorporating specific guidelines for adaptation and resilience disclosure in the Final Rule will be counterproductive. Now is the time to highlight the significance of adaptation, not ignore it."

Realistically, the final rule will not balance mitigation and adaptation provisions if the SEC holds to its timeline for an April 2023 release. But the story doesn't end there. The evidence clearly indicates that great urgency is needed to catch up on the adaptation side of climate efforts as compared to mitigation. We recognize that mitigation and adaptation are inextricably linked. To quote the hockey player Wayne Gretzky, the SEC should take note of "where the puck is going" in climate reporting. The regulated community can no longer ignore adaptation, and the lack of holistic corporate climate disclosures will not be acceptable going forward.

The SEC needs to get up to speed on adaptation and resilience rapidly. It must lead on this issue and encourage innovation and experimentation. We recommend the SEC convene a multi-stakeholder process or a series of listening sessions to become better informed on adaptation and resilience. As best practices emerge, the agency can issue guidance on adaptation metrics and the materiality of adaptation and resilience-related expenses. It could then formalize results-oriented provisions through a follow-up rulemaking or other process.

In the Biden administration's "whole of government" approach to climate change, the SEC must play its part. The proposed rule cannot be isolated or cordoned off in its own financial silo. At this juncture, the only coherent approach addresses both mitigation and adaptation. The absence of relevant provisions in the final rule will send the wrong signal to the regulated community—one that says that adaptation and resilience need not be considered yet. But if not now, then when?

Ira Feldman is founder & board chair of the nonprofit organization Adaptation Leader.

Agency Should Reevaluate Feasibility

By Tiffani Lee

THE Securities and Exchange Commission issued its proposed Climate-Related Disclosure Rules in an effort to address a lack of standardization in corporate reporting on climate risk. Drawing on frameworks set by the Task Force on Climate-Related Financial Disclosures, known as TCFD, and the Greenhouse Gas Protocol of 2001, the SEC attempted to create a disclosure framework that, as the agency said, "would provide consistent, comparable, and reliable—and therefore decision-useful—information to investors to enable them to make informed judgments about the impact of climate-related risks on current and potential investments."

The agency has received thousands of comments on its proposal. Within those comments, certain aspects of the proposal have been criticized for failing to meet the stated objective, being overly prescriptive, or imposing considerable burden and expense on registrants. As a litigator who defended public companies and their officers and directors in securities class actions and shareholder derivative actions for many years, I believe the expressed concerns about the proposal's Regulation S-X financial reporting requirements are warranted.

The proposal would add a new Article 14 to Regulation S-X to require disclosure of certain climate-related metrics in a footnote to a company's audited financial statements. Broadly, the mandated metrics would consist of disaggregated climate-related impacts of severe weather events and other natural conditions, as well as transition activities on existing financial statement line items if the amount exceeds one percent of the value of the relevant line item. These financial reporting requirements would be unworkable, impractical, overly burdensome, and unlikely to result in decision-useful information for investors.

First, the proposal would require disclosures related to severe weather events, but it is unclear how a "severe weather event" will be defined. The examples provided by the SEC are largely inapplicable to many companies. There is currently no accepted standard definition and no guidance on how such a definition would or should be adjusted by relevant factors such as location, industry, or time. One can readily imagine that different industries—and different companies within a given industry—might have a range of views on what constitutes a severe weather event at a given location or point in time. Because each company would have to define the term of art in the context of its business, there would be less consistent, comparable information.

Second, the proposed one percent disclosure threshold seems somewhat arbitrary and inexplicably low. Under the proposal, the disclosure of the financial impact on a line item of the registrant's consolidated financial statements "is not required if the sum of the absolute values of all the impacts on the line item is less than one percent of the total line item for the relevant fiscal year." The disclosure threshold does not appear to be tied to relevant financial reporting concepts, including materiality, and it is unclear why the SEC chose to depart from the generally applicable materiality constraint on required disclosures. Not surprisingly, several commentators have urged the SEC to replace the one percent line item reporting threshold with the materiality standard typically used in financial reporting.

