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A Guide to the SEC's Proposed Climate Disclosure Requirements

In This Issue:

On March 21, 2022, the SEC proposed significant new disclosure requirements (available here) to enhance and standardize climate-related disclosures.

Overview and Takeaways

Broadly speaking, the proposal focuses on three main disclosure topics: climate-related risks (including risk identification/impact, governance, oversight/risk management and mitigation), greenhouse gas emissions, and climate-related financial metrics. To enhance comparability and consistency, the SEC has modeled the proposed climate disclosure framework in part on the Task Force on Climate-Related Financial Disclosure ("TCFD") and the Greenhouse Gas Protocol ("GHG Protocol") emissions reporting framework, as was urged by many commentators.

The proposed disclosure requirements would be set forth in proposed new Subpart 1500 of Regulation S-K and proposed new Article 14 of Regulation S-X. The proposed requirements, though providing for some materiality thresholds, include many prescriptive line-items. Registrants would generally be required to present in their annual reports (or registration statements), in a separate section titled "Climate-Related Disclosure" and in a separate footnote to the financial statements, as applicable, information regarding the following:

- climate-related risks (and opportunities), including descriptions of:
  - climate-related risks and their real or likely material impacts on the company's business, strategy, outlook and financial statements;
  - the board's and management's oversight and governance of climate-related risks;
  - the company's climate-related risk management processes; and
  - climate-related risk mitigation, including the company's transition plans and targets and goals;
- greenhouse gas ("GHG") emissions, including:
  - Scope 1 emissions (which are direct GHG emissions from operations that are owned or controlled by a registrant);

  - Scope 2 emissions (which are indirect GHG emissions that are generated from the purchase or acquisition of electricity, steam, heat or cooling that is consumed by operations owned or controlled by a registrant);

  - if material, or if the registrant has set a GHG emissions target that includes them, Scope 3 emissions (which are all indirect GHG emissions not otherwise included in a registrant's Scope 2 emissions, which occur in the upstream and downstream activities of a registrant's value chain);

  - large accelerated filers and accelerated filers would be required to include an attestation report providing assurance on Scope 1 and Scope 2 GHG emissions from a "GHG emissions attestation provider," which must be independent and meet certain other specified requirements, but is not required to be an independent accounting firm; and

- specified climate-related financial statement metrics and related disclosures in a note to the audited financial statements.

These disclosure requirements would be phased in over time, depending on the registrant's filing status (see "Proposed Implementation Timing" below).

We include a detailed description of the proposal below. Please note that certain defined terms used in this alert are hyperlinked to their proposed definitions located at the end. We have also included in Annex A various disclosure examples offered by the SEC in its proposing release.

Companies should take stock of their current climate strategies, processes and disclosures, with an eye to evaluating what enhancements may be needed to comply with the proposed rules, if adopted. To the extent they have not yet done so, companies should consider the following questions:

- Who has oversight and responsibility for climate-related/ESG risks and opportunities? How is the board involved?

- What policies and procedures are in place regarding oversight and responsibility at the board and management level?

- What climate-related information is currently tracked, measured and monitored? What data is already being reported? Is this data subject to third-party verification or assurance?

- What other climate-related public statements, claims or commitments have already been made?

- How does the registrant define materiality for climate-related risk?

In particular, additional integration of climate disclosures and processes with the regular SEC and financial reporting disclosure processes may be appropriate. The SEC's proposed rules come alongside a host of similar regulations and proposals across the globe. Certain large companies in Britain and Japan will need to start disclosing their GHG emissions this year; the EU is set to require all large, listed companies to report their GHG emissions in 2024; and Brazil, Hong Kong, New Zealand, Singapore and Switzerland will also soon require mandatory climate risk reporting. As a result, companies should consider whether siloing of climate disclosure in a sustainability reporting function remains adequate to enable them to meet the requirements of the proposed rules, particularly in light of the added associated liability (including strict liability under the securities law for registration statements), and of the growing web of global requirements, even if the SEC does not adopt the rules as proposed.

Applicability

The proposed disclosure requirements would apply to U.S. domestic registrants and to foreign private issuers filing on Form 20-F, with a multi-year phase-in based on company filing status (as described below under "Proposed Implementation Timing"). The SEC has not at this time proposed that the requirements would apply to MJDS issuers filing on Form 40-F.

Location of Disclosure Requirements

The proposal creates a new Subpart 1500 of Regulation S-K and new Article 14 of Regulation S-X. The climate-related and GHG emissions disclosures set forth in proposed Subpart 1500 of Regulation S-K would be required to be set out in a separate section of the registrant's annual report on Form 10-K entitled "Climate-Related Disclosures" (although registrants may incorporate by reference from other parts of the report or a separately filed annual report or other periodic report). The financial statement requirements under proposed Article 14 of Regulation S-X would be required to be set forth in a separate footnote to the financial statements.

