# The SEC's Proposal on Climate Change Disclosure

## A Survey of U.S. Companies

In March 2022, the Securities and Exchange Commission (SEC) proposed a rule that would require public companies to disclose more information than is already disclosable under existing securities laws and guidance (including certain climate-related metrics in the audited financial statements) regarding climate-related risks and greenhouse gas emissions (Proposal).[1] The stated goal of the Proposal is for public companies to provide "consistent, comparable, and reliable" disclosure about the risks that climate change presents to their operations and financial performance.

There is little question that over the last decade, some investors have demanded more information from companies about climate change. However, broad new disclosure mandates typically come at a cost and must be appropriately examined and understood in advance of promulgating a rule. This survey of U.S. companies is intended to aid in understanding those direct and indirect costs associated with the Proposal, including to existing public companies, shareholders, and to those private businesses doing business with public companies that would be subject to the proposed rules or are considering entering the public markets. Any policy on disclosure must be informed by the constituency the policy will impact, particularly around economic growth and capital formation.

If ultimately adopted, the Proposal would represent one of the greatest expansions of reporting requirements the SEC has ever implemented, and a most expansive disclosure mandate that did not result from a Congressional mandate. The Proposal presents numerous questions and challenges for public companies as they consider how to comply with a potential final rule. These challenges are particularly acute around the prescriptive and granular nature of disclosure called for by the Proposal; the need for companies to make projections about climate change impacts to their business into the future, well beyond the time frame over which companies are able to and do assess materiality for securities law purposes; and the liability that would attach as a result of filing such expansive and, in many cases, estimated and unreliable information that may be based on assumptions and estimations, in a Form 10-K. While the Proposal does include an exemption from certain proposed emissions reporting requirements for smaller reporting companies (SRCs), SRCs, which the SEC estimated in the proposing release would have comprised approximately 50% of the registrants subject to the Proposal as of 2020, would still be subject to most of the proposed new reporting requirements, which would increase their overall regulatory burden and associated costs.[2]

1 The Enhancement and Standardization of Climate-Related Disclosures for Investors (87 FR 18312)

2 At the outset, it should be noted that while the results of the survey presented in this report seek to inform the SEC's understanding of current climate-related disclosure practices and estimated costs relative to the Proposal, we note that the respondent demographics are not a representative sampling of the population of registrants subject to the Proposal in that 45% of survey respondents are mega- and large-cap companies and 4% are private companies.

## Survey of SEC's Climate Change Proposal

Nasdaq conducted a survey to understand current climate-related disclosure practices and estimated costs amongst companies relative to the Proposal's requirements. The survey was conducted from late April until early June of 2022, with a total of 263 companies participating.[3] Reponses to the survey were informed by individuals holding several different roles within these companies, including Chief Financial Officer, General Counsel, Corporate Secretary, and representatives from investor relations, financial reporting, corporate sustainability, and government relations.

While companies across different market capitalizations are represented, respondents tended to be larger and more established public companies, with over half having a market capitalization above $5 billion, including 45% above $10 billion.

This survey is intended to inform policymakers and the general public about the potential impacts the Proposal, if adopted, may have on public companies, shareholders, private companies that would be indirectly impacted as a result of the proposed emissions disclosure requirements on public companies, and the broader capital markets.

## Survey Participants

- 263 total companies, with viewpoints from various roles, including CFO, general counsel, corporate secretary, and representatives from investor relations, financial reporting, corporate sustainability, and government relations.
- **Market capitalization of respondents:**
  - Below $250 million: **6%**
  - Between $250 million and $700 million: **7%**
  - Between $700 million and $5 billion: **26%**
  - Between $5 billion and $10 billion: **12%**
  - Over $10 billion: **45%**
  - Private company: **4%**
- **SEC filer profile of public company respondents:**
  - Smaller reporting company (SRC) (public float less than $250 million OR less than $100 million annual revenues with public float less than $700 million): **12%**
  - Accelerated filer (not an SRC, public float between $250 million and $700 million, annual revenues over $100 million): **6%**
  - Large accelerated filer (public float of $700 million or more): **82%**
- **Respondent profile based on number of employees:**
  - **34%** of companies less than 2,500
  - **9%** of companies between 2,500 and 5,000
  - **12%** of companies between 5,000 and 10,000
  - **14%** of companies between 10,000 and 25,000
  - **31%** of companies over 25,000
- **Industries Participating:**
  - Asset management/institutional investor
  - Biotechnology
  - Consumer Goods
  - Energy

