Baker McKenzie.

Navigating the SEC's New Climate Disclosure Rules

DEMYSTIFYING ESG WEBINAR SERIES

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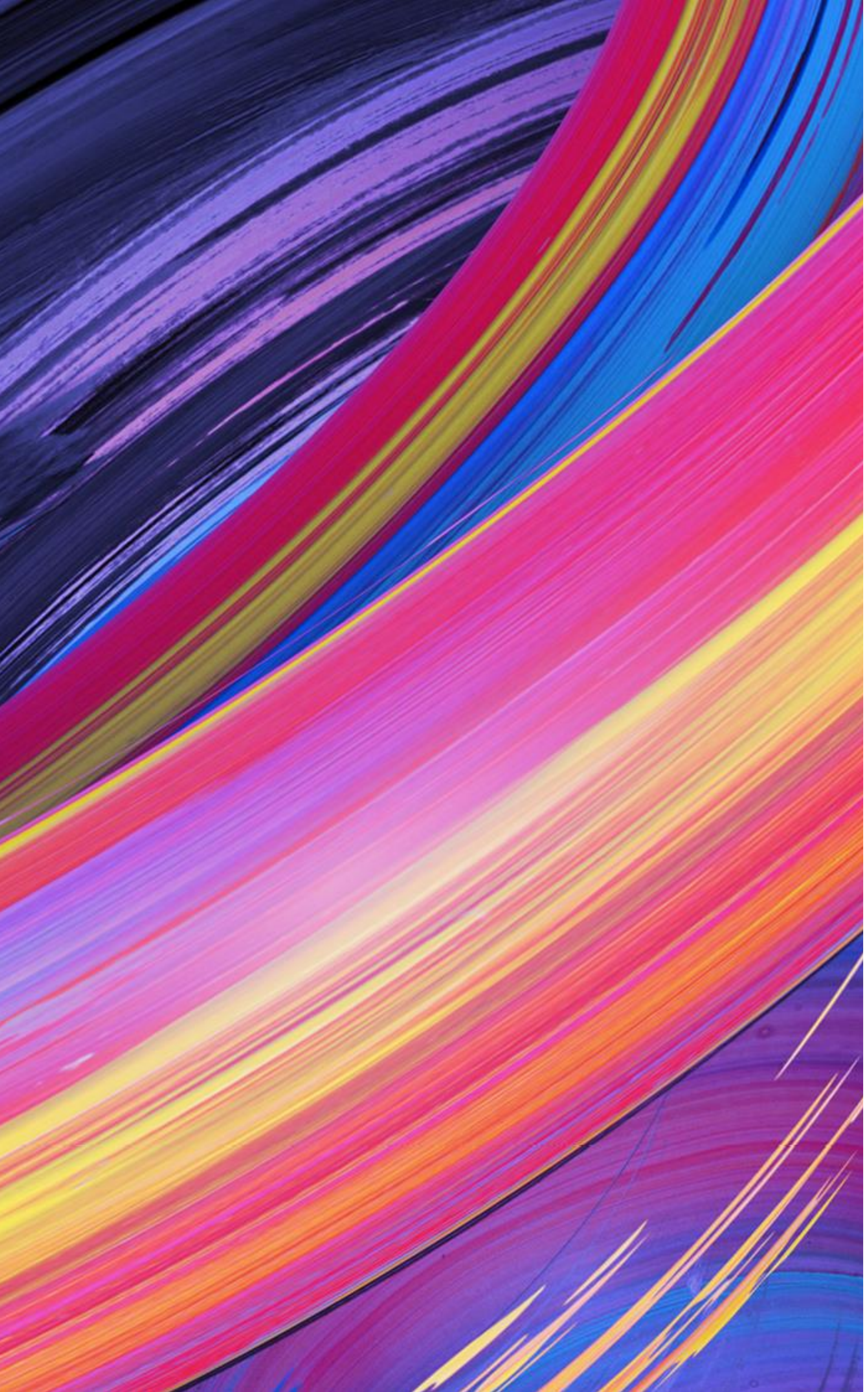
Overview of Climate-Related Disclosure Rules



