



Stakeholder Guide to SEC's Proposed Rule on Climate-Related Disclosures

ESG BY EDF: ACTIONABLE INSIGHTS FOR A DECARBONIZING WORLD



Highlights

- **A new proposed rule from the SEC would help investors obtain comparable, specific, and decision-useful climate risk information.** The proposal, open for public comment through at least May 20, calls for climate risk disclosure from publicly traded companies, building on the widely used TCFD framework.
- **Improving climate risk disclosure is a key first step to protecting the U.S. financial system from mounting risks presented by climate change.** Climate change poses major physical and transition risks with important implications for investors and the U.S. economy. To price risks accurately and allocate capital responsibly and efficiently, investors need rigorous, standardized corporate climate disclosures.
- **Stakeholders interested in preserving the health and stability of the financial system should comment in support of the proposal, encouraging the SEC to move expeditiously in adopting a final rule on climate risk disclosure.** The SEC is currently holding open a comment period where interested stakeholders can provide feedback and relevant evidence as the Commission seeks to finalize effective, durable disclosure standards that will best serve investment decision-making.

EDF AUTHORS:

Gabriel Malek

Michael Panfil

Stephanie Jones

EDITOR:

Jenny Mandel

April 4, 2022

Introduction

On March 21, 2022 the Securities and Exchange Commission (SEC) released a [proposed rule](#) for “The Enhancement and Standardization of Climate-Related Disclosures for Investors.” The proposal sets forth standards requiring publicly traded companies in the U.S. to disclose certain types of climate-related information, building on the widely accepted Task Force on Climate-Related Financial Disclosures (TCFD) framework and aligning U.S. markets with disclosure regimes in other jurisdictions including the European Union, United Kingdom, and Japan.

The SEC’s proposed rule would improve upon the current state of play, defined by inconsistent, vague reporting of climate risk exposure, by calling for comparable, specific disclosures that would enhance both investor and corporate climate risk management. Supporting this proposal would help strengthen investors’ capacity to manage portfolio-wide climate risks, protecting the overall health of the financial system.

Figure 1:
Timeline of recent SEC actions on climate risk disclosure



Overview of the proposed rule

Though the SEC issued important interpretative guidance on climate risk disclosure in 2010 – explaining that general disclosure requirements may necessitate reporting of climate change-related information in some circumstances – [numerous studies](#) have found that climate reporting remains insufficient. The proposed rule would fill this gap, calling for publicly traded companies to disclose relevant climate-related information in their 10-K filings. Requiring this disclosure will enable investors to more efficiently invest through improved access to climate-related financial risk information — data currently obscured by non-standardized, voluntary corporate climate reporting.

The proposed standards build upon the TCFD framework, asking companies to describe:

- Impacts of climate-related risks on business strategy and outlook

- Governance and management of climate-related risks
- Metrics and targets used to analyze climate-related risks, including greenhouse gas emissions
- Information on plans and progress for climate-related targets and goals, if publicly set by the company

The proposed standards include quantitative disclosure requirements for:

- The impact of climate-related risks on the line items of companies' consolidated financial statements, including their impact on estimates and assumptions.
 - Financial impacts of severe weather events and other natural conditions during the fiscal year presented
 - Expenditure to mitigate risks of severe weather events and other natural conditions
 - Financial estimates and assumptions impacted by severe weather events and other natural conditions
- Scope 1 and 2 greenhouse gas emissions for all reporting companies, and Scope 3 emissions if material or if the company has set a Scope 3 emissions target or goal, with an exemption for smaller reporting companies

Physical risk reporting: The SEC's proposed requirements on physical risk disclosure will help investors safeguard their portfolios from the effects of climate change. According to [research](#) from Swiss Re Institute, the world stands to lose 10% of total economic value by mid-century if climate change remains on its current trajectory due to factors such as severe weather events, shifting coastlines, and changes to agricultural and living conditions. An increase in [severe weather events](#) exacerbated by climate change is already impacting companies financially, but corporate disclosures [have not evolved adequately](#). The proposed rule can help fill this dangerous reporting gap.