Proposed Implementation Timing

Comments to the proposal are due May 20, 2022. The proposing release points to December 2022 as the effectiveness date of the rules and proposes implementation dates as below.

	Climate Disclosures (including Scope 1 and 2 Emissions Disclosures)	Scope 3 Emissions (if applicable)	Limited Assurance Attestation Report on Scope 1 and 2 Emissions	Reasonable Assurance Attestation Report on Scope 1 and 2 Emissions
Large Accelerated Filers	FY 2023 Report (filed in 2024)	FY 2024 Report (filed in 2025)	FY 2024 Report (filed in 2025)	FY 2026 Report (filed in 2027)
Accelerated Filers	FY 2024 Report (filed in 2025)	FY 2025 Report (filed in 2026)	FY 2025 Report (filed in 2026)	FY 2027 Report (filed in 2028)
Non-Accelerated Filers	FY 2024 Report (filed in 2025)	FY 2025 Report (filed in 2026)	Not required	Not required
Smaller Reporting Companies	FY 2025 Report (filed in 2026)	Not required	Not required	Not required

Liability Safe Harbors

Many of the disclosures elicited by the rules would constitute forward-looking statements. The SEC has confirmed that forward-looking statements included by registrants in response to the proposed rules would be eligible for the safe harbor of the Private Securities Litigation Reform Act, except for such disclosures in an IPO registration statement (as forward-looking statements in IPO registration statements are not eligible for the safe harbor). Notwithstanding the safe harbor, the SEC may still bring enforcement actions.

In addition, the SEC has proposed a safe harbor from liability under federal securities laws for Scope 3 emissions disclosure unless the disclosure was made or re-affirmed without a reasonable basis or disclosed other than in good faith.

Climate-Related Risk Disclosure

Description of Climate-Related Risks

Registrants would need to identify any climate-related risks reasonably likely to have a material impact on them (including their business or consolidated financial statements), which may manifest over the short, medium or long term. The disclosure must separately identify "physical risks" (relating to the physical impacts of the climate) and "transition risks" (relating to the potential transition to a lower carbon economy). In its proposing release, the SEC identified a number of examples of climate-related risks and associated impacts, which are listed in Annex A.

Materiality: In the proposing release, the SEC has confirmed that the materiality analysis to be undertaken with regard to climate-related risks should be consistent with the materiality analysis that registrants perform when preparing their MD&A.

Materiality determinations of potential future events must assess both the probability of the event over the short, medium and long term, and its potential magnitude or significance.

Time Horizons: Registrants must describe how they define short, medium and long term, including how they take into account or reassess the expected useful life of their assets and the time horizons for their climate-related planning processes and goals.

Physical Risks: Registrants would be required to describe (i) the nature of the physical risk, (ii) whether it is chronic (related to longer-term weather patterns and related effects) or acute (event-driven, e.g., short-term extreme weather events), and (iii) the location of the properties, processes or operations subject to the risk (the zip code or similar subnational postal zone or geographic location). In addition, if the physical risk is due to (i) flooding, registrants would need to disclose the percentage of buildings, plants or properties subject to this risk; or (ii) water stress, registrants would need to disclose the amount of assets (both book value and the percentage of total assets) subject to this risk, and the percentage of total water usage from water drawn in those regions.

Transition Risks: Registrants would be required to describe (i) the nature of the transition risk, (ii) whether it relates to regulatory, technological, market (including changing consumer, business counterparty and investor preferences), liability, reputational or other transition-related factors, and (iii) how those factors impact the registrant.

Impacts of Climate-Related Risks on Strategy, Business Model and Outlook

With a view to providing a meaningful analysis of the impact of climate-related risks, registrants would be required to describe the impact of those risks (including the time horizon of such impact – short, medium or long term) on:

- their business operations (with specificity about the type and locations of operations that would be impacted);
- their products or services;
- their suppliers and other parties in their value chain;
- activities to mitigate or adapt to climate-related risks, including adoption of new technologies or processes;
- expenditures for research and development; and
- any other significant changes or impacts.

Registrants would also be required to discuss how they have considered the identified impacts in their business strategy, financial planning, and capital allocation. As part of this discussion, so that investors can gauge whether and how the impacts have been incorporated into their business model and strategy, registrants would be required to include current and forward-looking disclosures that discuss the following:

- how resources are being used to mitigate climate-related risks; and
- how the following relate to the registrant's business model or strategy:
  - the financial statement climate-related metrics required by proposed Article 14 of Regulation S-X (see "Financial Statement Disclosures" below);
  - the GHG emissions disclosures required by proposed item 1504 of Regulation S-K (see "GHG Emissions Disclosures" below);

– the climate targets required by proposed Item 1506 of Regulation S-K (see "Climate-Related Risk Mitigation —Targets and Goals" below); and

– if applicable, the use of carbon offsets or renewable energy credits ("RECs").

