Key Provisions in the SEC's Proposed Climate Disclosures Rule
March 21, 2022

On March 21, the Securities and Exchange Commission issued a proposed rule to enhance and standardize climate-related disclosures by public companies. According to SEC Chairman Gary Gensler, the rule is designed to provide investors with "consistent, comparable, and decision-useful information" about companies' climate-related risks.

As NAM President and CEO Jay Timmons said following the release of the rule, "Manufacturers are proudly leading on climate solutions. After all, it is manufacturers that make the products and technologies needed to face this generational challenge—clean energy, carbon capture, batteries, microgrids, advanced vehicles, and more."

Given manufacturers' leadership on climate action, the NAM supports smart, company-specific disclosures to help shareholders make informed decisions. However, Timmons warned that any climate reporting requirements should be "tailored and targeted" because "broad, sweeping disclosures could be counterproductive" and create unnecessary costs for manufacturers.

The NAM will be engaging with the SEC in the coming months to ensure that its proposed climate disclosures rule enables manufacturers to provide material, decision-useful information to investors—without imposing one-size-fits-all mandates. NAM members can contact Charles Crain with questions or to provide feedback on the SEC's proposal.

Executive Summary

The proposed rule would create a wide range of new disclosure obligations for public companies. In general, the disclosures required under the proposed rule can be categorized under two headings: climate metrics and climate risks.

Climate Metrics

- Greenhouse gas emissions (*p. 3*):
  - All companies would be required to disclose Scope 1 and Scope 2 emissions. Scope 1 and Scope 2 reports would be subject to audit requirements for larger companies.
  - Scope 3 emissions reporting would be required if Scope 3 emissions are material for a company or if a company sets a Scope 3 emissions reduction target. Scope 3 reports would be eligible for a liability safe harbor.
- Climate-related financial metrics (*p. 5*): The proposed rule would amend Regulation S-X to require companies to analyze the impact of climate-related risks on existing line items (e.g., revenues, assets, cash flow) in their consolidated financial statements. Reporting would be required if, in the aggregate, climate risks affect 1% or more of the value of the relevant line item. As a "note" to the financial statement, these disclosures would be subject to audit requirements and internal controls over financial reporting.
- Targets and goals (*p. 7*): Companies would be required to report information related to any announced climate goals (e.g., emissions reductions targets), including the relevant baseline, metrics, and time horizon.

Climate Risks

- Climate-related risks (*p. 8*): The proposed rule would amend Regulation S-K to require companies to identify and disclose any material physical (i.e., weather- or environment-related) or transition (i.e., regulatory, technological, market-related, or reputational) risks attributable to climate change over the short, medium, and long term.

- Climate risk impacts (*p. 9*): Companies would be required to describe the impact of any material climate-related risks they identify and disclose. Additional reporting would be required to help investors understand companies' risk calculations, including disclosures related to scenario analyses, carbon offsets and renewable energy credits, and any internal carbon price methodologies.
- Governance and risk management (*p. 10* & *p. 11*): The proposed rule would require new annual disclosures related to board and management oversight of climate-related risks. Companies would also be required to report information about their climate-related risk management practices and any climate-related transition plans they have in place.

Other than the climate-related financial metrics (which would be incorporated into a company's financial statements), all the required disclosures under the proposed rule would be include in a new "Climate-Related Disclosure" section of Form 10-K. Climate-related disclosures under the proposed rule would be treated as "filed" with the SEC.

The SEC hopes to finalize the rule by the end of 2022, which would make it effective for large accelerated filers' FY 2023 filings, due in early 2024 (*see p. 12*). Accelerated filers (FY 2024) and smaller reporting companies (FY 2025) would have delayed compliance requirements. Scope 3 reporting would phase in one year after the rest of the rule takes effect—FY 2024 filings (due in early 2025) for large accelerated filers and FY 2025 filings (due in early 2026) for accelerated filers.

CLIMATE METRICS

Greenhouse Gas Emissions Disclosures

Key takeaway: All companies would be required to report Scope 1 and Scope 2 greenhouse gas emissions. Scope 1 and Scope 2 emissions would be subject to audit requirements for larger companies.

