ESG Update: SEC Requirements, Financial Impacts & What's Next

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Speaker

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Agenda

1. Introduction to ESG Disclosure Standards and Frameworks
2. Proposed SEC Regulation
3. GHG Inventory Considerations
4. What's Next and Key Takeaways

Introduction to ESG Disclosure Standards and Frameworks

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Voluntary Reporting – Frameworks & Standards

Voluntary Reporting – Frameworks & Standards

	Primary Purpose	Audience	Standard or Framework?	Primary Focus
GRI	Helps companies understand what ESG and CSR factors it can measure and manage, and guidance how to do so	All stakeholders	Standards	Covers all ESG topics – includes universal, sector-specific and topic-specific standards
SASB	Help companies understand what ESG factors are material to their business, and should be disclosed to investors	Primarily investors	Standards	Financially material ESG topics – identifies subset of ESG issues most relevant to financial performance of 77 industry sectors
CDP	Global disclosure system for investors, companies, cities, states and regions to manage environmental impact – disclosures scored	Investors, companies, cities, states, regions	Framework	Environmental topics – GHG, water, Forests
UNGC/ SDGs	Help companies set ESG and CSR targets in service of the UN SDGs	All stakeholders	Framework	Covers universal Sustainable Development Goals (SDGs)
TCFD	Help companies identify financial risks and opportunities related to climate change	Primarily investors	Framework	Climate-related financial risks
TNFD	Help companies report and act on nature-related risks	Primarily investors	Framework	Nature-related financial risks
IFRS/ ISSB	IFRS Trustees announced formation of ISSB at COB26 (11/2021) – will develop comprehensive global standards	Primarily investors	Standards	To cover all ESG topics on which investors want information

Reference: adopted from - https://movingworlds.org/esg-reporting-guide

Proposed SEC Regulation

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SEC Climate Disclosures

- Interpretive Release issued February 2, 2010, 'Commission Guidance Regarding Disclosure Related to Climate Change'
- Climate change related disclosures
    - Impact of legislation / regulation
    - International accords
    - Indirect consequences of regulation or business trends
    - Physical impacts

'Intended to remind companies of their obligations under existing Federal Securities laws and regulations to consider climate change and its consequences as they prepare disclosure documents'

Reference: https://www.sec.gov/rules/interp/2010/33-9106.pdf

SECURITIES AND EXCHANGE COMMISSION

17 CFR PARTS 211, 231 and 241

[Release Nos. 33-9106; 34-61469; FR-82]

Commission Guidance Regarding Disclosure Related to Climate Change

AGENCY: Securities and Exchange Commission.

ACTION: Interpretation.

SUMMARY: The Securities and Exchange Commission ("SEC" or "Commission") is publishing this interpretive release to provide guidance to public companies regarding the Commission's existing disclosure requirements as they apply to climate change matters.

EFFECTIVE DATE: February 8, 2010.

FOR FURTHER INFORMATION CONTACT: Questions about specific filings should be directed to staff members responsible for reviewing the documents the registrant files with the Commission. For general questions about this release, contact James R. Budge at (202) 551-3115 or Michael E. McTiernan, Office of Chief Counsel at (202) 551-3500, in the Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