The SEC's proposed line-item disclosure requirements on expenditures to mitigate severe weather and how projected severe weather events influence financial estimates will help investors assess not only companies' exposure to physical risks but also their resilience planning. With these metrics, investors will be able to make more refined assumptions about companies' forward-looking financial performance, a core element of prudent investment decision-making.

Transition risk reporting: Standardized disclosure of GHG emissions is useful to investors, as consumers increasingly demand low-emissions products and as the regulation of corporate GHG emissions becomes more stringent. Disaggregating GHG emissions by constituent gases, as the proposed rule directs, will also enable investors to better assess the risk exposure of companies in methane-intensive sectors like oil and gas and agriculture, which face methane-specific [regulation](#) given the gas's near-term warming [potency](#) compared to CO₂.

For companies that have publicly set climate-related targets or goals, the proposed rule also calls for disclosure of activities included in company targets, how the company plans to meet its targets, and how carbon offsets factor into such targets. This information would help investors evaluate companies' transition risk management. The credibility of a company's climate targets can show investors how prepared a company will be to meet shifting consumer and regulatory demands.

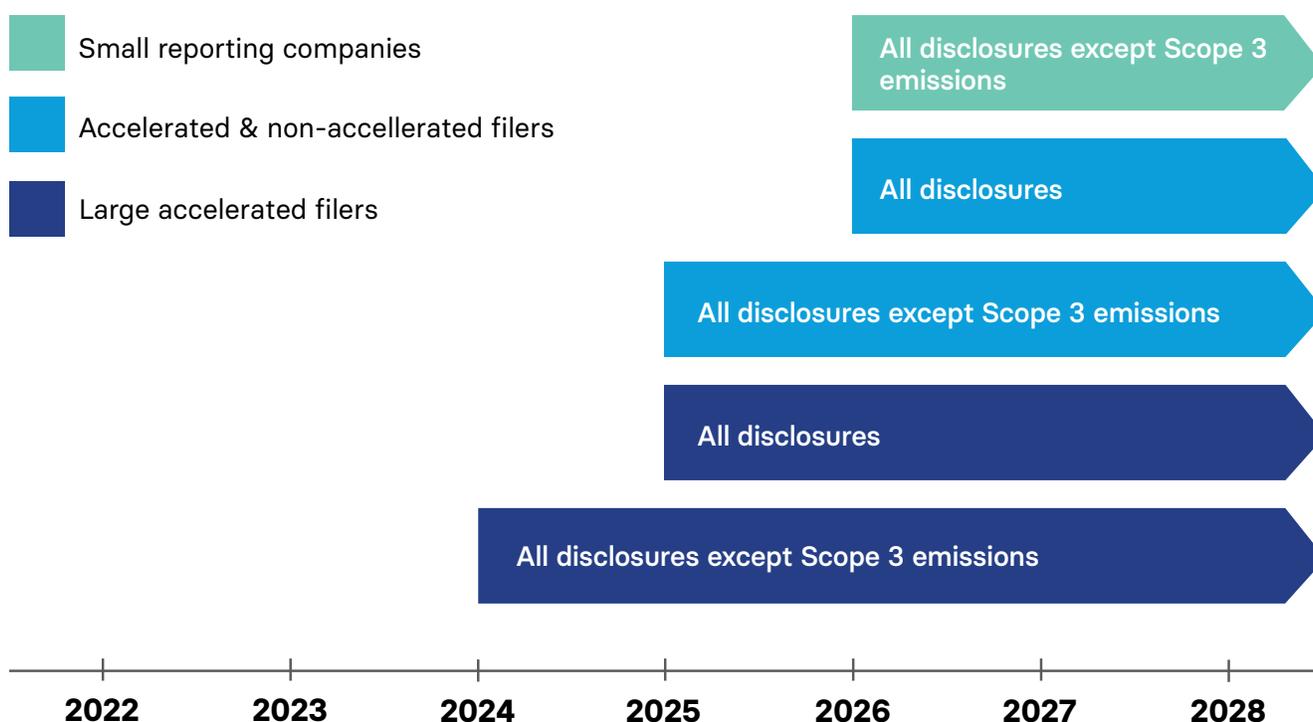
Disclosure format and timing: The proposed rule would require companies to include climate-related disclosures in their annual 10-K filings in a separate section captioned "Climate-Related Disclosure." Integrating climate risk information in 10-K filings is crucial to ensuring that the reporting of climate-related financial risks is on par with the reporting of other financial risks. Investors need credible risk information to make prudent financial decisions, and incorporating climate disclosures into 10-K filings – signed by companies' CEOs and CFOs – enhances the reliability of such information.

