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INSIGHTS REPORT

SEC Climate Disclosures: The Journey from Voluntary to Mandatory

The Securities and Exchange Commission (SEC) has implemented certain rules to improve and standardize climate-related disclosures on 6th March 2024. These amendments are in line with the Task Force on Climate-related Financial Disclosure (TCFD) which is a widely accepted sustainability disclosure standard. Following two years of public debate and comments, this landmark ruling transitions the state of sustainability reporting in the US region from voluntary to mandatory disclosure. The aim of these disclosures is to address the inconsistency and inaccessibility of current climate-related information provided by registrants for investors and consumers alike. The rules require registrants to disclose material climate-related risks that impact or are expected to impact the business, operations, strategy, and financial status. They also must disclose the information related to how these risks are managed, including governance, and financial impacts of severe weather and natural events. Registrants must disclose the information in their registration statements and annual reports.

Top 5 Key Points

- **Scope 1 and 2 emissions reporting** requirements will be **"phased-in"** for large publicly traded registrants based on when those emissions are material, along with a phased-in approach for assurance and inclusion of financial impact of severe weather events in financial statements . The bill also shields companies from legal challenges pertaining to future disclosures excluding historical facts.
- **Scope - 3 emissions reporting** has been **removed** due to high compliance cost and data reliability highlighted by numerous comments.
- The existing **single materiality** based on financial materiality remains unchanged.
- The new rules **eliminate** the need for registrants to **detail the climate expertise of board members** and to provide financial statements regarding the impact.
- Transitioned from regulation **S-X to S-K,** reducing audit requirements while maintaining reporting obligations for adjusted climate costs. According to S-X regulations, companies were required to amend their previous year's disclosures through a footnote which was a significant issue for opponents.

Who All Need to Report?

The SEC's new rule requires climate-related disclosures for about 7,000 U.S. companies and 900 foreign private issuers. A significant portion - 40% of U.S. and 60% of foreign entities are LAFs and AFs - must assess the materiality for Scope 1 and 2 emissions for investor relevance.

- **Large Accelerated Filers (LAFs) -** Entities with a minimum of $700 million in publicly held shares, excluding those held by company insiders or controlling stakeholders, as of the most recent second fiscal quarter.
- **Accelerated Filers (AFs) -** Entities with public shares of more than $75 million but less than $700 million as of the most recent second fiscal quarter.
- **Non-accelerated filers (NAFs) -** Entities with less than $75 million of shares held by the public.
- **Smaller reporting company (SRC) -** An asset backed issuer and with public float of less than $250 million or had annual revenues of less than $100 million and either no public float or a public float of less than $700 million.
- **Emerging growth company (EGC) -** Entities with total annual gross revenues of less than $1.235 billion during its most recently completed FY.

What to Report?

The key topics covered by the climate-related disclosures include:

- Any **climate-related risks** identified that have had or are reasonably likely to have a material impact.
- The **actual and potential material impacts** of any identified climate-related risks on the registrant's strategy, business model, and outlook.
- If a registrant has undertaken **activities to mitigate or adapt** to a material climate-related risk
- If a registrant has adopted a **transition plan** to manage a material transition risk
- If a registrant uses **scenario analysis** and, in doing so, determines that a climate-related risk is reasonably likely to have a material impact on its business.
- If a registrant's use of an **internal carbon price** is material to how it evaluates and manages a material climate-related risk.
- Any **oversight by the board of directors** of climate-related risks and any role by management in assessing and managing the registrant's material climate-related risks.
- Any **processes** the registrant has for identifying, assessing, and managing material climate-related risks.
- If a registrant has set a **climate-related target or goal** that has materially affected or is reasonably likely to materially affect.
- **Result** of the target or goal or actions taken to make progress.
- **Scope 1 and Scope 2 GHG emissions** disclosures and attestation report for LAFs and AFs given they fall under the purview of materiality requirements.
- The financial statement **(capitalized costs, expenditures expensed, charges, and losses)** effects of severe weather events and other natural conditions.
- The financial statement related to **carbon offsets and renewable energy credits or certificates.**
- If the **estimates and assumptions** a registrant uses to produce the financial statements were materially impacted by risks and uncertainties.