Overview

History of the Rule

- Proposed Rule
  - March 21, 2022 – SEC proposes new rules
  - Received over 24,000 comment letters, with nearly 5,000 unique letters
  - Original implementation proposed for Annual Reports for FYE 2023
- Final Rule
  - March 6, 2024 – Final rules adopted
  - Implementation was to begin for Annual Reports for FYB 2025
- Litigation
  - Immediately challenged by multiple states, business groups and environmental activists
  - March 15, 2024 – Fifth Circuit stays the rule (subsequently lifted by the Fifth Circuit when Eighth Circuit selected to hear consolidated case)
  - March 21, 2024 – Eighth Circuit selected to hear consolidated case
  - April 4, 2024 – SEC stays implementation of the rules pending completion of the consolidated judicial review

Overview

The Final Rules – By Topic

Risks and Impacts	Governance, Risk and Goals	GHG Emissions/ Attestation
Financial Statements	Other Climate Regimes	Practical Considerations

Climate-Related Risks and Impacts

Material Climate-Related Risks (CRR)

Item 1502(a)

- Physical Risks
  - Acute risk (short term, such as severe weather)
  - Chronic risk (long term, such as drought)
- Transition Risks
  - Attributable to regulatory, technological, and market changes to address the mitigation of, or adaptation to, climate related risks
  - Must disclose whether it relates to regulation, technology or market
- Transition risk is a broad category and would cover:
  - Increased costs due to changes in law or policy
  - Reduced demand for products and/or services
  - Devaluation of assets
  - Liability for, and costs of, climate-related litigation
  - Competitive pressures from changes in technology or consumer preference
  - Reputational impact