The SEC has proposed a phase-in period to provide companies time to collect and verify climate-related information needed for compliance. The proposed rule would require large accelerated filers to begin including required disclosures in reports filed in 2024, accelerated and non-accelerated filers in 2025, and smaller reporting companies in 2026.¹ Scope 3 emissions reporting would not begin for large accelerated filers until 2025 and not until 2026 for accelerated and non-accelerated filers. The SEC has also proposed a safe harbor for Scope 3 disclosure to alleviate filer concerns surrounding liability.

This implementation period gives companies sufficient time to adjust to new disclosure requirements while supporting near-term investor access to comparable, specific, and decision-useful climate risk information.

Figure 2.

Timeline for proposed filings and disclosures



¹ The SEC defines large accelerated filer using the following criteria: (i) the issuer had an aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates of \$700 million or more, as of the last business day of the issuer's most recently completed second fiscal quarter; (ii) the issuer has been subject to the requirements of Section 13(a) or 15(d) of the Exchange Act for a period of at least twelve calendar months; (iii) the issuer has filed at least one annual report pursuant to Section 13(a) or 15(d) of the Exchange Act; and (iv) the issuer is not eligible to use the requirements for small reporting companies under the small reporting company revenue test. Accelerated filers follow the same criteria as large accelerated filers but have a worldwide market value between \$75 million and \$700 million. A small reporting company is defined as an issuer that is not an investment company, an asset-backed issuer, or a majority-owned subsidiary of a parent that is not a smaller reporting company and that: (1) had a public float of less than \$250 million; or (2) had annual revenues of less than \$100 million and either: (i) no public float; or (ii) a public float of less than \$700 million.

Why climate risk disclosure matters for investors

Climate change poses significant financial risks to companies, investors, markets, and all those that depend upon a stable financial system. These risks are most often categorized as (1) physical risks to companies' assets and operations stemming from climate-change-related extreme weather events; and (2) transition risks to companies' business models linked to shifts in policy, technology, and consumer demand.

The United States [experienced](#) more than 40 weather and climate disasters with more than \$1 billion in damages each over the last two years. Moreover, according to recent studies, 215 of the world's largest companies face nearly [\\$1 trillion in climate-related risk](#). These figures only begin to capture the financial implications climate change imposes on financial markets. A 2021 report from the U.S. Financial Stability Oversight Council [concluded](#) that "climate change is an emerging threat to the financial stability of the United States."

In order to incorporate climate-related financial risks into their decision-making, investors must be able to identify and measure such risks. In the U.S., investors currently only have access to a handful of voluntary disclosure frameworks to obtain corporate climate risk information. There are several frameworks for substantive disclosure such as the TCFD, the Sustainability Accounting Standards Board (SASB), CDP (formerly the Carbon Disclosure Project), and the Global Reporting Initiative (GRI), but the non-standardized and voluntary nature of these protocols limits their utility for investors and the financial system more broadly in evaluating individual companies or comparing performance across an industry.

