article

How the SEC’s Climate Disclosure Plan Raises the Bar for Boards

Corporate Secretary
June 8, 2022

On March 21, 2022, the SEC proposed sweeping new disclosure requirements that would require public companies (both US issuers and foreign private issuers) to provide information about climate-related risks.

The almost 500-page release has substantial implications for boards and their oversight of these risks and related activities. In addition, the new requirements will be phased in over a relatively short period of time given the significant increase in time and effort boards and board committees will have to devote to climate-related issues.

The proposed disclosure requirements relate to climate-related risks that are reasonably likely to have a material impact on a company’s business, results of operations or financial condition. Among other things, they cover greenhouse gas emissions, climate-related financial metrics, strategy and related matters – as well as attestation requirements and disclosures related to board governance in an attempt to address the perceived gap in climate change disclosures.

The SEC takes the position that the proposed rule changes ‘would provide investors with consistent, comparable and decision-useful information for their investment decisions and would provide consistent and clear reporting obligations for issuers.’

Although the proposal had been expected by the market, its scope and breadth – including the significant disclosures related to board governance – have surprised many. Comment letters on the proposal the SEC has received so far vary widely. One from certain members of the US House of Representatives urges the commission ‘to immediately table this rule’ because it would add ‘red tape and bureaucracy that would be extremely burdensome, if not impossible, for many public companies to fully comply with.’

Another letter, from members of the Coalition on Inclusive Economic Growth and others, expresses support for the proposal because it ‘will improve corporate accountability and promote transparency for investors.’ The accountability in this regard appears to rest with the board.

Additional governance disclosure

The proposal raises the bar with respect to board governance and has substantial implications for boards in their oversight of climate-related risks and, if applicable, climate-related opportunities. It identifies several areas requiring additional disclosure related to board governance, including:

- The identity of any board members or board committee responsible for the oversight of climate-related risks
- Whether any member of the board of directors has expertise in climate-related risks, with disclosure in such detail as necessary to fully describe the nature of the expertise
- The processes by which the board of directors or board committee discusses climate-related risks, including how the board is informed about climate-related risks and the frequency of such discussion
- Whether and how the board of directors or board committee considers climate-related risks as part of its business strategy, risk management and financial oversight
- Whether and how the board sets climate-related targets or goals and how it oversees progress against those targets or goals, including the establishment of any interim targets or goals.

First and foremost a board must decide, if it has not done so already, whether the full board or a particular board committee is responsible for the oversight of climate-related risks. In many public companies, the oversight of climate-related risks is likely to fall within the audit committee’s purview given that it is generally responsible for overseeing the company’s overall risk management. For companies that have extensive climate-related impacts, there may be several board committees responsible for oversight in this area. Some companies may decide to set up a separate sustainability committee to focus on these issues, given the complexity of requirements of the proposed rules.

Regardless of whether the whole board or a committee is charged with the oversight of climate-related risks, the audit committee would likely oversee the following aspects of the proposed rules:

- Disclosures related to the company's climate-related matters in notes to financial statements
- Assurance requirements, which will require the engagement of an audit firm or other third party to provide an attestation report
- Changes to internal control over financial reporting to address proposed disclosure requirements outlined in the proposed rules, as well as the assurance requirement.

Irrespective of whether the audit committee or another board committee is responsible for climate-related risks, consideration should be given as to how the oversight and process for addressing climate-related risks is reflected in the relevant committee charter and board or committee minutes to facilitate the appropriate governance mechanism and disclosure of such information in SEC filings.

The requirement for identifying the expertise of board members related to climate-related risks could trigger a discussion by the board about what type of expertise would be necessary for the company given its operations. The company may want to send a questionnaire to directors to determine whether existing board members possess any of these skills.

This disclosure requirement related to board expertise can also lead to a discussion of whether the board needs to have additional expertise in this area or find a consultant to advise it on climate-related issues. Finding appropriate board members with climate-related expertise may prove difficult as such individuals do not typically sit on public company boards.