Third, it would likely be extremely burdensome and costly for companies to assess the threshold at the line-item level. To do so, companies would need to invest in new systems, processes, and personnel. Further, the need for internal controls and assurance associated with including this information in financial statements would require significant investments of capital, time, and attention, regardless of the disclosure threshold. Additionally, the audit costs are not knowable, because of the potentially large number of line items in the financial statements that may be impacted.

Finally, it is unclear how a company would isolate the financial impacts of severe weather and other natural conditions using any threshold. There are currently no universally accepted standards for measuring climate-related financial impacts and expenditures. Therefore, requiring companies to estimate the impacts of severe weather events is unlikely to result in comparable, decision-useful information for investors. As a result, some commentators have urged the SEC to drop the financial statement requirements altogether.

The increasing importance of climate-related information to investors and other stakeholders cannot be ignored. It is laudable that the SEC is attempting to address the lack of standardization in corporate reporting on climate risk to provide decision-useful information to investors. That said, the proposal's financial statement requirements would present significant challenges for registrants and would not deliver comparable climate-related information. In my opinion, there is a need for further study and analysis about the best way to address financial statement disclosure of climate-related impacts.

Tiffani Lee is a partner at Holland & Knight LLP and a co-chair of its ESG practice.

Bringing Climate Issues to the Global Stage

By Robert Pojasek

THE chair of the SEC, Gary Gensler, had two choices for how he could best influence the emerging field of climate financial reporting. Most readers may not be aware that by virtue of his position at the SEC, Gensler also serves as a member of the board of directors of the International Organization of Securities Commissions, or IOSCO. It's through collaboration with this lesser-known global entity that Gensler could have focused the agency's climate efforts—with benefits that may have spanned broader than the current SEC proposal.

IOSCO is the leading global policy forum for securities regulators and sets international standards for securities regulation. The organization counts 130 jurisdictions—or countries—in its membership, constituting more than 95 percent of global securities markets. It's a credible, respected group that does exactly the kind of work that aligns with SEC's climate goals: developing, implementing, and promoting globally recognized standards to build investor confidence in securities markets. Due to its cooperative nature, it also provides a useful platform for exchanging information at global and regional levels to further strengthen securities regulations.

With its new climate disclosure proposal, the SEC is setting out to do something IOSCO and the broader international community is already working on. For the past 20 years, IOSCO and the International Financial Reporting Standards Foundation, or IFRS, have worked together in the global accounting field. They have agreed to cooperate in developing robust financial reporting standards for climate change at a global level—and great strides have already been made.

In November 2021 at the UN climate conference in Glasgow, the IFRS launched the International Sustainability Standards Board, charged with creating IFRS sustainability disclosure standards, including for climate issues. In January, IFRS Chair Erkki Liikanen announced that ISSB would be releasing the finalized, first global standards for sustainability and climate reporting this June. Once finalized, these standards will provide a baseline of requirements that can be adopted by countries as they stand or incorporated into existing reporting policies.

Instead of moving forward with his own agency's rulemaking process, SEC Chair Gensler could have intensified collaborations with the ongoing IOSCO efforts, to ensure that the SEC's views and priorities were addressed in the new global standards. As a member of the board of directors, he had the option of sitting down with IOSCO to advise on the guidelines and have a say on its contents. In this scenario, new ISSB guidelines created with U.S. input, once completed, could have eventually been adopted by the U.S. government.

International guidelines like the forthcoming ISSB climate standards have major advantages over federal rules. Once adopted by nations, they can be applied across global supply chains. This is particularly important given the globalized nature of production and markets.

The other advantage of the ISSB guidelines is that they are robustly evaluated and researched, and reflect the input of securities regulators around the world. Many of IOSCO's and other international accounting body's guidelines are accepted as best practice and adopted in the majority of nations.

The one hiccup, however, is that any IFRS, ISSB, or IOSCO standard must be formally approved and adopted by the individual IOSCO jurisdiction. (Remember, countries are "jurisdictions.") Given partisan battles over ESG policies, Congress is likely to be hostile to this type of regulation.

It would then appear that Chair Gensler felt that developing a rulemaking through the SEC itself would be a more effective way of tackling the climate question. That way, the agency could focus on developing a good policy that companies could follow. This could be a great contribution, but here, Gensler faces the same issue again: will the federal government let him go through with it?

