

MEMO# 35639

March 6, 2024

SEC Adopts Final Rules on The Enhancement and Standardization of Climate-Related Disclosures for Investors

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TO: ICI Members

Investment Company Directors

ICI Global Members SUBJECTS: ESG RE: SEC Adopts Final Rules on The Enhancement and Standardization of Climate-Related Disclosures for Investors

This morning, the SEC voted 3-2, along party lines, to adopt final rules on The Enhancement and Standardization of Climate-Related Disclosures for Investors. This rule applies to public companies.

ICI is reviewing the final rules and will provide more detailed information as soon as possible. The final rules are summarized below.

The Enhancement and Standardization of Climate-Related Disclosures for Investors

The final rules require public companies to disclose certain climate-related information in registration statements and annual reports. The final rules will also require foreign private issuers that file Exchange Act annual reports or registration statements) to provide the same climate-related disclosures as domestic registrants. The Commission declined to exempt other registrants, such as BDCs, REITs, or issuers of registered non-variable insurance contracts from the final rules.

Differences from the Proposal

The final rules reflect a number of modifications to the proposed rules, including:

- Eliminating the proposed requirement to provide Scope 3 emissions disclosure (which the proposal would have required in certain circumstances).
- Eliminating the proposed requirement for all registrants to disclose Scope 1 and Scope 2 emissions and instead requiring such disclosure only for large accelerated filers and

accelerated filers, on a phased in basis, and, importantly, only when those emissions are material.

- Modifying the proposed assurance requirement covering Scope 1 and Scope 2 emissions for large accelerated filers and accelerated filers by extending the reasonable assurance phase in period for large accelerated filers and requiring only limited assurance for accelerated filers.
- Extending certain phase in periods.

Content of the Disclosures

The final rules require a registrant to disclose:

- Climate-related risks that have had or are reasonably likely to have a material impact on the registrant's business strategy, results of operations, or financial condition.
- The actual and potential material impacts of any identified climate-related risks on the registrant's strategy, business model, and outlook.
- If, as part of its strategy, a registrant has undertaken activities to mitigate or adapt to a material climate-related risk, a quantitative and qualitative description of material expenditures incurred and material impacts on financial estimates and assumptions that directly result from such mitigation or adaptation activities.
- Specified disclosures regarding a registrant's activities, if any, to mitigate or adapt to a material climate-related risk including the use, if any, of transition plans, scenario analysis, or internal carbon prices.
- Any oversight by the board of directors of climate-related risks and any role by management in assessing and managing the registrant's material climate-related risks.
- Any processes the registrant has for identifying, assessing, and managing material climate-related risks and, if the registrant is managing those risks, whether and how any such processes are integrated into the registrant's overall risk management system or processes.
- Information about a registrant's climate-related targets or goals, if any, that have materially affected or are reasonably likely to materially affect the registrant's business, results of operations, or financial condition. Disclosures would include material expenditures and material impacts on financial estimates and assumptions as a direct result of the target or goal or actions taken to make progress toward meeting such target or goal.
- For large accelerated filers and accelerated filers information about material Scope 1 emissions and/or Scope 2 emissions.
- For those required to disclose Scope 1 and/or Scope 2 emissions, an assurance report at the limited assurance level, which, for large accelerated filers, following an additional transition period of four years (which itself follows a three-year phased in compliance period), will be at the reasonable assurance level.
- Financial Statement Disclosure
 - The capitalized costs, expenditures expensed, charges, and losses incurred as a result of severe weather events and other natural conditions, such as hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures, and sea level rise, subject to applicable one percent and de minimis disclosure thresholds, disclosed in a note to the financial statements.
 - The capitalized costs, expenditures expensed, and losses related to carbon offsets and renewable energy credits or certificates if used as a material component of a registrant's plans to achieve its disclosed climate-related targets or goals, disclosed in a note to the financial statements.

- If the estimates and assumptions a registrant uses to produce the financial statements were materially impacted by risks and uncertainties associated with severe weather events and other natural conditions or any disclosed climate-related targets or transition plans, a qualitative description of how the development of such estimates and assumptions was impacted, disclosed in a note to the financial statements.

