TheCorporateCounsel.net

# "The (Former) Corp Fin Staff Forum"

## Tuesday, April 19, 2022

## Course Materials

“**<u>The (Former) Corp Fin Staff Forum</u>**”

**Tuesday, April 19, 2022**

2:00 – 3:00 pm, eastern [archive and transcript to follow]

**Save This Webcast To Your Calendar:** Outlook **|** iCalendar **|** Google Calendar

Come hear former Senior Staffers from the SEC’s Division of Corporation Finance weigh in on the latest rulemakings - and interpretations - from the Corp Fin perspective. We’ll discuss the most important initiatives at the SEC and Corp Fin – and provide practical guidance about what you should be doing as a result. This panel includes:

- **Sonia Barros**, Partner, Sidley Austin
- **Meredith Cross**, Partner, WilmerHale LLP
- **Tom Kim**, Partner, Gibson Dunn & Crutcher, LLP
- **Keir Gumbs**, Chief Legal Officer, Broadridge Financial Solutions
- **Dave Lynn**, Partner, Morrison & Foerster and Senior Editor, TheCorporateCounsel.net

This program will cover:

- Filing Reviews
- Staff Guidance Updates
- Cybersecurity Proposal
- Rule 10b5-1 & Buybacks Proposals
- Climate Disclosure Proposal
- Beneficial Ownership Reporting Proposal
- Human Capital Disclosure
- Shareholder Proposals & No-Action Process
- Expectations for Future Rulemaking

**<u>“The (Former) Corp Fin Staff Forum”</u>**

Course Outline / Notes

1. Filing reviews
2. Staff guidance updates
3. Cybersecurity proposal
4. Rule 10b5-1 & buybacks proposals
5. Climate disclosure proposal
6. Beneficial ownership reporting proposal
7. Human capital disclosure
8. Shareholder proposals & no-action process
9. Expectations for future rulemaking

# “The (Former) Corp Fin Staff Forum”

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**See Our In-House Accelerator For 101 Resources on Securities Law & Corporate Governance!**

If you're somewhat new to securities law or in-house life, familiarize yourself on the basics with our "In-House Accelerator" resource.
This covers the nuts and bolts of the following topics, in an easy to digest FAQ format:

- Board leadership & meetings
- Board committee meetings & obligations

- Director independence
- D&O questionnaires & board disclosure
- Proxy season and annual meetings
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For more information about this site, contact info@ccrcorp.com.

← Shareholder Proposals: More Nuggets from SLB 14L | Main | D&O Insurance: How Much Coverage Should a Private Company Buy? →

**November 4, 2021**

## Shareholder Proposals: New Staff Legal Bulletin a Game Changer for ESG-Related Proposals?

Yesterday, Corp Fin issued Staff Legal Bulletin 14L, which rescinds Staff Legal Bulletins 14I, 14J and 14K, and effectively takes a sledgehammer to four years of interpretive guidance on the exclusion of ESG-related shareholder proposals from proxy statements. In doing so, the new SLB may open the door for the inclusion of a wide range of previously excludable ESG proposals.

SLB 14I was issued in 2017 and addressed, among other things, the scope & application of Rule14a-8(i)(5) (the "economic relevance" exception) & Rule 14a-8(i)(7) (the "ordinary business" exception). In SLB 14I, Corp Fin observed that the key issue in evaluating both the economic relevance and ordinary business exceptions was whether a particular proposal focused on a policy issue that was sufficiently significant to the company's business, and called for the board's analysis of the significance issue to be contained in any no-action request. SLB 14J & 14K subsequently provided further interpretive guidance on these topics, and also addressed in some detail when proposals may be excluded under the ordinary business exception because they involve "micromanagement."

Yesterday's action effectively trashes the approach to the economic relevance & ordinary business exclusions outlined in these SLBs. Instead, SLB 14L says that Corp Fin will return to its traditional approach to social policy proposals:

> Going forward, the staff will realign its approach for determining whether a proposal relates to "ordinary business" with the standard the Commission initially articulated in 1976, which provided an exception for certain proposals that raise significant social policy issues, and which the Commission subsequently reaffirmed in the 1998 Release. This exception is essential for preserving shareholders' right to bring important issues before other shareholders by means of the company's proxy statement, while also recognizing the board's authority over most day-to-day business matters.
>
> For these reasons, staff will no longer focus on determining the nexus between a policy issue and the company, but will instead focus on the social policy significance of the issue that is the subject of the shareholder proposal. In making this determination, the staff will consider whether the proposal raises issues with a broad societal impact, such that they transcend the ordinary business of the company.
>
> Under this realigned approach, proposals that the staff previously viewed as excludable because they did not appear to raise a policy issue of significance for the company may no longer be viewed as excludable under Rule 14a-8(i)(7). For example, proposals squarely raising human capital management issues with a broad societal impact would not be subject to exclusion solely because the proponent did not demonstrate that the human capital management issue was significant to the company.

In light of Corp Fin's return to a non-company specific approach to the significance of a social policy issue, Corp Fin says that it will no longer expect a board analysis as described in the rescinded SLBs as part of demonstrating that the proposal is excludable under the ordinary business exclusion. SLB 14L adopts a similar approach to the economic relevance exclusion, and therefore will also no longer require a board analysis here either.

SLB 14L also addressed the micromanagement exclusion, and observed that the rescinded guidance may have been taken to mean that any limit on company or board discretion constitutes micromanagement. In doing so, Corp Fin noted that “specific methods, timelines, or detail do not necessarily amount to micromanagement and are not dispositive of excludability.”

It’s a certainty that there will be a lot of commentary in the coming weeks about how much of a departure SLB 14L represents from actual Staff practice versus what was laid out in the now rescinded SLBs. But in any event, Corp Fin seems to be sending a message that the proponents of ESG-related topics are likely to face a friendlier environment than they have in recent years. That’s a message that won’t be lost on those proponents, who still have plenty of time to submit proposals for next proxy season.

**– John Jenkins**

Posted by John Jenkins
Permalink: https://www.thecorporatecounsel.net/blog/2021/11/shareholder-proposals-new-staff-legal-bulletin-a-game-changer-for-esg-related-proposals.html

← SEC Regulatory Agenda: Commissioners Peirce & Roisman Fire a Shot Across the Bow | Main | Tomorrow's Webcast: "Compensation Committee Responsiveness: How to Regain High Say-on-Pay Support" →

**December 14, 2021**

## Shareholder Proposals: Corp Fin Returns to Written Responses to No-Action Requests

A couple of years ago, Corp Fin initiated a policy under which some Rule 14a-8 no-action requests received an oral response only. Yesterday, Corp Fin announced that it was discontinuing that policy. Here's an excerpt:

> We have reconsidered this approach, and after review of the practice we believe that written responses will provide greater transparency and certainty to shareholder proponents and companies alike. Beginning with the publication of this announcement, we will return to our prior practice and the staff will once again respond to each shareholder proposal no-action request with a written letter, similar to those issued in prior years. Our response letters will be posted publicly on the Division's website in a timely manner. We will no longer communicate our responses via a chart, but we expect to publish a chart upon completion of the proxy season.

The original decision to provide oral responses to some letters was prompted in part by Corp Fin's desire to enhance the efficiency of the no-action process, but my guess is that this change in policy is likely to have the opposite effect. At the very least, it isn't going to ease the burden on the Staff when it comes to processing no-action requests – which may well spike this year as a result of Corp Fin's issuance of SLB 14L.