With respect to the proposed disclosure related to the processes and frequency that the board or board committees discuss climate-related risks, the requirement to make these disclosures necessitates a determination from a governance perspective of whether any changes should be made to existing processes and board or committee meeting agendas.

In addition, the proposed requirement to disclose how the board is informed about climate-related risks should result in further co-ordination between a public company's ESG team, investor relations and the corporate secretary's office, as well as careful documentation of these processes, which will facilitate the ultimate disclosure of these matters in SEC filings.

Climate as part of the business strategy

Another key aspect of the proposed disclosures is whether climate-related matters, both risks and opportunities, are embedded in the company's risk-management process and made part of the business strategy. These matters should be discussed during the strategic planning process that the board engages in with management and noted in the strategic plan to facilitate later disclosure.

The board's role in setting targets or goals related to climate-change matters and its oversight of this area are two additional disclosure requirements that will take some thought, as well as time, to be appropriately included in materials delivered to the board and documented in the board minutes so that they can form the basis for the disclosure that will be included in the company's SEC filings. It should be noted that investors will likely be interested in understanding the board's oversight over setting climate-related goals and targets, as well as its monitoring of what is done in this area after goals and targets are established.

The proposed rules also require governance disclosures regarding management's role in assessing and managing climate-related risks and, if applicable, climate-related opportunities, including the following:

- Whether certain management positions or committees are responsible for assessing and managing climate-related risks and, if so, the identity of such positions or committees and the relevant expertise of the position holders or members in such detail as necessary to fully describe the nature of the expertise
- The processes by which such positions or committees are informed about and monitor climate-related risks
- Whether and how frequently such positions or committees report to the board or a committee of the board on climate-related risks.

These proposed disclosures about the management's role will dovetail with governance disclosures related to the board's oversight over climate-related risks and opportunities and are aimed at creating a streamlined governance process in this area. The board should be well informed as to how management is handling climate-related risks and opportunities to ensure effective oversight of these matters.

Not stand-alone requirements

The proposed rules should not be viewed as stand-alone requirements, but rather as a new element of the company's ESG journey. As a first step in unpacking the proposal, the board may want to start discussing with management the following questions that will help put the company in the best position from a governance perspective to implement the new requirements:

- What impact will the proposed rules have on the company?
- Which matters from the proposed rules has the company already implemented as part of its ESG initiatives?
- What climate-related risks are material for the company and its shareholders?
- Has the company engaged in a dialogue with its stakeholders about climate-related risks and opportunities for the company?
- What governance structure exists to oversee and manage ESG matters, including climate-related matters?
- What ESG risks have been integrated into the company's enterprise risk management process?
- Has the company effectively integrated ESG risks and opportunities into the company's overall business strategy?
- What ESG disclosures has the company been making and where? For example, SEC filings, stand-alone reports, corporate or investor relations webpage?
- Has the company implemented an internal control system over the ESG disclosures, including climate-related disclosure and metrics?

From a governance perspective, there is no shortage of matters and actions that should be taken to address the requirements of the SEC climate-related proposal. Even though it is unclear what the final rule will look like at this point, companies should flag actions to be taken if the board has not already addressed some of the governance issues outlined in this article.

Enhanced board governance disclosure will likely be included in the final rule adopted by the SEC as it is the least controversial portion of the proposal. The sooner some of these items are addressed and preparations are made, the better prepared the company and its board will be to hit the ground running when the rule is effective.

Additional disclosure requirements will undoubtedly increase the time and effort that boards and board committees will have to devote to climate-related issues so preparation in this area is critical. This proposal, regardless of the final form, is likely to set the standard for board governance in the future, similar to how the Sarbanes-Oxley Act requirements became best practices in governance over the last two decades.

"How the SEC's Climate Disclosure Plan Raises the Bar for Boards," by Yelena M. Barychev and Jane Storero* was published in Corporate Secretary on June 8, 2022. Reprinted with permission.

* *Jane Storero serves as senior corporate governance counsel at LTSE Services.*