

SEC's Final Climate Disclosure Rules: An Explainer

On March 6th, 2024, the Securities and Exchange Commission (SEC) issued the long-awaited [Final Rule](#) addressing climate-related disclosures in a public company's financial statements.

This move reflects the SEC's efforts to respond to investors' demand for more consistent, comparable, and reliable information about the financial effects of climate-related risks on the business of a company. The new rule would standardize how companies report climate-related risks that may have a material impact on business strategy, results of operations, or financial condition.

Watered-down finalized version

The Final Rule is less intense than the more prescriptive March 2022 proposed rule which garnered more than 24,000 comment letters, making it the most commented-on proposal in SEC history. The responses to the release of the original proposal spurred major modifications resulting in the eventual "slimmed-down" final rule. Some of the changes include: (1) removal of the proposed Scope 3 greenhouse gas (GHG) emissions disclosure requirement, now requiring only Scope 1 and Scope 2 reporting (and only when the emissions are material), (2) the exemption of small reporting companies and emerging growth companies from the proposed GHG emissions disclosure requirements, limiting the requirements to large accelerated filers (LAFs) and accelerated filers (AF), (3) elimination of the requirement to disclose the impact of severe weather events on a line item basis, (4) removal of the proposed requirement to describe climate expertise of board members, and (5) the introduction of additional time to get in

compliance and obtain necessary attestation reports.

Materiality

A common theme that runs through the Final Rule is the existence of materiality qualifiers, introducing some element of judgment. The Final Rule requires an entity to disclose **material** climate-related risks faced by the entity as well as any governance and processes it used to manage climate-related risks. An entity is also required to disclose if it used transition plans, scenario analysis, or internal carbon prices to manage a **material** climate-related risk. An entity also must disclose **material** climate-related targets or goals (if the entity has them), plans for achieving those targets or goals, and annual progress. **Material** expenditures directly resulting from activities to

mitigate climate-related risks as well as transition plans and targets or goals must also be disclosed.

The Final Rule aligns with precedent that a matter is material "if there is a substantial likelihood that a reasonable investor would consider it important when determining whether to buy or sell securities or

how to vote or such a reasonable investor would view omission of the disclosure as having significantly altered the total mix of information made available." Materiality determination is fact specific and requires both quantitative and qualitative considerations

"...in those instances where the rules reference materiality—consistent with our existing disclosure rules and market practices—materiality refers to the importance of information to investment and voting decisions about a particular company, not to the importance of the information to climate-related issues outside of those decisions." - SEC Release No. 33-11275



PLANNING POINT

Entities should develop effective systems to help identify material climate-related items as they prepare to comply with the rules.

Disclosures Required

Entities will be required to disclose the following:

Strategy, Business Model, and Financial Outlook

- A description of any climate-related risks that have materially impacted or are likely to have an impact on the company, including on its strategy, result of operations, and financial condition
- Actual or potential impacts of any identified climate-related risks on strategy, business model, or outlook
- Specific disclosures regarding activities intended to mitigate or adapt to a material climate-related risk or use of transition plans, scenario analysis, or internal carbon prices
- Board of director oversight and management's role in assessing climate-related risks
- Description of processes used to assess or manage material climate-related risks and if they are managing the risks, how any processes are integrated into overall risk management
- Targets and goals that have materially affected or are reasonably likely to affect the company's business, including material expenditures and impacts on estimates and assumptions as a direct result of or from actions taken to meet the goal.



PLANNING POINT

Consider the need for more complex materiality and risk assessments. Review existing risks and disclosures for additional areas of exposure.

Severe Weather Events and Other Natural Conditions

- Financial statement effects of severe weather events and other natural conditions in the notes to consolidated financial statements
 - Expenditures and losses recognized in the income statement subject to a threshold of 1% of pretax income or \$100,000
 - Capitalized costs, expenditures, and losses subject to a threshold of 1% of shareholders equity or \$500,000

- If estimates and assumptions were materially impacted by risks and uncertainties associated with severe weather events and how they were impacted

"Severe weather events" refers to events such as hurricanes, tornadoes, floods, extreme temperatures, and a rising sea level



PLANNING POINT

The new requirement that contextual information be provided in certain circumstances also means that an entity must state its accounting policy for carbon offsets and renewable energy credits (RECs). It may be helpful to have climate and risk management experts involved in the policy drafting process.