**– John Jenkins**

Posted by John Jenkins
Permalink: https://www.thecorporatecounsel.net/blog/2021/12/shareholder-proposals-corp-fin-returns-to-written-responses-to-no-action-requests.html

← Buybacks: SEC Proposes to Ramp Up Disclosure Requirements for Repurchases | Main | Auditor Terminations: Are Disclosures Useless? →

**December 16, 2021**

## Rule 10b5-1: SEC Proposes Amendments to Conditions & Disclosure Requirements

Yesterday, the SEC issued proposed amendments to Rule 10b5-1 and related rules imposing new conditions & disclosure requirements for 10b5-1 plans and securities transactions by companies and insiders. Here’s a copy of the163-page proposing release & the two-page fact sheet on the proposed rules.  The SEC’s press release also provides a good summary of the proposal:

> The proposed amendments to Rule 10b5-1 would update the requirements for the affirmative defense, including imposing a cooling off period before trading could commence under a plan, prohibiting overlapping trading plans, and limiting single-trade plans to one trading plan per twelve month period. In addition, the proposed rules would require directors and officers to furnish written certifications that they are not aware of any material nonpublic information when they enter into the plans and expand the existing good faith requirement for trading under Rule 10b5-1 plans.
>
> The amendments also would elicit more comprehensive disclosure about issuers’ policies and procedures related to insider trading and their practices around the timing of options grants and the release of material nonpublic information. A new table would report any options granted within 14 days of the release of material nonpublic information and the market price of the underlying securities the trading day before and the trading day after the disclosure of the material non-public information. Insiders that report on Forms 4 or 5 would have to indicate via a new checkbox whether the reported transactions were made pursuant to a Rule 10b5-1(c) or other trading plan. Finally, gifts of securities that were previously permitted to be reported on Form 5 would be required to be reported on Form 4.

For the most part, the proposed changes to Rule 10b5-1 track the recommendations made by the SEC’s Investor Advisory Committee, but the proposal does not include Form 8-K & proxy disclosure requirements relating to corporate & insider 10b5-1 plans that the IAC advocated. The portions of the proposed rules addressing disclosure of the timing of option grants follow up on the Staff’s recent guidance on accounting for “spring loaded” awards.  Finally, in what’s become a very unusual event in recent years, the commissioners unanimously voted to approve the issuance of the rule proposal.

**– John Jenkins**

Posted by John Jenkins
Permalink: https://www.thecorporatecounsel.net/blog/2021/12/rule-10b5-1-sec-proposes-amendments-to-conditions-disclosure-requirements.html

← 10b5-1 Proposal: A Solution (At Least Partially) In Search Of A Problem? | Main | Rule 10b5-1: SEC Proposes Amendments to Conditions & Disclosure Requirements →

**December 16, 2021**

## Buybacks: SEC Proposes to Ramp Up Disclosure Requirements for Repurchases

At yesterday's open meeting, the SEC also issued proposed rules addressing disclosure requirements for issuer repurchases. Here's the 101-page proposing release along with the two-page fact sheet. This excerpt from the SEC's press release summarizes the proposal:

> The proposed rules would require an issuer to provide a new Form SR before the end of the first business day following the day the issuer executes a share repurchase. Form SR would require disclosure identifying the class of securities purchased, the total amount purchased, the average price paid, as well as the aggregate total amount purchased on the open market in reliance on the safe harbor in Exchange Act Rule 10b-18 or pursuant to a plan that is intended to satisfy the affirmative defense conditions of Exchange Act Rule 10b5-1(c).
>
> The proposed amendments also would enhance existing periodic disclosure requirements regarding repurchases of an issuer's equity securities. Specifically, the proposed amendments would require an issuer to disclose: the objective or rationale for the share repurchases and the process or criteria used to determine the repurchase amounts; any policies and procedures relating to purchases and sales of the issuer's securities by its officers and directors during a repurchase program, including any restriction on such transactions; and whether the issuer is making its repurchases pursuant to a plan that it intends to satisfy the affirmative defense conditions of Exchange Act Rule 10b5-1(c) and/or the conditions of the Exchange Act Rule 10b-18 non-exclusive safe harbor.

SEC Chair Gary Gensler mentioned that buybacks were on the SEC's agenda when he discussed his desire to make changes to Rule 10b5-1, but the release notes that some of the disclosure proposals date back to the 2016 Reg S-K concept release. As Broc pointed out at the time, footnote 625 of that release noted that Australia required next day disclosure of buybacks. Well, G'day America! because it looks like that requirement may be heading your way.

Unlike the Rule 10b5-1 proposal, this one prompted a dissent from Commissioner Peirce (here's her statement) and Commissioner Roisman (here's his statement). Speaking of statements, the SEC acted on the PCAOB's budget and proposed rule amendments on securities-based swaps & money market funds yesterday as well, and every commissioner issued a statement on every action. If you subscribe for updates from the SEC's website, you already noticed this, because your inbox started exploding early yesterday afternoon.

**– John Jenkins**

Posted by John Jenkins
Permalink: https://www.thecorporatecounsel.net/blog/2021/12/buybacks-sec-proposes-to-ramp-up-disclosure-requirements-for-repurchases.html

← SEC Proposes Changes to Whistleblower Rules (Again) | Main | January-February Issue of "The Corporate Counsel" →

**February 11, 2022**

## Section 13(d) Reform: SEC Proposal Has Arrived!

Even before SEC Chair Gary Gensler was officially confirmed to his current office, people were predicting that Section 13(d) reform would be high on his list of priorities. Yesterday, the SEC announced that it is proposing amendments to Regulation 13D-G. If adopted, the primary impact of the amendments would be to accelerate the filing deadline for Schedule 13D and 13G reports – to address the concern over "information asymmetry" that John blogged about last month.

This is a welcome development for the contingent of folks who think the current rules are outdated – see this 2011 WLRK petition, for example. If this proposal is adopted, it'll be the most significant amendment to Regulation 13D-G since the rules were adopted in 1968.

Here's the 193-page proposal – and here's the 2-page fact sheet. The fact sheet explains that the proposal would:

> – Accelerate the filing deadlines for Schedules 13D and 13G beneficial ownership reports – generally, from 10 to 5 days for Schedule 13D and from 45 days from the end of the year to 5 business days from the end of the month for Schedule 13G;
>
> – Expand the application of Regulation 13D-G to certain derivative securities;
>
> – Clarify the circumstances under which two or more persons have formed a "group" that would be subject to beneficial ownership reporting obligations; and
>
> – Require that Schedules 13D and 13G be filed using a structured, machine-readable data language.

Chair Gensler issued a statement in support of the proposal. But not everyone is celebrating. Commissioner Peirce, who doesn't share the view that information asymmetry is a problem in this context, issued a dissenting statement. We'll be posting memos about this proposal in our "Schedules 13D & 13G" Practice Area. Comments are due 30 days after publication in the Federal Register or April 11th, whichever is later.

**– Liz Dunshee**

Posted by Liz Dunshee
Permalink: https://www.thecorporatecounsel.net/blog/2022/02/section-13d-reform-sec-proposal-has-arrived.html

← Transcript: "Whistleblowers – Best Practices in a New Regime" | Main | BlackRock's 2022 Engagement Priorities: Director Accountability For Long-Term Value →

**March 3, 2022**

## Human Capital: What a Prescriptive Disclosure Rule Could Look Like

According to its updated "human capital management" commentary, BlackRock continues to believe that companies that have strong relationships with their workforce are more likely to deliver long-term shareholder value. Particularly in this labor market, robust HCM can be a competitive advantage – so companies need to explain how they set themselves apart. The commentary outlines several workforce-related topics that BIS is expecting to understand through disclosures & engagements – which may be mapped to the SASB materiality framework or other standards.

BlackRock isn't alone. According to this WSJ article, other asset managers, as well as pension funds, are also continuing to clamor for more "human capital" info. In response to this investor appetite for specific data, the SEC is aspiring to propose amendments to the human capital disclosure requirements in Item 101 of Regulation S-K. Here's a reminder of what a more prescriptive rule could include:

> Commission staff have been working on a rule that would mandate additional disclosures around human capital since SEC Chairman Gary Gensler took office last April. The new requirements would likely be mandatory for public companies and could touch on turnover, skills and development training, compensation, benefits, workforce demographics including diversity, and health and safety, he has said.

According to investors quoted in the article, most disclosure being provided in response to the principles-based 2020 rule isn't getting them the info they want. In particular, the events of the past few years have heightened investor interest in turnover, health & safety, pay equity, and broader DEI progress – but only a small minority of companies publish specific metrics for those topics. Check out the memos in our "Human Capital Management" Practice Area for more analysis of disclosure trends under the current rule.

