SEC Unveils Climate Disclosure Proposal

The agency wants companies to outline material climate-related risks and what management is doing about it.

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FUNDfire
March 22, 2022

Managers may soon have more data at their disposal on how the companies they invest in are responding to climate change, if the Securities and Exchange Commission enacts a sweeping new rule proposal released yesterday.

The SEC is proposing mandatory climate disclosures for companies in their registration information and periodic reports. The proposed rules will make public companies outline material climate-related risks, the threat these risks pose to a company's bottom line, and what management and company boards are doing about it. Firms will also have to calculate their carbon footprints using the greenhouse gas or GHG Protocol Corporate Standard and have the estimates independently verified.

"This is a watershed moment for investors and financial markets as the commission… addresses disclosure of climate change risk, which is one of the most momentous risks to face capital markets since the inception of this agency," said commissioner Allison Herren Lee during the SEC's meeting on the proposal Monday. Lee opened a comment period a year ago to collect feedback on broader climate proposals while she served as acting SEC chief, as reported.

As part of the proposal, the SEC will also force companies to outline their plans and the risks associated with transitioning to lower carbon products, practices and services; the financial implications of climate-related events such as weather or other natural calamities, and transition plans for those climate events.

Firms will have to categorize their direct and indirect emissions under the GHG Protocol's categories: scope one, two and three. Scope three emissions, which stem from broad indirect sources such as the production and transportation of goods from vendors, would only be required if material. Small companies, with a market cap of less than $250 million or less than $100 million in annual revenues, will be exempt.

Targets, such as net-zero greenhouse gas emissions goals, are also included in the rules the agency floated.

The SEC voted 3-1 to approve the proposal for public comment, with the lone Republican commissioner, Hester Peirce, casting the one dissenting vote.

The proposal aims to provide “consistent, comparable decision-useful information” for investors as they evaluate investment strategies, said SEC Chair Gary Gensler.

“Over the generations, the SEC has stepped in when there's significant need for the disclosure of information relevant to investors’ decisions,” he said. “This is a core bargain that Congress laid out in the 1930s. And that core bargain is that investors get to decide which risks to take as long as public companies provide full and fair disclosure and are truthful in those disclosures.”

Getting portfolio companies to provide climate-related data has been a challenge for asset management firms. More than 680 managers, including Capital Group, State Street and Vanguard, partnered with the Carbon Disclosure Project, a climate-focused advocacy group to press companies for additional disclosures last week, as reported.

The SEC staff, in reviewing nearly 7,000 annual reports for 2019 and 2020, found that just a third of public companies included disclosures related to climate change, Gensler said.

SEC rules will help asset managers get the climate information they need from companies that have been unwilling to be forthcoming, Fionna Ross, a senior environmental, social and governance analyst at abrdn, formerly Aberdeen Standard Investments, told FundFire.

“Common excuses we hear from companies who do not currently report include being unclear on what they should report or being unwilling to disclose something if their peers do not report,” she said. “The SEC’s proposal should help level the playing field in that respect.”

Many companies have made net-zero pledges, but few think creating a roadmap to get there is a priority, Marina Severinovsky, Schroders’ head of sustainability for North America, told FundFire.

“There's just been a lot of good intentions,” she said. “In the minds of many companies, this is very far away indeed – 30 or 40 years away. From an optics perspective, it's great to make the commitment to send out a press release about the commitment, but then I think that the reality has to set it in terms of what does that really mean.”

In voting against the proposal, Republican Commissioner Hester Peirce said the SEC had gone too far.

“The proposal turns the disclosure regime on its head,” she said. “Current SEC disclosure mandates are intended to provide investors with an accurate picture of the company's present and prospective performance through the [company] manager’s own eyes… The proposal by contrast, tells corporate managers how regulators, [who are] doing the bidding of an array of non-investor stakeholders, expect them to run their companies.”

Implementing the proposal could also prove expensive for companies, Peirce said.

Asset management firms are already fielding questions from investors about so-called ‘greenflation’ as portfolio companies grapple with higher expenses due to labor shortages and supply-chain pressures while trying to implement sustainability measures, as reported.

Companies will see their expenses inch higher as they prepare reports with risk assessments, measure emissions and obtain assurance, where applicable, said Jessica Wachter, the SEC’s chief economist, during the meeting. But the additional cost will be "limited to the extent that companies already fulfill some of the requirements [and] are already collecting information necessary to meet the requirements.” The costs will also diminish as the market for related services, such as accounting and consulting services, matures, she added.

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