Resilience of Business Strategy and Scenario Analyses

Registrants would also be expected to discuss the resilience of their business strategy in light of potential future changes in climate-related risks. If a registrant uses any analytical tools, such as a scenario analysis, in assessing the impact of climate-related risks and the resilience of its strategy, it would be required to disclose qualitative and quantitative information about the scenarios considered (including parameters, assumptions and any analytic choices) and the projected principal financial impacts under each scenario considered. However, registrants would not be required to conduct scenario analyses.

Impact of Climate-Related Risks on Financial Statements

Registrants would be required to discuss whether and how the identified climate-related risks have affected or are reasonably likely to affect their consolidated financial statements over the short, medium or long term. This discussion is intended to provide climate-related disclosure that is similar to the disclosure in MD&A and, where identified climate-related risks have had a material impact on the registrant's financial condition or operations, should refer to those financial statement climate-related metrics required by proposed Article 14 of Regulation S-X that demonstrate that impact. This discussion may be included in the registrant's MD&A section instead of in the "Climate-Related Disclosures" section.

Carbon Price

To help investors understand and assess the use of internal carbon prices, the proposed rules would require registrants to make certain disclosures about the calculation and use of the price, if any, but would not mandate the adoption of an internal carbon price or the use of any particular carbon pricing methodology. Specifically, registrants that have adopted an internal carbon price would be required to disclose:

- the price in units of the registrant's reporting currency per metric ton of carbon dioxide equivalents (or "CO_2e");
- the total price, including how the total price is estimated to change over time, if applicable;
- the boundaries for measurement of overall CO_2e on which the total price is based if different from the GHG emission organizational boundary required for the Scope 1 and Scope 2 emissions presentation;
- the rationale for selecting the internal carbon price applied; and
- how they use the internal carbon price to evaluate and manage climate-related risks.

If the registrant uses more than one internal carbon price, it would be required to provide the above disclosures for each carbon price, as well as to disclose why it uses different prices.

Climate-Related Opportunities

Registrants may also disclose the actual and potential impacts of any climate-related opportunities when describing the climate-related risks they face, and in their disclosures regarding their governance, strategy, and risk management. Because such disclosure could contain sensitive competitive information, it would be optional.

Climate-Related Risk Governance

Registrants would be required to include disclosures about their governance of climate-related risks at both the board and management levels. Registrants would be required to provide descriptions of the board's and management's roles with regard to overseeing, and assessing and managing, climate-related risks. Among other things, this would include whether the board sets climate related targets/goals, their processes for staying informed about and monitoring climate-related risks and considerations in doing so (including whether and how frequently management reports to the board on climate-related matters), and the identification of the persons, committees and/or divisions responsible for climate-related disclosure and their expertise.

Climate-Related Risk Management

Registrants would be required to describe in detail their processes for identifying and assessing climate-based risks: specifically, how they determine the relative significance and materiality of climate-related risks, and how they assess regulatory, market and technological impacts on these risks. Registrants would also be required to disclose how they manage risks – how they decide whether (and if applicable, how) to mitigate, accept or adapt to particular risks, how they prioritize addressing these risks, and how their climate-based risk management is integrated with their overall risk management processes.

Climate-Related Risk Mitigation

Transition Plans

Registrants who develop a strategy and implementation plan to reduce climate-related risks (a "transition plan") as part of their risk management strategy would be required to describe the plan, any relevant metrics or targets they use to identify and manage those risks, and to provide annual updates about progress towards their plan's targets and goals. Registrants may also describe climate-based opportunities they plan to realize. In its proposing release, the SEC identified a number of examples of transition plan disclosures, which are listed in Annex A.

Targets and Goals

Registrants that set any climate-related targets or goals (which could relate to the reduction of GHG emissions, usage of energy or water, and/or conservation or ecosystems restoration) would be required to provide a description of these targets or goals in the "Climate-Related Disclosures" section, either in the context of the registrant's discussion of climate-related impacts on its strategy, business model or outlook or when discussing its transition plan as part of its risk management disclosure.

This description would be required to include:

- the scope of activities and emissions included in the target;
- the unit of measure for the target;
- the time horizon by which the target is intended to be achieved and whether such time horizon is consistent with other climate-related goals;
- the baseline time period and baseline emissions against which progress will be monitored;
- interim targets set by the registrant (if any); and
- how the targets and goals are to be met.