**– Liz Dunshee**

Posted by Liz Dunshee
Permalink: https://www.thecorporatecounsel.net/blog/2022/03/human-capital-what-a-prescriptive-disclosure-rule-could-look-like.html

← Restatements: Chief Accountant's Statement on Materiality Assessments | Main | Nasdaq Board Diversity Rule: CII Files Amicus Brief in Lawsuit →

**March 10, 2022**

## Cybersecurity: SEC Proposes Cyber Disclosure Rules

Yesterday, the SEC announced that it was proposing a series of new rules focusing on enhanced disclosure of cybersecurity issues by public companies. Here's the 129-page proposing release and here's the 2-page fact sheet. The proposed rules would require current reporting & periodic updating about material cybersecurity incidents, and periodic disclosures about policies and procedures to address cybersecurity risks. In addition, companies would be required to disclose management's role in implementing cybersecurity policies & the board's cybersecurity expertise. This excerpt from the fact sheet spells out the specifics, and notes that the SEC proposes to:

> – Amend Form 8-K to require registrants to disclose information about a material cybersecurity incident within four business days after the registrant determines that it has experienced a material cybersecurity incident;
>
> – Add new Item 106(d) of Regulation S-K and Item 16J(d) of Form 20-F to require registrants to provide updated disclosure relating to previously disclosed cybersecurity incidents and to require disclosure, to the extent known to management, when a series of previously undisclosed individually immaterial cybersecurity incidents has become material in the aggregate and amend Form 6-K to add "cybersecurity incidents" as a reporting topic;
>
> – Add Item 106 to Regulation S-K and Item 16J of Form 20-F to require a registrant to: Describe its policies and procedures, if any, for the identification and management of risks from cybersecurity threats, including whether the registrant considers cybersecurity as part of its business strategy, financial planning, and capital allocation; and require disclosure about the board's oversight of cybersecurity risk and management's role and expertise in assessing and managing cybersecurity risk and implementing the registrant's cybersecurity policies, procedures, and strategies;
>
> – Amend Item 407 of Regulation S-K and Form 20-F to require disclosure regarding board member cybersecurity expertise. Proposed Item 407(j) would require disclosure in annual reports and certain proxy filings if any member of the registrant's board of directors has expertise in cybersecurity, including the name(s) of any such director(s) and any detail necessary to fully describe the nature of the expertise.

Commissioner Peirce dissented from the proposal. In her dissenting statement, she argues that "the governance disclosure requirements embody an unprecedented micromanagement by the Commission of the composition and functioning of both the boards of directors and management of public companies," and that the granular nature of the proposed disclosure requirements makes them "look more like a list of expectations about what issuers' cybersecurity programs should look like and how they should operate."

The criticism of the rule as "micromanagement" of governance may be a fair comment, but if Commissioner Peirce thinks that kind of thing is unprecedented, she may want to take another look at what governance disclosures are already required by Item 407 of S-K. In any event, the comment period will end 60 days following publication of the proposing release on the SEC's website or 30 days following publication of the proposing release in the Federal Register, whichever period is longer.

**– John Jenkins**

Posted by John Jenkins
Permalink: https://www.thecorporatecounsel.net/blog/2022/03/cybersecurity-sec-proposes-cyber-disclosure-rules.html

**PracticalESG.com's Perspectives on the Climate Disclosure Proposal**

***By Lawrence Heim, Editor***

**Summary/Highlights**

The proposal weighs in at 510 pages and is comprehensive. Based on both TCFD and Greenhouse Gas Protocol regimes, it stays focused on the SEC's existing definition/interpretation of financial materiality and doesn't attempt to wade into double or dynamic materiality of other ESG disclosure frameworks. The SEC believes that proposing rules based on the TCFD framework and GHG protocol may facilitate achieving a balance between eliciting better disclosure and limiting compliance costs.

In general, the proposal would require registrants to:

- Provide the climate-related disclosure in registration statements and Exchange Act annual reports;
- Provide the Regulation S-K mandated climate-related disclosure in a separate, appropriately captioned section of a company's registration statement or annual report, or alternatively to incorporate that information in the separate, appropriately captioned section by reference from another section, such as Risk Factors, Description of Business, or Management's Discussion and Analysis ("MD&A");
- Provide the Regulation S-X mandated climate-related financial statement metrics and related disclosure in a note to the registrant's audited financial statements and in conformance with US accounting standards (GAAP);
- Obtain independent third party assurance for the GHG emissions disclosure and climate-related financial disclosure;
- Electronically tag both narrative and quantitative climate-related disclosures in Inline XBRL; and
- File rather than furnish the climate-related disclosure.

When it comes to information that the proposed rules would require, registrants would need to disclose:

- Scopes 1 and 2 GHG emissions metrics, separately, and expressed:
    - Both by disaggregated constituent greenhouse gases and in the aggregate, and
    - In absolute and intensity terms;
- Scope 3 GHG emissions and intensity, if material, or if the registrant has set a GHG emissions reduction target or goal that includes its Scope 3 emissions;
- The oversight and governance of climate-related risks by the registrant's board and management;
- How any climate-related risks identified by the registrant have had or are likely to have a material impact on its business and consolidated financial statements, which may manifest over the short-, medium-, or long-term;
- How any identified climate-related risks have affected or are likely to affect the registrant's strategy, business model, and outlook;
- The registrant's processes for identifying, assessing, and managing climate-related risks and whether any such processes are integrated into the registrant's overall risk management system or processes;

- The impact of climate-related events (severe weather events and other natural conditions as well as physical risks identified by the registrant) and transition activities (including transition risks identified by the registrant) on the line items of a registrant's consolidated financial statements and related expenditures, and disclosure of financial estimates and assumptions impacted by such climate-related events and transition activities; and
- The registrant's climate-related targets or goals, and transition plan, if any.

In terms of timing/phase-in, the proposal contemplates a phase-in period that would first require compliance from the largest filers in 2024 assuming the final rule is adopted and effective by December 2022.

There is a lot of ground covered in the proposal, and this is only a high-level overview. I'll be posting more blogs this week examining some of the details and offering commentary – including on the compliance cost estimates.

A Fact Sheet is available to accompany the full text of the proposal. The deadline for submitting comments is the later of either (a) 30 days after date of publication in the Federal Register or (b) May 20, 2022. Comments that have already been filed (as memoranda of meetings) are available here.

**What Happens Now**

Liz blogged yesterday on TheCorporateCounsel.net about the SEC's rulemaking process. Like any other regulatory proposal, the climate disclosure proposal is now open for public comment. We expect there to be lots and lots of comments. The really interesting part is what happens after the public comment period closes. The SEC Staff will, of course, have to review and consider all of them and will formulate responses for the Commissioners to consider as part of the adopting release. There may be more face-to-face meetings between interested parties and Staff. The comment period may extend beyond the allotted 30 days. The Commissioners would then decide whether to consider and adopt final rules – and by that time, we may have new individuals on the roster, due to the vacancy created by former Commissioner Roisman's departure and the planned departure of Commissioner Lee after her term expires in June and a successor is confirmed.

Some of the big regulatory process questions are:

- How long will the Staff need to develop the final rule and the accompanying adopting release?
- When will the Commissioners consider the adopting release?
- If the climate disclosure rules are adopted, will the contemplated phase-in period also be adopted as-is?
- Will a lawsuit be filed challenging the substantive provisions and/or delaying the effective date?
- How long will any legal challenges take before they are resolved?
- If and when the final rule is adopted, will all or part of it be remanded back to the SEC for further rulemaking as part of any legal challenge, and if so, how long will that take?
- Will parts of the final rules remain in effect during any legal challenge?

**Risk Disclosure & Governance**

**Proposed Risk Disclosures**

The proposed rules would require a registrant to describe any processes the registrant has for identifying, assessing, and managing climate-related risks, and whether and how climate-related risks are integrated into the registrant's overall risk management system or processes. These proposed disclosures would help investors assess whether the registrant has centralized and adequate processes for managing climate-related risks and whether they are aligned with investor preferences.

A registrant would have to disclose any climate-related risks reasonably likely to have a material impact on the registrant's business or consolidated financial statements. A registrant may also disclose, as applicable, the actual and potential impacts of any climate-related opportunities it is pursuing.