Greenhouse Gas Emissions

- Scope 1 and Scope 2 material emissions, on a gross basis before adding in the effects of offsets
- Attestation reports required with limited assurance and reasonable assurance over emissions information, depending on registrant type

Scope 1 greenhouse gas emissions are direct emissions from operations that are owned or controlled by the registrant. Scope 2 emissions are indirect emissions from the generation of purchased energy such as electricity, steam, heating and/or cooling.

Carbon Offsets and Renewable Energy Credits

Carbon offsets and renewable energy credits (RECs) are not subject to a one percent threshold; instead, if they are material to the registrant's plan to achieve a disclosed target or goal, certain disclosures must be made. These disclosures include the following:

- Aggregate amount of carbon offsets and RECs expensed
- Aggregate amount of carbon offsets and RECs capitalized
- Aggregate losses incurred on capitalized carbon offsets and RECs during the year
- Beginning and ending balanced of capitalized carbon offsets and RECs on the balance sheet for the fiscal year

Location of Disclosures

Climate-related disclosures should be provided in annual reports at the time of filing. Emissions disclosures may be provided in the second-quarter 10-Q for the year after the time period to which the emissions are related.

Disclosures that are not required in notes to financial statements should be disclosed in a separate section or in an appropriately titled

section of the 10-K, such as Management's Discussion and Analysis (MD&A), Risk Factors, or Description of Business.

Note: All footnote disclosures will be subject to Regulation S-X requirements, which includes an audit of information disclosed.

Additionally, all disclosures are required to be tagged in Inline XBRL.

Location of Disclosures		
Disclosure	Notes	Annual Report
Strategy, Business Model, and Financial Outlook		
Description of any climate-related risks with an impact to the company		X
Actual or potential impacts of any identified climate-related risks on strategy, business model, or outlook		X
Specific disclosures regarding activities intentioned to mitigate or adapt to a material climate-related risk or use of transition plans, scenario analysis or internal carbon prices		X
Board of director oversight and management's role in assessing climate-related risks		X
Description of processes used to assess or manage material climate-related risks		X
Targets and goals that have materially affected or are reasonable likely to affect the company's business		X
Severe Weather Events and Other Natural Conditions		
Expenditures and losses recognized in the income statement subject to a threshold of one percent of pretax income or \$100,000	X	
Capitalized costs, expenditures and losses subject to a threshold of one percent of shareholders equity or \$500,000	X	
If estimates and assumptions were materially impacted by risks and uncertainties associated with severe weather events	X	
Greenhouse Gas Emissions		
Scope 1 and Scope 2 material emissions, on a gross basis before adding in the effects of offsets		X
Attestation reports with limited assurance and reasonable assurance over emissions information depending on registrant type required		X
Carbon Offsets and Renewable Energy Credits (RECs)		
The aggregate amount expensed, the aggregate amount capitalized, and the aggregate amount of losses incurred related to such instruments during the year	X	
The financial statement line items affected must be called out and accounting policies for the instruments	X	

Safe Harbor

The rule provides a safe harbor from private securities litigation for the climate-related disclosures relating to transition plans, scenario analysis, the use of internal carbon pricing, and targets and goals where the information is considered forward-looking. Historical statements are not protected under the safe harbor rules.



PLANNING POINT

Taking inventory of all claims, goals, and targets made in the past, documenting what was said, where it was said, and developing a strategy to move forward and lessen liability is an exercise that may be helpful to implement.

Ongoing Litigation and Future Impacts

The Final Rule has been the subject of various legal challenges with several cases filed in the courts from the day of their release. One of such was a request for a stay which the Fifth Circuit granted on March 15, 2024, temporarily halting the new rules. Facing at least nine other challenges in six different circuits, the SEC requested a random selection of a single court as the venue in which the consolidated cases will be litigated. On March 21, 2024, the Eighth Circuit was picked in the lottery. With the choice of the Eighth Circuit, the Fifth Circuit transferred its cases and lifted the temporary administrative stay that it had ordered.

3/6/2024.....Final rule passes in 3-2 Commissioner vote.

3/15/2024Fifth Circuit pauses the rule following Liberty Energy Inc.'s request for emergency relief.

3/19/2024The SEC files a *Notice of Multicircuit Petitions for Review* to have a sole court picked to hear the consolidated case.

3/21/2024Eighth Circuit selected to hear consolidated litigation.

3/22/2024.....Fifth Circuit lifts pause on the Final Rule.

