AN INVESTOR GUIDE TO THE SEC RULE ON CLIMATE-RELATED DISCLOSURES

ACTIONABLE INSIGHTS FOR A DECARBONIZING WORLD

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INTRODUCTION

On March 6, 2024, the Securities and Exchange Commission (SEC) issued a final rule for "The Enhancement and Standardization of Climate-Related Disclosures for Investors." The rule builds on the SEC's initial interpretative guidance on climate risk disclosure in 2010, and will provide investors with comparable, specific, and decision-useful information about companies' environmental risks and strategies. The final rule follows release of a proposed rule in March 2022 and a subsequent comment period in which over 24,000 letters were filed by investors, businesses, and other stakeholders, with most of those supportive of the proposal.

The final rule requires covered companies to disclose certain types of climate-related information, bringing climate risk disclosure on par with other financial reporting requirements for publicly traded companies. The SEC has long required publicly traded companies to disclose information that indicates risks they may face, like from legal proceedings, market shifts, resource scarcity, or uncertain circumstances like Y2K or COVID-19. In adding climate risk disclosures to the SEC reporting framework, the rule mirrors similar requirements in other jurisdictions including the European Union, United Kingdom, and Japan. The SEC requirements will be phased in over several years and will replace inconsistent, voluntary reporting of climate risk exposure with clear and consistent standards. Better information will allow for better management of risk. The rule therefore marks an essential step forward in enhancing investors' capacity to manage portfolio-wide climate risks, protecting the overall health of the financial system.

The purpose of this investor guide is to provide the financial sector with an overview of the rule and its key components, summarize the implications of the rule for investors, put the rule into context with other international frameworks, and map out next steps towards implementation of the rule. In all, EDF believes that this rule represents a crucial step forward in climate-related financial risk reporting and will strengthen the overall health and stability of the financial system. We recommend that investors – the direct beneficiaries of this rule – publicly voice their perspectives on the importance of climate risk disclosure to help inform and support the rule's implementation.

OVERVIEW OF THE RULE

The new rule on climate-related disclosures requires publicly traded companies registered with the SEC to disclose certain climate-related information in registration statements and annual reports. This information includes: 1) material climate-related risks to the company,[1] 2) the company's activities to mitigate or adapt to such risks, 3) information about management's role in managing material climate-related risks and the board of directors' oversight of those risks, and 4) information on climate-related targets or goals that are material to the company's business operations.

Additionally, the rule requires larger companies to disclose Scope 1 (direct) and Scope 2 (from energy use) greenhouse gas (GHG) emissions, if material, to facilitate investors' assessment of transition-related risks. In response to input from commenters, the SEC will allow such disclosures to be filed on a delayed basis (e.g., for domestic companies, any required GHG emissions disclosures may be made in the second quarter following the relevant fiscal year). Starting in 2029, companies required to make GHG emissions disclosures will need to include an attestation report from a qualified, independent third party affirming their calculations.

Finally, the rule requires companies to disclose certain relevant information in their financial statements. Companies will disclose costs, expenditures, charges, and losses related to severe weather events, subject to certain thresholds, and related to carbon offsets and renewable energy credits or certificates, if material to climate-related targets or goals. Companies will also need to describe material impacts, if any, of climate-related factors on the estimates and assumptions that went into preparing the financial statement.

The final rule incorporates longer phase-in periods for reporting requirements than were in the initial proposal, with compliance deadlines depending on a company's filer status and the type of disclosure. For many of the disclosure requirements, large accelerated filers will first need to report on fiscal year 2025, accelerated filers on fiscal year 2026, and other filers (smaller reporting companies, emerging growth companies, and non-accelerated filers) on fiscal year 2027. Companies will have additional time to comply with certain disclosure requirements. For example, Scope 1 and 2 emissions disclosures are required for fiscal year 2026 for large accelerated filers, and for fiscal year 2028 for accelerated filers that are subject to the requirement, while other filers are not required to report on emissions at all. These extended phase-in periods provide companies with time to develop, modify, and implement any processes and controls necessary to the assessment and reporting of material climate-related risks.

[1] Per the rule, "materiality refers to the importance of information to investment and voting decision about a particular company, not to the importance of the information to climate-related issues outside of those decisions."

The SEC received thousands of comments from affected stakeholders and other parties on the proposed rule and made a number of modifications as a result. Key changes are highlighted below.