Presentation of the Disclosures

The final rules require a registrant (including a foreign private issuer) to:

- File the climate-related disclosure in its registration statements and Exchange Act annual reports filed with the Commission.
- Provide the Regulation S-K mandated climate-related disclosures either in a separate, appropriately captioned section of its registration statement or annual report or in another appropriate section of the filing, such as Risk Factors, Description of Business, or Management's Discussion and Analysis, or, alternatively, by incorporating such disclosure by reference from another Commission filing as long as the disclosure meets the electronic tagging requirements of the final rules.

Phase-In Periods and Accommodations

The final rules will be phased in for all registrants with the compliance date dependent upon the status of the registrant as a large accelerated filer, an accelerated filer, or non-accelerated filer, smaller reporting company, or emerging growth company, and the content of the disclosure and provides several accommodations, including:

- Additional phase-in periods for disclosures pertaining to material expenditures, GHG emissions, the assurance requirement, and the electronic tagging requirement if the registrant is a large accelerated filer.
- A safe harbor from private liability for climate-related disclosures (excluding historical facts) pertaining to transition plans, scenario analysis, the use of an internal carbon price, and targets and goals.
- An exemption from the GHG emissions disclosure requirement for smaller reporting companies and emerging growth companies.
- An accommodation that allows Scope 1 and/or Scope 2 emissions disclosure, if required, to be filed on a delayed basis as follows:
 - If a domestic registrant, in its Form 10-Q for the second fiscal quarter in the fiscal year immediately following the year to which the GHG emissions disclosure relates.
 - If a foreign private issuer, in an amendment to its annual report on Form 20-F, which shall be due no later than when such disclosure would be due for a domestic registrant.
 - If filing a Securities Act or Exchange Act registration statement, as of the most recently completed fiscal year that is at least 225 days prior to the date of effectiveness of the registration statement.

Effective Date and Compliance

- The final rules will become effective 60 days after publication in the Federal Register, and the SEC adopted delayed and staggered compliance dates for the final rules that vary according to the filing status of the registrant.

The final rule release is available at <https://www.sec.gov/files/rules/final/2024/33-11275.pdf>.

The SEC Fact Sheet is available at <https://www.sec.gov/files/33-11275-fact-sheet.pdf>.

The press release is available at <https://www.sec.gov/news/press-release/2024-31>.

SEC Chair Gary Gensler and Commissioners Peirce, Crenshaw, Uyeda, and Lizárraga delivered statements on the final rules:

- Chair Gensler stated that the final rules, "would provide investors with consistent, comparable, decision-useful information, and issuers with clear reporting requirements."

He noted that "the SEC has no role as to climate risk itself" and acknowledged the "lively debate about [the] climate rule." The Chair stated that "today's final rules are grounded in materiality" and noted that the "standard of materiality that is reflected in Commission rules" was articulated by the "Supreme Court ... in cases in the 1970s and 1980s." He indicated that that "same materiality standard ... appears in numerous disclosure rules governing registration statements and public company annual reports," and is the "same materiality standard that is used throughout the final rules." He further stated that "the final rules require that climate risk disclosures be included in a company's SEC filings, such as annual reports and registration statements," and "[b]ringing them into the filings will help make them more reliable," as "[t]here are standard controls and procedures for filings unlike for sustainability reports."

The Chair's full statement is available at

<https://www.sec.gov/news/statement/gensler-statement-mandatory-climate-risk-disclosures-030624>.

- In her dissent, Commissioner Peirce cited "the rule's fundamental flaw" as "its insistence that climate issues deserve special treatment and disproportionate space in Commission disclosures and managers' and directors' brain space." She noted that the Commission's "existing disclosure regime already requires companies to inform investors about material risks and trends—including those related to climate...." She stated that "[t]he Commission, in adopting today's climate prescriptions, dismisses the role that materiality ought to play in balancing the costs and benefits of disclosure," and observed that the "rule replaces our current principles-based regime with dozens of pages of prescriptive climate-related regulations." Commissioner Peirce noted her view that the "resulting flood of climate-related disclosures will overwhelm investors, not inform them." She further noted that "only a mandate from Congress should put us in the business of facilitating the disclosure of information not clearly related to financial returns." She stated that "[e]ven companies that do not end up reporting material climate risks or expenditures will be forced to invest in systems to reach a determination that they do not have material items to disclose," and the "rule's anticipated benefits do not outweigh the costs." She concluded by noting that the Commission "should be re-proposing this rule not adopting it," as the "final rule differs quite dramatically from the proposal, both by excluding major provisions and including new rule elements."