Following the initial disclosure, the registrants would be required to update the targets and goals disclosure annually to show what actions were taken during the year to achieve the goals or targets and how much progress has been made in achieving these goals and targets. At the same time, the proposed rules recognize that some registrants may still be developing the specific plans and ways in which they aim to achieve their goals and targets, in which case it would be sufficient if such registrants informed investors of their general progress.

Additionally, if a registrant has used carbon offsets or RECs in its plan to achieve climate-related targets or goals, it would be required to disclose the following:

- the amount of carbon reduction represented by offsets or the amount of generated renewable energy represented by the RECs;
- the source of the offsets or RECs;
- a description and location of the underlying projects;
- any registries or other authentication of the offsets or RECs; and
- the cost of the offsets or RECs.

GHG Emissions Disclosures

Required Disclosures

The SEC has largely based its GHG emissions disclosure requirements on the GHG Protocol (with the notable exception of the "organizational boundaries" to be used in determining Scope 1 and Scope 2 emissions, as described below).

Registrants would be required to disclose (i) Scope 1 emissions; (ii) Scope 2 emissions; and (iii) if material, or if the registrant has set a GHG emissions target that includes them, Scope 3 emissions.

Many registrants already calculate their Scope 1 and Scope 2 emissions in their sustainability reports and updates to investors. For these registrants, the proposed GHG emissions disclosure requirements may not impose a tremendous burden. From a practical standpoint, registrants might determine that Scope 3 emissions are not material and need not be disclosed, thereby reducing the burden of calculating such emissions. However, the SEC has indicated that, given their magnitude, for many registrants, Scope 3 emissions may be material. Discussion in the proposing release noted that Scope 3 emissions may form a significant part of the carbon footprint of a company in the automobile manufacturing or oil and gas industries, for example.

As with other matters, the determination of materiality would require a qualitative and quantitative analysis. Though the SEC has not proposed specific thresholds, it did note that some companies consider Scope 3 emissions to be material when they constitute 40% or more of their GHG emissions. When calculating Scope 3 emissions, registrants would need to include GHG emissions from outsourced activities that were previously conducted as part of their operations, as reflected in the financial statements for the periods covered in the filing,[1] as part of the materiality assessment, as well as in any Scope 3 emissions disclosure. Additionally, the SEC has indicated that financial company registrants would likely need to include GHG emissions from companies to which they provide debt or equity financing in calculating their Scope 3 emissions (though the SEC has not proposed a methodology for calculating these).

Presentation

Time Periods: Registrants must present emissions disclosure for the most recently completed fiscal year, and for the historical fiscal years included in their consolidated financial statements in the filing.

Organizational Boundary: The emissions data must be presented for those entities, operations, assets, and other holdings included in the same "organizational boundary" as in the consolidated financial statements. This is a significant deviation from the GHG Protocol which uses an "equity share" or "control" approach for the determination of which assets/operations are to be

1 The SEC has not indicated how far back registrants must look historically in terms of including outsourced operations.

included. For registrants already disclosing GHG emissions, it will be important to ensure that they are using the organizational boundary required under the proposed rules, if adopted.

No Aggregation: Scope 1 and Scope 2 emissions, and Scope 3 emissions, if applicable, must each be disclosed separately.

Emissions: The disclosure must present emissions disaggregated by each type of greenhouse gas.

Offsets: The disclosure should exclude the use of any purchased or generated offsets.

GHG Intensity: The disclosure would need to present GHG intensity for Scope 1 and Scope 2 emissions on an aggregate basis, expressed as metric tons of CO_2e per unit of total revenue (or, if it has no revenue, an alternative financial measure, such as total assets) and per unit of production, disclosing the basis for its choice of unit (or, if no unit of production is applicable, some other measure of economic output). If Scope 3 emissions are required to be disclosed, Scope 3 GHG intensity must be separately presented as well.

Methodology and Assumptions: The SEC would not prescribe any particular methodology for the emissions determinations. Registrants would need to describe the methodology (including organizational boundaries, operational boundaries, calculation approach – for Scope 1 emissions, whether they are directly measuring emissions, or using an emissions factor to calculate them based on other inputs; for Scope 2 emissions, whether they are using a market-based method or location-based method – and any other calculation tools), significant inputs, and significant assumptions used to calculate their GHG emissions metrics. Registrants must also disclose any material changes to the methodology or assumptions from the prior year.

Use of Range for Scope 3 Emissions: Scope 3 emissions may be disclosed as a range (in which case the registrant must also disclose its reasons for using the range and any underlying assumptions).

Use of Estimates, Third-Party Data and Gaps

Registrants would be permitted to use reasonable estimates when disclosing their GHG emissions as long as they describe the basis for those assumptions and their reasons for using the estimates. Registrants would also be permitted to use reasonable estimates for their fourth quarter emissions, together with actual GHG emissions data for the first three quarters when presenting emissions for the most recently completed fiscal year, so long as they promptly disclose any material differences between the estimate and actual determined GHG emissions data in a subsequent filing. The SEC has not specified whether this can be done in a periodic report or must be made via a Form 8-K.

