NIRI Town Hall

SEC Climate Disclosure Proposal

May 5, 2022

Agenda

- Introductions
  - ➢ Matthew Brusch, CAE, Interim President & CEO, NIRI
  - ➢ Niels Holch, JD, Vice President, Public Policy and Advocacy, NIRI
  - ➢ Gary LaBranche, FASAE, CAE, Special Advisor to the Interim President & CEO, NIRI
- Background and Context
- Rule Proposal Summary
- Questions and Feedback

Background: SEC Climate Change Disclosure Rule

- NIRI Comment Letter (June 11, 2021): https://www.sec.gov/comments/climate-disclosure/cll12-8907317-244255.pdf
- Proposed rule to mandate certain climate-related disclosures by public companies
- Issued on March 21, 2022: https://www.sec.gov/rules/proposed/2022/33-11042.pdf
    - Federal Register Version (April 11): https://www.govinfo.gov/content/pkg/FR-2022-04-11/pdf/2022-06342.pdf
- Comments due: May 20
- SEC Comment Letter File: https://www.sec.gov/comments/s7-10-22/s71022.htm

Materiality Standard

- **<u>NIRI Comment Letter (6/11/2021)</u>**: Existing disclosure standards in the United States require disclosure of information by public companies that is "material" to a reasonable investor in making informed investment and proxy voting decisions. Ensuring that any new disclosure standards are rooted in the materiality standard is critical to preserving the ability of investors to identify and act on decision-useful information. NIRI believes that the materiality standard forms a solid foundation that supports the goal of enhanced climate change disclosures by public companies.

- **<u>Draft Response</u>**: The SEC should not mandate climate change disclosures unless such disclosures involve *material* climate-related risks, impacts, and/or opportunities. For any *material* climate-related risks that are disclosed, NIRI acknowledges the SEC's goal of developing a regulatory framework that standardizes certain metrics to provide "consistent, comparable, and reliable" information.

- For companies that do not have *material* climate-related risks or impacts, NIRI believes that the current "private ordering" process involving sustainability reports and other disclosures should be encouraged and continue to evolve.

SEC Climate-Related Disclosures – Regulation S-K

- **SEC Proposed Rule**: The SEC's Proposed Rule would add a new subpart to Regulation S-K that would require all public companies to disclose certain climate-related information, including risks that are reasonably likely to have *material* impacts on their business or financial statements.

- **Draft Response**: Issuers are already required under the existing disclosure regime to disclose material climate risks and impacts. However, NIRI acknowledges that it would be helpful to investors for there to be more disclosures about the internal processes companies use to determine the materiality of climate related risks and impacts.

SEC Climate-Related Disclosures—Regulation S-X

(Integration of Climate Information with Financial Statements)

- **SEC Proposed Rule**: The SEC proposes to amend Regulation S-X—which governs financial statements included in documents filed with the SEC—to require climate-related metrics in existing financial statement line items, with further explanation of those issues in the notes to a company's financial statements. Under the Proposed Rule, there would be disclosures in three categories: (1) financial impact metrics; (2) expenditure metrics; and (3) financial estimates and assumptions.

- **Draft Response**: The traditional concept of materiality already requires the disclosure of climate-related impacts that materially affect an issuer's financial condition and results of operations. Additionally, current SEC regulations (17 CFR 210.4-01(a)(1)) state that financial statements filed with the Commission that are not prepared in accordance with GAAP are "presumed to be misleading or inaccurate, despite footnote or other disclosures."

- NIRI does not support the proposed amendments to Regulation S-X, as they are unnecessary to address climate issues. Issuers are already required to disclose material financial impacts on the financial statements that are climate-related. Instead, issuers should continue to apply existing GAAP and materiality standards to climate-related risks and impacts. If there are to be additional disclosures mandated, they should be provided outside of the financial statements.

