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SEC Climate Change Disclosure Proposal: What Non-US Companies Need to Know

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The Securities and Exchange Commission has proposed new rules that would require extensive climate change disclosure in registration statements and periodic reports. The Wall Street Journal has called this proposal "the biggest potential expansion in corporate disclosure since the creation of the Depression-era rules over financial disclosures that underpin modern corporate statements." Elements of the proposal include:

- **Risk factors:** This element provides prescriptive requirements for a detailed discussion of climate-related risks (both physical and transition risks), and their actual or likely material impact on business strategy and outlook, including consolidated financial statements, business operations and value chains.
- **Governance and risk management:** This element requires identification of board and management climate oversight bodies, as well as a description of the process to assess climate risks and a description of transition plans, if any. Climate-related targets or goals would also need to be disclosed, if set.
- **Audited financial statements:** This element mandates an additional note showing metrics that break out the impact of the climate-related risks and expenses on a line-by-line basis, and disclosure of the impact of any climate-related risk or event on estimates and assumptions used to produce the financial statements.
- **Greenhouse gas (GHG) emissions disclosure:** This element requires all public companies to measure and disclose direct (Scope 1) and energy-related (Scope 2) emissions. Larger companies must disclose supply chain (Scope 3) emissions, if material, and provide third-party attestation for Scopes 1 and 2 emissions.

Foreign private issuers (FPIs) and non-US companies considering a US initial public offering or secondary listing in the future also would be impacted by these rules, if adopted as proposed. Some specific considerations for non-US clients are laid out below. For more in-depth analysis, we encourage you to refer to the Cooley PubCo blog posts on this topic from March 24 and March 28, 2022, as well as our April 2022 client alert.

1. What will the final rules look like, and when will they kick in?

The SEC's proposal is just that – a proposal, not yet adopted and binding – and is subject to public comment, the period for which was recently extended to June 17. Given the level of interest in the topic, we expect that there could be fairly significant changes to the proposal ahead of adoption. In addition, the proposal already has seen significant media, political and legal attention, and we expect whatever rules are adopted likely will be subject to legal challenges.

The proposal has an (optimistic but possible) effective date of December 2022, which would require compliance for large accelerated filers for fiscal year 2023, and other filers for fiscal years 2024 and 2025.

2. Will FPIs benefit from any exemptions?

The proposal applies substantially all the rules to FPIs, with some minor modifications to address the use of International Financial Reporting Standards (IFRS) for calculating the climate-related financial statement metrics and setting the organizational boundary for GHG measurement. Because information included on a Form 6-K is "furnished" rather than "filed," periodic Form 6-Ks from FPIs that include the required disclosure may be excluded from certain liability provisions, as compared to domestic Form 8-K/10-Q filers.

Overall, the SEC appears less willing to exempt FPIs from the proposed climate change disclosures than it has

been previously when imposing new rules. The SEC notes that climate change impacts foreign companies just as it does domestic companies – and requiring FPIs to provide this disclosure is important to achieving the SEC's goal of more consistent, reliable and comparable information across registrants, regardless of jurisdiction of incorporation.

That being said, the proposal does include a request for comment on any ways in which FPIs should be treated differently than domestic companies, including if compliance with any alternative reporting regimes – in particular whether the International Sustainability Standards Board (which is an IFRS-related body) – should be acceptable to qualify FPIs as compliant with SEC regulations, similar to how IFRS is acceptable alongside US Generally Accepted Accounting Principles (GAAP).

3. Will there be phase-in periods for emerging growth companies (EGCs) or newly public companies?

The current proposal includes longer transition periods and exemptions for supply chain (Scope 3) GHG disclosures and third-party attestation for smaller reporting companies, but no specific exemptions for EGCs. Indeed, the SEC's view is that "because of their broad impact across industries and jurisdictions, climate-related risks may pose a significant risk to the operations and financial condition of domestic and foreign issuers, both large and small."