- **Physical risk:** "Acute" and "chronic" risks pose harm to businesses and their assets arising from acute climate-related disasters such as wildfires, hurricanes, tornadoes, floods, and heatwaves. Companies and their investors may also face chronic risks and more gradual impacts from long-term temperature increases, drought, and sea level rise.
- **Transition Risk**: Risks may arise from potential adoption of climate-related regulatory policies including those that may be necessary to achieve the national climate goals that may be or have been adopted in the United States and other countries; climate-related litigation; changing consumer, investor, and employee behavior and choices; changing demands of business partners; long-term shifts in market prices; technological challenges and opportunities, and other transitional impacts. Transition risks would include, but are not limited to:
    - increased costs attributable to climate-related changes in law or policy,
    - reduced market demand for carbon-intensive products leading to decreased sales, 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, or
    - reputational impacts (including those stemming from a registrant's customers or business counterparties) that might trigger changes to market behavior, changes in consumer preferences or behavior, or changes in a registrant's behavior.

The proposed rules would require a registrant to specify whether an identified climate-related risk is a physical or transition risk so that investors can better understand the nature of the risk and the registrant's actions or plan to mitigate or adapt to the risk. A registrant would have to describe the nature of transition risks, including whether they relate to regulatory, technological, market (including changing consumer, business counterparty, and investor preferences), liability, reputational, or other transition-related factors, and how those factors impact the registrant.

If a registrant has adopted a transition plan as part of its climate-related risk management strategy, the proposed rules would require the registrant to discuss, as applicable, how it plans to mitigate or adapt to any physical risks identified in the filing, including but not limited to those concerning exposure to sea level rise, extreme weather events, wildfires, drought, and severe heat.

*Our view:* The gap between a company's internal risk management function and the sustainability/ESG/climate practitioners has long been noted as a meaningful obstacle in corporate programs. This proposal would likely force companies to begin integrating the disparate activities, risk valuation approaches and risk management solutions. In addition, the proposal would require that companies specifically assess operational business risks and costs association with moving to a transition economy. In a time when many place more emphasis on what I have called “sprinkling ESG fairy dust on shares” rather than evaluating practical business impacts/opportunities, I welcome this component of the proposal.

**Proposed Governance Disclosures**

The proposed rules would require a registrant to disclose, as applicable, certain information concerning the board’s oversight of climate-related risks, and management’s role in assessing and managing those risks. A comprehensive understanding of a board’s oversight, and management’s governance, of climate-related risks is necessary to aid investors in evaluating the extent to which a registrant is adequately addressing the material climate-related risks it faces, and whether those risks could reasonably affect the value of their investment.

A registrant would have to disclose a number of board governance items, as applicable:

- Identify any board members or board committees responsible for the oversight of climate-related risks. The responsible board committee might be an existing committee, such as the audit committee or risk committee, or a separate committee established to focus on climate-related risks;
- Whether any member of a registrant’s board of directors has expertise in climate-related risks, with disclosure required in sufficient detail to fully describe the nature of the expertise;
- A description of the processes and frequency by which the board or board committee discusses climate-related risks. The registrant would have to disclose how the board is informed about climate-related risks, and how frequently the board considers such risks.
- Whether and how the board or board committee considers climate-related risks as part of its business strategy, risk management, and financial oversight. The proposed disclosure requirement could help investors assess the degree to which a board’s consideration of climate-related risks has been integrated into a registrant’s strategic business and financial planning and its overall level of preparation to maintain its shareholder value;
- Whether and how the board sets climate-related targets or goals and how it oversees progress against those targets or goals, including the establishment of any interim targets or goals; and
- A number of items, as applicable, about management’s role in assessing and managing any climate-related risks in a manner similar to that for Boards.

*Our view:* Strengthening climate-specific governance structures is an important element of any compliance activity or corporate initiative.  Transparency here should enhance the quality and efficacy of governance. It also means that, if the rule is finalized, methods for ensuring Director education/awareness of climate issues will no longer be discretionary.

## Materiality, Scenarios, Offsets/RECs & Internal Carbon Price

**How the Proposal Addresses “Materiality”**

The preamble clarifies that the proposal is based on financial materiality as defined/interpreted by the SEC and the courts. Therefore, the proposal focuses on the financial impact of climate matters to the company and does not address company impact on the environment or society, nor a societal cost of carbon. The preamble makes no mention of double materiality or dynamic materiality that are elements of some international disclosure regimes.

Registrants would have to disclose

- how they assess materiality,
- whether they consider likely future regulatory actions,
- how they prioritize, mitigate, or adapt to climate-related risks,
- overall how climate-related factors are integrated into the registrants' risk management systems or processes,
- detailed descriptions on any transition plans, as applicable, including relevant targets and metrics, how physical and transition risks are managed, and actions taken and progress made toward the plan's targets or goals.

All of these matters would be shaped by a registrant's assessment of the financial materiality of climate risks.

*Our view:* This responds to input from many investors who have voiced to their holdings and to the SEC that climate information is decision-useful to them. It also clarifies SEC's jurisdiction, likely as a strategy of head off threats of lawsuits based on claims that SEC is attempting to regulate beyond its authority and mission of investor protection. Finally, it supports the position of the regulation being consistent with US accounting and disclosure regimes under FASB.

Some registrants may be able to use existing materiality assessments, however we caution that "social impact" based materiality determinations may not be consistent with the more focused financial materiality basis of the SEC's proposal.

**Proposed Scenario Disclosure**

This is a big one and something that investors have been clamoring for. A registrant also would be required to describe any analytical tools, such as scenario analysis, that the registrant uses to assess the impact of climate-related risks on its business and consolidated financial statements, or to support the resilience of its strategy and business model in light of foreseeable climate-related risks.

Disclosure of the parameters, assumptions, and analytical choices involved in the described scenarios would help investors better understand the various considered scenarios and help them evaluate whether the registrant has a plan to manage the climate-related risks posed by each scenario. Because a registrant's scenario analysis disclosure would necessarily include predictions and other forward-looking statements based on assumptions concerning future events, the SEC believes that the Private Securities Litigation Reform Act (PSLRA) forward-looking safe harbors would apply to much of the disclosure concerning scenario analysis.

*Our view*: Understanding various assumptions and scenarios incorporated into company evaluations is critical to transparency. With safe harbor protections afforded scenario disclosure under the proposal, companies should feel less constrained about communicating those.

**Proposed Offsets and RECs Disclosures**

The proposed rules would require registrants to disclose the role that carbon offsets or renewable energy credits or certificates ("RECs") play in the registrant's climate-related business strategy. Understanding the role that carbon offsets or RECs play in a registrant's climate-related business strategy can help investors gain useful information about the registrant's strategy, including the potential risks and financial impacts. A registrant that relies on carbon offsets or RECs to meet its goals might incur lower expenses in the short term but could expect to continue to incur the expense of purchasing offsets or RECs over the long term. The value of an offset may decrease substantially and suddenly if, for example, the offset represents protected forest land that burns in a wildfire and no longer represents a reduction in GHG emissions. There is also the risk that the availability or value of offsets or RECs might be curtailed by regulation or changes in the market.

*Our view:* Increased visibility into the use of offsets may be a disincentive for companies to use (or overuse) them. This disclosure may also help weed out fraud and low quality offsets to an extent as the risk to such providers would be far greater than it is today.

**Proposed Internal Carbon Price Disclosure**

If a registrant uses an internal carbon price, the proposed rules would require disclosure of information about how the price is estimated, boundaries for measurement, rationale for selecting the price used, and how it uses its disclosed internal carbon price to evaluate and manage climate-related risks.

*Our view:* A requirement to report on internal carbon prices and the associated assumptions used may become a disincentive for companies to use them. It could also unintentionally shed light on certain competitive information that some companies prefer remain confidential.

## Financial Statement Metrics & Compliance Costs

**Proposed Financial Statement Metrics**

Although the SEC agreed that registrants are currently required to disclose material financial impacts on the financial statements, the proposed climate-related financial statement metrics should provide additional transparency into the impact of climate-related events on information reported in the financial statements that would be relevant to investors when making investment or voting decisions.

The proposed rules would require disclosure falling under the following three categories of information:

- Financial Impact Metrics;
- Expenditure Metrics; and
- Financial Estimates and Assumptions.