GHG Emissions Disclosure Requirement (Scopes 1 and 2)

- **SEC Proposed Rule**: Irrespective of materiality, public companies would be required to calculate and disclose their direct greenhouse gas (GHG) emissions (Scope 1) and indirect GHG emissions from purchased electricity and other forms of energy (Scope 2). These disclosures could rely on broadly accepted disclosure frameworks, such as the Task Force on Climate-Related Financial Disclosures (TCFD) and the Greenhouse Gas Protocol.

- **Draft Response**: NIRI acknowledges that there are clearly a number of industries where greenhouse gas emissions are material items. According to the Environmental Protection Agency (EPA), the primary sources of greenhouse gas emissions in the United States in 2020 were: (1) transportation (27%), electricity (25%), industry (24%), commercial and residential (13%), agriculture (11%), and land use and forestry (13%). Instead of taking an industry-specific approach, the SEC's Proposed Rule requires all companies to calculate and disclosure Scopes 1 and 2 GHG emissions without regard to materiality.

- Public companies with large stationary sources of emissions already report Scope 1 emissions data to the EPA, and the agency provides detailed methodologies for a range of industries with significant Scope 1 emissions. The EPA also provides detailed guidance for the calculation of Scope 2 emissions.

Scopes 1 and 2 Emissions Disclosure (continued)

- Instead of requiring every public company to calculate its Scope 1 and 2 emissions, the SEC should:

  1) require all companies filing GHG reports with the EPA to provide these reports in their next 10-Q or 10-K filing;

  2) require companies that have identified Scopes 1 and 2 GHG emissions that are *material* to their business operations and/or financial condition and are not disclosed in reports to the EPA, to calculate and disclose such Scopes 1 and 2 emissions using a broadly accepted disclosure framework, such as the TCFD framework and/or the Greenhouse Gas Protocol; and

  3) initiate a cooperative process with the EPA, using the EPA's authority under the Clean Air Act, to adjust its existing reporting regime to integrate with the SEC's reporting process for companies with material Scope 1 and Scope 2 GHG emissions.

GHG Emissions Disclosure Requirement (Scope 3)

- **SEC Proposed Rule**: Companies would be required to disclose indirect emissions from upstream and downstream activities in their value chain (Scope 3), if such emissions are *material*, or if a company has established a target or a goal that includes such Scope 3 emissions. If a company has publicly set climate-related targets or goals, the SEC's Proposed Rule would require the company to provide additional information about how it intends to meet climate-related targets or goals, including updates each fiscal year.

- **Draft Response**: NIRI agrees that Scope 3 emissions should only be required to be disclosed if *material*, or if a company has established a target or goal that includes Scope 3 emissions. Companies should not be required to calculate their Scope 3 emissions quantitatively in order to determine the materiality of those emissions.

Safe Harbor for Scope 3 Emissions Disclosure

- **SEC Proposed Rule**: Since the calculation and disclosure of Scope 3 emissions presents a number of challenges and difficulties, the SEC proposes a "safe harbor" from certain forms of liability under the Federal securities laws for Scope 3 emissions disclosures. This safe harbor is intended to "alleviate concerns that registrants may have about liability for information that would be derived largely from third parties in a registrant's value chain."

- **Draft Response**: NIRI advocated for this type of safe harbor in its 2021 comment letter to the SEC, as Scope 3 data points and estimates are outside of a company's control and are difficult to collect in a reliable and standardized manner.

Exemption for Smaller Reporting Companies - Disclosure of Scope 3 Emissions

- **SEC Proposed Rule**: The SEC proposes to exempt smaller reporting companies (SRCs) from disclosures involving Scope 3 emissions. The agency's rationale is to shield these companies from the "proportionately higher costs they could incur, compared to non-SRCs, to engage in the data gathering, verification, and other actions associated with Scope 3 emissions reporting, many of which have fixed cost components."