Scope 3 emissions reporting would be required if Scope 3 emissions are material for a company or if a company sets a Scope 3 emissions reduction target. Scope 3 reports would be eligible for a liability safe harbor.

Companies would also be required to report GHG intensity (emissions per economic output).

The proposed rule would require disclosure of Scope 1, Scope 2, and, if material or used as an emissions reduction target, Scope 3 greenhouse gas emissions.

- **Scope 1** emissions are defined as direct greenhouse gas emissions from operations that are owned or controlled by a company.
- **Scope 2** emissions are defined as indirect greenhouse gas emissions from the generation of purchased or acquired electricity, steam, heat, or cooling that is consumed by operations owned or controlled by a company.
- **Scope 3** emissions are defined as all indirect greenhouse gas emissions not otherwise included in a company's Scope 2 emissions that occur in the upstream and downstream activities of its value chain.
    - Upstream emissions include emissions attributable to goods and services that the company acquires, the transportation of goods, and employee business travel and commuting.
    - Downstream emissions include the use of the company's products, transportation of products, end of life treatment of sold products, and investments made by the company.

Companies would be required to provide Scope 1, Scope 2, and (if required) Scope 3 emissions disclosures on an aggregate basis and disaggregated per constituent greenhouse gas. The disclosures would be reported in terms of carbon dioxide equivalent ("CO_2e") and would be presented as gross emissions (i.e., excluding any usage of offsets).

Companies would also be required to disclose information about their methodologies for calculating emissions (e.g., setting organizational and operational boundaries, choosing emission factors, use of any third-party data, any material changes to methodology year-over-year, any gaps in relevant data, etc.).

Scope 3 Emissions

Companies would be required to disclose Scope 3 emissions data if material. The proposing release re-states the Supreme Court's "reasonable investor" materiality standard, but it encourages disclosure if Scope 3 emissions "make up a relatively significant portion of [the company's] overall GHG emissions." The rule also encourages companies to consider disclosing the basis for any determination that some or all Scope 3 categories are not material.

A materiality assessment would not be needed if a company set a greenhouse gas emissions target or goal that includes Scope 3 emissions given that these goals would always necessitate Scope 3 emissions disclosures.

If required to disclose Scope 3 emissions, companies would have to identify the categories of upstream and downstream activities included in their Scope 3 calculation and describe the data sources used to calculate the emissions.

In recognition of the challenge of reporting Scope 3 emissions data, the proposed rule would provide a liability safe harbor protecting Scope 3 reports made with a reasonable basis and in good faith. Additionally, smaller reporting companies would be exempt from the Scope 3 requirement and all companies would have an additional year to provide Scope 3 reports after the rule is effective.

GHG Intensity

In addition to reporting greenhouse gas emissions in gross terms, companies also would be required to disclose the sum of their Scope 1 and Scope 2 emissions in terms of GHG intensity. Companies reporting Scope 3 emissions would make separate disclosures for Scope 3 GHG intensity.

GHG intensity is defined as the ratio between GHG emissions and economic value (specifically, metric tons of CO_2e per unit of total revenue) or between GHG emissions and units of production (specifically, metric tons of CO_2e per unit of production).

Attestation of Scope 1 and Scope 2 Emissions Disclosures

Scope 1 and Scope 2 emissions disclosures by accelerated filers and large accelerated filers would be subject to audit requirements. These companies would be required to file a report with external attestation of their Scope 1 and Scope 2 emissions disclosures on the following schedule:

- The first year the rule is effective would not require any assurance.
- The second and third years the rule is effective would require "limited assurance."
- The fourth year the rule is effective (and beyond) would require "reasonable assurance."

If the SEC finalizes the proposed rule by the end of 2022, the compliance dates for the rule's attestation requirements would be as follows:

	Definition	**Scope 1 & 2 Required**	**Limited Assurance**	**Reasonable Assurance**
Large Accelerated Filers	Public float >$700M	FY 2023 (filed 2024)	FY 2024 (filed 2025)	FY 2026 (filed 2027)
Accelerated Filers	Public float $250M-$700M and Revenues >$100M	FY 2024 (filed 2025)	FY 2025 (filed 2026)	FY 2027 (filed 2028)

Attestation providers would not be limited to just accounting firms; rather, companies could select any provider with the appropriate expertise and independence, including specialized GHG-centric firms. Auditors' attestation reports would be required to be provided pursuant to publicly available standards promulgated via appropriate due process procedures. Greenhouse gas emissions reporting would not be subject to attestation related to companies' internal controls.