For each type of financial statement metric, the registrant would have to disclose contextual information to enable a reader to understand how it derived the metric, including a description of significant inputs and assumptions used, and if applicable, policy decisions made by the registrant to calculate the specified metrics.

The new item under Regulation S-K would require a registrant to provide a narrative discussion of whether and how any of its identified climate-related risks have affected or are reasonably likely to affect the registrant's consolidated financial statements. The proposed rules would also require a registrant to disclose the financial impact of any identified transition risks and any efforts to reduce GHG emissions or otherwise mitigate exposure to transition risks (collectively, "transition activities") on any relevant line items in the registrant's consolidated financial statements during the fiscal years presented.

The financial impact metric disclosure requirements in proposed Rules 14-02(c), (d), and (i) would require a registrant to disclose the financial impacts of severe weather events, other natural conditions, transition activities, and identified climate-related risks on the consolidated financial statements included in the relevant filing unless the aggregated impact of the severe weather events, other natural conditions, transition activities, and identified climate-related risks is less than one percent of the total line item for the relevant fiscal year.

*Our view*: These elements of the proposal align with the SEC's financial materiality emphasis, including the 1% value which is already used by the SEC as a reporting threshold for certain excise taxes, open option contracts and transactions by a smaller reporting company (SRC). The proposal would bring significant clarity to a registrant's climate programs and plans through the detailed financial breakdowns. However, some will criticize this as not considering social costs or other externalities that – in the eyes of numerous economists and academics – far outweigh direct costs currently accounted for.

**SEC's Estimated Compliance Costs**

The preamble includes an extensive discussion of benefits of the disclosure item by item, including a thorough discussion of voluntary disclosures and why those are inadequate in the SEC's opinion. The primary direct costs that the proposed rules would impose on registrants are compliance costs. To the extent that they are not already gathering the information required to be disclosed under the proposed rules, registrants may need to re-allocate in-house personnel, hire additional staff, and/or secure third-party consultancy services. Registrants may also need to conduct climate-related risk assessments, collect information or data, measure emissions (or, with respect to Scope 3 emissions, gather data from relevant upstream and downstream entities), integrate new software or reporting systems, seek legal counsel, and obtain assurance on applicable disclosures (i.e., Scopes 1 and 2 emissions). In addition, even if a registrant already gathers and reports the required information, some or all of this information may be in locations outside of SEC filings (such as sustainability reports posted on company websites or emissions data reported to the EPA) or in a form inconsistent with the SEC's proposed requirements.

Total costs estimated for non-smaller reporting company (SRC) registrants:

- First year compliance cost – $640,000 ($180,000 for internal costs and $460,000 for outside professional costs)
- Subsequent annual costs – $530,000 ($150,000 for internal costs and $380,000 for outside professional costs)

Total costs estimated for SRC registrants:

- First year compliance cost – $490,000 ($140,000 for internal costs and $350,000 for outside professional costs)

- Subsequent annual costs – $420,000 ($120,000 for internal costs and $300,000 for outside professional costs)

A company qualifies as an SRC if it has

- public float of less than $250 million or
- less than $100 million in annual revenues and
  - no public float, or
  - public float of less than $700 million

These costs are expected to decrease over time for various reasons, including increased institutional knowledge, operational efficiency, and competition within the market for relevant services.

Much of the cost depends on whether a registrant is already collecting and disclosing climate data. The SEC believes that third-party cost estimates of preparing TCFD reports or completing the CDP questionnaire offer a rough approximation of potential compliance costs due to their similarity with the proposed rules. Some companies indicated that anticipated incremental costs of a mandatory climate disclosure rule are expected to be minimal. One company reported the cost of producing their first TCFD report was less than $10,000 and another company reported the costs of preparing its first CDP questionnaire was no more than $50,000. A multinational financial institution reports the cost of producing its first TCFD report, SASB report, and CDP questionnaire were each less than $100,000 given that such information overlaps with what the company already discloses under the EU's Prospectus Regulation (Regulation (EU) 2017/1129).

Headcount requirements ranged from two to 20 full-time equivalent employees. Fees for external advisory services ranged from $50,000 to $1.35 million annually, which generally included legal counsel and consulting services related to environmental engineering, emissions, climate science, modeling, or sustainability reporting.

Assurance cost estimates (included in the above figures) were:

- For limited assurance, SEC estimated that accelerated filers will incur costs ranging from $30,000 to $60,000 (with a median of $45,000), while large accelerated filers will incur costs ranging from $75,000 to $145,000 (with a median of $110,000).
- For reasonable assurance, SEC estimated that accelerated filers will incur costs ranging from $50,000 to $100,000 (with a median of $75,000), while large accelerated filers will incur costs ranging from $115,000 to $235,000 (with a median of $175,000).

The UK's Department for Business, Energy & Industrial Strategy, as part of its Green Finance Strategy, released cost estimates that a company with no pre-existing climate-related disclosure practices or expertise could incur costs of $201,800 in the first year and $177,900 in subsequent years, plus additional costs due to subsidiaries, as applicable. While these costs reflect conformance to UK requirements, the SEC considered them a reasonable benchmark.

*Our view:* There are numerous cost estimate components and benchmarks provided in the preamble. To be frank, I was taken aback by the numbers. If you are a buyer of GHG quantification and disclosure services, it would be worth challenging your current fee structure and checking out alternative providers. If this becomes a final rule, there will almost certainly be more service providers in the market to increase competition and rationalize pricing. At the same time, one difficulty facing service providers is that engineering firms that know how to do emissions inventories don't know assurance, and the audit firms who know assurance aren't particularly strong in air emissions inventories.

While IT systems may offer cost and efficiency benefits here, it is worth being cautious when it comes to systems that claim to automatically calculate or determine emissions, especially those from suppliers (Scope 3) based on procurement data/systems. If the final release is substantially similar to the proposal, registrants will be required to understand, evaluate and report on third-party emissions data relied on, and the methodologies used. Some procurement-based IT systems making claims about Scope 3 data capabilities may be cost effective, but may not provide emissions data credible enough for SEC reporting.

The assurance cost estimates seem reasonable in my opinion, especially given that they cover two separate engagements – the financial metric and GHG emissions assurance statements. At the same time, I would expect first year costs to be higher than expected due to the learning curve that assurance providers will have to go through. After that, I hope to see costs come down due to increased competition in the space and work efficiencies gained from first year experiences.

## Forms Affected, GAAP & Targets and Goals

### Forms Affected by the Proposal

The proposal would require a registrant to include climate-related disclosure in Securities Act or Exchange Act registration statements (Securities Act Forms S-1, F-1, S-3, F-3, S-4, F-4, and S- 11, and Exchange Act Forms 10 and 20-F) and Exchange Act annual reports (Forms 10-K and 20-F), including the proposed financial statement metrics. Similar to the treatment of other important business and financial information, the proposed rules would also require registrants to disclose any material change to the climate-related disclosure provided in a registration statement or annual report in its Form 10-Q (or, in certain circumstances, Form 6-K for a registrant that is a foreign private issuer that does not report on domestic forms).

The climate-related disclosures would be "filed" and therefore subject to potential liability under Exchange Act Section 18, except for disclosures furnished on Form 6-K. The proposed filed climate-related disclosures would also be subject to potential Section 11 liability if included in or incorporated by reference into a Securities Act registration statement.

### GAAP Would be the Applicable Accounting Standards

A registrant would be required to apply the same set of accounting principles that it is required to apply in preparation of the rest of its consolidated financial statements included in the filing, US accounting standards – GAAP. Financial statements filed with the Commission that are not prepared in accordance with GAAP will be presumed misleading or inaccurate unless the Commission has otherwise provided. The SEC felt it was important to clarify the application of this concept in the proposed rules, given the possible confusion that may arise between the current body of GAAP and the proposed requirements.

Foreign private issuers that file consolidated financial statements under home country GAAP and reconcile to U.S. GAAP, would be required to use U.S. GAAP as the basis for calculating and disclosing the proposed climate-related financial statement metrics. The same requirement would apply for the purpose of determining the proposed GHG emissions metrics.