Issue	Proposed Rule	Final Rule
Overall	Disclosures on climate-related risks to company and company's governance, strategy, risk management, and targets/metrics relating to those risks (similar to TCFD). Disclosures on Scope 1 and 2 GHG emissions with independent auditing, and Scope 3 if material or if part of a target. Financial statement metrics and disclosures on climate-related impacts and expenditures.	Less prescriptive (i.e., more flexible) disclosures on climate-related risks to company and company's governance, strategy, risk management, and targets/ metrics relating to those risks (similar to TCFD). (For example, eliminated the proposed requirement to describe board members' climate expertise.) Disclosures on Scope 1 and 2 GHG emissions for larger companies, if material, with independent auditing (no Scope 3). Scaled-back set of financial statement metrics and disclosures on climate-related impacts and expenditures. (For example, eliminated the proposed requirement to disclose climate-related impacts above a 1% threshold on each line item of the financial statement.)
Materiality	Materiality limitations for certain requirements – i.e., disclosure only required if the company deems the information material to investors – such as for Scope 3 GHG emissions disclosures and some of the TCFD-aligned disclosures.	Materiality limitations specified for most requirements, including Scope 1 and 2 GHG emissions disclosures (no Scope 3) and TCFD-aligned disclosures.
GHG Emissions Disclosures	Scope 1 and 2 GHG emissions, with independent auditing, and Scope 3 if material or if part of a target. Smaller reporting companies exempted from auditing and Scope 3 requirements.	Scope 1 and 2 GHG emissions disclosures, with independent auditing, required only for large accelerated filers and accelerated filers, and only when those emissions are material (no Scope 3 requirements). Option to provide this disclosure on a delayed basis.
Safe Harbors	Safe harbor from liability for Scope 3 GHG emissions disclosures and for forward-looking statements pursuant to the Private Securities Litigation Reform Act.	Safe harbor from private liability for forward-looking statements pursuant to the Private Securities Litigation Reform Act, and affirmation that forward-looking disclosures pertaining to transition plans, scenario analysis, the use of an internal carbon price, and targets and goals fall within this protection. (No Scope 3 GHG emissions disclosure requirements.)
Implementation Timeline	Phased in by type of disclosure and company size, with first disclosures from large accelerated filers for FY2023, and full implementation by FY2028.	Phased in by type of disclosure and company size, with first disclosures from large accelerated filers for FY2025, and full implementation by FY2033. More gradual phase-in and more exemptions for small filers than in proposal.

IMPLICATIONS FOR INVESTORS

Transparency around the scope and scale of climate risk is fundamental to healthy investment markets. Climate change adds risk to the financial system through physical climate risks, such as extreme weather events that damage companies' assets and operations, and transition risks to companies' business models linked to shifts in policy, technology, and consumer demand. These risks are distributed unequally across regions, sectors, and individual businesses.

To incorporate climate-related financial risks into their decision-making, investors must be able to identify and evaluate such risks. Investors in the U.S. have so far had to rely upon voluntary disclosures that companies make under frameworks like the Task Force on Climate-related Financial Disclosures (TCFD). However, the voluntary nature of these protocols has limited their utility. The new SEC climate risk disclosure rule aligns the reporting practices that many U.S. businesses already have in place and supports investors' ability to accurately assess and price climate risks in investment decisions.

The SEC received support for its rulemaking in public comments from companies and financial institutions including Bank of America, Vanguard, Walmart, Total Energies, General Motors, and United Airlines. These companies and others have called for enhanced standardization of climate risk disclosures because:

> **Climate risk is financial risk.** Substantial research documents the potentially disruptive impacts of climate change across a wide range of industries, including both physical risks to companies' assets and operations, as well as transition risks. Market participants have significant interest in understanding the size and scope of these risks.
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> **Investors need better information to make more informed investment decisions.** Climate-related information is essential to managing financial risk. Non-standardized and voluntary risk disclosures are of limited value for market participants in evaluating individual companies or comparing performance across an industry, due to data gaps and inconsistency. Many financial institutions resort to paying large sums to third party data providers for modelled data, in the absence of consistent company-reported data. The new rule will provide market participants with consistent, comparable, and decision-useful information.
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> **The rule brings disclosure of climate-related financial risks level with the disclosure of other forms of financial risk.** Historically, the SEC has required publicly traded companies to disclose various financial risks. However, climate-related risks, despite their potential impact on the global economy by 2050, have not been subject to the same level of rigor. The new rule changes that.
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> **Climate disclosure rules are rapidly becoming the norm.** With the new rule, the U.S. aligns with other jurisdictions that have adopted climate-related disclosure requirements, including the European Union and California. Standardized U.S. climate risk disclosure enhances the comparability of U.S. data with data from other jurisdictions, enabling market participants to effectively manage climate-related financial risks.