[See News Coverage SEC Climate Rules Face Fracking Company's Second Lawsuit and SEC Renews Bid to Keep Court Hold Off Climate Reporting Rules](#)

Though the fate of the Final Rule is uncertain, companies should not delay taking necessary steps to comply. Identifying, tracking, and reporting the data required under the disclosure rules can be challenging and time-consuming. If a company waits for the outcome from the litigation, they may risk noncompliance through poor data quality or simply failure to report due to lack of preparedness.

Additionally, the SEC rule is not the only climate-related regulation that may impact companies. Many of the companies that will be impacted by the SEC Rule are US companies with EU subsidiaries that meet certain criteria that subject them to disclosure requirements under the EU's more encompassing [Corporate Sustainability Reporting Directive \(CSRD\)](#). Many companies are also within scope of the California climate bills (SB-253, SB-261). There is therefore some semblance of familiarity for many of these companies. However, for others, it is not advisable to adopt a "wait-and-see" approach but to be prepared.

Summary of Effective Dates

Large Accelerated Filer	Accelerated Filer	SRC, EGC, and Non-accelerated Filer
Climate-related risks on strategy, business, or financial outlook 2025	Climate-related risks on strategy, business, or financial outlook 2026	Climate-related risks on strategy, business, or financial outlook 2027
Targets and goals 2025	Targets and goals 2026	Targets and goals 2027
Carbon Offsets 2025	Carbon Offsets 2026	Carbon Offsets 2027
Severe Weather Events 2026	Severe Weather Events 2027	Severe Weather Events 2028
Scope 1 and Scope 2 Emissions 2026	Scope 1 and Scope 2 Emissions 2028	
Limited Assurance Report over Emissions Disclosures 2029	Limited Assurance Report over Emissions Disclosures 2031	
Reasonable Assurance Report over Emissions Disclosures 2033		

Large Accelerated Filer	Accelerated Filer	Foreign Private Issuer	Small Reporting Company	Emerging Growth Company	Non-Accelerated Filer
Stock of at least \$700 million with public investors	Stock of at least \$75 million with public investors	Incorporated outside of the US and majority of stock is owned by non-US residents	Stock of less than \$250 million with public investors	Revenues less than 1.235 billion in recent FY and hadn't sold securities under a registration statement	Revenue less than \$100 million <u>and</u> public stock \$700 million or Public stock less than \$75 million

SEC Climate Rule Checklist: Carbon Offsets and Renewable Energy Credit

Carbon Offsets and Renewable Energy Credits (RECs) ¹			
	Yes	No	N/A
Has the entity disclosed their amount of carbon avoidance?			
Has the entity separately disclosed the reduction or removal represented by offsets or amount generated by renewable energy represented by the REC?			
Has the entity disclosed the nature and source of the carbon offsets or credit?			
Has the entity disclosed the description and location of the underlying projects, any registries or other authentication of the carbon offsets or RECs?			
Has the entity disclosed the costs of carbon offsets and RECs?			
Has the entity disclosed the aggregate amount of carbon offsets and RECs expensed?			
Has the entity disclosed the aggregate amount of carbon offsets and RECs capitalized?			
Has the entity disclosed the aggregate losses incurred on the capitalized carbon offsets and RECs during the year?			
Has the entity disclosed the beginning and ending balances of capitalized carbon offsets and RECs on the balance sheet for the fiscal year?			
Has the entity disclosed where on the income statement or balance sheet the capitalized costs, expenditures expensed, and losses related to carbon offsets and RECs are presented?			

SEC Climate Rule Checklist: Severe Weather Events

Severe Weather Events and Other Natural Conditions			
	Yes	No	N/A
Has the entity disclosed expenditures expensed as incurred and losses if the aggregate amount of such expenditures and losses equals or exceeds: <ul style="list-style-type: none"> 1% of the absolute value of income or loss before income tax expense; or \$100,000?² 			
Has the entity disclosed capitalized costs and charges recognized if they equal or exceed: <ul style="list-style-type: none"> 1% of stockholder's equity; or \$500,000?² 			
Has the entity provided a qualitative description of how estimates and assumptions were impacted by the risks and uncertainties related to severe weather events or climate-related targets/transition plans?			
Has the entity disclosed where the capitalized costs, expenditures expensed, charges and losses as a result of severe weather events are presented on the balance sheet or income statement?			

Other Related Materials

[BTAX OnPoint: SEC Issues Final Climate-related Disclosures Rule](#)

[ESG Watch](#)

¹ Effects or impacts to the statement of cash flow do not need to be addressed.

² The aggregate amounts should be determined excluding recoveries.