WILMERHALE

SEC Adopts Final Rules on Climate-Related Disclosures

MARCH 11, 2024

On March 6, 2024, in a 3-2 vote along party lines, the SEC adopted the long-awaited final rules on climate-related disclosures. The proposed rules faced intense public scrutiny over the last two years, with the SEC receiving more than 24,000 comment letters.

The final rules are scaled back in many respects from the March 2022 proposed rules. Most notably, the changes include (1) the elimination of the proposed requirement to disclose Scope 3 greenhouse emissions ("emissions"), (2) the limitation of certain requirements to large accelerated filers and accelerated filers (such as Scope 1 and Scope 2 emissions disclosure and related attestation reports), (3) an accommodation that allows Scope 1 and Scope 2 emissions disclosure to be filed on a delayed basis each year, (4) a less prescriptive approach to climate-related risk disclosure, (5) removal of the requirement to disclose climate expertise of directors and (6) a narrowing of financial statement disclosure requirements. Although these changes alleviate some of the burden on public companies compared to the proposed rules, the new requirements under Regulation S-X and Regulation S-K imposed by the final rules will dramatically increase climate disclosures in registration statements and annual reports.

The final rules include a compliance phase-in based on a company's filer status, requiring certain disclosures for fiscal years beginning in 2025 for large accelerated filers (LAFs), 2026 for accelerated filers (AFs) and 2027 for smaller reporting companies (SRCs), emerging growth companies (EGCs) and non-accelerated filers (NAFs). The rules also have additional phase-in periods for disclosures related to material expenditures and impacts, emissions, assurance and electronic tagging, as summarized in a table at the end of this post. While these phase-ins are welcome, they are not long, and for LAFs require almost immediate preparation for the first set of filings.

A summary of the key elements of the final rules, including how the final rules differ from the proposed rules, can be found below. As we explore the extensive requirements and nuances of the final rules in greater detail, including how they interact with state law or other regulatory requirements, we look forward to sharing additional thoughts, including practice tips for companies as they begin to navigate next steps.

Summary of Disclosure Requirements Added to Regulation S-K

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The final rules add a new subpart 1500, *Climate-Related Disclosure*, to Regulation S-K, which requires extensive disclosure regarding climate-related risks, transition plans, targets and goals, risk management, governance and GHG emissions. This new subpart is applicable to Exchange Act periodic reports and Securities Act and Exchange Act registration statements.

Board and Management Oversight (S-K Item 1501)

Under new Item 1501(a), companies must disclose any oversight by the company's board of directors of climate-related risks, including the role of any committees or subcommittees and how such committees or subcommittees are informed of the risks. If a target, goal or transition plan for climate-related risks is disclosed and described, disclosure of whether and how the board oversees progress against the target, goal or transition plan is also required. In a departure from the proposed rules, no discussion is required of how often the board or its committees receive information about climate-related risks or of the climate-related expertise of board members.

Under new Item 1501(b), companies must also disclose management's role in assessing and managing material climate-related risks, as well as the relevant expertise of each member of management who is responsible for assessing and managing such risks. Unlike Item 1501(a), Item 1501(b) has a materiality qualifier, which potentially narrows its applicability. The requirements for disclosure under Item 1501(b) generally mirror the requirements for disclosure of management's oversight of cybersecurity risk under Item 106(c)(2).

Climate-Related Risks, Targets and Goals, and Risk Management (S-K Items 1502, 1503 and 1504)

Key disclosures required pursuant to new Regulation S-K Items 1502, 1503 and 1504 include:

- Description of any climate-related risks that have materially impacted or are reasonably likely to have a material impact on the company, including on its strategy, results of operations and financial condition in the short-term (i.e., next 12 months) and in the long-term (i.e., beyond the next 12 months).
- Disclosure of whether a climate-related risk is a physical risk or a transition risk and, depending on the type of risk, detailed disclosure about the risk. However, unlike the proposed rules, the final rules do not require a company to disclose the specific location (including ZIP code or other subnational postal zone) and nature of the properties, processes or operations subject to any physical risk.
- Disclosure of the actual or potential material impacts of the risks noted above (i.e., material risks) on the company's strategy, business model, and outlook, and whether the company considers these impacts as part of its strategy, financial planning, and capital allocation. In a departure from the proposed rules, the SEC added a materiality qualifier to this disclosure in addition to the requirement that the risk itself be material.
- Quantitative and qualitative disclosures regarding a company's activities, if any, to mitigate or adapt to a material climate-related risk and such activities' material impacts on financial estimates and assumptions.
- Description of any transition plan adopted to manage a material transition risk, if any, and

updated disclosures in subsequent years describing the actions taken under such plan during the year. Disclosure about transition plans is required to include quantitative and qualitative disclosure of material expenditures incurred and material impacts on financial estimates and assumptions as a direct result of the transition plan.

- Disclosure regarding use of scenario analysis, if the result of such analysis is that a climate-related risk is reasonably likely to have a material impact on the company's business, results of operations, or financial condition.
- Disclosure about the company's internal carbon price, if the use of an internal carbon price is material to how the company evaluates and manages a material climate-related risk.
- Disclosure about any targets or goals that have materially affected or are reasonably likely to materially affect the company's business, results of operations or financial condition, including the company's progress towards meeting such targets or goals.

  Relatedly, companies must discuss any material impacts to their business, results of operations or financial condition as a direct result of the target or goal or actions taken to make progress on them, including quantitative and qualitative disclosure of any material expenditures and material impacts on financial estimates and assumptions from such targets or goals.

  To the extent that a company has targets or goals related to Scope 3 emissions, disclosure about such targets or goals is required, which has raised ambiguity regarding whether this may trigger disclosure of Scope 3 emissions. However, based on the strong statements that the rules as adopted do not require disclosure of Scope 3 emissions, we anticipate that the rule will not be interpreted to require that a company disclose Scope 3 emissions.

- Disclosure about any targets or goals that have materially affected or are reasonably likely to materially affect the company's business, results of operations or financial condition, including the company's progress towards meeting such targets or goals.

- Description of any processes used to identify, assess or manage material climate-related risks and, if the company is managing a material climate-related risk, whether and how such processes are integrated into the company's overall risk management system.

Scope 1 and Scope 2 Emissions (S-K Items 1505 and 1506)

As anticipated, the final rules do not require disclosure of Scope 3 emissions. For LAFs and AFs only, disclosure under new S-K Item 1505 regarding aggregated Scope 1 and Scope 2 emissions (each as defined in Item 1500) is required when such emissions are material. While the SEC has added a materiality standard, the adopting release includes some language that may be intended to drive companies toward a conclusion that such emissions are material in many instances. For example, the SEC noted in the adopting release that emissions can be material if their calculation and disclosure are necessary to enable investors to understand whether the company has made progress toward achieving a target or goal or a transition plan.

When Scope 1 and/or Scope 2 emissions disclosure is required, the disclosure must include a description of the company's methodology, significant inputs, significant assumptions,

organizational boundaries, operational boundaries and the reporting standard used to calculate the emissions. To the extent that a company's organizational boundary for Scope 1 and Scope 2 emissions differs from the scope of the consolidated financial statements, the company must provide appropriate disclosure of how the boundary differs. In addition, when Scope 1 and/or Scope 2 emissions disclosure is required, and any constituent gas of the disclosed emissions is individually material, the company must also disclose such constituent gas disaggregated from the others.

Emissions disclosure will be required to be provided for the most recently completed fiscal year and, to the extent previously disclosed, for the historical year(s) included in the filing.

As discussed more fully under "Presentation of Disclosures" below, new Item 1505 includes an accommodation allowing this disclosure to be filed on a delayed basis in the company's Form 10-Q for the second fiscal quarter in the fiscal year immediately following the year to which the disclosure relates.

In addition to the disclosure itself, new Item 1506 requires an attestation report verifying the Scope 1 and/or Scope 2 emissions disclosure. The requirement for an attestation report will be phased in over multiple years with additional phase-in periods for increasing assurance levels depending on the company's filer status, as shown in the table under "Compliance Schedule" below.

