

## KEY ELEMENTS OF PROPOSED SEC GUIDANCE ON CLIMATE DISCLOSURE

The Commission should issue an interpretive release clarifying registrants' obligation under existing law and regulations to assess the risks they face in connection with climate change and to disclose those risks that are material. This guidance should set forth the process by which a registrant should make this assessment and the types of information most likely to be relevant to the assessment, and should direct registrants to disclose the following risks if they are material:

1. Physical risks associated with climate change;
2. Financial risks associated with present or probable regulation of greenhouse gas emissions; and
3. Legal proceedings relating to climate change.

### **Basis for Interpretive Release**

As explained in our petition, climate change has become increasingly important to the operations and financial condition of many registrants. Developments associated with global warming, including physical changes associated with a warming climate and regulatory measures adopted to mitigate greenhouse gas emissions, can affect companies in a variety of ways, such as by posing risks to physical assets of the registrant or its customers or suppliers, introducing new regulatory compliance costs and obligations, increasing the costs of important inputs, and opening up opportunities for new products and services. Many investors are now seeking information concerning companies' response to the physical changes, regulatory developments, and new opportunities associated with climate change.

While some registrants have been providing information on the impacts of climate change in their periodic filings, disclosures remain inconsistent and in many cases incomplete. In particular, corporate disclosure of the risks posed by climate change is lacking, even for companies that do address the impact of climate change and their own emissions. The uneven state of disclosure of climate information, the pervasive emergence of global warming as a significant influence upon the economy, the numerous and complex ways in which it may bear materially on registrants' financial condition, and the widespread adoption of greenhouse gas

regulations in recent years, all indicate a need for guidance concerning registrants' disclosure obligations with respect to climate issues.

Climate-related risks that constitute material contingent liabilities must be expressed on a company's balance sheet or in footnotes to financial statements. *See* Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*. Our petition sets forth examples of climate risk that may require such treatment. *See* Petition Part 3.

Whether or not climate risk can be estimated with a degree of certainty warranting its classification as a material contingent liability, registrants have obligations under various provisions of Regulation S-K to disclose in narrative form material information regarding the physical risks associated with climate change and with governmental regulations intended to limit emissions of greenhouse gases. Registrants should carefully examine the potential implications of climate change and present or probable regulation of greenhouse gas emissions for their own operations and financial condition. Whether disclosure is required will depend, as in other areas, upon an informed judgment about whether the information is material. In addressing that question, companies should not limit their consideration merely to particular projects and sites, but should also consider whether the overall degree of risk posed by climate change is material to the corporation's long-term ability to create and maintain value for shareholders.

Several provisions of Regulation S-K have particular importance when considering the impact of climate change and related developments. As part of the narrative description of its business under Item 101, a registrant must disclose any material effects of compliance with Federal, State and local laws regulating the discharge of materials into the environment or otherwise relating to the protection of the environment may have upon the registrant's capital expenditures, earnings and competitive position. 17 C.F.R. § 229.101(c)(xii). Item 103 requires disclosures concerning certain judicial or administrative proceedings arising under laws intended to protect the environment. 17 C.F.R. § 229.103 & Instruction 5. Under Item 303, Management's Discussion and Analysis of Financial Condition and Results of Operations must include discussions of factors bearing materially on the company's financial condition and business operations, including an identification of known trends or uncertainties expected to have a material impact on the registrant's liquidity, capital resources, net sales or revenues or income from continuing operations. 17 C.F.R. § 229.303(a).

As the Commission noted in its recent guidance on MD&A disclosure, companies now have “access to and use substantially more detailed and timely information about their financial conditions and operating performance than they did when our MD&A requirements initially were introduced . . . . Some of this information is itself non-financial in nature, but bears on companies’ financial condition and operating performance.”<sup>1</sup> Information bearing on the consequences of climate change and greenhouse gas regulation for a registrant’s operations and financial condition is an important part of that expanding body of information, and registrants should review it carefully and make disclosures where appropriate.

As the MD&A release observed, “in identifying, discussing and analyzing known material trends and uncertainties, companies are expected to consider all relevant information, even if that information is not required to be disclosed.”<sup>2</sup> In assessing the impact of climate change and greenhouse gas regulation on their financial condition and operations, registrants should examine any corporate policies or governance structures that have been established to address climate issues, and review the company’s institutional mechanisms for assembling and analyzing information about the various ways in which climate change can affect the company. Where the company has not established internal mechanisms for assembling and assessing climate information, it may need to do so in order to exercise informed judgments concerning the nature and materiality of climate-related risk.