- Materiality – traditional concept of materiality under US securities laws:
  - There is a substantial likelihood that a reasonable investor would consider it important when determining whether to buy or sell securities or how to vote or such a reasonable investor would view omission of the disclosure as having significantly altered the total mix of information made available
- Emissions Reduction Jurisdictions – for US multinationals with operations or listings in such a jurisdiction, transition risk disclosure should be carefully drafted to consider those regimes, including whether adverse disclosure in such jurisdiction is a "reputational impact"

Impacts on Strategy, Business Model, Outlook

Item 1502(b), (c) and (d)

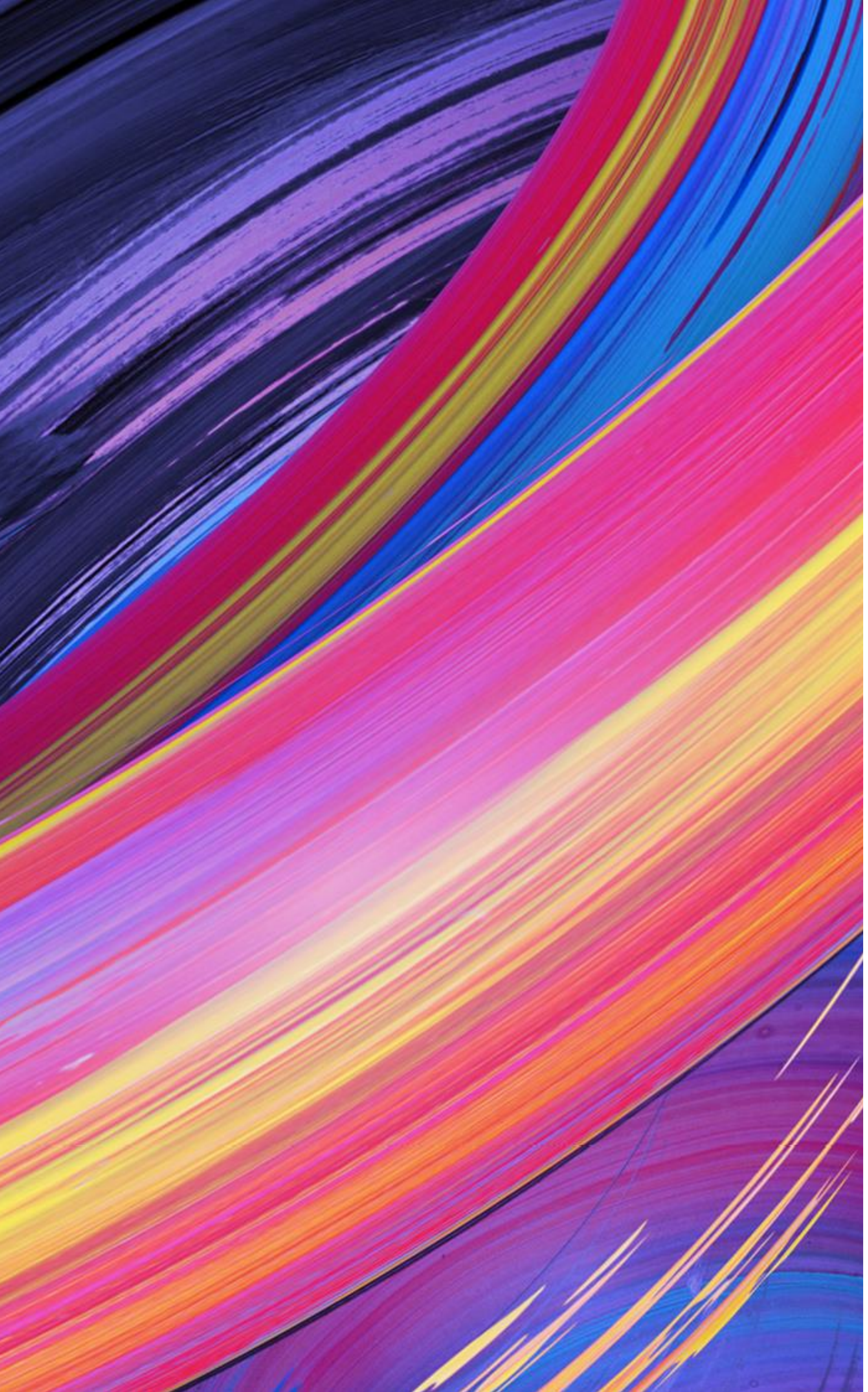
- Strategy, Business Model and Outlook – actual and potential impacts
  - Includes business operations
  - Products and services
  - Suppliers, purchasers and counterparties
  - Activities to mitigate climate-related risks
  - Research and development expenditures
- Business, Results of Operations and Financial Condition – actual and potential impacts
  - Impacts on the registrant's business, including impact to financial statements
  - Impacts on financial estimates and assumptions from activities to mitigate CRRs
- Strategy, Financial Planning and Capital Allocation
  - Describe how any material impacts disclosed above are considered as part of strategy, financial planning and capital allocation
  - Includes describing whether risks/impacts have been integrated into model or strategy, and how any targets, goals or transition plans relate to model or strategy
  - Disclose use of any carbon offsets or renewable energy credits if they are a material component of a plan or goal
  - Forward-looking disclosure is voluntary