3 The number of responses to this survey was limited by the SEC's unusually short comment period.

- Financial Services
- Healthcare
- Information Technology
- Manufacturing
- Real Estate Investment Trust (REIT)
- Retail
- Telecommunications
- Transportation
- Utilities

## Main Findings

- Companies believe the costs necessary to implement the Proposal will be much higher than the SEC estimates. **79%** of non-SRCs and **72%** of SRCs believe the SEC has underestimated the direct costs of compliance.
- Based on actual experience, companies have a different perspective than the Proposal suggests about the level of investor demand for more climate change-related disclosure. **68%** of companies say their investors "seldom or never" urge them to disclose more information regarding climate change.
- Companies have significant concerns over liability exposure and are not confident that the Proposal's safe harbor for Scope 3 emissions assuages those concerns. **92%** of companies are not confident the proposed safe harbor would mitigate liability concerns.
- Complying with the Proposal's Scope 3 emissions requirement would be immensely difficult for companies due to a lack of information currently provided by suppliers – many of which are private companies not currently subject to the SEC's disclosure regime. **99%** of companies say that not all of their suppliers provide reliable information that could be used to reliably estimate Scope 3 emissions.

## Current State of Climate Change-Related Disclosure and Investor Demand

Public companies are currently required to disclose material information in their SEC filings, including any information related to climate change. Many companies also publish voluntary corporate social responsibility (CSR) (or similar) reports and/or website disclosure (herein individually and collectively, "CSR Reports") that includes information on climate change or other environmental, social, and governance (ESG) issues. Companies may elect to include this type of information in their CSR reports and not in their SEC filings if the information is not material to the company or its investors. Other companies may elect to include climate change or ESG information in both their CSR reports and their SEC filings without regard to materiality.

According to the proposing release, the Proposal's mandates are reportedly modeled in part on the 11 Task Force on Climate-Related Financial Disclosure (TCFD) recommendations. While some respondents to our survey indicated that their companies have already closely aligned their disclosures with the TCFD, most companies either selectively align with the TCFD recommendations that are most meaningful to their business or have not aligned are not reporting in line with TCFD.

The survey results show a significant divergence between investor demand for more climate change-related information in SEC filings as contemplated by the Proposal and respondents' interactions with their investors and indicated that the Proposal's reliance on non-governmental standard setters such as the TCFD and the Greenhouse Gas Protocol (GHG) will present transition challenges for many companies.

- A large majority of respondents already provide disclosure regarding climate change either in their SEC filings or through CSR or similar reports. **77%** of companies disclose risks about climate change, including **39%** that include such information in both their SEC filings and CSR or similar reports.

- **68%** of respondents say their investors "seldom or never" urge them to disclose more information regarding climate change. Only **5%** say their investors "regularly" urge them to disclose more climate change-related information.
- Amongst respondents, alignment with the TCFD recommendations varies widely:[4]
  - **33%** of respondents say they are already largely aligned with TCFD framework
  - **31%** of respondents follow some, but not all, TCFD standards
  - **20%** of respondents do not follow any TCFD standards
  - **16%** of respondents are not familiar with TCFD standards

## Reporting on Emissions

The Proposal would require that all public companies disclose Scope 1 and Scope 2 emissions. Companies would also be required to disclose Scope 3 emissions (emissions resulting from assets that a company indirectly impacts through its value chain) if such emissions are determined to be material to the company or the company has set a GHG emissions reduction target or goal that includes Scope 3 emissions.

Additionally, accelerated filers and large accelerated filers would be required to obtain attestation from a third party for their Scope 1 and Scope 2 emissions. The SEC has also proposed a safe harbor for those companies that disclose Scope 3 emissions, so long as the disclosure is not "made or reaffirmed without a reasonable basis or disclosed other than in good faith."[5]

- **93%** of respondents with less than a $700 million market cap do not report emissions.
- **51%** of respondents that report emissions estimates hired a third-party consulting firm to construct their disclosure on emissions; **49%** constructed such disclosure in-house.
- **87%** of all respondents say they have not received a request from their investors to obtain a third-party attestation for their Scope 1 and Scope 2 emissions.