Financial Statement Metrics

Key takeaway: The proposed rule would require companies to evaluate the impact of climate-related risks on the existing line items in their consolidated financial statements. These new disclosures would be required if, in the aggregate, climate risks impacted at least 1% of the total value of any given line item.

The proposed rule would amend Regulation S-X to require companies to add a note to their consolidated financial statements that includes information on the impact of climate-related risks on the line items in the statement. Specifically, disclosures would be required about financial impact metrics, expenditure metrics, and financial estimates and assumptions.

Because the proposed financial statement metrics would be required to be included in a company's consolidated financial statements, they would be included in any audits of the financial statements and subject to a company's internal controls over financial reporting.

Financial Impact Metrics

Companies would be required to provide information about the impact of climate-related events and transition activities on any of the line items included in their existing consolidated financial statements (e.g., revenues, cost of revenues, expenses, cash flow, inventories, assets, debt, contingent liabilities).

Companies would be required to calculate the aggregate impact of climate-related events and transition activities on each financial statement line item, including both positive and negative impacts; disclosure would be required if the aggregated impact of all climate-related risks is equal to at least 1% of the total line item in a given fiscal year.

Climate-related risks that could trigger disclosure by virtue of their aggregate impact on a financial statement line item include:

- Severe weather events and conditions, including flooding, drought, wildfires, extreme temperatures, and sea level rise; for example, changes to:
    - Revenue or costs from disruptions to operations or supply chains;
    - Impairment charges due to the assets being exposed to severe weather events;
    - Loss contingencies or reserves due to severe weather events; or
    - Total expected insured losses due to flooding or wildfire patterns.
- Transition activities, including those related to government commitments, any transition risks (e.g., those driven by regulatory, technological, market, liability, or reputational factors), and any efforts to reduce greenhouse gas emissions; for example, changes to:
    - Revenue or cost due to new emissions pricing;
    - Cash flow from changes in upstream costs;
    - The carrying amount of assets due to a reduction of their useful life; or
    - Interest expense driven by financing instruments such as climate-linked bonds.
- Any risks identified pursuant to the new requirements under Regulation S-K ("identified physical risks" and "identified transition risks").

Companies would be required to identify both positive and negative impacts from these and other climate-related events and transition activities.

Expenditure Metrics

Companies would be required to report on the effect of climate-related risks (i.e., severe weather events, transition activities, and identified risks) on the expenditure metrics in their consolidated financial statements.

If the aggregate impact (including both positive and negative effects) of these risks is at least equal to 1% of a given line item, companies would be required to add a note to their financial statement describing their effect on line items related to:

- Expenditure expensed; and
- Capital costs incurred.

Expenditure metrics would be reported separately for severe weather events (plus identified physical risks) and transition activities (plus identified transition risks):

- With respect to severe weather events, the proposing release highlights potential disclosure of expenditures expensed or capitalized costs incurred to:
  - Increase the resilience of assets or operations;
  - Retire or shorten the estimated useful lives of impacted assets;
  - Relocate assets or operations at risk; or
  - Reduce the future impact of severe weather events.
- With respect to transition activities, the proposing release highlights potential disclosure of expenditures expensed or capitalized costs incurred for transition activities related to:
  - R&D into new technologies; or
  - Purchase of assets/infrastructure/products intended to reduce emissions, increase energy efficiency, offset emissions, or improve resource efficiency.

Companies would be required to identify both positive and negative impacts from these and other climate-related events and transition activities.

Financial Estimates and Assumptions

Companies would be required to explain how any estimates and assumptions used to produce their consolidated financial statements (e.g., projected financial information used in impairment calculations, estimated loss contingencies, estimated credit risks, commodity price assumptions, etc.) were impacted by risks from climate-related events and transition activities.

Targets and Goals Disclosures

Key takeaway: Companies would be required to report information related to any announced climate-related targets or goals.

If a company has set any climate-related targets or goals (e.g., to reduce greenhouse gas emissions), then the proposed rule would require disclosure of certain information about those targets or goals, including:

- 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; and
- How the company intends to meet its climate-related targets or goals.