Registrants must also disclose, to the extent material, any third-party data they have used in calculating their GHG emissions. They must identify the source of the data and any process by which they obtained and assessed the data.

Registrants would be required to disclose, to the extent material, any gaps in the data required to calculate GHG emissions, how they addressed such gaps and how that has affected the accuracy or completeness of their GHG emissions disclosure. The SEC also noted that Securities Act Rule 409 and Exchange Act Rule 12b-21 would be available for the proposed Scope 3 emissions disclosures. These rules allow for the conditional omission of required information when such information is unknown and not reasonably available to the registrant, either because obtaining the information would involve unreasonable effort or expense, or because the information rests peculiarly within the knowledge of another person not affiliated with the registrant.

GHG Emissions Attestation Reports

As discussed above, large accelerated filers and accelerated filers would be required to include attestation reports in the "Climate-Related Disclosures" section on their Scope 1 and Scope 2 emissions, initially providing limited assurance and then scaling up to reasonable assurance (see "Proposed Implementation Timing" above for the applicable timelines). The SEC has described these as "minimum" requirements and registrants may provide attestation in excess of the requirements (for example, they may provide a "reasonable assurance" attestation report earlier than required, or their assurance may cover

Scope 3 emissions). While registrants providing such voluntary attestation would not be required to provide a full attestation report, they would be required to provide certain disclosures, as described below under "Voluntary Reports."

The SEC did consider but has not chosen to propose at this time "controls" requirements similar to existing disclosure controls and procedures and internal control over financial reporting requirements.

GHG Emissions Attestation Provider
The attestation report would need to be prepared and signed by an independent GHG emissions attestation provider who is:

- an expert in GHG emissions by virtue of having significant experience in measuring, analyzing, reporting, or attesting to GHG emissions. "Significant experience" means having sufficient competence and capabilities necessary to:
  - perform engagements in accordance with professional standards and applicable legal and regulatory requirements; and
  - enable the service provider to issue reports that are appropriate under the circumstances; and
- independent with respect to the registrant, and any of its affiliates, for whom it is providing the attestation report, during the attestation and professional engagement period.

Independence: The SEC has proposed an independence definition similar to the one used for accountants. An emissions attestation provider would not be independent if, "during the attestation and professional engagement period such attestation provider is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that such attestation provider is not, capable of exercising objective and impartial judgment on all issues encompassed within the attestation provider's engagement." Registrants would need to evaluate the provision of services and any other relationships they have with the attestation provider to determine whether the attestation provider would be providing assurance on their own work, or acting as management or an employee of the registrant or its affiliates or as an advocate for the registrant.

Expert Status: Attestation providers would be named as "experts" and be subject to liability for their attestation conclusion or opinion. Registrants would need to obtain their consent to being so named in their SEC filings.

Qualifications: Registrants also would need to disclose the qualifications of their attestation providers, including:

- whether they have a license to provide assurance, the licensing or accreditation body that issued such license, and whether the attestation provider is a member in good standing of such body;
- whether they are subject to any oversight inspection program (and if so, which); and
- whether they are subject to record-keeping requirements with respect to the engagement (and if so, to describe those requirements, including their duration).

Attestation Report Requirements
The SEC is not prescribing a standard or framework but, similar to the internal control over financial reporting requirement, would set minimum requirements for that framework. Attestation reports would need to be prepared and provided in accordance with standards that are publicly available at no cost and are established by a body or group that has followed due process procedures, including the broad distribution of the framework for public comment. The SEC noted that the attestation standards of the PCAOB, AICPA, and IAASB would meet these requirements (other standards may as well).

The attestation report would be required to include:

- the matter being reported upon (i.e., Scope 1 and Scope 2 emissions disclosures) and the time period;
- the criteria against which the subject matter was measured or evaluated;
- the level of assurance provided and the nature of the engagement (i.e., scope and work performed);
- the attestation standard or standards used;
- a description of the registrant's responsibility on the subject matter or assertion being reported on;
- a description of the attestation provider's responsibilities in connection with the preparation of the attestation report;
- a statement that the attestation provider is independent;
- for limited assurance engagements, a description of the work performed as a basis for the attestation provider's conclusion;
- a description of any significant inherent limitations associated with measuring or evaluating the emissions disclosures;
- the signature of the attestation provider (which may be signed on behalf of a firm); and
- the city and state where the report was signed.