- **Draft Response**: A company is an SRC if it has a public float of less than $250 million, or less than $100 million in annual revenues. The SEC's rationale for an exemption could also apply equally to companies that are larger than an SRC and would be faced with similar Scope 3 costs that exceed the benefits of calculating and reporting on these emissions. For this reason, NIRI recommends this exemption be broadened to include small and mid cap companies that are larger than an SRC.

Attestation of Scope 1 and Scope 2 Emissions Disclosure

- **SEC Proposed Rule**: Accelerated or large accelerated filers would be required to obtain an attestation report from an independent attestation service provider covering, at a minimum, disclosures involving Scopes 1 and 2 emissions. The rule does not require the attestation service provider to be registered with the Public Company Accounting Oversight Board (PCAOB), but the provider must satisfy independence and expertise requirements.

- Under the SEC's proposal, companies that are not accelerated or large accelerated filers are permitted to engage a third-party *voluntarily* to attest or verify its Scopes 1 and 2 emissions. If it chooses to engage in a voluntary attestation process, it is required to disclose information about the process it used with a third-party provider, to help investors "understand the nature and reliability of the attestation or verification provided."

- **Draft Response**: In its Proposed Rule, the SEC concedes that "GHG emissions reporting and assurance landscapes are evolving." For this reason, NIRI believes it is premature to require all companies to engage in third-party attestation of Scope 1 and Scope 2 emissions disclosures. As an alternative, NIRI recommends that the SEC expand its voluntary attestation proposal to all public companies, including accelerated filers and large accelerated filers.

Filed vs. Furnished

- **NIRI Comment Letter (6/11/2021)**: Since there is no widespread consensus among companies and investors about many different climate change metrics and risks, public companies are concerned about their potential liability if a new climate change disclosure regime is promulgated. To address these concerns, NIRI recommended that any new climate change disclosure requirements should be treated as "furnished," so that they are not subject to the same level of liability under the securities laws as information that is "filed" with the Commission.

- **SEC Proposed Rule**: The SEC proposes to treat required climate-related disclosures as "filed" and, therefore, subject to the application of a stricter liability standard than if the disclosures are treated as "furnished."

- **Draft Response**: Climate change metrics and data that are disclosed by companies, including Scopes 1, 2 and 3 emissions, should be treated as "furnished." As the SEC concedes, the "methodology underlying climate data continues to evolve." Companies should not be subject to a stricter liability standard for disclosures of metrics and data that rely heavily on estimates and assumptions, and are still in an evolutionary stage.

Compliance Deadlines

- **<u>NIRI Comment Letter (6/11/2021)</u>**: In developing any new disclosure requirements, the SEC should provide for "scaled" disclosure, which would allow smaller issuers more time to comply and would subject these companies to less onerous requirements. The SEC should also consider phasing in any new rules, to permit companies enough time to gather data, assess risks, and prepare their disclosures.

- **<u>SEC Proposed Rule</u>**: The SEC has proposed a series of compliance deadlines in its Proposed Rule. These deadlines assume that a Final Rule has an effective date in December 2022:

  - Large Accelerated Filers would have until 2024 (pertaining to fiscal year 2023) to incorporate the new required climate-related disclosures, including Scope 1 and Scope 2 GHG emissions, into their SEC filings.

  - Accelerated and Non-Accelerated Filers would have until 2025 (pertaining to fiscal 2024) to comply with the new climate disclosure requirements; and Smaller Reporting Companies would have until 2026 (pertaining to fiscal 2025).

  - Additional phase-in periods would apply to disclosures of Scope 3 GHG emissions and third-party attestations.

  - Smaller Reporting Companies would be provided a longer compliance transition and would be exempt from the Scope 3 emissions disclosure requirement.

- **<u>Draft Response</u>**: NIRI should request extensions of 1-2 years for each of these compliance deadlines.