The proposed rule would also require a company to disclose, on an annual basis, relevant data to indicate whether it is making progress toward achieving the target or goal and how such progress has been achieved.

If a company uses carbon offsets or renewable energy credits or certificates 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.

CLIMATE RISKS

Disclosure of Climate-Related Risks

> **Key takeaway:** Companies would be required to identify and disclose material climate-related risks, defined to include both physical and transition risks over the short, medium, and long term.
>
> The proposed rule would maintain the existing "materiality" standard, as well as existing liability protections for forward-looking statements.

Companies would be required to disclose on an annual basis any climate-related risks "reasonably likely to have a material impact on [their] business or consolidated financial statements." These risks would be required to be evaluated over the short, medium, and long term, and companies would be required to describe how they evaluate these time horizons.

Companies would be required to report their climate-related risks under one of two categories: physical risks and transition risks.

- **Physical risks** are defined to include both acute (i.e., event-driven risks driven by extreme weather) and chronic (i.e., risks driven by long-term weather patterns) risks. The proposing release provides prescriptive suggestions for how companies should disclose specific physical risks; for example, acute water-related risks would necessitate disclosure of "the percentage of buildings, plants, or properties (square meters or acres) that are located in flood hazard areas."
- **Transition risks** are those attributable to "changes to address the mitigation of, or adaptation to, climate-related risks." Companies would be required to classify transition risks as regulatory, technological, market (including changing consumer, business counterparty, and investor preferences), liability, reputational, or other risks.

Companies would be required to specify whether a given risk is a physical risk or a transition risk; physical risks would be categorized either acute or chronic. Descriptions of physical risks would also be required to include the "location of the properties, processes, or operations subject to the physical risk," identified by ZIP code.

Companies would also be allowed to disclose the actual and potential impacts of any climate-related opportunities they are pursuing.

The proposing release re-emphasizes the Supreme Court's "reasonable investor" standard for determining materiality. This standard would continue to apply to companies' decisions about whether a given climate-related risk should be disclosed. However, irrespective of what risks are ultimately disclosed, companies would be required to "discuss [their] assessment of the materiality of climate-related risks over the short, medium, and long term" in order to "help ensure that management considers the dynamic nature of climate-related risks."

Existing safe harbors for forward-looking statements would continue to apply to forward-looking climate-related risk disclosures.

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

Key takeaway: Companies would be required to describe the impact of any material climate-related risks. Additional disclosures would be required related to scenario analyses, carbon offsets and RECs, and any internal carbon price methodologies.

Material Climate Impacts

After defining and disclosing its climate-related risks, a business would be required to describe the actual and potential impacts of those risks on its strategy, business model, and outlook. Specifically, a company would be required to disclose any short-, medium-, or long-term impacts on its:

- Business operations;
- Products or services;
- Suppliers and value chain;
- Activities to mitigate or adapt to climate-related risks (including new technologies and processes); and
- R&D expenditures.

Additionally, companies would be required to disclose:

- How they considered these risks as part of their business strategy, financial planning, and capital allocation;
- The impact of any physical risks on their strategy, business model, and outlook; and
- Whether and how these risks affect their consolidated financial statements.

Carbon Offsets and Renewable Energy Credits

If utilized, companies would be required to disclose the role that carbon offsets or RECs play in their emissions reductions strategies. Companies would also have to disclose any short- or long-term costs and risks associated with the usage of offsets and RECs.

Maintained Internal Carbon Price

If a company utilizes an internal carbon price to evaluate climate risks or set climate-related business strategies, it would be required to disclose:

- The price per metric ton of CO_2e;
- The total price, including how the total price is estimated to change over time;
- The boundaries for measurement of overall CO_2e on which the total price is based; and
- The rationale for selecting the internal carbon price applied.

A company would also be required to describe how it uses its disclosed internal carbon price to evaluate and manage climate-related risks.

Scenario Analysis

As part of its description of the resilience of its business strategy in light of climate-related risks, a business would be required to describe any analytical tools—including scenario analyses—it uses to evaluate the impact of climate-related risks. Companies' disclosure of scenario analyses would need to include parameters, assumptions, and analytical choices, as well as any projected financial impacts. The proposing release specifically highlights global temperature increase scenarios as candidates for disclosure.