U.S. agencies must similarly have legislative support to allow the use of new SEC reporting requirements. This is not likely, again due to the debate over ESG terminology. If Gensler had gone the route of working directly with IOSCO, IFRS, and ISSB instead, it's possible there may have been a greater chance of legislative support for climate disclosure, given existing structures for partnership between the U.S. government and IOSCO.

All things considered, now may actually be a good time for Gensler to sit at the table with IOSCO, IRFS, and ISSB and double down on the United States' cooperation at the international level. ISSB's climate change rule will become mandatory for use in participating jurisdictions starting next year. IOSCO will be promoting the activity to maximize the number of jurisdictions that are participating.

Robert Pojasek is president of Pojasek & Associates and specializes in business sustainability and process improvement.

Exposing Gaps in Implementation and Enforcement

By Dottie Schindlinger

AS PUBLICLY traded companies prepare for the SEC's proposed rule on climate disclosures, uncertainty remains around which requirements companies will have to disclose and how those disclosures will be enforced.

Given that the proposal applies to both domestic and foreign SEC-reporting issuers, it's imperative that processes are clearly delineated, standardized, and measurable over time. Combatting the climate crisis will require additional guidance from federal agencies, not less. On its own, the current SEC proposal won't solve the climate crisis. A combination of actions by both the public and private sectors will be necessary to adequately curb carbon.

One potential model is Europe's Corporate Sustainability Reporting Directive, known as CSRD, a global approach that effectively tasks all large companies—both listed and private—to report on the social and environmental risks they face, and on how their business practices affect the environment. In conjunction with the European Green Deal, the CSRD aims to equip investors, civil society organizations, and consumers with the insight necessary to analyze the sustainability performance of companies.

In contrast, not every organization will need to comply immediately with the SEC's current proposal. We might even see a trend of public companies deciding to go private in an attempt to skirt initial requirements. But avoidance will not stave off corporate inquiries forever, nor will it prevent companies from having to comply eventually. Investors are already forming future decisions based on current or perceived ESG intel, regardless of federal requirements, as they look to identify and diversify green investment opportunities.

The proposal exposes three major gaps that organizations and the SEC will need to address: implementation, skills, and technology.

Effective implementation will require a deeper organizational restructuring of leadership roles, to tie climate to both personal and firm-wide performance evaluations. This may entail adding an ESG-focused position or new ESG goals to an existing role. Should the proposal come to pass, organizations would be required to disclose Scopes 1 and 2 greenhouse gas emissions, and some would need to include Scope 3 emissions if deemed financially material. However, vast differences among company ESG policies makes it difficult to compare between companies and hold them accountable. For these reasons and more, the SEC will likely not require companies to comply with scope 3 until implementation gaps are addressed.

The proposal also reveals gaps in skills. It calls for a refocusing of corporate skillsets to include overseeing ESG initiatives. Boards and directors will be held accountable for ESG progress and therefore will need to develop the expertise necessary to create sustainable growth strategies. New training and certification programs must prioritize climate risk and ESG fundamentals, tying business success to ongoing ESG efforts.

Finally, improvements in technology are needed to measure and achieve new sustainability benchmarks. Organizations will need software that can track their carbon emissions and maintain a database that encompasses information from across their value chain. They will also need to report this data in a consistent and standardized fashion—especially if the only tools in use are spreadsheets. Most organizations will likely need to make new investments to future-proof ongoing ESG initiatives, including new technology. Before these investments are made, companies need to analyze their current suite of tools to better understand how existing or new technology can help enable higher quality measurements.

On a positive note, the SEC proposal aligns with the Task Force on Climate-Related Financial Disclosures, known as TCFD, the de facto foundation for all three major global climate reporting proposals that exist today: the SEC rule, Europe's CSRD, and the International Sustainability Standards. Encouragingly, the SEC proposal will certainly increase accountability for environmental impacts.

It's important to note that today's SEC climate rule would have traditionally taken decades to create and gone through endless rounds of federal proposals. We should consider this bureaucratic expediency a win. Furthermore, the technological advancements made over the last decade have equipped investors with reputable climate-disclosure information, enabling them to make holistic investment decisions regardless of any new requirements. This demonstrates the importance of climate as a component of future financial decisions and why this proposal is so timely.