### **Process for Assessment of Material Climate Risks**

To assess potential financial risks associated with present and probable regulatory requirements concerning greenhouse gases, registrants should determine their current and projected emissions levels. Companies should tabulate their current greenhouse gas emissions, including direct emissions from their own operations and emissions from purchased electricity and purchased products and services. They should estimate their past greenhouse gas emissions to the extent necessary to assess significant trends in their emissions levels, and should also project their future greenhouse gas emissions, as necessary to evaluate the costs they are likely to face from greenhouse gas regulation.

---

<sup>1</sup> Interpretation: Commission Guidance Regarding Management’s Discussion and Analysis of Financial Condition and Results of Operations, Securities Act Release No. 8350, Exchange Act Release No. 48,960, 68 Fed. Reg. 75,056 (Dec. 29, 2003).

<sup>2</sup> *Id.*

Well established tools such as the Greenhouse Gas Protocol exist to aid in the calculation of greenhouse gas emissions.

### **Factors to Evaluate in Assessing the Materiality of Climate Risks**

While disclosure obligations will depend upon individual registrants' particular circumstances, and assessment of the materiality of climate risks, the following kinds of information should be considered and may be subject to disclosure obligations under existing Commission regulations.

### **Physical Risks Associated with Climate Change**

A registrant should review and evaluate the consequences that physical risks and effects associated with climate change may have for the registrant's business and operations, including its personnel, physical assets, supply chain, and distribution chain, and must disclose information on those consequences when they are material to corporate performance.

Examples of such physical effects may include the impact of changes in weather patterns, such as increases in the storm intensity, sea-level rise, melting of permafrost, and temperature extremes, on facilities or operations; effects of climate change upon land, water availability or quality, or other natural resources on which the registrant's business depends; damage to facilities or decreased efficiency of equipment; or effects of changes in temperature on the health of the workforce.

For some registrants, financial risks associated with climate change may arise from physical risks to entities other than the registrant itself. For example, climate change-related physical changes and hazards to coastal property may pose a material credit risks for banks whose borrowers are located in at-risk areas. Climate change may also affect a registrant's supply chain in a variety of ways: climatic changes may diminish supplies of important inputs, physical damage to suppliers' infrastructure may cause costly interruptions in deliveries, and physical changes associated with climate change may decrease consumer demand for products or services. Registrants should evaluate whether they are subject to such risks and disclose any material information related to them. Physical impacts associated with climate change will vary widely depending upon companies' location and the nature of their facilities and operations, but

all registrants should review their exposure to such risks and, where the risks are material, must disclose them.

### **Financial Risks Associated with Greenhouse Gas Regulation**

For many registrants, present or probable greenhouse gas regulation has material effects warranting disclosure. When compliance with any international, federal, state, or local laws and regulations concerning climate, including laws regulating greenhouse gas emissions, may have a material effect on the capital expenditures, earnings, and competitive position of the registrant and its subsidiaries, such laws should be identified and their effect discussed.

In conformity with Item 303 of Regulation S-K, registrants must describe any known trends or uncertainties in connection with the impact of climate change or greenhouse gas regulation that they reasonably expect will have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. When costs associated with compliance with such laws, or penalties for noncompliance, are material to a registrant's financial condition or operations, the registrant's disclosures must include an analysis of any such material effects, including a discussion of the financial risks and opportunities afforded by such regulations.

When a registrant concludes that legislative and regulatory proposals, although not yet enacted into law, are reasonably likely to be enacted and that such proposals, if adopted, would have a material effect on the company's financial condition or operations, the registrant should identify and discuss the proposals. The registrant should describe and evaluate realistic alternative regulatory scenarios.

Greenhouse gas regulation may have a material effect upon a registrant that is not itself directly subject to the regulation, for example by increasing the costs or decreasing the supply of some product or service on which the registrant's business depends, or increasing or decreasing demand for the registrant's products or services. Where material, such indirect effects should be identified and analyzed.

### **Legal Proceedings Relating to Climate Change**

Under Item 103, registrants must describe any pending judicial or administrative proceeding other than routine business litigation, arising under any Federal, State or local laws, if the proceeding is considered material to the business or financial condition of the registrant; or involves a claim for damages exceeding 10 percent of the assets of the registrant and its subsidiaries on a consolidated basis; or a government authority is a party to such proceeding(s) and the proceeding(s) involves potential monetary sanctions above \$100,000. Registrants must disclose any proceedings arising under laws relating to climate change, including those regulating emissions of greenhouse gases, when the proceedings meet the Item 103 criteria.