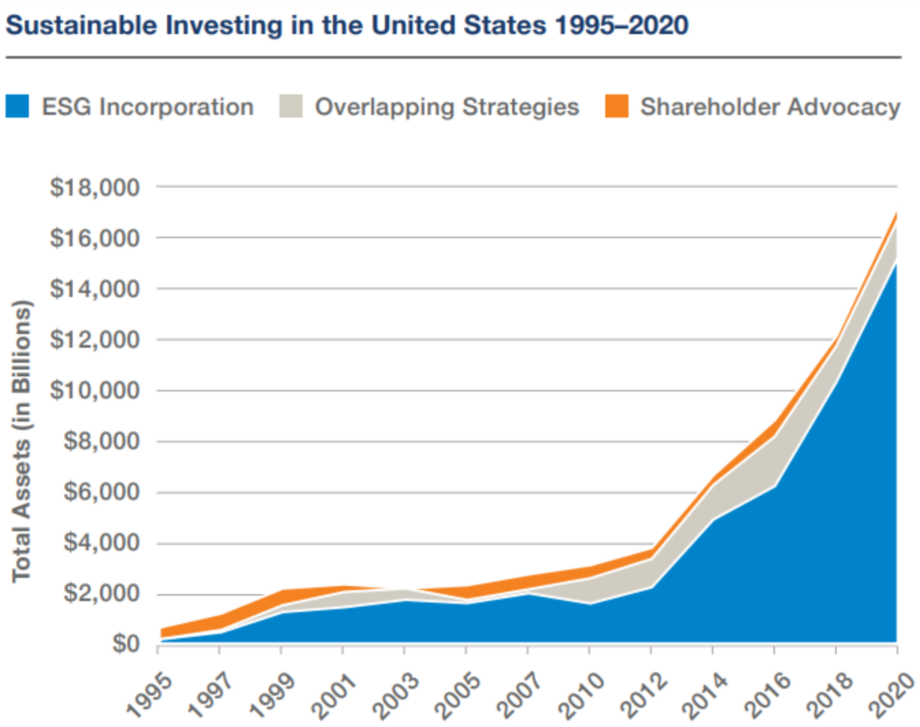
SUPPLEMENTARY INFORMATION:

I. Background and purpose of interpretive guidance

A. Introduction

Climate change has become a topic of intense public discussion in recent years. Scientists, government leaders, legislators, regulators, businesses, including insurance companies, investors, analysts and the public at large have expressed heightened interest in climate change. International accords, federal regulations, and state and local laws and

Sustainable Investing Trends



SOURCE: US SIF Foundation.

Reference: https://www.ussif.org/files/US%20SIF%20Trends%20Report%202020%20Executive%20Summary.pdf

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Investor Initiatives

- In 2019, more than 630 investors (managing $37 trillion) signed **Global Investor Statement to Governments on Climate Change** urging mandatory climate-related financial disclosure
- In 2021, 733 global institutional investors (managing $52 trillion) signed **Agenda's 2021 Global Investor Statement to Governments on Climate Crisis** urging mandatory climate-related financial disclosure
- Additional initiatives driving climate disclosures:
  - **UN Principles for Responsible Investment (PRI)** with 4,000 signatories (managing > $120 trillion)
  - **Net Zero Asset Managers Initiative** with 128 signatories (managing $43 trillion)
  - **Climate Action 100+** with 617 investors (managing > $60 trillion)
  - **Glasgow Financial Alliance for Net Zero** with 450 financial firms (with > $130 trillion in assets)

September 2021 SEC Letter Excerpts

Risk Factors

2. Disclose the material effects of transition risks related to climate change that may affect your business, financial condition, and results of operations, such as policy and regulatory changes that could impose operational and compliance burdens, market trends that may alter business opportunities, credit risks, or technological changes.
3. Disclose any material litigation risks related to climate change and explain the potential impact to the company.

Management's Discussion and Analysis of Financial Condition and Results of Operations

4. There have been significant developments in federal and state legislation and regulation and international accords regarding climate change that you have not discussed in your filing. Please revise your disclosure to identify material pending or existing climate change-related legislation, regulations, and international accords and describe any material effect on your business, financial condition, and results of operations.
5. Revise your disclosure to identify any material past and/or future capital expenditures for climate-related projects. If material, please quantify these expenditures.

