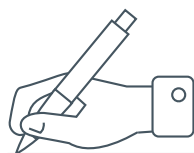
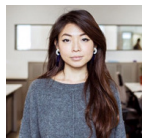


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Ecofin Editorial: SEC Landmark Climate Disclosure Proposal

From the desk of Ecofin's Sustainability Strategist



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SEC Landmark Climate Disclosure Proposal

The U.S. securities regulator, the Securities and Exchange Commission (SEC), recently published a breakthrough climate disclosure proposal that would mandate corporate disclosure of greenhouse gas (GHG) emissions and climate-related risks. This announcement marks the first U.S. federally mandated disclosure for corporate environmental, social and governance (ESG) data. The proposal aligns with the transformative global shift toward standardizing the responsible investing industry at large and would put the U.S. more in-line with the EU and UK in terms of ESG disclosures. These initiatives equip investors with the necessary transparency tools to better align their investment objectives with more comparable ESG criteria. Conversely, disclosure alignment will be vital for U.S. companies to attract more climate-focused investors.

Ecofin welcomes the SEC proposal on Climate Disclosure: the current proposal is the result of a thorough contemplation of investment community feedback from last year. It coincides with the SEC'S long-standing mission to protect investors by requiring companies to provide key information to enhance investment decisions, business strategy and growth planning. Transparency has been a significant challenge for investors, so we therefore welcome the proposal as it would provide more consistent and comparable climate data. It would also improve engagement dialogue between investors and companies. Further, the proposal emphasizes the critical role of climate risks within investment analysis. Finally, it aligns with the International Sustainability Standards Board (ISSB) proposals, which would alleviate burdens for issuers that are reporting in different jurisdictions with global shareholders.

SEC Proposal Overview

The proposal responds to growing pressure from investors demanding more standardized climate data disclosures and aligns with the increasing global push for ESG regulation. Some companies have already taken initiative to offer voluntary disclosures but a significant amount of issuers in major global indices still do not report any climate-related data.

Who is required to disclose?

The proposal would require U.S.-listed companies to disclose emissions based on the GHG Protocol Standards' emissions within their periodic filings. Firms would be required to disclose Scope 1 (direct), Scope 2 (indirect), and material Scope 3 (upstream and downstream activities') emissions. Smaller reporting companies (SRCs) would be exempt from disclosing Scope 3 emissions.

What to disclose?

The SEC proposal would require companies to disclose in a few key areas

- Their governance and oversight of climate-related risks;
- How short to long term climate-related risks materially impact their business and financial statements;
- How these risks affect their company's strategy and business model; and finally;
- How climate-related events and transition activities' impact on their financial statements.



- Further disclosures would also be required for firms who have already released climate scenario analysis, transition plans or particular set goals or targets.

SEC goes beyond TCFD

The proposal is aligned with the Task Force on Climate Related-Financial Disclosures (TCFD) and the Greenhouse Gas Protocol, but it also expands beyond those initiatives' scope. It would further enhance the TCFD's position as a global climate reporting framework and more importantly would become compulsory. It is not simply a reporting framework as the ultimate purpose would be to provide standardized, material and comparable data to be incorporated within investment decisions.

Some major expansions beyond TCFD are detailed below:

Governance: In terms of Governance, the SEC expands on identifying board members for the oversight of climate risks and members' and management's climate-related expertise.

Forward-looking data: In addition to emissions data, which depict historical trends, companies would also be required to disclose some forward-looking data including climate targets and strategies to meet such targets. Annual data to indicate progress and information on how this has been achieved would also be disclosed; major asset managers are already gathering this data within their ESG analysis across various formats. Whenever available, details of transition plans would also be disclosed under the requirement.

Climate-related financial metrics: The new proposal defines three categories in which it would require disclosures for financial statements: financial impact metrics, expenditure metrics and financial estimates and assumptions. This would be a real step-forward toward ESG integration at a corporate level. This is a reflection of the fact that economic models are expanding to include climate factors. The intrinsic relationship between climate risks and financial risks is undebatable, therefore they should be identified and quantified accordingly within financial statements. The proposal is also more descriptive than TCFD around metrics and methodologies.

Internal carbon pricing: If a firm utilizes internal carbon pricing, the proposal would require disclosures of internal carbon pricing. An internal carbon price is a firm's internal estimated cost of carbon. The disclosure of such pricing would allow further insight into company planning tools.

Assurance: The proposal would require an attestation report with various assurance levels on Scope 1 and 2 emissions. Traditional financial statement audits leverage this concept of assurance to ensure companies are held accountable. Further, the proposal would require firms to use a third party to verify GHG emissions data. This verification would lead to further alignment, transparency and honesty across disclosures.

Other thoughts on the proposal:

- **Less complex but less comprehensive vs the EU Taxonomy:** we believe the EU Taxonomy is the most comprehensive sustainability regulation currently, however it comes with its complexities of interpretations and implementations. It also needs to follow a quite elaborate bureaucratic process. Around matters related to E, the SEC proposal appears to be a more straightforward and less complex framework. Nonetheless, we believe the proposal is lacking consideration around social issues. We expect the scope to expand to the entirety of the ESG spectrum, especially given the increasing focus on a just transition, which will be a main topic of discussion at the 27th session of the Conference of the Parties (COP 27).
- **Scope to close regulatory gap with other regions:** we are seeing more and more local ESG taxonomies emerging with Europe as the leader in providing guidance. ESG fund labelling and disclosure requirements are consolidating around the globe. Historically the U.S. has lagged in climate disclosure, hence this could represent an opportunity to demonstrate leadership with a more straightforward framework.
- **It will be a bumpy journey:** the proposal has been welcomed by some investors, but it has also received strong opposition, including the Republican commissioner Hester Peirce, who stated on the SEC website that "we are not the Securities and Environment Commission" and "the proposed rule would hurt investors, the economy and this agency." Manchin has also jumped on the wagon questioning the authority of the SEC and accusing the proposal to target American fossil fuel companies. The proposal is facing a severe threat; it must counterbalance a messy backdrop of strong fossil fuel support amidst the Ukrainian war, a global energy crisis and the alarming findings from the freshly released Intergovernmental Panel on Climate Change (IPCC) report.

**What is next?**

The proposal is open for public comment from investors and companies for 60 days. When the SEC first proposed the idea, it was overwhelmed by responses from a broad range of stakeholders; hence we expect another significant round of feedback, especially from companies around Scope 3 disclosures.

After the public comment period, the SEC will respond to meaningful comments for or against the finalization. If the proposal passes, the implementation would include a phase-in period staggering registrants by filing status, Scope 3 emissions and third party assurance requirements.

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