*Our view*: This shouldn't be a surprise given that this is a proposed US regulatory requirement. Anyone waiting for US alignment to/convergence with an IFRS climate-related accounting standard will have to wait awhile.  Possibly quite a long while.

**Proposed Disclosure of Targets and Goals**

If a registrant has set any climate-related targets or goals (the proposal does not require these), then the registrant would have to provide certain information about those targets or goals. Despite the numerous commitments to reduce GHG emissions, SEC believes many companies do not provide their investors with sufficient information to understand how the companies intend to achieve those commitments or the progress made regarding them. The proposed disclosure requirements are intended to elicit enhanced information about climate-related targets and goals so that investors can better evaluate these points.

If a registrant has set climate-related targets or goals, the proposed rules would require disclosing, as applicable, a description of:

- The scope of activities and emissions included in the target;
- The unit of measurement, including whether the target is absolute or intensity based;
- The defined time horizon by which the target is intended to be achieved, and whether the time horizon is consistent with one or more goals established by a climate-related treaty, law, regulation, policy, or organization;
- The defined baseline time period and baseline emissions against which progress will be tracked with a consistent base year set for multiple targets;
- Any interim targets set by the registrant;
- How the registrant intends to meet its climate-related targets or goals;
- The baseline year for multiple targets; and
- Relevant data to indicate whether it is making progress toward achieving the target or goal and how such progress has been achieved.

Some companies might establish climate-related goals or targets without yet knowing how they will achieve those goals. They might plan to develop their strategies over time, particularly as new technologies become available that might facilitate their achievement of their goals. The fact that a company has set a goal or target does not mean that it has a specific plan for how it will achieve those goals. What is important is that investors be informed of a registrant's plans and progress wherever it is in the process of developing and implementing its plan.

If the registrant includes carbon offsets or renewable energy certificates (RECs) in its plan to achieve climate-related targets or goals, it would be required to disclose the amount of carbon reduction represented by the 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.

A registrant's disclosure of its climate-related targets or goals should not be construed to be promises or guarantees. To the extent that information regarding a registrant's climate-related targets or goals would constitute forward-looking statements, which the SEC would expect, for example, with respect to how a registrant intends to achieve its climate-related targets or goals and expected progress regarding those targets and goals, the Private Securities Litigation Reform Act (PSLRA) safe harbors would apply to such statements, assuming all other statutory requirements for those safe harbors are satisfied.

*Our view:* A requirement to disclose this level of detail about Net Zero commitments may trigger dramatic changes in those commitments, pledges and public statements for companies that viewed Net Zero as simply a PR/marketing opportunity. If this component is included in the final release, I expect it will go a long way in very clearly separating those companies that are seriously managing climate-related business risks and those that aren't.

## Emissions Inventory Reporting & Assurance

### Proposed GHG Emissions Inventory Reporting – Scope 1 and 2

The proposed rules would require a registrant to disclose its GHG emissions for its most recently completed fiscal year. "Greenhouse gases" are defined as carbon dioxide ("$CO_2$"); methane ("$CH_4$"); nitrous oxide ("$N_2O$"); nitrogen trifluoride ("$NF_3$"); hydrofluorocarbons ("HFCs"); perfluorocarbons ("PFCs"); and sulfur hexafluoride ("$SF_6$") – consistent with those that are currently commonly referenced by international, scientific, and regulatory authorities as having significant climate impacts and the GHG Protocol.

For those that are not familiar already, the GHG Protocol calculates GHG emissions in a spreadsheet once the user enters certain information. There are different protocols available for emissions types/sources including:

- fuel burning (stationary and mobile sources)
- refrigeration equipment
- cement production
- pulp and paper manufacturing
- other manufacturing sectors

Important things to know about the GHG Protocol spreadsheets are they:

- require the user to have a level of technical knowledge about chemical and fuel types and the processes in which they are used, and
- apply emissions factors to calculate emissions, therefore no emissions sampling/analysis is necessary.

The proposed definitions of Scope 1 and Scope 2 emissions are substantially similar to the corresponding definitions provided by the GHG Protocol. Direct emissions are GHG emissions from sources that are owned or controlled by a registrant, whereas indirect emissions are GHG emissions that result from the activities of the registrant, but occur at sources not owned or controlled by the registrant.

The organizational scope of reporting for a registrant's GHG emissions metrics would be consistent with the scope of reporting for the proposed financial statement metrics and other financial data included in its consolidated financial statements in order to provide investors a consistent view of the registrant's business across its financial and GHG emissions disclosures. For an equity method investee or an operation that is proportionally consolidated, the registrant would be required to include its share of emissions based on its percentage ownership of such investee or operation. For a registrant that applies the equity method to an investee, the percentage of ownership interest used to record its share of earnings or losses in the investee must be the same for measuring its share of GHG emissions by the equity method investee.

A registrant would have to disclose its total Scope 1 emissions separately from its total Scope 2 emissions after calculating them from all sources that are included in the registrant's organizational and operational boundaries. In addition, the disclosure would be disaggregated by each constituent greenhouse gas and in the aggregate.

GHG emissions would be expressed in terms of carbon dioxide equivalent ("CO2e") in gross terms, excluding any use of purchased or generated offsets. Disclosure would also include GHG intensity – metric tons of CO2e per unit of total revenue and per unit of production for the fiscal year. If the registrant has no revenue for a fiscal year, it would be required to calculate its GHG intensity with another financial measure (*e.g.,* total assets), with an explanation of why the particular measure was used. Similarly, if the registrant does not have a unit of production, it would be required to calculate its GHG intensity with another measure of economic output, depending on the nature of its business (*e.g.*, data processing capacity, volume of products sold, or number of occupied rooms) with an explanation of why the particular measure was used.

The proposal would require registrants to describe the methodology, significant inputs, and significant assumptions used to calculate its GHG emissions metrics. As proposed, the description of the registrant's methodology must include:

- the registrant's organizational boundaries,
- operational boundaries,
- calculation approach, and
- any calculation tools used to calculate the registrant's GHG emissions, including emissions factors applied and any gaps in the data required to calculate its GHG emissions (as well as the importance of those gaps).

By sharing certain basic concepts and a common vocabulary with the GHG Protocol, the proposed rules should help limit the compliance burden for those registrants that are already disclosing their GHG emissions pursuant to the GHG Protocol. Similarly, to the extent that registrants elect to follow GHG Protocol standards and methodologies, investors already familiar with the GHG Protocol may also benefit.

Because GHG emissions data compiled for the EPA's own GHG emissions reporting program would be consistent with the GHG Protocol's standards, and thus with the proposed rules, a registrant may use that data in partial fulfillment of its GHG emissions disclosure obligations pursuant to the proposed rules.

*Our view:* Air emissions inventories and the use of emissions factors are nothing new to environmental professionals, but putting them in the SEC reporting context is – and may create heightened professional liability risk for environmental professionals providing these services. Based on my history with auditing emissions inventories and calculations, I predict a lot of companies will need to start paying more attention to details that have previously been brushed aside. Under the proposal, whatever set of emission factors a registrant chooses to use, it must identify the emission factors, its source and any use of third-party data when calculating its GHG emissions, regardless of the particular scope of emissions. A registrant can't blindly use third party data since part of the disclosure would require a description of the process the registrant undertook to obtain and assess such data.

Expressing emissions in both actual absolute terms (i.e., not applying any offsets/RECs) and intensity should offer meaningful insight into company activities. Absolute emissions show total gross emissions without the benefit or effect of offsets/RECs. In subsequent years, there will likely be significant business activities (mergers, acquisitions and divestitures) that have a big impact on the absolute values. Registrants will want to provide a clear and direct explanation of such events to allow readers to understand the reason for the changes. Intensity metrics are also valuable in that they indicate process efficiency gains – how companies get the most "use" out of their emissions.

When the final release is issued, GHG data that has been collected for other purposes/reporting should be reviewed to ensure it is consistent with SEC requirements. This is especially true where intensity metrics use units of measure other than what the SEC deems appropriate in the final reliance once issued.