Figure 3:

Select voluntary climate-related disclosure frameworks

	TCFD	SASB	CDP	GRI
Description	Cross-sectoral climate disclosure framework	Industry-specific sustainability disclosure framework	Sector-specific climate questionnaire	Cross-sectoral ESG disclosure framework with specific standards for oil, gas and coal
Sector Specificity	Low	High	High	Low
Disclosure Coverage	Four-part framework covering governance, strategy, risk management, and metrics and targets	Framework covers environment, social capital, human capital, business model and innovation, and governance	Questionnaire covers TCFD framework with additional categories on carbon pricing, emission methodology, and verification, among others	Framework covers a wide array of ESG topics from emissions to workplace diversity to occupation health

Both academic research and analysis from voluntary disclosure frameworks like SASB have concluded that companies typically provide boiler-plate language to describe their exposure to climate risk. This non-specific language limits investors' ability to compare companies' risk profiles, a necessary facet of efficient investment decision-making. According to [TCFD's 2021 Status Report](#), only 27% of companies disclose how they integrate climate change into broader risk management. A 2020 SASB [report](#) also found that only 7% of companies include SASB-aligned disclosure in their annual reports.

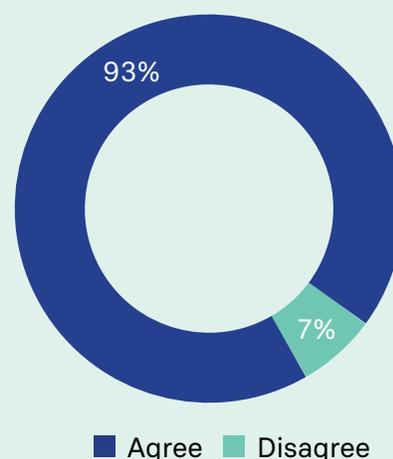
Given the substantial risks that climate change poses to the financial system, reporting of climate-related financial risks should parallel reporting on traditional financial metrics. Standardizing climate risk disclosure would offer the following benefits:

- **Correct asset mispricing:** According to a [survey](#) from BNY Mellon Investment Management, 93% of institutional investors believe that climate-related financial risk has yet to be priced into key global financial markets. This perceived mispricing – validated by empirical studies from the [International Monetary Fund](#) and others – prevents markets from functioning efficiently and limits the ability of asset managers to prudently allocate capital. Without decision-useful information, investors are less able to determine the soundness of an asset's value, jeopardizing financial returns and destabilizing markets. Proposed standards on climate risk disclosure remedy this inefficiency and enable investors to price assets accurately.
- **Protect against systemic risks:** Though highly diversified institutional investors are well insulated from company-specific risks, they remain vulnerable to systemic risks like climate change. Improving corporate climate disclosure would help investors better assess these risks which – though not entirely avoidable – can be managed through informed shareholder engagement and asset allocation.
- **Avoid a financial shock:** Financial experts have warned that persistent asset mispricing could create a "[climate bubble](#)." If the market reprices assets abruptly, such as in response to a major climate event, dramatic changes in valuations could destabilize the financial system. Introducing proposed standards requiring climate risk disclosure now would allow for a smoother repricing process to take place, as investors incrementally incorporate updates to climate data into decision-making. Delaying disclosure standards until the climate crisis worsens could disrupt financial markets.

Figure 4:

Climate Risk is Financial Risk

93% of institutional investors believe climate-related risk has yet to be priced into key financial markets



Source: BNY Mellon Investment Management survey

Climate risk disclosure in other jurisdictions

Requiring public companies to disclose climate risk information in a manner that draws inspiration from the TCFD framework would help align the U.S. with other jurisdictions internationally. In recent years, more than 30 countries with over \$23.3 trillion in GDP have taken steps to require corporate climate risk disclosure. To remain competitive in increasingly transparent global markets and meet the risk management needs of multinational investors, the U.S. would benefit from introducing standards that would require climate risk disclosure. In drawing on the TCFD framework, the SEC proposal aligns U.S. reporting requirements with those being implemented in other jurisdictions and reduces costs for the many companies and investors that have already built capacity around this framework.