Commissioner Peirce's full statement is available

at <https://www.sec.gov/news/statement/peirce-statement-mandatory-climate-risk-disclosures-030624>

- Commissioner Crenshaw observed that the final rule "establishes a floor for a disclosure framework that will provide investors with climate risk information, help

inform investors' investment decisions, and be subject to the rigor of Commission filings." She noted the new requirements "move a haphazard potpourri of public company disclosures into the Commission's well-developed and standardized filing ecosystem." Commissioner Crenshaw cautioned that "[i]mportant disclosures remain absent from this final rule" and referenced the elements of the proposal which would have required "1) a more robust GHG emissions reporting requirement and 2) transition-related expenditure disclosure in the financial statements." She further noted that the "final rule excludes requirements to disclose Scope 3 GHG emissions" and asserted that it represents a "comparable, quantitative metric that allows investors to measure that risk across companies, sectors, and their portfolios." She addressed the matter of the Commission's statutory authority to adopt the final rule and noted that the "Commission has clear authority under the Securities Act and the Exchange Act to require disclosures that are in the public interest and for the protection of investors." Finally, she urged the Commission to "issue an order to recognize alternative regimes that would satisfy compliance with the rule..." and observed that it "would be an easy and meaningful step for the Commission to take in order to avoid a patchwork of reporting obligations and potentially conflicting demands."

Commissioner Crenshaw's full statement is available at

<https://www.sec.gov/news/statement/cresnshaw-statement-mandatory-climate-risk-disclosures-030624>.

- Commissioner Uyeda opened his dissent by observing that "this rule is climate regulation promulgated under the Commission's seal" and that the "rule is the culmination of efforts by various interests to hijack and use the federal securities laws for their climate-related goals." He noted that the "Commission is a securities regulator without statutory authority or expertise to address political and social issues" and that it "ventured outside of its lane and set a precedent for using its disclosure regime as a means for driving social change." Commissioner Uyeda cited Supreme Court statements on the major questions doctrine and noted that "[t]oday's rulemaking is an extraordinary exercise of regulatory authority by the Commission that involves an economically and politically significant policy decision" which "elevates climate above nearly all other issues facing public companies." He then indicated that the Commission "conducted a flawed process by not re-proposing the rule," and raised a question as to whether "appropriate notice was provided under the Administrative Procedure Act." He observed that the "Commission has essentially admitted that the proposal did not get it right," and that, accordingly, it "should have re-proposed this rule with an updated economic analysis and solicited additional public feedback." He cautioned that in order to "avoid potential liability, companies may voluntarily disclose climate-related information despite concluding that the information is immaterial," and "[e]ven when a company does not ultimately make any disclosure, it will have spent considerable resources to gather and assess climate-related information...." He then noted that "not one dime of money spent on compliance will be used for actual reductions in GHG emissions, and that shareholders will be footing this bill." He concluded by observing that "the Commission continues to diverge from its historic practice of largely deferring to the disclosures made by foreign private issuers ... pursuant to their home country reporting requirements," and that the "Commission could have eased the reporting burdens of FPIs and made the U.S. capital markets more attractive to them by allowing these foreign companies to report climate-related information pursuant to their home country requirement."

Commissioner Uyeda's full statement is available at <https://www.sec.gov/news/statement/uyeda-statement-mandatory-climate-risk-disclosures-030624>.

- Commissioner Lizárraga stated that "the climate-related disclosures we are advancing today are no different from many of the Commission's existing disclosure requirements" and that "[t]oday's reforms respond to investor demand for standardized and comparable information on climate-related risks and impact." He said that by "requiring registrants to provide standardized climate risk-related disclosures in Commission filings, market participants will benefit from being able to more efficiently analyze information that will be integrated with other important disclosures, such as a full description of the company, other disclosed risks, and the company's financial statements." Commissioner Lizárraga observed that "[s]everal changes to the rule between proposal and adoption also demonstrate the Commission's careful analysis of stakeholder input" and that the "final rule is a product of the Commission's standard exercise of its basic authority to require full and fair disclosure by public companies to investors."

Commissioner Lizárraga's full statement is available at <https://www.sec.gov/news/statement/lizarraga-statement-mandatory-climate-risk-disclosures-030624>.

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