However, the proposal does request comments on exempting EGCs from some or all of the disclosure rules (including a blanket exemption from Scope 3 disclosures), and the SEC's Small Business Capital Formation Advisory Committee is considering recommending that the SEC provide more scaling and phase-in periods for EGCs and smaller reporting companies, and address considerations that could deter companies from conducting IPOs.

The proposed rules could require climate-related disclosures in IPO registration statements with no phase-in period. As a result, if the rules are implemented as proposed, late-stage private companies could need to plan accordingly to ensure they have the internal and external resources in place to enable compliance.

4. What will the impact be for technology and life sciences issuers?

As noted above, the SEC's view is that climate risks manifest themselves across industries. While immaterial supply chain (Scope 3) emissions generally are not required to be disclosed under the proposal, disclosure may still be required for Scopes 1 and 2 emissions, even if it could be argued that they are immaterial. Although many internet and early-stage life sciences companies have very limited Scope 1 and 2 emissions, such as emissions from company-owned delivery vehicles (Scope 1) or emissions from electricity purchased to run servers (Scope 2), such issuers still could be required to quantify and provide attestation over these limited sources of emissions. While the quantification and attestation process for such limited emissions issuers could be straightforward compared to companies with complex manufacturing operations and supply chains, such efforts may nonetheless cause a drain on resources.

5. Will your home jurisdiction or other potential listing venues adopt similar requirements? And, even without a legal requirement, will investors demand a similar level of climate disclosure?

The SEC has been clear that it views the growth of environmental, social, and governance (ESG) investing, as well as the proliferation of requests by investors for climate-risk information, as an indication that many investors consider climate change disclosure to be material to their overall investment decisions, and one of the goals of this proposal is to improve the "consistency, comparability, and reliability of climate-related information for

investors." Given the pressure from institutional investors to provide climate-risk information, companies may feel obligated to provide climate disclosure, even absent a formal requirement.

FPIs and other registrants with dual listings also will need to consider home jurisdiction requirements and their interaction with the potential SEC rules, which may prove inconsistent. While the SEC's proposal incorporates some concepts and vocabulary from the widely adopted Task Force on Climate-Related Financial Disclosures (TCFD) framework, other regulators around the world have been rapidly developing their own climate disclosure standards, which are aligned with the TCFD to varying degrees. Examples include:

- The European Union's Sustainable Finance Taxonomy and Corporate Sustainability Reporting Directive.
- The UK Financial Conduct Authority's climate policy statements.
- The Securities and Exchange Board of India's Business Responsibility and Sustainability Reporting for the 1,000 largest Indian public companies.
- The Hong Kong, Tokyo and Singapore stock exchanges' moves to mandatory ESG reporting.
- Other regional initiatives, such as the Association of Southeast Asian Nations' sustainable finance standards.
- However, in many respects, the proposed SEC rules go beyond the requirements of TCFD-aligned reporting in other jurisdictions, and FPIs may end up including more detailed climate disclosure than their home country requires. For companies considering a public listing (or in some non-US jurisdictions, even large private companies), the increasing global breadth of these standards mean that adopting mandatory ESG reporting may be more a question of when, and under what standards, rather than if.

6. What should FPIs and companies that are considering US listings be thinking about now to prepare?

- Consider the climate expertise of your board and management team, as well as any need to invest in personnel, consultants or training.
- Bear in mind that climate-related targets and plans that are currently internal-only might need to be publicly disclosed in some form if the SEC proposal is enacted in its current form.
- Consider climate-related compliance costs in future budgeting, including the potential need for additional training and third-party service providers.
- When building out financial reporting and investor relations functions, think about how a future climate reporting team could fit into your structure, culture and reporting schedule.
- Consider if you have enough visibility over your supply chain to collect the information for supply chain (Scope 3) GHG reporting.
- Start a dialogue with your auditors about the proposed financial statement notes and third-party attestation requirements so you understand how these would be handled if the proposal is enacted in its current form.
- Stay tuned for further developments in climate change disclosure in the US and in your home jurisdiction.

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