Transition Plan, Scenario Analysis, and Carbon Price

Items 1502(e), (f) and (g)

- Transition Plan (Item 1502(e)(1))
  - Plan for managing/mitigating material transition risk
  - Strategies, steps or initiatives taken or planned to address risks under the plan
- Scenario Analysis (Item 1502(f))
  - Process for identifying/assessing a range of outcomes of possible climate related scenarios and how those risks may affect the registrant
  - If used, and a material impact is identified, each scenario must be described
  - SEC expects disclosure to be more quantitative over time
- Carbon Price (Item 1502(g))
  - Organization's estimation of internal price of carbon emissions
  - If use of such price is material to management of a CRR, must disclose in term of price per metric ton of CO_2e and total carbon price

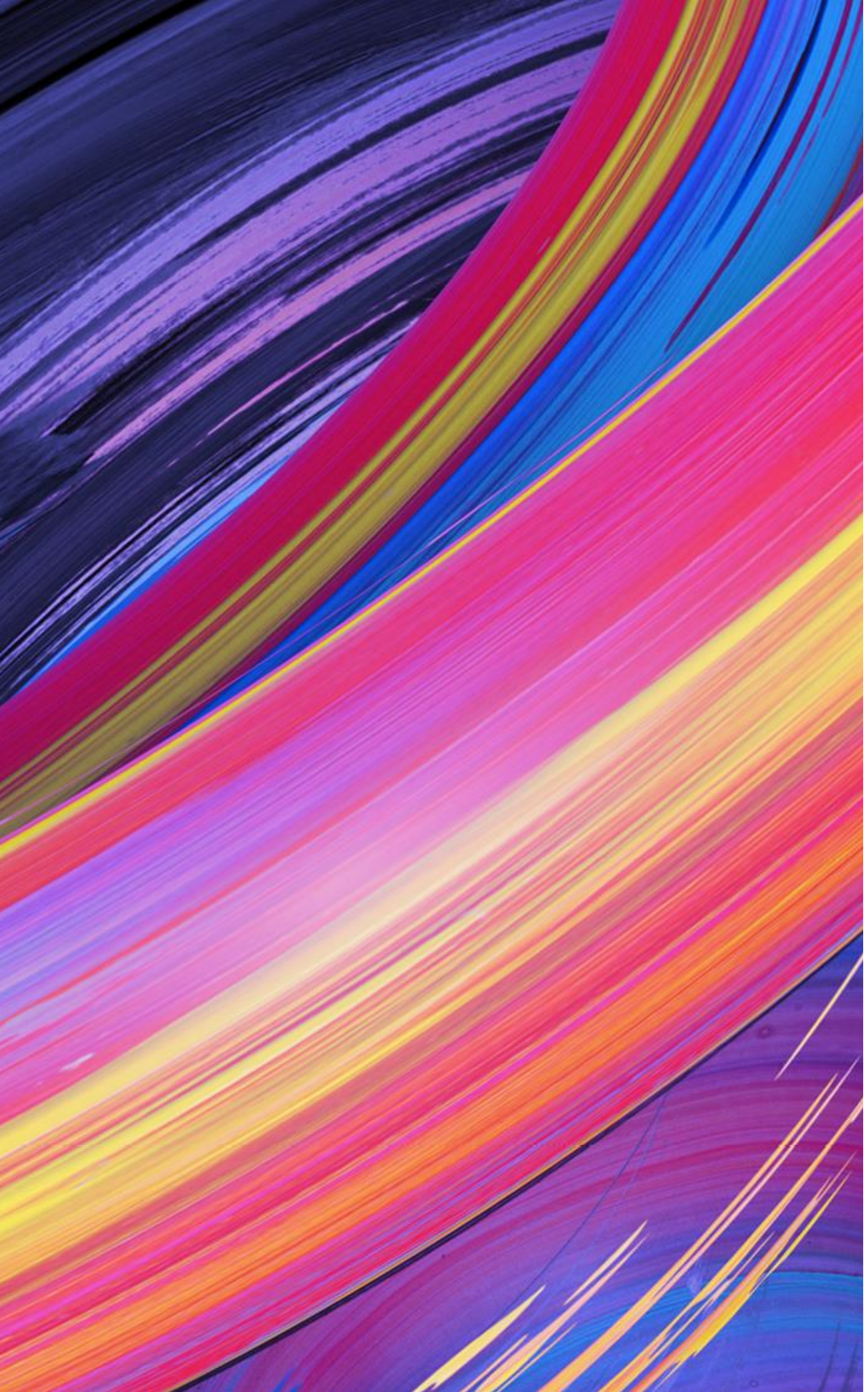
Governance,
Risk Management
and Targets/Goals



Governance Disclosure

Item 1501

- Board Oversight
  - Board committee or subcommittee responsible for oversight of CRRs
  - How the board oversees CRRs
  - How the board oversees progress on targets and goals
- Management Role in Assessing and Managing CRRs
  - Management positions or committees responsible for assessing and managing CRRs and relevant experience of each person
  - How management assesses and manages CRRs
  - How management reports information on CRRs to the board or its committee/subcommittee



Risk Management Disclosure

Item 1503

Any processes to identify, assess and manage material CRRs

- Risk Identification and Mitigation– whether the company has incurred, or is reasonably likely to incur, a material physical or transition CRR, and how it decides to mitigate, adapt or accept this risk
- Prioritization – how CRRs are prioritized
- Processes for Material Risks – how disclosed processes have been integrated into risk management systems

Targets and Goals

Item 1504

Targets and Goals (if any)

- Any climate-related target or goal that has materially affected, or is reasonably likely to materially affect, the company
  - Disclosure is required even if goal was not previously announced or formally adopted by the board or the CEO
- Information required to be disclosed, includes:
  - Scope of activities
  - Unit of measurement
  - Time to achievement
  - If baseline for target, time period for such baseline and how progress will be tracked
  - Qualitative disclosure about plan to achieve target
- Progress made over the period and any material impacts as a result of target or goal or the actions taken to make progress toward target or goal
- Quantitative and qualitative disclosure of material expenditures and material impacts on financial estimates and assumptions because of actions taken to make progress toward goal/target (subject to phase-in period)
- If carbon offsets or renewable energy credits (RECs) were used and material to the target or plan:
  - Amount of the offset/REC
  - Nature and source of the offset/REC
  - Description of the underlying projects
  - Registries or authentication of the offset/REC
  - Cost of offsets/RECs