Sample Letter to Companies Regarding Climate Change Disclosures[1]

Reference: https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures

Proposed SEC Rulemaking

The Enhancement and Standardization of Climate-Related Disclosures for Investors

- March 15, 2021: SEC seeks comments on climate-related disclosures *"with an eye toward facilitating the disclosure of consistent, comparable, and reliable information on climate change."*
- March 21, 2022: SEC proposes to amend existing rules to require public companies to provide certain climate-related information in their SEC filings (e.g., registration statements, annual Form 10-Ks)
- 4/11/2022: Proposed Rule published in Federal Register (87 FR 21334)
- Public Comment Period ends ~~**5/20/2022**~~ **Extended to 6/17/2022**
- Requirements are based on existing disclosure frameworks and standards:
    - **Task Force on Climate-Related Financial Disclosure (TCFD)**
    - **GHG Protocol Corporate Reporting Standard**

Reference: https://www.sec.gov/rules/proposed/2022/33-11042.pdf

TCFD – Recommended Disclosures

TCFD TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES

Figure 6

Recommendations and Supporting Recommended Disclosures

Governance	Strategy	Risk Management	Metrics and Targets
Disclose the organization's governance around climate-related risks and opportunities.	Disclose the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning where such information is material.	Disclose how the organization identifies, assesses, and manages climate-related risks.	Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material.
Recommended Disclosures	**Recommended Disclosures**	**Recommended Disclosures**	**Recommended Disclosures**
a) Describe the board's oversight of climate-related risks and opportunities.	a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term.	a) Describe the organization's processes for identifying and assessing climate-related risks.	a) Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process.
b) Describe management's role in assessing and managing climate-related risks and opportunities.	b) Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning.	b) Describe the organization's processes for managing climate-related risks.	b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks.
	c) Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management.	c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.

Reference: Annex: Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures (2021) - https://www.fsb-tcfd.org/publications/.

Proposed GHG Inventory Disclosure Requirements

Risk Identification and Management

- Climate –related risks and management processes (e.g., whether there is governance by BOD or management)
- How the **physical risks** (e.g., severe weather events, sea level rise, temperature pattern changes) associated with climate change impact financial statement line items and assumptions
- How the **transition risks** (e.g., increased cost of carbon, cost to implement low carbon technology or strategies) associated with climate change impact financial statement line items and assumptions
- Disclosure of information concerning any **identified climate-related opportunities is optional**

Reference: https://www.sec.gov/rules/proposed/2022/33-11042.pdf

TCFD – Climate-Related Risks

	Risks
Transition	**Policy and Legal** • Carbon pricing and reporting obligations • Mandates on and regulation of existing products and services • Exposure to litigation **Technology** • Substitution of existing products and services with lower emissions options • Unsuccessful investment in new technologies **Market** • Changing customer behavior • Uncertainty in market signals • Increase cost of raw materials **Reputation** • Shift in consumer preferences • Increased stakeholder concern/negative feedback • Stigmatization of sector
Physicial	• Acute: Extreme weather events • Chronic: Changing weather patterns and rising mean temperature and sea levels

Reference: https://assets.bbhub.io/company/sites/60/2020/10/TCFD_Booklet_FNL_Digital_March-2020.pdf.

Proposed GHG Inventory Disclosure Requirements

Other Required Disclosures

- **If company** uses internal cost of carbon, disclose how price is determined
- **If company** uses **scenario analysis** to assess risks, disclose description of scenarios, assumptions, and projected financial impacts
- **If company** has climate transition plan, describe plan and relevant targets and metrics
- **If company** set GHG reduction targets, disclose basis for targets, the plan for achieving them (including details related to use of carbon offsets and RECs), and progress made year over year