## Costs of Proposal

The economic analysis accompanying the Proposal estimates that initial first-year costs of compliance for non-SRC filers would be $640,000 per issuer, with ongoing annual costs of $530,000. For SRCs, the SEC estimates first-year costs would be $490,000, with ongoing annual costs of $420,000. The SEC explains that these costs "are expected to decrease over time for various reasons, including increased institutional knowledge, operational efficiency, and competition within the market for relevant services."[6]

- Nearly three-quarters (**73%**) of respondents expect that their costs to comply with the Proposal would likely exceed the SEC's estimates, including **41%** of respondents that expect that their costs for comply with the Proposal would exceed $1 million on an annual ongoing basis.

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4 As noted previously, given the nature of respondents to this survey (i.e., a majority are larger public companies with market caps over $5 billion and are large accelerated filers), these survey responses overstate the level of current TCFD alignment amongst all public companies. For example, a 2021 TCFD Status Report cited throughout the Proposal reveals an average disclosure rate of 20% across all 11 recommended disclosures (with individual recommendation disclosure rates ranging from 7% to 48%) based on the TCFD's 2017 implementing guidance, which has been superseded by more prescriptive guidance, for which benchmarking data is not yet publicly available. (available at https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Status_Report.pdf ). A Moody's report cited by the Proposal shows an even lower disclosure rate across the 11 TCFD recommendations, with significant disclosure differences by company size and industry, which is particularly relevant here in view of the survey respondent company size demographics. For example, the Moody's report reveals that 19% of U.S. companies (across sizes and industries) disclose Scope 1, Scope 2, and, if appropriate, Scope 3 emissions per the TCFD framework. That same report also shows a lower-take up rate on disclosures regarding board oversight of climate-related risks (17%), metrics used to assess climate-related risks (21%), description of a company's process for managing climate-related risks (17%), and process for identifying and assessing climate-related risks (15%) among companies overall, with much lower disclosure rates by companies with less than $5 billion in revenues. (available at https://www.moodysanalytics.com/articles/pa/2022/tcfd_aligned_reporting_by_major_us_and_european_corporations).

5 Section II(G)(3) of Proposal

6 Proposal at 373

- **79%** of **non-SRC respondents** believe that the SEC underestimated the costs of the Proposal in its economic analysis.
- **72%** of **SRC respondents** believe that the SEC underestimated the costs of the Proposal in its economic analysis.
- **Nearly all respondents** (**99%**) that would be subject to the Proposal's Scope 3 GHG emissions disclosure requirements say not all of their suppliers provide reliable information regarding Scope 3 emissions, which would make compliance with this proposed requirement extremely challenging, if not impossible, for the vast majority of companies.

## Potential Liability Concerns

Respondents expressed significant concerns over the potential liability exposure of the Proposal, in particular liability related to Scope 3 emissions disclosure. The Proposal does include a limited safe harbor for Scope 3 disclosures; however, most companies are not convinced that the safe harbor will be useful in practice.

- For those respondents that have analyzed the proposed safe harbor, **92%** are not confident it will mitigate their liability concerns regarding Scope 3 disclosures.
- In its economic analysis, the SEC stated its view that litigation risk to issuers will be mitigated both by the Proposal's safe harbor and the phase-in periods for compliance, which would help issuers become more familiar with what is expected under the rule. Respondents, however, do not agree that these provisions mitigate the Proposal's litigation risks:
  - **15%** of respondents somewhat agree the proposed safe harbor and phase-in periods mitigate litigation risk
  - **2%** of respondents strongly agree the proposed safe harbor and phase-in periods mitigate litigation risk
  - **34%** of respondents somewhat disagree the proposed safe harbor and phase-in period mitigate litigation risk
  - **35%** of respondents strongly disagree the proposed safe harbor and phase-in period mitigate litigation risk
  - **14%** have no opinion

## Easing the Burden of Compliance

When presented with potential changes to the Proposal that would ease the overall burdens of compliance, respondents responded as follows:

- **83%** of respondents say providing broader safe harbor would ease compliance burdens.
- **79%** of respondents say offering a more extended phase in would ease compliance burdens.
- **64%** of respondents say adopting a "comply or explain" methodology would ease compliance burdens.
- **28%** of respondents say more exemptions for small companies would ease compliance burdens.

## Conclusion

Given the prodigious scope and nature of the Proposal, market participants are still assessing all the ramifications it could have on public companies, their shareholders, and the broader economy. This survey is based upon public companies' initial assessment of the Proposal and the possibility of having to comply with its requirements within the next two years. We hope that these results help provide the SEC, Congress, and the general public with a better understanding of the real-world impact of the Proposal.

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