Figure 5:
Global Frameworks for Mandatory Climate Disclosure

European Union 	Japan 	New Zealand 	United Kingdom 
Proposed 2021	Introduced November 2021	Passed October 2021	Finalized January 2022
Incorporates TCFD	Aligned with TCFD	Aligned with TCFD	Aligned with TCFD
All large companies in EU and all European stock-exchange listed companies	Companies listed on the Tokyo Stock Exchange's "Prime" market	All banks, credit unions, building societies, and investment managers with more the NZ\$1 billion	Companies with >500 employees publicly traded in the UK
Reporting begins 2024	Reporting begins April 2022	Reporting begins 2023	Reporting begins April 2022

Key points of emphasis for commenters

The proposed rule would provide critical improvements to current corporate climate reporting practices. Stakeholders can support the proposal by submitting comments to the SEC. Feedback on the following points, in particular, will be highly useful to the SEC:

- Climate change poses relevant financial risks:** Substantial research has been published documenting the potentially disruptive impacts of climate change on the financial system, including both physical risks to companies' assets and operations and transition risks. First-hand accounts on how climate change affects portfolio management would further strengthen this argument.
- Standardized, TCFD-inspired descriptive disclosures, Scopes 1, 2, and 3 emissions reporting, and financial metrics on climate-related risks support investment decision making:** In recent years, the world's largest asset managers have asked companies to provide TCFD-aligned disclosures and other climate-related information, voting against board members of companies that lack such reporting. These engagement trends highlight strong investor demand for corporate climate risk information. Additional explanation of why TCFD disclosures, Scope 1, 2, 3 emissions reporting, and climate-related financial metrics are necessary for prudent financial decision-making could support SEC rulemaking.
- Gathering climate risk information from companies and third parties is currently expensive and inefficient:** Highlighting the inefficiencies that come from an overreliance on multiple voluntary disclosure frameworks can underscore the cost-effectiveness of standardizing climate reporting practices through regulation. With the SEC's proposed rule, investors and stakeholders can more easily compare companies' climate risk exposure without having to translate dissimilar reporting frameworks into like metrics.

Public comment process and next steps

The SEC proposal is open for public comment through at least May 20. If the proposed standards are published in the *Federal Register* later than April 20, the comment deadline will be 30 days after *Federal Register* publication.

EDF encourages interested stakeholders to indicate their support for climate risk disclosure by urging the SEC to move expeditiously to finalize and implement this proposed rule. Comments can be submitted to the SEC using [this link and clicking "Submit comments on S7-10-22."](#) The regulatory docket, including submitted public comments, can be found [here](#).

After the public comment window closes, the SEC will review stakeholder comments and consider how to incorporate that feedback into a final rule. The exact release date of the final rule is not yet known, though the proposed rule assumes an effective date of December 2022.

Were the proposed rule to move forward along this timeline, large accelerated filers would be required to begin including required disclosures in reports filed in 2024; accelerated and non-accelerated filers in 2025; and smaller reporting companies in 2026. This phase-in schedule provides companies with time to gather and process the data needed for compliance.

Though news outlets have reported that the proposed rule may face litigation in the years ahead, the proposed rule is squarely within the SEC's long-established authority to require publicly traded companies to disclose financial risks. As Professor George Georgiev of Emory Law [has noted](#): "A close review of the Proposal...suggests that it is firmly grounded within the traditional SEC disclosure framework that has been in place for close to nine decades. The Proposal is certainly ambitious (and overdue), but it is by no means extraordinary."

Further reading

- [Mandating Disclosure of Climate-Related Financial Risk](#) – a joint report from EDF and the Institute for Policy Integrity at NYU Law School outlining gaps in voluntary climate disclosure frameworks, explaining the legal basis for and benefits of SEC regulation of climate disclosure, and providing process-oriented recommendations on how the SEC can develop a rule on climate risk disclosure.
- [Comments to SEC on Climate Disclosure](#) – joint comments filed by EDF, the Institute for Policy Integrity at NYU Law School, and the Initiative on Climate Risk and Resilience Law in June 2021 supporting and making recommendations on the development of a climate risk disclosure rule.
- [What Investors and the SEC Can Learn from the Texas Power Crises](#) – a report from EDF and scholars at Brookings Institution unpacking the real-world implications of poor climate risk disclosure through the lens of the February 2021 Texas power crisis.
- [Climate change creates financial risks. Investors need to know what those are](#) – a blog from EDF's Lead Counsel and Director of Climate Risk Strategies on the need for enhanced climate risk disclosure to ensure prudent financial decision-making.