Reference: https://www.sec.gov/rules/proposed/2022/33-11042.pdf

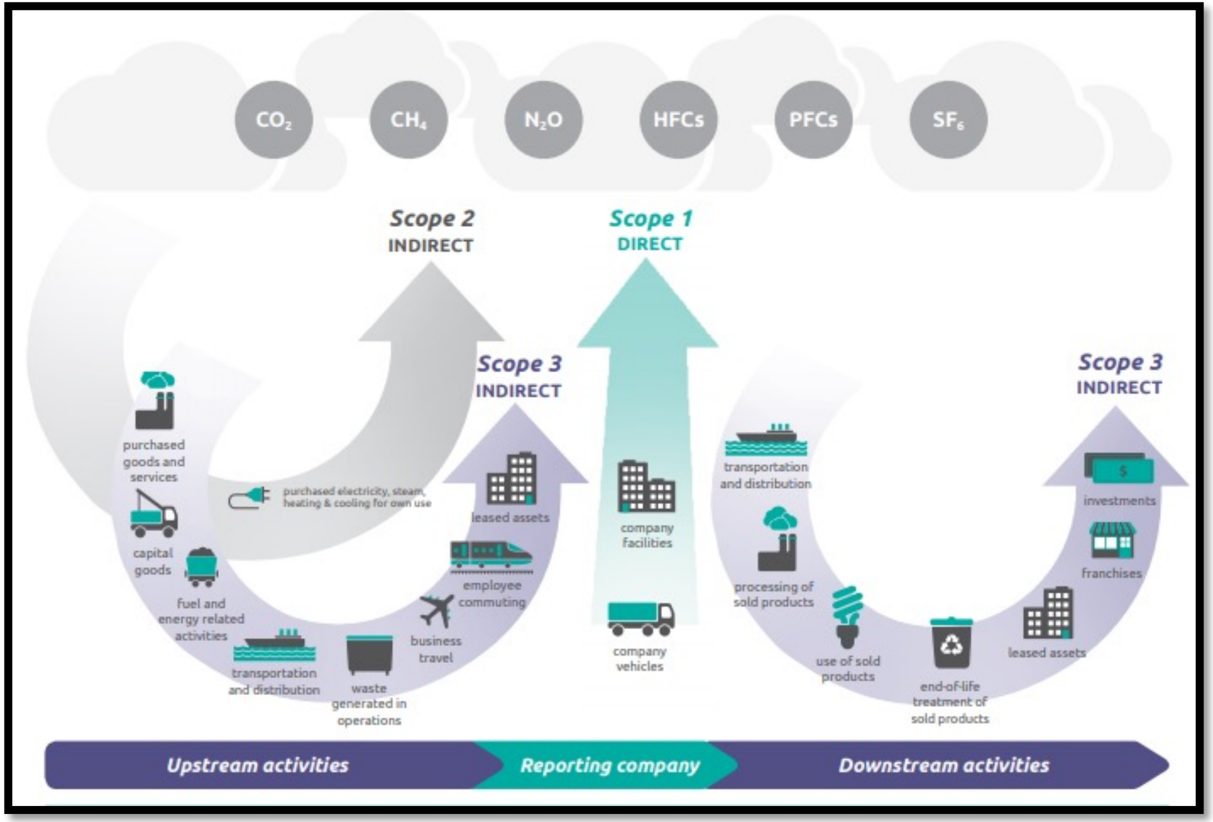
Proposed GHG Inventory Disclosure Requirements

GHG Emissions Data Disclosure and Verification Requirements

- Scope 1 and Scope 2 emissions from company's owned or controlled operations – ***excluding*** the impact of any purchased or generated offsets
- Scope 3 emissions ***if considered "material"*** or if the company has set a GHG emissions target or goal that includes Scope 3 emissions
  - Proposed rule includes a "safe harbor" for liability for Scope 3 disclosure
  - Proposed rule excludes Scope 3 disclosure requirement for smaller companies
- Report each GHG separately as well as aggregated together as CO2e
- Report in terms of intensity metric (i.e., per unit of economic value or production)
- Large accelerated filers and accelerated filers must obtain a ***third-party verification*** of their Scope 1 and Scope 2 emissions
  - Limited assurance during phase-in period
  - Reasonable assurance after first two years
  - Rule includes 3rd party verifier to meet certain minimum qualifications

Reference: https://www.sec.gov/rules/proposed/2022/33-11042.pdf

GHG Protocol Scopes & Emissions Across the Value Chain



Reference: https://ghgprotocol.org/sites/default/files/standards/Corporate-Value-Chain-Accounting-Reporing-Standard_041613_2.pdf.