Curtailing the environmental crisis presents a strong opportunity for leadership driven by international organizations and the global community. The focus should be on taking immediate action, not shaming companies that traditionally have been slower to innovate. While some may say that the SEC proposal is none of their business, the future of the planet is everyone's business.

Dottie Schindlinger is executive director of Diligent Institute, which works to inform, educate, and connect leaders to champion modern governance.

Creating Order Out of Chaos

By Kristina Wyatt

IT WOULD be hard to work in sustainability without being a determined optimist. Luckily, developments in the global regulatory reporting landscape over the last two years give me significant hope.

To appreciate the importance of the SEC's climate proposal, we need to consider its place in the broader international context. Thinking back to 2021, which feels like ancient history, the sustainability reporting landscape was crowded, confusing, and fragmented.

Market participants' views of what companies should report concerning sustainability or ESG issues varied widely, as did their views on what those terms even meant. Investors were not receiving the consistent, comparable, reliable information they needed to evaluate and factor sustainability matters into their investment decisions. Companies, for their part, were mired in an alphabet soup of different reporting standards that sought, in disparate ways, to sort out the information investors were looking for.

This fragmentation created confusion, wasted effort, and, worst of all, an uneven playing field for investors. ESG raters sought to satisfy investors' demands by piling questionnaires on issuers. The raters then sold their assessments to investors who could afford these services. Small investors, for their part, did not have access to the same data. This informational asymmetry reflected a market failure.

Things changed in 2021. Securities regulators around the world—independently and through the International Organization of Securities Commissions, or IOSCO—saw the need for clear, harmonized sustainability reporting rules. At the same time, the alphabet soup of independent standard setters—including the Sustainability Accounting Standards Board (SASB), International Integrated Reporting Council (IIRC), and Climate Disclosure Standards Board (CDSB)—formed an alliance to develop prototype standards that could inform global regulatory reporting requirements.

As the alliance worked on its prototype, the International Financial Reporting Standards Foundation, known as IFRS, formed an International Sustainability Standards Board, or ISSB, to develop guidelines that would provide a global baseline to inform jurisdictional sustainability reporting requirements. The ISSB issued its draft standards early in 2022, drawing on the work of the alliance.

It was against this backdrop that the SEC issued its climate disclosure proposal in March 2022. During this time, international regulators regularly collaborated to inform the shaping of the ISSB and the alliance's prototype. The SEC proposal closely aligns with the ISSB's draft climate reporting standards and brings hope for global regulatory convergence.

What does this mean for companies and investors? Global alignment will reduce reporting fragmentation, where companies are required to report different information in different jurisdictions. It will also help investors gain access to more consistent and comparable data, even as they invest in companies operating in various countries. The global markets will operate more efficiently, and the aggregate burden on companies and investors will be reduced.

This convergence is critical from a process perspective. But what of the substance of the ISSB and SEC climate proposals? How sound are they, and how will they lay the foundation for further sustainability reporting on other topics in the future?

Here again, I'm hopeful. The SEC's proposed rule, like the ISSB standards, build on two well-established foundations: the Greenhouse Gas Protocol and the Taskforce on Climate-related Financial Disclosures, known as TCFD.

The GHG Protocol defines how companies measure and report their emissions. It establishes the methodology for calculating direct emissions from a company's operations (called Scope 1 emissions), indirect emissions from the generation of electricity the company purchases (Scope 2), and other indirect emissions throughout the company's value chain (Scope 3). The TCFD provides a logical framework to assist companies in evaluating and reporting on how climate risks translate into financial risks.

The SEC rule would require uniform disclosure of companies' Scopes 1 and 2 emissions as well as certain companies' Scope 3 emissions. This would give investors the comparable data they need to understand climate-related transition risks.

The agency's proposal also incorporates the pillars of the TCFD framework. These provide a mechanism for companies to explain how their governance structures support oversight of climate-related risks, how they evaluate and manage those risks, and how they measure their progress.

By providing companies with a clear set of rules, built on the same foundation as international standards, the SEC will help create order and guide better management and reporting of climate-related financial risks. As the world moves on to address other sustainability topics, such as biodiversity, nature, human rights, and other issues, we will have a model in the climate rules.

Kristina Wyatt is deputy general counsel and senior vice president of global regulatory climate disclosure at Persefoni.