**Proposed GHG Emissions Inventory Reporting – Scope 3**

Except for smaller reporting companies (SRCs) – which are exempted from Scope 3 reporting – a registrant would also be required to disclose separately its total Scope 3 emissions for the fiscal year if those emissions are material, or if it has set a GHG emissions reduction target or goal that includes its Scope 3 emissions. Consistent with the Commission's definition of "material" and Supreme Court precedent, a registrant would be required to disclose its Scope 3 emissions if there is a substantial likelihood that a reasonable investor would consider them important when making an investment – or voting – decision.

When assessing the materiality of Scope 3 emissions, registrants should consider whether Scope 3 emissions make up a relatively significant portion of their overall GHG emissions. While the SEC did not propose a quantitative threshold for determining materiality, they noted that some companies rely on, or support reliance on, a quantitative threshold such as 40% when assessing the materiality of Scope 3 emissions under TCFD and the Science Based Targets Initiative (SBTi).

However, even when Scope 3 emissions do not represent a relatively significant portion of overall GHG emissions, a quantitative analysis alone would not suffice for purposes of determining whether Scope 3 emissions are material. Consistent with the concept of materiality in the securities laws, this determination would ultimately need to take into account the total mix of information available to investors, including an assessment of qualitative factors. Accordingly, Scope 3 emissions may make up a relatively small portion of a registrant's overall GHG emissions but still be material where Scope 3 represents a significant risk, is subject to significant regulatory focus, or "if there is a substantial likelihood that a reasonable [investor] would consider it important."

If a registrant determines that its Scope 3 emissions are not material, and therefore not subject to disclosure, it may be useful to investors to understand the basis for that determination.

If required to disclose its Scope 3 emissions, a registrant would also be required to apply the same organizational boundaries used when determining its Scopes 1 and 2 emissions as an initial step in identifying the sources of indirect emissions from activities in its value chain over which it lacks ownership and control and which must be included in the calculation of its Scope 3 emissions. For an equity method investee or an operation that is proportionally consolidated, the registrant would be required to include its share of emissions based on its percentage ownership of such investee or operation. For a registrant that applies the equity method to an investee, the percentage of ownership interest used to record its share of earnings or losses in the investee must be the same for measuring its share of GHG emissions by the equity method investee.

The proposed rules would also require a registrant to disclose its Scope 3 emissions if it has set a GHG emissions reduction target or goal that includes Scope 3 emissions. This disclosure requirement would enable investors to understand the scale and scope of actions the registrant may need to take to fulfill its commitment to reduce its Scope 3 emissions and the potential financial impact of that commitment on the registrant. It would also enable an investor to assess the registrant's strategy for meeting its Scope 3 emissions target or goal and its progress towards that target or goal, which may affect the registrant's business.

If a registrant has a relatively ambitious Scope 3 emissions target, but discloses little investment in transition activities in its financial statements and little or no reduction in Scope 3 emissions from year to year, these disclosures could indicate to investors that the registrant may need to make a large expenditure or significant change to its business operations as it gets closer to its target date, or risk missing its target. Both potential outcomes could have financial ramifications for the registrant and, accordingly, investors.

Similar to Scopes 1 and 2, Scope 3 emissions disclosures would be disaggregated by each constituent greenhouse gas and in the aggregate.

Disclosure would also include GHG intensity – metric tons of CO2e per unit of total revenue and per unit of production for the fiscal year. If the registrant has no revenue for a fiscal year, it would be required to calculate its GHG intensity with another financial measure (*e.g.,* total assets), with an explanation of why the particular measure was used. Similarly, if the registrant does not have a unit of production, it would be required to calculate its GHG intensity with another measure of economic output, depending on the nature of its business (*e.g.*, data processing capacity, volume of products sold, or number of occupied rooms) with an explanation of why the particular measure was used.

If required to disclose Scope 3 emissions, a registrant would have to identify the categories of upstream and downstream activities that are included in the calculation of its Scope 3 emissions. In some cases, the category in which an emissions source belongs may be unclear, or the source might fit within more than one category. In those cases, registrants would need to use their best judgment as to the description of the emissions source and provide sufficient transparency as to the reasoning and methodology to facilitate investor understanding of the emissions category and source. Avoiding double-counting will be important for accuracy.

Also, if required to disclose Scope 3 emissions, registrants would have to describe the methodology, significant inputs, and significant assumptions used to calculate its GHG emissions metrics. As proposed, the description of the registrant's methodology must include the registrant's organizational boundaries, operational boundaries, calculation approach, any calculation tools used to calculate the registrant's GHG emissions and any gaps in the data required to calculate its GHG emissions (as well as the importance of those gaps).

If required to disclose Scope 3 emissions, a registrant would also be required to describe the data sources used to calculate those emissions, including the use of any of the following:

- Emissions reported by parties in the registrant's value chain, and whether such reports were verified by the registrant or a third party, or unverified;
- Data concerning specific activities, as reported by parties in the registrant's value chain; and
- Data derived from economic studies, published databases, government statistics, industry associations, or other third-party sources outside of a registrant's value chain, including industry averages of emissions, activities, or economic data.

A registrant would not be expected to blindly use third party data as part of the disclosure would require a description of the process the registrant undertook to obtain and assess such data.

The proposal includes a targeted safe harbor for Scope 3 emissions data in light of the unique challenges associated with this information. This safe harbor would provide that disclosure of Scope 3 emissions by or on behalf of the registrant would be deemed not to be a fraudulent statement unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.

*Our view:* Given investor interest in emissions for both investment decisions and voting decisions, it may be difficult for a company to successfully claim that Scope 3 emissions are not material. If this provision ends up in the final release, companies that determine Scope 3 emissions are not material should anticipate being challenged about how they reached that conclusion.

Registrants will likely end up expending meaningful effort chasing down this information from suppliers, determining its credibility and explaining those efforts in their disclosure. Simply emailing suppliers the GHG Protocol spreadsheet to complete won't be adequate. I also expect there will be significant disparities in the quality, quantity and validity of data received from suppliers for a few years. This will probably follow a similar path as conflict minerals supplier information requests processes did when they were launched. Registrants should expect to conduct some review and validation of climate information received from suppliers.

The requirement to disclose Scope 3 data sources will create more professional liability risk for IT systems making claims of automatically calculating GHG emission from suppliers based on procurement data. An increased concern for/attention to detail may well be warranted as I am not aware how/whether the emissions calculations from such IT systems have been validated – or if they have, whether the criteria used would be acceptable for SEC reporting. Moreover, the proposal requires that whatever set of emission factors a registrant chooses to use, it must identify the emission factors, its source and any use of third-party data when calculating its GHG emissions, regardless of the particular scope of emissions. This could also be a factor in registrants successfully claiming safe harbor protections.

**Proposed Disclosure Audit and Attestation Requirements**

The proposal contains a minimum level of attestation services for accelerated filers and large accelerated filers including: (1) limited assurance for Scopes 1 and 2 emissions disclosure that scales up to reasonable assurance after a specified transition period; (2) minimum qualifications and independence requirements for the attestation service provider; and (3) minimum requirements for the accompanying attestation report.

The proposed transition periods would provide existing accelerated filers and large accelerated filers one fiscal year to transition to limited assurance and two additional fiscal years to transition to reasonable assurance. For existing accelerated filers, this transition period would be in addition to the one additional year they will have to comply with the Scopes 1 and 2 emission disclosure requirements (compared to large accelerated filers). During this transition period, GHG emissions attestation providers would also have time to prepare themselves for providing such services in connection with Commission filings.

- **Financial statement:** As part of the registrant's financial statements, the financial statement metrics would be subject to audit by an independent registered public accounting firm, and come within the scope of the registrant's internal control over financial reporting ("ICFR").
- **Emissions disclosures**: The proposed rules would require an accelerated filer or a large accelerated filer to include, in the relevant filing, an attestation report covering, at a minimum, the disclosure of its Scope 1 and Scope 2 emissions and to provide certain related disclosures about the service provider. An attestation service provider would not have to be a registered public accounting firm and the attestation report would not need to cover the effectiveness of internal control over GHG emissions disclosure (i.e., ICFR).