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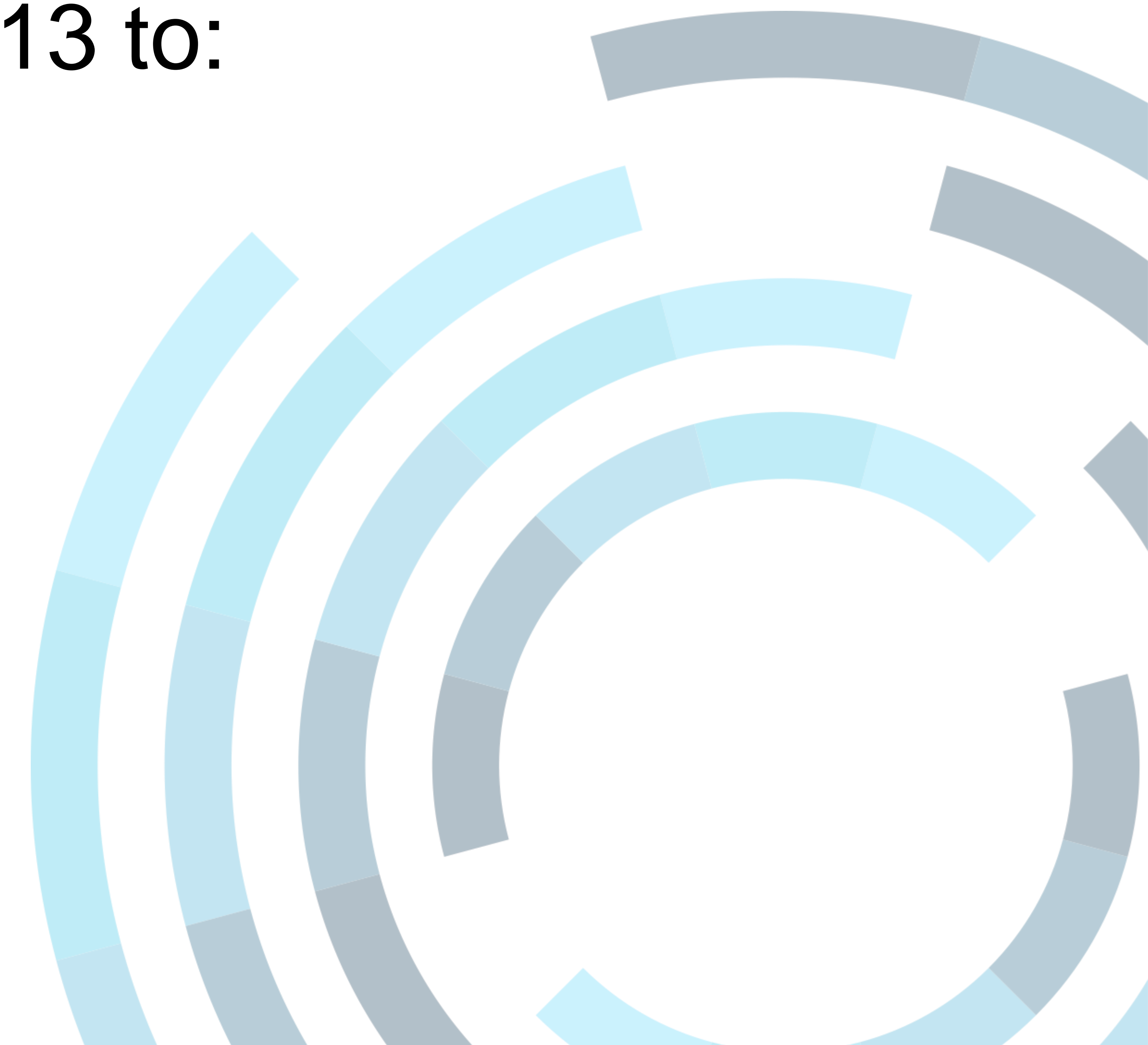
- Questions / feedback
- Enter in chat box
- Comments after the Town Hall can be sent by May 13 to:

  secclimatedisclosure@niri.org



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