Voluntary Reports
Registrants who are not required to include a GHG emissions attestation report but whose GHG emissions disclosures were subject to third-party verification or attestation must include the below, similar, though scaled down disclosures about such verification/attestation:

- the provider of the verification or attestation;
- the verification or attestation standard used;
- the level and scope of verification or attestation provided;
- the results of the verification or attestation;
- whether the provider has any other business relationships with or has provided any other professional services to the registrant that might impair their independence; and
- what, if any, oversight inspection program the provider is subject to.

Financial Statement Disclosures

Proposed Article 14 of Regulation S-X would require registrants to include in their consolidated financial statements, and discuss in a separate footnote to the financial statements, specified climate-related metrics relating to financial impact and expenditures and financial estimates and assumptions.

Presentation

Organizational Boundaries: Registrants would be required to calculate the metrics using financial information consistent with their consolidated financial statements (e.g., registrants would have to include financial information from consolidated subsidiaries in their calculations).

Accounting Principles: Registrants would be required to apply the same set of accounting principles they are required to apply in the preparation of the rest of their consolidated financial statements.

Time Periods: The climate-related financial metrics must be provided for the same time periods reflected in the applicable filing (e.g., two years of climate-related financial metrics that correspond to balance sheet line items and three years of climate-related financial metrics that correspond to income statement line items; less for emerging growth companies and smaller reporting companies). If historical information is not available, registrants may avail themselves of Rule 12b-21 or Rule 401, which, as discussed above, allow for the conditional omission of required information when such information is unknown and not reasonably available to the registrant, either because obtaining the information would involve unreasonable effort or expense, or because the information rests peculiarly within the knowledge of another person not affiliated with the registrant.

Contextual Information: Registrants would be required to describe how each specified metric was derived and describe the significant inputs, assumptions and, if applicable, policy decisions made in the calculation of such metric.

Financial Impact Metrics

Registrants would be required to disclose the impact of climate-related conditions and events, physical and transition climate-related risks and any efforts to reduce GHG emissions or otherwise mitigate exposure to transition risks (collectively, "transition activities") on any line item in the consolidated financial statements. This disclosure would not be required if the aggregated impact of climate-related conditions and events, climate-related risks and transition activities, is less than 1% of that line item for the relevant fiscal year. To calculate the aggregated impact, registrants would add the absolute value of all impacts on the line item, such that positive and negative impacts would not offset each other (e.g., a positive impact of $2 million and a negative impact of $3 million would be calculated as an aggregated impact of $5 million).

In their disclosure, registrants would be required to disaggregate the impacts so that they:

- address the impact of climate-related conditions and events and physical climate-related risks on a line item separately from the impact of transition activities and transition climate-related risks; and
- address positive impacts and negative impacts separately.

Registrants may present this disclosure in narrative or tabular form.

Registrants may also present financial impact metrics for climate opportunities, so long as they follow the same presentation and disclosure threshold requirements described above.

Expenditure Metrics

Similarly, registrants would be required to present expenditures related to climate-related events, physical and transition climate-related risks and transition activities, if such expenditures exceed 1% of capital costs or expenses, as applicable. For the purpose of calculating the impact, registrants would separately aggregate all capitalized expenditures related to climate-related events and risks and transition activities (and compare that to total capital costs) and all expenses related to climate-related events and risks and transition activities (and compare that to total expenses).

Where such expenditures exceed the 1% threshold, registrants would be required to disaggregate the expenditures so that they distinguish capital costs and expenses, and in each such category, further distinguish between expenditures related to climate-related events and physical climate-related risks on the one hand, and transition activities and risks on the other hand. Registrants may present this disclosure in narrative or tabular form.

Registrants may also present expenditures arising from the pursuit of climate-related opportunities associated with transaction activities, so long as they follow the same presentation and disclosure threshold requirements described above for expenditures related to transition activities and risks.

Financial Estimates and Assumptions

Registrants 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 with, or known impacts from, climate-related events (including identified physical risks and severe weather events and other natural conditions) and transition activities (including transition risks), and to qualitatively describe how they impacted the development of the estimates and assumptions. In their discussions, registrants would distinguish between the impact of climate-related events and transition activities.

Definitions

To enhance comparability and consistency, the SEC's definitions are based on, and substantially similar to, the definitions used by the TCFD and GHG Protocol.

"*CO_2e*" means carbon dioxide equivalents.

"*Climate-related opportunities*" means the actual or potential positive impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations, or value chains, as a whole.