Safe Harbor for Forward-Looking Statements (S-K Item 1507)

The final rules provide a safe harbor for forward-looking climate-related disclosures, including both facts and projections, pertaining to transition plans, scenario analysis, internal carbon pricing, and targets and goals, all of which the SEC has deemed forward-looking statements for purposes of the Private Securities Litigation Reform Act. The safe harbor does not extend to disclosures regarding the company's actual Scope 1 and Scope 2 emissions or historical facts.

Summary of Disclosure Requirements Pursuant to Regulation S-X (S-X Items 14-01 and 14-02)

In a departure from the proposed rules, the final rules do not require disclosure of the impact of severe weather events, other natural conditions,[2] carbon offsets or RECs on each line item of the consolidated financial statements. Instead, new Article 14 to Regulation S-X will require all companies, including SRCs and EGCs, to disclose less disaggregated information in the notes to their annual audited financial statements, including:

- Expenditures expensed as incurred and losses as a result of severe weather events and other natural conditions if the aggregate amount equals or exceeds 1% of the absolute value of income or loss before income tax expense or benefit for the relevant fiscal year, subject to a $100,000 de minimis disclosure threshold.
- Aggregate amount of capitalized costs and charges, excluding recoveries, incurred during the fiscal year as a result of severe weather events and other natural conditions if the aggregate amount of the absolute value of capitalized costs and charges equals or exceeds 1% of the absolute value of stockholders' equity or deficit at the end of the relevant fiscal year, subject to a $500,000 de minimis disclosure threshold.

- Aggregate amount of any recoveries recognized during the fiscal year as a result of severe weather events and other natural conditions if amounts described in the preceding two bullets are also disclosed.
- Certain aggregate expenditures, losses and capitalized amounts related to carbon offsets and RECs if used as a material component of a plan to achieve disclosed climate-related targets or goals.

Companies must also provide a qualitative description of how the development of estimates and assumptions were impacted, if such estimates and assumptions used to produce the financial statements were materially impacted by risks and uncertainties associated with severe weather events and other natural conditions or any disclosed climate-related targets or transition plans.

These disclosures are focused on the capitalized costs, expenditures expensed, charges, and losses resulting from severe weather events, other natural conditions, carbon offsets or RECs and how they are presented on the balance sheet and income statement (with no disclosure requirements regarding the statement of cash flows). The SEC clarified in the adopting release that a company is not required to make a determination that a severe weather event or other natural condition was, in fact, caused by climate change to trigger Regulation S-X disclosure.

Similar to disclosure regarding Scope 1 and Scope 2 emissions discussed above, the financial statement disclosures are required for the most recently completed fiscal year, and to the extent previously disclosed or required to be disclosed, for the historical year(s) included in the filing.

Presentation of Disclosures (S-K Item 1508)

Climate-related disclosures must be included in registration statements and annual reports with both narrative and quantitative disclosure tagged in Inline XBRL. While the proposed rules would have required all of the disclosure required under Regulation S-K to be included in a separately captioned "Climate-Related Disclosure" section of the registration statement or annual report, the final rules leave placement of these disclosures largely up to the company, who may choose to retain the separate "Climate-Related Disclosure" section or incorporate the disclosure in various other relevant areas of the filing, such as in MD&A, Description of Business and Risk Factors. Companies may also incorporate by reference some of the climate-related disclosures from other filings so long as the incorporated disclosure is responsive to the Regulation S-K requirements and is tagged using Inline XBRL.

Scope 1 and Scope 2 emissions disclosure, if required, can be presented in (i) the annual report on Form 10-K, (ii) in the quarterly report on Form 10-Q for the second fiscal quarter following the year to which the disclosure relates incorporated by reference into the Form 10-K, or (iii) in an amendment to the Form 10-K filed no later than the due date for the Form 10-Q for the second fiscal quarter. If the registrant is a foreign private issuer, the emissions disclosure may be included in an amendment to its annual report on Form 20-F, due no later than 225 days after the end of the fiscal year to which the disclosure relates. If the disclosure is to be included in a registration statement, the disclosure may be as of the most recently completed fiscal year that is at least 225 days prior to the date of effectiveness of the registration statement.