GHG Emissions Disclosure/Attestation Requirements

GHG Emissions Disclosure

Item 1505

- Required for Large Accelerated Filers and Accelerated Filers if "material"
- Implementation Timeline
  - LAFs – FYB 2026
  - AFs – FYB 2028
- Covered Emissions
  - Scope 1 – GHG emissions from operations owned or controlled by the company
  - Scope 2 – indirect GHG emissions from the generation of purchased or acquired electricity, steam, heat or cooling that is consumed by operations owned or controlled by the company
- Materiality – not exclusively based on amount of omissions, and companies are to consider the following in making the materiality assessment:
  - If significant enough to expose company to transition risk (including exposure to other climate disclosure regimes)
  - If relevant to any progress for achieving a goal or target
- Timeline and Historical Periods – most recently completed fiscal year and any historical year required in the filing if GHG emission disclosure was required for such historical year
- Extended Timing for GHG emissions disclosure
  - Amended 10-K on due date of second quarter 10-Q, or amended 20-F or 225 days after fiscal year end
  - Can also incorporate by reference to second quarter 10-Q

Attestation Requirements

Item 1506

- Implementation Timeline
  - LAFs
    - Limited assurance – 2029
    - Reasonable assurance – 2033
  - AFs
    - Limited assurance – 2031
- Attestation report must follow standards that are:
  - Publicly available or widely used in GHG emissions assurance
  - Established by a body that has followed due process procedures
    - **Note the SEC has indicated the PCAOB, AICPA and IAASB would meet the proposed**
- Attestation Provider
  - Expert in GHG emissions by virtue of their significant experience measuring, analyzing, reporting and attesting GHG emissions, and independent from the company
- Other Attestation Details
  - Details about whether the provider is subject to any oversight inspection program
  - If another attestation provider was engaged for the relevant period and resigned or was dismissed

Financial Statement Requirements

Climate-Related Expenditures and Effects

Article 14 of Regulation S-X

- Significantly Scaled Back from Proposed Rules
  - Originally required Financial Impact Metrics, Expenditure Metrics and Financial Estimates and Assumptions
- Expenditures/Capitalized Costs Disclosure – Requires footnote disclosure of cost expenditures and losses from "climate-related events"
  - Aggregate amount of expenditures expensed as incurred and losses, excluding recoveries
  - Aggregate amount of capitalized costs and charges, excluding recoveries
- Scope of Climate-Related Events – "severe weather events and other natural conditions"
  - Includes hurricanes, tornadoes, flooding, drought, wildfires, extreme temperatures, and sea level rise
  - May arise from activities from restoring operations, relocating or repairing assets, retiring assets, recognizing related impairments or losses, or other activities responding to events
- One percent threshold
  - Expenses – 1% of income/loss
  - Capitalized costs – 1% of shareholders' equity/deficit
- De minimis amounts excluded
  - Expenses – $100,000
  - Capitalized costs – $500,000

Climate-Related Expenditures and Effects

Article 14 of Regulation S-X

Other Disclosures:

- Carbon offsets/RECs – If material component of plan to achieve targets or goals:
  - Must disclose the aggregate amount of (i) expenditures expensed, (ii) capitalized costs and (iii) losses incurred on such capitalized amounts
- Recoveries – Must disclose the aggregate amount of any recoveries resulting from severe weather events and other natural conditions to reflect the net effect that climate-related events have on the company
- Estimates and Assumptions – If material, must disclose whether any estimates or assumptions used in the financial statements were materially impacted by:
  - Exposures to climate-related risks or uncertainties
  - Known climate-related impacts
- If any risks or impacts are identified, a qualitative description must be provided of how such estimates or assumptions were impacted by such "events, conditions, targets or plans"

Climate-Related Expenditures and Effects

Article 14 of Regulation S-X

- Contextual Information - Must provide contextual description of the risks and impacts affecting the financial statements, including:
  - How each effect disclosed was derived
  - Any significant inputs, assumptions or judgments
  - Any other important information, such as policy decisions in calculating impacts
  - Qualitative description of how such estimates/assumptions were impacted
- Periods Presented
  - Must cover all historical fiscal years included in the audited financial statements of the report or registration statement, unless the company was not required to report a historical year given phase in compliance dates
  - LAFs – FYB 2025
  - AFs – FYB 2026
  - SRCs, EGCs, NAFs – FYB 2027

Other Climate Standards

International Sustainability Standards Board ("ISSB")