"*Climate-related risks"* means the actual or potential negative impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations or value chains, as a whole. Climate-related risks include the following:

- "*Physical risks*" include both acute risks and chronic risks to the registrant's business operations or the operations of those with whom it does business.
- "*Acute risks*" are event-driven and may relate to shorter-term extreme weather events, such as hurricanes, floods, and tornadoes, among other events.
- "*Chronic risks*" relate to longer-term weather patterns and related effects, such as sustained higher temperatures, sea level rise, drought, and increased wildfires, as well as related effects such as decreased arability of farmland, decreased habitability of land, and decreased availability of fresh water.
- "*Transition risks*" are the actual or potential negative impacts on a registrant's consolidated financial statements, business operations, or value chains attributable to regulatory, technological, and market changes to address the mitigation of, or adaptation to, climate-related risks, such as increased costs attributable to changes in law or policy, reduced market demand for carbon-intensive products leading to decreased prices or profits for such products, the devaluation or abandonment of assets, risk of legal liability and litigation defense costs, competitive pressures associated with the adoption of new technologies, reputational impacts (including those stemming from a registrant's customers or business counterparties) that might trigger changes to market behavior, consumer preferences or behavior, and registrant behavior.

"*Greenhouse gases ("GHG")*" means carbon dioxide ("CO_2"), methane ("CH_4"), nitrous oxide ("N_2O"), nitrogen trifluoride ("NF_3"), hydrofluorocarbons ("HFCs"), perfluorocarbons ("PFCs"), and sulfur hexafluoride ("SF_6").

"*RECs*" means renewable energy credits.

"*Scenario analysis*" means a process for identifying and assessing a potential range of outcomes of various possible future climate scenarios, and how climate-related risks may impact a registrant's operations, business strategy, and consolidated financial statements over time. For example, registrants might use scenario analysis to test the resilience of their strategies under certain future climate scenarios, such as those that assume global temperature increases of 3°C, 2°C, and 1.5°C above pre-industrial levels.

"Scope 1 emissions" are direct GHG emissions from operations that are owned or controlled by a registrant.

"*Scope 2 emissions*" are 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 registrant.

"*Scope 3 emissions*" are all indirect GHG emissions not otherwise included in a registrant's Scope 2 emissions, which occur in the upstream and downstream activities of a registrant's value chain.

- (1) Upstream activities in which Scope 3 emissions might occur include: (i) a registrant's purchased goods and services; (ii) a registrant's capital goods; (iii) a registrant's fuel and energy related activities not included in Scope 1 or Scope 2 emissions; (iv) transportation and distribution of purchased goods, raw materials, and other inputs; (v) waste generated in a registrant's operations; (vi) business travel by a registrant's employees; (vii) commuting by a registrant's employees; and (viii) a registrant's leased assets related principally to purchased or acquired goods or services.

- (2) Downstream activities in which Scope 3 emissions might occur include: (i) transportation and distribution of a registrant's sold products, goods or other outputs; (ii) processing by a third party of a registrant's sold products; (iii) use by a third party of a registrant's sold products; (iv) end-of-life treatment by a third party of a registrant's sold products; (v) a registrant's leased assets related principally to the sale or disposition of goods or services; (vi) a registrant's franchises; and (vii) investments by a registrant (for example, a financial company's Scope 3 emissions disclosures would likely include the emissions from companies to which registrant provides debt or equity financing).

"*Transition activities*" means the impact of climate-related conditions and events, physical and transition climate-related risks and any efforts to reduce GHG emissions or otherwise mitigate exposure to transition risks.

"*Value chain*" means the upstream and downstream activities related to a registrant's operations.

- Upstream activities include activities by a party other than the registrant that relate to the initial stages of a registrant's production of a good or service (e.g., materials sourcing, materials processing and supplier activities).

- Downstream activities include activities by a party other than the registrant that relate to processing materials into a finished product and delivering it or providing a service to the end user (e.g., transportation and distribution, processing of sold products, use of sold products, end-of-life treatment of sold products, and investments).

* * *

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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Annex A – Disclosure Examples from the Proposing Release

Physical Risks

- A registrant in the construction industry might be required to disclose the physical risk of increased heat waves that affect the ability of its personnel to safely work outdoors, which could result in a cessation or delay of operations, and a reduction in its current or future earnings.
- A registrant in the real estate sector might be required to disclose the likelihood that sea levels could rise faster than expected and reduce the value of its coastal properties.
- A registrant operating in wildfire-prone areas could be exposed to potential disruption of operations, destruction of property, and relocation of personnel in the event of heat induced wildfires.