What is considered “Material”? (Slide 1 of 2)

- GHG Protocol Corporate Reporting Standard:
  “information is considered to be material if, by its inclusion or exclusion, it can be seen to influence any decisions or actions taken by its users.

- SEC Proposed Rule preamble:
  - Disclose Scope 3 if there is **“substantial likelihood that reasonable investor would consider important when making investment or voting decision”**
  - Rule mentions SBTi reference which states that if **S3 > 40% of total S1/S2/S3** it is likely material

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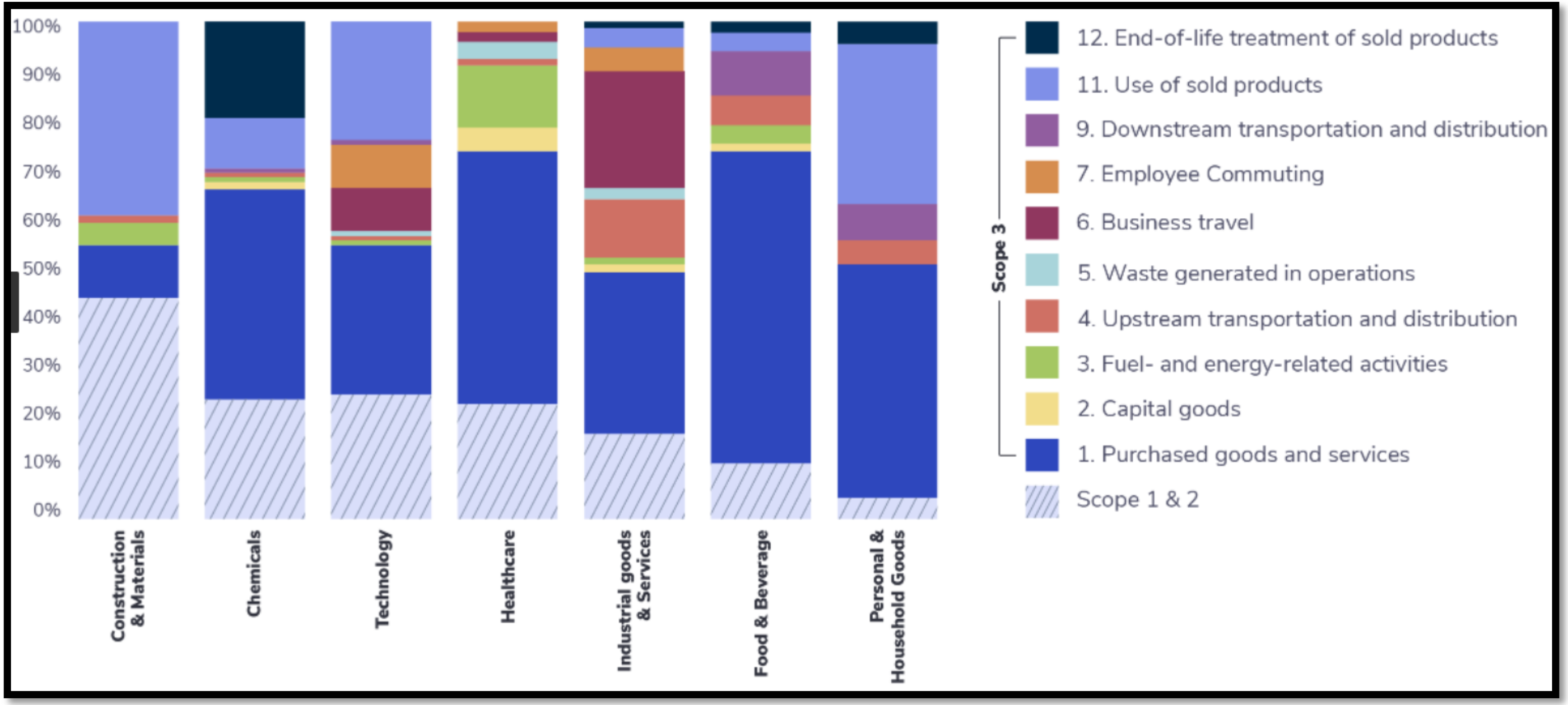
What is considered “Material”? (Slide 2 of 2)