Governance Disclosure

Key takeaway: The proposed rule would require new annual disclosures related to board and management oversight of climate-related risks.

The proposed rule would provide investors with “a comprehensive understanding of a board’s oversight, and management’s governance, of climate-related risks.” The disclosures in the proposed rule are largely based on the TCFD framework.

Board Oversight

Specific to board oversight of climate-related risks, companies would be required to disclose:

- Any board members or committees responsible for the oversight of climate-related risks;
- Whether any specific board member has expertise in climate-related risks (and a description of said expertise);
- The process and frequency for board or committee discussions of climate-related risks;
- Whether and how the board considers climate-related risks as part of its business strategy, risk management, and financial oversight; and
- Whether and how the board sets climate-related targets or goals and how it oversees progress toward those targets or goals.

Management Oversight

Specific to management’s role in assessing and managing climate-related risks, companies would be required to disclose:

- Whether certain management positions or committees are responsible for assessing and managing climate-related risks (and a description of their expertise);
- The process by which management is informed about and monitors climate-related risks; and
- Whether and how frequently management reports to the board on climate-related risks.

Risk Management Disclosure

Key takeaway: Companies would be required to disclose risk management processes related to climate change as well as information about any climate-related transition plans they have in place.

Identifying, Assessing, and Managing Climate-Related Risks

Under the proposed rule, companies would be required to disclose any processes they have for identifying, assessing, and managing climate-related risks. Additionally, they would be required to disclose how climate-related risks are integrated into their overall risk management processes.

With respect to its processes for identifying and assessing climate-related risks, a company would be required to disclose how it:

- Determines the relative significance of climate-related risks;
- Considers existing or likely regulatory requirements when identifying climate-related risks;
- Considers shifts in customer or counterparty preferences, technological changes, or changes in market prices in assessing potential transition risks; and
- Determines the materiality of climate-related risks, including how it assesses the potential size and scope of any identified climate-related risk.

When describing its processes for managing climate-related risks, a company would be required to disclose how it:

- Decides whether to mitigate, accept, or adapt to a particular risk;
- Prioritizes addressing climate-related risks; and
- Determines how to mitigate a high priority risk.

Companies may also need to disclose any insurance or other financial products they use to manage climate-related risks.

Transition Plans

The proposed rule would require a company to disclose information about any transition plans it has in place—for example, if it operates in a jurisdiction that has made commitments under the Paris Agreement or to reduce greenhouse gas emissions. Companies would be required to provide a description of any transition plans, including any relevant metrics or targets included in the plan.

If the transition plan is incorporated into a company's climate-related risk management strategy, it would have to discuss how the transition plan would enable it to respond to any:

- Physical risks (including sea level rise, extreme weather events, wildfires, drought, and severe heat); or
- Transition risks, including:
    - Laws, regulations, or policies that restrict greenhouse gas emissions or require the protection of specific land or assets;
    - The imposition of a carbon price; and
    - Changing demands from consumers and other stakeholders.

Companies would also be allowed to disclose information on transition plans for climate-related opportunities.

Compliance Dates

Key takeaway: The SEC expects to finalize the rule by the end of 2022, which would mean compliance for FY 2023 reports (filed in 2024) for the largest companies. Smaller businesses would have phased-in compliance obligations.

For large accelerated filers, the rule would take effect in the fiscal year following adoption of the rule. Accelerated filers would have an additional year to comply, while smaller reporting companies would have an extra year after that.

Scope 3 emissions would in all cases be required a year after the rule's other requirements (except for SRCs, which are exempt from Scope 3 emissions disclosures).

Assuming a final rule is promulgated in late 2022 (the SEC's stated goal), the relevant compliance dates would be:

	Definition	**Climate Rule Effective**	**Scope 3 Reporting Required**
Large Accelerated Filers	Public float >$700M	FY 2023 (filed 2024)	FY 2024 (filed 2025)
Accelerated Filers	Public float $250M-$700M and Revenues >$100M	FY 2024 (filed 2025)	FY 2025 (filed 2026)
Smaller Reporting Companies	Public float <$250M or Public float <$700M and Revenues <$100M	FY 2025 (filed 2026)	N/A