Impacts

- An agricultural producer or distributor might disclose the likely impacts of drought on its own product mix or that of its suppliers, including increased expenses for additional water or due to the procurement of alternative product sources.
- A mining company that operates in areas susceptible to extreme rise in temperatures might disclose the likely impacts that this temperature rise has on its workforce and on its production schedule, including a reduction in output and future earning capacity.
- A real estate company that owns coastal property might disclose the likely impacts of rising sea levels on such property, including the potential diminution in value of, and a potential change in its strategy and outlook regarding such properties.
- Wildfires in California, which recently have become more frequent and more intense, may be a material risk for wineries, farmers, and other property owners. Some insurance companies have withdrawn from certain wildfire prone areas after concluding the risk is no longer insurable.
- Examples of potential impacts from physical risks may include:
  - Changes to revenues or costs from disruptions to business operations or supply chains;
  - Impairment charges and changes to the carrying amount of assets (such as inventory, intangibles, and property, plant and equipment) due to the assets being exposed to severe weather, flooding, drought, wildfires, extreme temperatures, and sea level rise;
  - Changes to loss contingencies or reserves (such as environmental reserves or loan loss allowances) due to impact from severe weather events; and
  - Changes to total expected insured losses due to flooding or wildfire patterns.

Transition Risks

- An automobile manufacturer might describe how market factors, such as changing consumer and investor preferences for low-emission vehicles, have impacted or will likely impact its production choices, operational capabilities, and future expenditures.

- An energy producer might describe how regulatory and reputational factors have impacted or are likely to impact its operational activities, reserve valuations, and investments in renewable energy.

- An oil company might determine that a likely change in demand for fossil fuel-based products would require it to modify its business model or alter its product mix to emphasize advanced diesel gas and biofuels in order to maintain or increase its earning capacity, thereby requiring disclosure under the proposed rules.

Impacts

- An automobile manufacturer might discuss an increase in operating costs or capital expenditures due to the need to revamp its assembly lines to build lower emission vehicles to comply with new regulatory guidelines or to meet changing consumer demand.

- A freight company might discuss impairment charges or early write-offs for older equipment it might need to replace due to anticipated changes in regulation or policy favoring lower emissions equipment.

- An industrial manufacturer might describe how investments in innovative technologies, such as carbon capture and storage, have impacted or are likely to impact its consolidated financial statements, such as by increasing its capital expenditures.

- An electric utilities company might disclose as an impact an increase in the amount of electricity generated from less carbon-intensive sources, such as wind turbines, or nuclear, hydroelectric or solar power to meet current or likely regulatory constraints.

- A registrant that operates in a jurisdiction that has imposed or is likely to impose limits on GHG emissions in support of the Paris Agreement might set a long-term target of net zero GHG emissions from its operations in 2050, a medium-term target of reducing its emissions by 30% by 2030, and a short-term target of maintaining its emissions at its 2020 rate through 2023. This registrant could face material transition risks due to the estimated costs of the operational changes expected to be implemented to achieve these targets. The registrant would be required to disclose these transition risks and their impacts on its strategy, business model, and outlook.

- Examples of potential impacts from transition risks may include:

  - Changes to revenue or cost due to new emissions pricing or regulations resulting in the loss of a sales contract;

  - Changes to operating, investing, or financing cash flow from changes in upstream costs, such as transportation of raw materials;

  - Changes to the carrying amount of assets (such as intangibles and property, plant, and equipment), for example, due to a reduction of the asset's useful life or a change in the asset's salvage value by being exposed to transition activities; and

  - Changes to interest expense driven by financing instruments such as climate-linked bonds issued where the interest rate increases if certain climate-related targets are not met.

Transition Plan Disclosures

- If a registrant has a transition plan that includes the development of lower carbon products and processes, that registrant might disclose that it expects to incur higher initial capital costs to implement its strategy, but anticipates increased revenues or reduced expenses over the longer term.
- An automobile manufacturer that transitions from the production of internal combustion engine vehicles to the production of electric vehicles might disclose that it expects to incur costs in the short term to change its manufacturing processes, but over the longer term, it expects to realize increased sales, protect its market share against transition risks, including reputational risks, and potentially avoid regulatory fines or other costs as consumer and regulatory demands change.
- A company with significant operations in areas vulnerable to sea level rise might plan to relocate its vulnerable operations as part of any transition plan.
- A company operating in areas subject to severe storms might have a transition plan that includes reinforcing its physical facilities to better withstand such weather events, or a plan to relocate those facilities.
- An agricultural producer that operates in areas subject to increasing water stress might discuss its plans to adjust its business strategy or operations, for example, by developing or switching to drought-resistant crops, developing technologies to optimize the use of available water, or acquiring land in other areas.
- An energy company might discuss how, due to actual or potential regulatory constraints, it intends to take advantage of climate-related opportunities by increasing the amount of electricity purchased that is produced using renewable energy sources, reducing its medium- and long-range fossil fuel exploration and production, increasing the percentage of its products consisting of biofuels and other lower-emission fuels, or investing in carbon capture and storage technologies.
- A transportation company might discuss how, to mitigate reputational risk, it plans to realize any climate-related opportunities presented by switching its existing fleet to one composed of low- or no-emission vehicles by a certain date.