- GHG Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard criteria for Scope 3 “relevance”:
  - **Size based on magnitude of emissions**
  - **Size based on financial spend or revenue**
  - **Other Criteria/Considerations:**
    - Company has influence over
    - Contributes to company’s risk exposure
    - Stakeholders deem critical
    - Outsourced activities previously performed in-house or are typically performed in-house by others in industrial sector
    - Have been identified as significant in sector-specific guidance

Relative Scope 3 Category Contributions by Industry



Reference: https://envizi.com/guide-to-scope-3-emissions-reporting/

Compliance Phase-In Schedule

- Following table provided by SEC for explanatory purposes
- Assumes proposed rules adopted with effective date of Dec. 2022 and filer has Dec. 31st fiscal year-end

Registrant Type	Disclosure Compliance Date	
	All proposed disclosures, including GHG emissions metrics: Scope 1, Scope 2, and associated intensity metric, but excluding Scope 3	GHG emissions metrics: Scope 3 and associated intensity metric
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)
Accelerated Filer and Non-Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)
SRC	Fiscal year 2025 (filed in 2026)	Exempted

Filer Type	Scopes 1 and 2 GHG Disclosure Compliance Date	Limited Assurance	Reasonable Assurance
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)	Fiscal year 2026 (filed in 2027)
Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Fiscal year 2027 (filed in 2028)

GHG Inventory Considerations

Steps in Calculating & Managing GHG Emissions

1.
   - Select Baseline Year
   - Identify Sources (Scope 1,2,3)
2.
   - Evaluate Calculation Methods
   - Select Pollutants, Emission Factors & GWP
3.
   - Collect Activity Data
4.
   - Perform Calculations
   - Assess Materiality
5.
   - Compile Results/Roll-Up to Corporate Level

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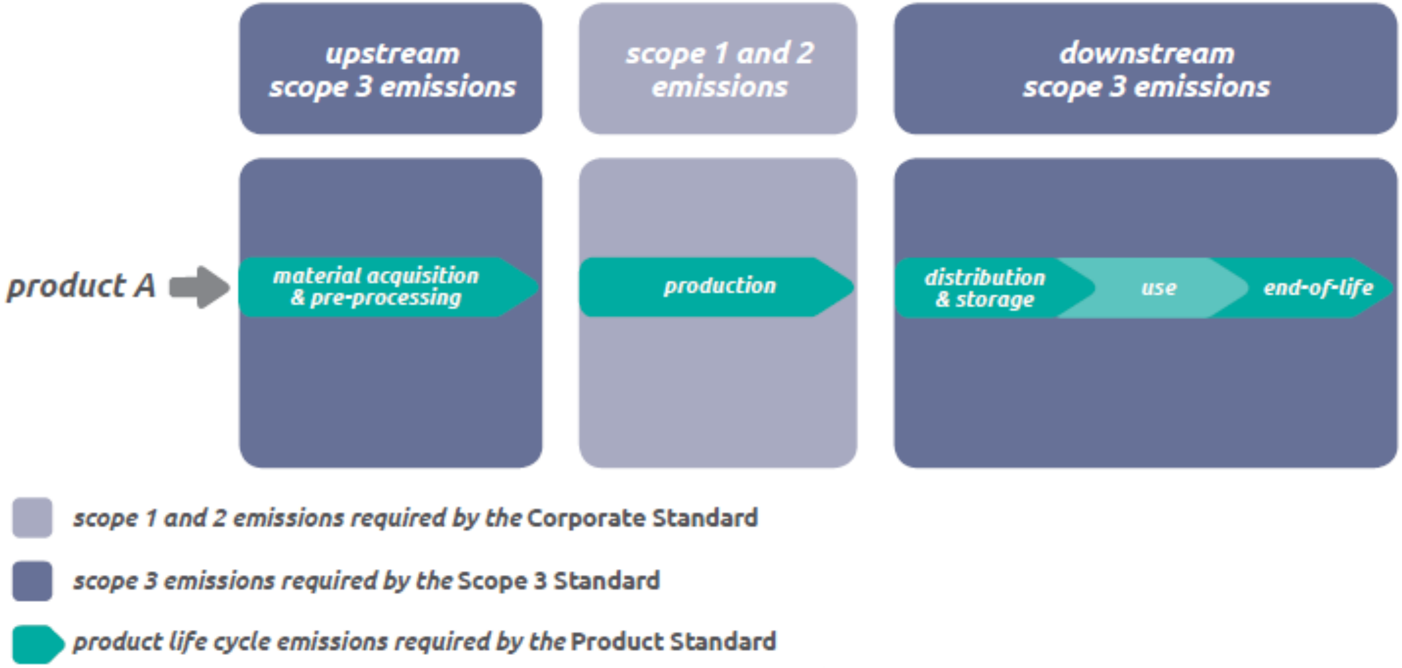
Scope 3 GHG Inventory vs. Product Life Cycle Analysis