It is also imperative to note that organizations with listed entities or subsidiaries outside US, will also need to comply with the local regulations like CSRD, BRSR, ISSB and other upcoming mandates in Singapore, Australia, China, New Zealand etc. For these organizations, additional disclosure requirements at a regional level will still be applicable, which will further necessitate data collection, reporting and performance management at a regional level.

How to Report

Registrants including a foreign private issuer will require to file under regulation S-K, except for Scope 1 and Scope 2 emissions, with SEC regular annual filings. LAFs and AFs will need to include **attestation report** with second quarterly report filing. Scope 1 and 2 disclosure need to be filed on Form 10K in its quarterly report. Registrants must disclose information either in a separate, appropriately captioned section of registration statement or annual report or in another appropriate section of the filing if the disclosure meets the electronic tagging requirements in Inline XBRL.

When to Report and Get Assured

LAFs and AFs must fulfil reporting obligations for a calendar year, submitting an annual report and surpassing revenue thresholds to no longer qualify as SRC. SRC and ECG are both exempt from GHG emissions reporting.

While the reporting journey for LAFs starts in 2025, the assurance process for Scope 1,2 emissions kicks in by FY 2029 with limited assurance and by FY 2033 for reasonable assurance. The AFs, other than SRCs and EGCs are expected to start disclosing climate related data beginning FY 2026, with only limited assurance scope kicking in by FY 2031. For the SRCs, ECGs and NAFs, there is no expectation for GHG emissions disclosure or assurance while the other disclosures needed for S-K and S-X will be reported as early as FY 2027.

The disclosures also expect electronic in-line tagging for sustainability disclosures in the form of XBRL reports.

The current status of climate disclosures

According to SEC, only 36% companies currently report on any climate related keywords as part of annual financial filings in 2022 and within the accelerated filer status, the status improves to 41% at an overall level.

A deeper sectoral analysis reveals that hard-to-abate sectors have taken the lead in including climate-related disclosures and have achieved a good maturity status for reporting needs

Challenges and opportunities

As with every change, these new regulations present a unique opportunity for organizations based in the US to pivot on their sustainability journey. To effectively adopt these rules and prepare for the necessary assurance timelines, organizations will need to embed sustainability into their core business strategy and invest in people, processes, and technologies to enable effective reporting. While the regulations themselves have been mired in public debate over the course of last two years and the final rules are a much more watered-down version of the initial proposals, minimum compliance would still take significant effort from organizations who still view sustainability as a "good to have" and standalone function within the organization.

The need for consistent, transparent sustainability data gathering, goal setting, performance tracking and assurance will necessitate an investment in the underlying data foundation for organizations.

In addition, embedding climate risk assessments and assessing the material impact of climate related events on the financial metrics of the organization will need to be supported by strategy, sustainability risk identification and quantification of climate related financial impacts (aligned to the TCFD framework). Furthermore, these financial impacts will be drilled down within the organization at a department, business unit or operational unit level to drive decision-making and risk mitigation.

The lack of sustainability talent continues to be a challenge for organizations. For effective implementation of these rules, organizations will need to not only invest in hiring or upskilling existing talent, but also educate and engage all stakeholders internally to understand the driving forces for sustainability related actions and implications.

How Can TechM Help?

With decades of experience in sustainability and a consistent performance in ***sustainability awards and rankings,*** TechM is the ideal partner of choice to provide the ***end to end services*** from strategy to execution to complexity associated with implementing these rulings. Our consulting-led offerings range from strategic offerings like materiality assessment, climate-based risk assessment, scenario analysis to compliance-based offerings like SEC reporting as a service, goal setting. TechM also offers solutions around decarbonization and net zero modelling and supports organizations in their carbon offset, renewable transition journey.

With a strong foundation, our tech-led offerings and investment in IPs like i.Sustain and ***i.RiskMan*** serve as a strong foundation for meeting the technology needs for ESG Data Management, climate risk and integrations and sustainable supply chain assessment. We also provide blockchain based solutions for meeting our clients' sustainable supply chain goals for materials traceability and product compliance network. Our end-to-end approach is designed for organizations of all sizes and sustainability maturity to navigate the new SEC regulations and the global sustainability imperatives.

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