CLIMATE RISK DISCLOSURE IN OTHER JURISDICTIONS

The SEC's adoption of climate risk disclosure standards in the US aligns with a trend toward such requirements in key jurisdictions globally. In recent years, more than 40 other countries with over $55 trillion in GDP have taken steps to require corporate climate disclosures.

The establishment of the ISSB and the 2023 publication of its inaugural standards created a global baseline for corporate sustainability disclosures that many jurisdictions have built from. However, the scope of disclosure rules varies by jurisdiction. Most major jurisdictions outside the US include Scope 1, 2 and 3 emissions in their disclosure frameworks. In the EU, the Corporate Sustainability Reporting Directive goes beyond investor-focused climate data reporting to address environmental, social and governance topics from a double materiality perspective[2], an approach that has also been proposed in China.

Global Frameworks for Mandatory Climate Disclosure

	Key elements	Status	Scope of Coverage
US	• Scope 1 and 2 GHG emissions, if material • Narrative disclosures in line with TCFD's four pillars: governance, strategy, risk management, metrics/targets	Finalized in March 2024, with phased-in compliance beginning for large accelerated filers on some disclosures in 2026 for FY2025.	Companies registered with the SEC (over 7,000 entities), with smaller filers exempt from certain requirements
China	• Scope 1, 2 and 3 • Double materiality	Published in February 2024, with application expected in 2026 for FY2025	Large, listed entities (over 400 entities)
EU	• Scope 1, 2 and 3 • Double materiality • Sector-agnostic standards covering environmental, social and governance topics	Legislation published in December 2022 (Sector-agnostic standards published in December 2023). Phased application with first reporting in 2025 for FY2024. Upcoming: sector-specific standards	All large companies operating in the EU and all listed companies (50,000 entities)
California	• Scope 1, 2, and 3 • Climate-related financial risk disclosures consistent with recommendations from the TCFD framework	SB 253 (the Climate Corporate Data Accountability Act) and SB 261(the Climate-Related Financial Risk Act) both signed into law October 2023. SB 253 requires scope 1 and scope 2 disclosures by FY 2026, and scope 3 disclosures by 2027. SB 261 requires TCFD-aligned disclosures by 2026. Upcoming: implementing regulations	SB 253 covers public and private companies doing business in California with $1 billion or more in annual revenue. SB 261 covers public and private companies doing business in California with $500 million or more in annual revenue.

[2] Double materiality refers to the consideration of how a company's activities impact people and the planet (impact materiality), in addition to how social and environmental factors may impact the company's development and performance (financial materiality).

WHAT COMES NEXT

Rigorous, standardized climate risk disclosures are essential for investors to accurately price risks and allocate capital prudently, which is why investors have supported the need for a mandatory disclosure framework offering comparable, specific, and decision-useful information about climate risk. When implemented, the SEC rule will improve the quality and quantity of climate risk information available to investors in the U.S. market.

In the months ahead, the climate risk disclosure rule will be the subject of litigation challenges in federal courts from various parties – so far, some oil and gas sector entities and state attorneys general – that asserted opposition to the rule even before the language was published.[3] And while many members of Congress have recognized the importance of SEC action on climate risk disclosures, others have announced their intentions to attack the rule using the Congressional Review Act or other legislative tools.

Investors can help ensure that the rule successfully goes into effect by supporting it publicly and otherwise. This can include restating previous endorsements, issuing new statements of support, engaging with professional membership organizations to encourage support for (and discourage opposition to) the rule, and participating directly in the litigation over the rule.

CONCLUSION

This final rule, informed by the SEC's rigorous analysis and consideration of investor and business feedback, represents an important step forward in climate-related financial risk reporting. It replaces the current fragmented system with a standardized approach, enabling market participants to make informed decisions based on consistent, comparable, and decision-useful information. Ultimately, this rule will strengthen the overall health and stability of the U.S. financial system.

Further reading

Banking Regulators Take Critical Steps to Account for Climate-Related Financial Risks - an article by EDF's Lead Counsel for Climate Risk (Nov 2022).

What Investors and the SEC Can Learn from the Texas Power Crises – a report from EDF and scholars at The Brookings Institution (June 2021).

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 (June 2021).

Mandating Disclosure of Climate-Related Financial Risk – a joint report from EDF and the Institute for Policy Integrity at NYU Law School (Feb 2021).

The SEC should require companies to disclose climate change risk – an article by EDF's Lead Counsel and Director of Climate Risk Strategies (Dec 2020).

[3] Environmental organizations are also seeking court review of the rule, but are not asking the courts to strike it down. Rather, they are challenging the SEC's decision to drop some of the proposed disclosure requirements.