Source: *https://ghgprotocol.org/standards/scope-3-standard*

What is a Life Cycle Assessment?

A Life Cycle Assessment (LCA) is an analysis of a product's environmental impact along its entire value chain.

- Acquisition of raw materials
- Manufacturing
- Transportation of raw materials / product
- Product use
- End-of-life treatment (Landfill, recycle, etc.)

The entire value chain may consist of:

- Cradle to Grave
- Gradle to Gate
- Gate to Gate

What’s Next and Key Takeaways

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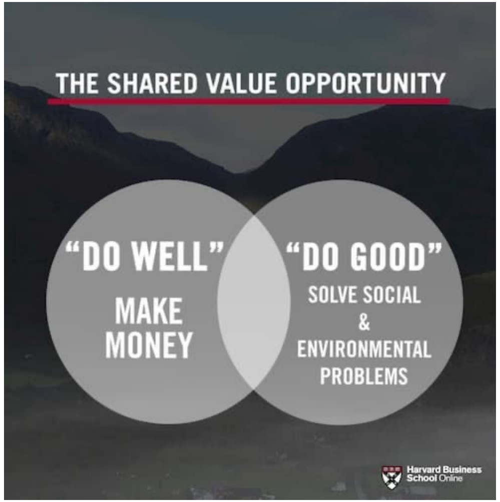
Key Takeaways (1 of 4)

1. Sustainability can drive business success, the importance of a robust ESG program cannot be understated.

2. Climate-related financial disclosure is coming. Prepare a comprehensive GHG inventory and review TCFD disclosures.



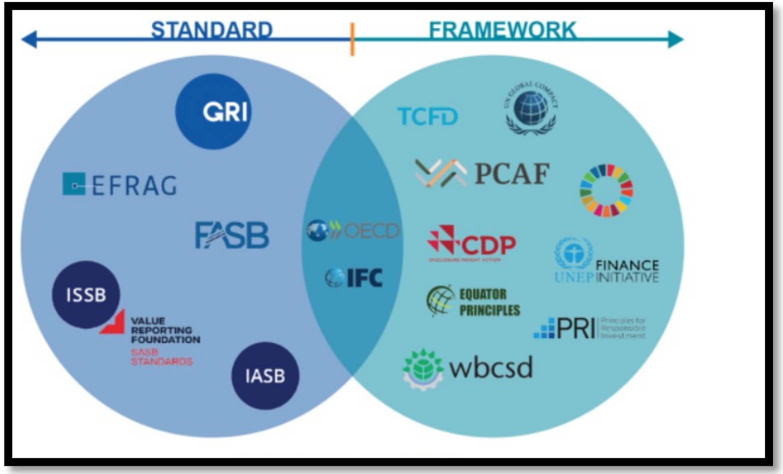
SEC Proposed Rule Seeks Transparency and Standardization of Public Disclosures on Climate-Related Risks