California State Law Implications

Companies that do business in California may be subject to disclosure requirements under both the federal and state rules. As we previously reported, last year California enacted two climate disclosure rules, the Climate Corporate Data Accountability Act (SB 253) and the Climate-Related Financial Risk Act (SB 261). SB 253 requires companies doing business in California with revenues over $1 billion to disclose Scope 1 and Scope 2 emissions by 2026 and Scope 3 emissions by 2027, among other requirements. SB 261 requires certain companies in California, by 2026, to prepare and submit climate-related financial risk reports, consistent with recommendations from the Task Force on Climate-Related Financial Disclosures. Both laws are being challenged in court. If the California laws survive the legal challenges, it remains to be seen whether the final rules will ultimately preempt California's and other state rules on climate disclosures. During the open meeting, SEC Staff commented that the federal rules do not explicitly preempt state rules, but could impliedly preempt state rules depending on the factual circumstances at issue.

Compliance Schedule

The final rules will become effective 60 days from publication in the Federal Register. Once effective, compliance dates will be phased in according to the table below.

<table>
<tr><th colspan="7">Compliance Dates under the Final Rules[1]</th></tr>
<tr><th rowspan="2">Filer Status</th><th rowspan="2">Financial Statement Disclosure and All Other Disclosure (Except Material Expenditures and Impacts Disclosure and GHG Emissions Disclosure)</th><th rowspan="2">Material Expenditures and Impacts Disclosure[2]</th><th rowspan="2">Scope 1 and Scope 2 GHG Emissions Disclosure (Item 1505)</th><th colspan="2">Attestation on Scope 1 and Scope 2 GHG Emissions Disclosure (Item 1506)</th><th rowspan="2">Electronic Tagging (Excluding Financial Statement Disclosure)[3]</th></tr>
<tr><th>Limited Assurance</th><th>Reasonable Assurance</th></tr>
<tr><td>LAFs</td><td>FYB 2025</td><td>FYB 2026</td><td>FYB 2026</td><td>FYB 2029</td><td>FYB 2033</td><td>FYB 2026</td></tr>
<tr><td>AFs (excluding SRCs and EGCs)</td><td>FYB 2026</td><td>FYB 2027</td><td>FYB 2028</td><td>FYB 2031</td><td>N/A</td><td>FYB 2026</td></tr>
<tr><td>SRCs, EGCs, and NAFs</td><td>FYB 2027</td><td>FYB 2028</td><td>N/A</td><td>N/A</td><td>N/A</td><td>FYB 2027</td></tr>
<tr><td></td><td colspan="6">1 "FYB" refers to any fiscal year beginning in the calendar year listed.
2 Consists of disclosure pursuant to Regulation S-K Item 1502(d)(2), 1502(e)(2) and 1504(c)(2).
3 Financial Statement Disclosure will be required to be tagged in accordance with existing Rule 405(b)(1)(i) of Regulation S-T.</td></tr>
</table>

[1] As defined in Item 1500, "physical risks" include both acute and chronic climate-related risks to the registrant's business and operations, whereas "transition risks" are the actual or potential negative impacts on a registrant's business, results of operations or financial condition attributable to regulatory, technological and market changes to address the mitigation of, or adaptation to, climate-related risks. Transition risks include increased costs attributable to changes in law or policy, reduced market demand for carbon-intensive products leading to decreased prices or profits for such products, the devaluation or abandonment of assets, risk of legal liability and litigation defense costs, competitive pressures associated with the adoption of new technologies and reputational impacts (including those stemming from a registrant's customers or business counterparties) that might trigger changes to market behavior, consumer preferences or behavior and registrant behavior.

[2] The adopting release acknowledged that commenters had asked the SEC to provide examples of "other natural conditions;" however, the SEC refrained from offering clarification, leaving the ultimate breadth ambiguous.

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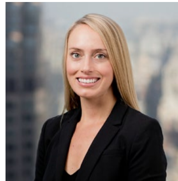

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