The proposed approach to assurance was guided by "attestation" standards published by organizations including the PCAOB, AICPA, and the International Auditing and Assurance Standards Board ("IAASB"). Such attestation standards apply to engagements other than audit and review of historical financial statements and have been widely used in the current voluntary ESG and GHG assurance market for a number of years. The SEC believes that open access to the standard (i.e., publicly available at no cost to investors who desire to review them) is an important consideration when determining the suitability of attestation standards for application to GHG emissions disclosure because it would enable investors to evaluate the report against the requirements of the selected attestation standard.

The proposed minimum attestation engagement and report requirements are primarily derived from the AICPA's attestation standards (*e.g.,* SSAE No. 18), which are commonly used by accountants who currently provide GHG attestation engagement services as well as other non- GHG-related attestation engagement services, and are largely similar to the report requirements under PCAOB AT-101 and IAASB ISAE 3410. The report would include the following:

- Identification or description of the subject matter or assertion on which the attestation provider is reporting

- The point in time or period of time to which the measurement or evaluation of the subject matter or assertion relates
- The criteria against which the subject matter was measured or evaluated. The criteria against which the subject matter is measured or evaluated must be "suitable"
- A statement that identifies the level of assurance provided, a statement that identifies the attestation standard (or standards) used and describes the nature of the attestation engagement
- A statement that describes the registrant's responsibility to report on the subject matter or assertion being reported on in order to make it clear to investors who is ultimately responsible for the disclosure
- A statement that describes the attestation provider's responsibilities in connection with the preparation of the attestation report
- A statement that the attestation provider is independent
- For a limited assurance engagement, a description of the work performed as a basis for the attestation provider's conclusion
- A statement that describes any significant inherent limitations associated with the measurement or evaluation of the subject matter (at a minimum, Scopes 1 and 2 emissions) against the criteria
- The attestation provider's conclusion or opinion, as applicable, based on the attestation standard(s) used
- The signature of the attestation provider (whether by an individual or a person signing on behalf of the attestation provider's firm), the city and state where the attestation report has been issued, and the date of the report
- Whether the attestation provider has a license from any licensing or accreditation body to provide assurance, and if so, the identity of the licensing or accreditation body, and whether the attestation provider is a member in good standing of that licensing or accreditation body
- Whether the GHG emissions attestation engagement is subject to any oversight inspection program, and if so, which program (or programs)
- Whether the attestation provider is subject to record-keeping requirements with respect to the work performed for the GHG emissions attestation engagement and, if so, identify the record-keeping requirements and the duration of those requirements.

If a registrant (other than a large accelerated filer or an accelerated filer that is required to include a GHG emissions attestation report) chooses to obtain voluntary third party assurance or verification of its GHG reporting, the registrant would be required to disclose within the separately captioned "Climate-Related Disclosure" section in the filing the following information:

- Identification of the provider of such assurance or verification;
- Description of the assurance or verification standard used;
- Description of the level and scope of assurance or verification provided;
- Brief description of the results of the assurance or verification;
- Whether the third-party service provider has any other business relationships with or has provided any other professional services to the registrant that may lead to an impairment of the service provider's independence with respect to the registrant; and
- Any oversight inspection program to which the service provider is subject (*e.g.,* the AICPA's peer review program).

Although many registrants have reportedly voluntarily obtained some level of assurance for their climate-related disclosures, current voluntary ESG assurance practices have been varied with respect to the levels of assurance provided (*e.g.,* limited versus reasonable), the assurance standards used, the types of service providers, and the scope of disclosures covered by the assurance. This fragmentation has diminished the comparability of the assurance provided and may require investors to become familiar with many different assurance standards and the varying benefits of different levels of assurance.

While some experienced assurance providers may be proficient in applying attestation standards to GHG emissions disclosures, other assurance providers may lack GHG emissions expertise. Similarly, some service providers providing assurance may have expertise in GHG emissions but have minimal assurance experience. Moreover, some service providers may use standards that are developed by accreditation bodies with notice and public comment and other robust due process procedures for standard setting, while other service providers may use privately developed "verification" standards

The proposed rules would define a GHG emissions attestation provider to mean a person or a firm that has all of the following characteristics:

- 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.
- Is 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.

If the service provider is a firm, the SEC expects it to have policies and procedures designed to provide it with reasonable assurance that the personnel selected to conduct the GHG emissions attestation engagement have significant experience with respect to both attestation engagements and GHG disclosure. This would mean that the service provider has the qualifications necessary for fulfillment of the responsibilities that it would be called on to assume, including the appropriate engagement of specialists if needed. The proposed expertise requirement would apply to the person or the firm signing the GHG emissions attestation report.

The GHG emissions attestation provider would also be subject to liability under the federal securities laws for the attestation conclusion or, when applicable, opinion provided. Such liability should encourage the attestation service provider to exercise due diligence with respect to its obligations under a limited or reasonable assurance engagement.

*Our view*: I strongly believe that auditing/assurance is appropriate for this disclosure, especially since it has been lacking. Strangely, one statement in the preamble said "80 percent of S&P 100 companies currently subject certain items of their ESG information, including climate-related disclosures such as greenhouse gas emissions, to some type of third-party assurance or verification." That statement is not consistent with my personal experience, knowledge or recent research I completed for my book.

It is also worth noting that under certain practice standards, attestation providers may assess the validity and reliability of third-party information used by the registrant that forms a basis of what the attestation covers.

Once a rule is adopted as final, I foresee a battle in the market between environmental firms accustomed to and qualified in performing air emissions inventories (but not up to snuff in assurance/audit practices, experience, or securities law liability) and accounting firms who are generally the inverse. I expect acquisitions and staffing changes, along with a bunch of newly-minted “experts” on both sides. The vast majority of engineering/environmental consultants will not be familiar with the attestation report elements or the prescriptive audit practice requirements specified in the proposal. It wouldn’t be surprising if those factors serve to intimidate technical service firms and to some extent reduces the number entering the market on their own. However, they are better positioned to apply technical professional skepticism about emissions data based on their experience with manufacturing, chemical use, fuel burning and air pollution control equipment design, operation and maintenance.

## Regulations S-K/S-X & Compliance Dates

### Proposed Amendments to Regulations S-K and S-X

The proposal adds a new subpart to Regulation S-K and Regulation S-X

- **Regulation S-K** would be amended to include information about a registrant’s climate-related risks that are reasonably likely to have material impacts on its business or consolidated financial statements, and GHG emissions metrics that could help investors assess those risks. A registrant may also include disclosure about its climate-related opportunities if it chooses to, but this is not mandatory. Regulation S-K would require disclosure of a registrant’s:
    - governance of climate-related risks;
    - any material climate-related impacts on its strategy, business model, and outlook;
    - climate-related risk management;
    - GHG emissions metrics; and
    - climate-related targets and goals, if any (these are not required by the proposal).

- The proposed new subpart to Regulation S-K would include an attestation requirement for accelerated filers and large accelerated filers regarding certain proposed GHG emissions disclosures.

- **Regulation S-X** would be amended to require certain climate-related financial statement metrics and related disclosure to be included in a note to a registrant’s audited financial statements. The proposed financial statement metrics would consist of disaggregated climate-related impacts on existing financial statement line items. The registrant would have to disclose in a note to its financial statements certain disaggregated climate-related financial statement metrics that are mainly derived from existing financial statement line items. These proposed disclosures fall under the following three categories of information:
    - financial impact metrics;
    - expenditure metrics; and
    - financial estimates and assumptions.

**Proposed Compliance Dates**

The following compliance dates assume the final release is adopted and effective by December 2022, although this is likely to be delayed in the event lawsuits are filed (as is expected):

| Registrant Type | Disclosure Compliance Date | | Financial Statement Metrics Audit Compliance Date |
|---|---|---|---|
| | All proposed disclosures, including GHG emissions metrics: Scope 1, Scope 2, and associated intensity metric, but excluding Scope 3. | GHG emissions metrics: Scope 3 and associated intensity metric | |
| Large Accelerated Filer | Fiscal year 2023 (filed in 2024) | Fiscal year 2024 (filed in 2025) | Same as disclosure compliance date |
| Accelerated Filer and Non-Accelerated Filer | Fiscal year 2024 (filed in 2025) | Fiscal year 2025 (filed in 2026) | |
| SRC | Fiscal year 2025 (filed in 2026) | Exempted | |