The Securities and Exchange Commission's (SEC) highly anticipated rule requiring the disclosure of climate-related risks and metrics in public filings was proposed on March 21, 2022. The SEC's heightened focus on climate change has been very apparent over the past year. After creating a 22-person Climate and Environmental, Social, and Governance Task Force and releasing an illustrative letter regarding companies' climate-related disclosure (or lack thereof), the SEC then turned its attention to climate disclosure rulemaking which requires more robust and standardized disclosure. The Enhancement and Standardization of Climate-Related Disclosures for Investors rule proposes to amend existing rules and require companies to provide certain climate-related information in their registration statements (required when a company is going public for the first time) and annual reports (e.g., Form 10-K). The proposed disclosures are based broadly on the Task Force on Climate-Related Financial Disclosure (TCFD) framework from a risk management perspective and the Greenhouse Gas (GHG) Protocol from a GHG metric perspective. The proposed rule comment period will remain open for 30 days after publication in the Federal Register, or 60 days after March 21, whichever period is longer.

Key Takeaways (2 of 4)

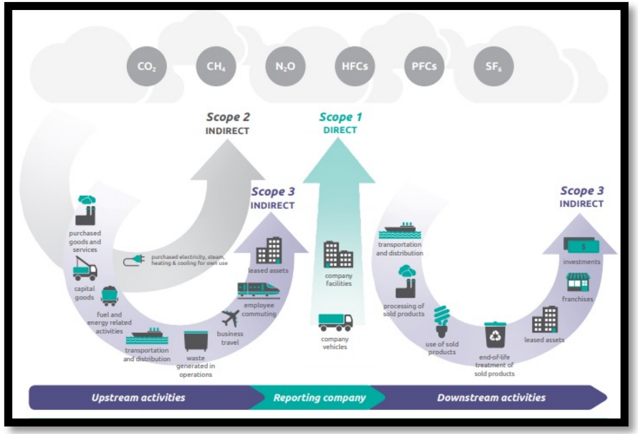
3. The Biden Administration action has occurred at a steady pace in 2021 which is expected to continue for the next 3 years.

4. Understand what is material to your company and develop KPIs in response. Utilize existing frameworks to inform your process.



Key Takeaways (3 of 4)

5. Not all Scope 3 categories may be material to your organization; however, the expectation is that an entity knows what is material and what is not and has sufficient emissions data if material.



6. Accurate environmental KPI data, such as water and waste indicators, is equally as important as traditional GHG data. The data that is required to disclose on said topics varies depending upon the standard or framework being used.

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Key Takeaways (4 of 4)

7. A reasonable or limited level of assurance for GHG verification is becoming a requirement for certain entities.

8. Internationally recognized standards for quantitative and qualitative ESG data are under development as the validity of such data is increasingly important to stakeholders.

Non-Financial Information Focus	
Standard-setting or Development of Non-Authoritative Guidance on Climate Change Disclosures	Information gathering and research activities to identify priority actions related to climate change disclosures (in the context of a separate assurance engagement or related to circumstances when such disclosures are presented in the entity's annual report or in the notes to the financial statements). Priority actions will likely include revising our existing international standards or guidance, or developing new standards or guidance, and maintain and support them.
Standard-setting or Development of Non-Authoritative Guidance on Sustainability / ESG Reporting	Information gathering and research activities to identify priority actions related to sustainability / ESG reporting, including: • Development of new subject-matter specific standard(s) to address sustainability / ESG reporting (or aspects thereof) (i.e., a subject-matter specific standard(s) that builds on and supplements the application of ISAE 3000 (Revised)[26] in an assurance engagement to report on a particular subject matter); • Possible targeted enhancements to ISAE 3000 (Revised) as necessary; or • Other related actions that are necessary in the public interest, for example, revising our existing guidance or developing new guidance.

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Thank you!