- ISSB was created from the merger of the Sustainability Accounting Standards Board ("SASB") and IRRC and then was moved into the International Financial Reporting Standards ("IFRS") (which is the European based counterpart to US GAAP and widely used around the world) which now oversees ISSB.
- The Task Force on Climate-Related Financial Disclosure ("TCFD") has been disbanded as a stand-alone entity and is now part of ISSB, which also released two additional climate disclosure standards last year.
- Significantly, CSRD, California and the SEC disclosure rules all reference or are based on TCFD but each has some different approaches particularly related to climate financial risk and opportunity disclosure.
- ISSB requires disclosure of Scope 1,2 and 3 emissions. It also provides increasingly detailed and wide-ranging disclosure requirements around governance, strategy, risk management and scenario analysis to assess climate risk. The latter involves an evaluation of the physical and transition risk exposure and an identification of the areas of opportunity related to climate change using scenario analysis of three potential future climate pathways which is to include a quantification of financial impacts and physical climate risks.
- ISSB also includes roughly 80 SASB ESG industry reporting standards which purport to reflect the material ESG issues for each industry including industry specific climate disclosure metrics.
- ISSB is seeking to be the primary global ESG reporting standard and in fact, a number of countries have either recently adopted ISSB as the required disclosure standard or are considering doing so, including among others - Australia, Brazil, Canada, Korea and Japan. It currently appears less likely that the EU will go in that direction and instead seems more intent on developing its own further rules, although ISSB continues to lobby the EU to at least require use of the industry standards in the absence of European ones.

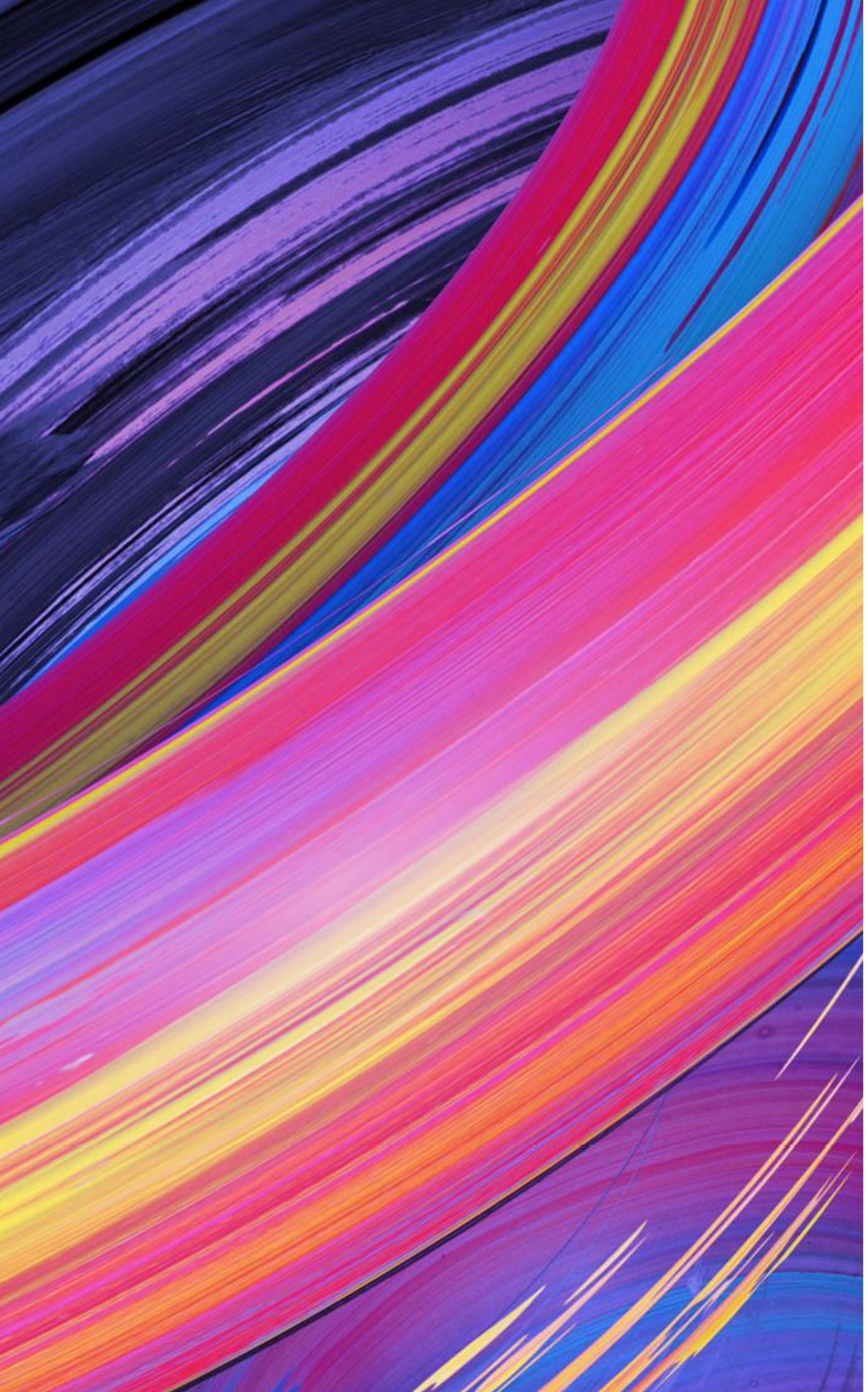
EU Corporate Sustainability Reporting Directive ("CSRD")

- CSRD sets forth far-reaching ESG disclosure requirements including relating to climate, which mandate assessment of topics and disclosures to be made based on a "double materiality" perspective ("financial materiality" and "impact materiality").
- CSRD applies to public and private companies including non-EU entities which meet two of three criteria defined as "large companies“: (1) 250 employees, (2) EU based revenue exceeding 50 million euros, (3) a balance sheet total of more than 25 million euros.
- Depending on the size of the company and some other criteria, there is a phased in compliance reporting schedule beginning with large companies required to file in 2025 regarding 2024 performance information.
- External assurance by auditors is required. Initially limited assurance is required with reasonable assurance applicable beginning in 2028.
- CSRD requires the disclosure of Scope 1, 2 and 3 data.
- CSRD requires extensive financial risk and opportunity disclosure generally based on TCFD but also contains more expansive obligations under the double materiality standard especially related to climate impacts on others.

CA Climate Disclosure Laws

GHG emissions and climate-related financial risk

Climate Corporate Data Accountability Act (SB 253, Cal Health & Safety Code 38532)	Climate-Related Financial Risk Act (SB 261, Cal Health & Safety Code 38533)
GHG emissions (scope 1, scope 2 and scope 3) Initially limited assurance; later reasonable assurance	Climate-related financial risks and measures to reduce and adapt to those risks (TCFD)
US Companies that do business in CA with annual revenues > $1 billion	US Companies that do business in CA with annual revenues > $500 million
Report submitted to reporting organization Information posted on public database	Report must be posted on company website Possibly required to submit to state?
Penalties of up to $500,000 No penalties for Scope 3 disclosures with reasonable basis made in good faith	Penalties up to $50,000
Scope 1 and 2 disclosures due in 2026 Scope 3 in 2027 Annually thereafter	Report due January 1, 2026 Biennially thereafter



CA Climate Disclosure Laws

Key Considerations

- Several roadblocks to implementation
  - Time and expertise needed for CARB rulemaking
  - No money in initial state budget proposal to implement the laws (estimated to cost $16 million and needed now to meet 2025 regulation deadline)
  - US & CA Chambers of Commerce lawsuit challenges laws on free speech grounds
  - CA argues lawsuit is not ripe – no implementing regulations yet
- Key differences from SEC Rules
  - Applies to US public and private companies – focus is on CA activities & revenue thresholds
  - No materiality threshold
  - Requires disclosure of Scope 3 emissions
- Intended to avoid duplication/inconsistencies with other laws (e.g., CSRD, SEC)
- Will CARB rules bring CA laws more in line with SEC Rules?

AB 1305

Carbon offsets and green claims

Carbon Offset Sellers	Carbon Offset Buyers	Green Claims
Marketing or selling offsets in CA	Operates in CA Purchases or uses offsets in CA Makes public climate claims	Operates in CA Makes public climate claims in CA
Provide details about projects, including any verification	Provide details about projects, including verification	Provide info about public climate claims, including how measure progress, any SBTIs, any verification
Post on website		
Penalties up to $500,000 (with daily penalties of $2,500)		
Enforced by state AG or any district attorney or city attorney		

- Effective date? Likely January 1, 2025.
- What does it mean to "operate in CA"? To "make claims in CA"?
- How does this information need to be conveyed? Existing ESG reports ok?

Practical Considerations

Questions