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Climate Change Disclosure Report: From Omission to Commission

By Rob Peters

If you picked up a pen in the year 2010 and wrote a few thousand words about climate change, would it still hold up today? For most of us, the answer is no. Given how much we've learned in the last decade—and how much severe weather we've endured—our views would inevitably require updating.

The Securities and Exchange Commission, however, may have pulled off the trick. Only twice in its history has the agency directly addressed public companies' disclosure obligations related to the increasingly important topic of climate change—first in 2010, and again in 2021. In 2010, the SEC released interpretive guidance with the stated purpose of clarifying "existing disclosure obligations as they apply to climate change."

After reviewing the SEC's history of guidance on environmental disclosure, which has been evolving since the 1970s, the interpretive guidance identified:

- **The areas of an SEC filing that may require climate change-related disclosures.** The guidance pointed specifically to:
  - Description of Business
  - Legal Proceedings
  - Risk Factors
  - Management's Discussion and Analysis
  - Foreign Private Issuers
- **Topics that may trigger climate change-related disclosure obligations.** The guidance pointed specifically to:
  - The impact of legislation and regulation
  - International accords
  - Indirect results of regulation or business trends, for example:
    - Decreased demand for goods that produce significant greenhouse gas emissions
    - Increased demand for goods that result in lower emissions than competing products
    - Increased competition to develop innovative new products
    - Increased demand for generation and transmission of energy from alternative energy sources
    - Decreased demand for services related to carbon-based energy sources, such as drilling services of equipment maintenance services
  - Physical impacts of climate change

The 2010 interpretive guidance remained the prevailing word on the subject until 2021 when the Division of Corporate Finance published a sample comment letter on climate change disclosures. The sample letter did not supersede the 2010 interpretive guidance. Instead, as the format of the document suggests, it merely provided examples of comments the Division might issue to public companies about their climate change-related disclosures (or lack thereof).

Nonetheless, the context behind the sample letter is significant. In 2021, a new presidential administration had come into power, and in February of that year, then-Acting SEC Chair Allison Herren Lee directed the Division of Corporate Finance to intensify its scrutiny of climate-related disclosures in public filings. Thus, while the 2010 interpretive guidance retains its authority, the 2021 sample letter offers a window into the agency's current thinking and enforcement priorities.

To further our understanding of the SEC's direction on climate-change-related disclosure requirements, we used the Intelligize platform to identify comment letters related to climate change-related disclosure after 2010. Our review included a (relatively brief) window of time after the release of the 2021 sample letter. We have organized our discussion to include three sections of securities filings covered by both the 2010 interpretive guidance and the 2021 comment letter: risk factors, MD&A, and general disclosures. Across all sections, we discovered that pre-2021 enforcement focused on information companies *didn't* provide, while post-2021 enforcement, by contrast, focused on the information they *did* provide—potentially problematic positive assertions about their environmental records.

Risk Factors

The 2010 interpretive guidance and 2021 sample letter both identify the "risk factors" section of securities filings as one in which a company might make climate-related disclosure. Both, however, keep their commentary about the section brief.

The interpretive guidance simply restates the relevant requirement from Regulation S-K—to disclosure "the most significant factors that make an investment in the registrant speculative or risky"—which is not specific to climate change.

The 2021 letter offers a few more clues about what the SEC expects from risk factor disclosures. In two sample comments, it instructs "ABC Corporation" to disclose:

- "Transition risks" related to climate change, offering four examples: policy and regulatory changes, market trends, credit risks, and technological changes.
- Litigation risks related to climate change.

An Intelligize search reveals the SEC has issued relatively few comment letters focused on risk factor disclosures. The below chart details three examples, two issued before the sample letter and one after. The two earlier letters focus on missing disclosures, while the 2021 letter to Stronghold Digital Mining questions its boldest claims of environmental friendliness.

ISSUER	DATE OF COMMENT LETTER	PROBLEMATIC DISCLOSURE(S)	SEC REQUEST(S)	RESPONSE
STATE AUTO FINANCIAL CORP.	3/5/10	Lack of disclosure about operational risk related to climate change.	Consider a risk factor about increases in global temperatures.	Pointed to mention of climate change risks in other risk factors.
			Disclose the impact of proposed legislation to combat climate change.	Added language in two risk factors: "Regulation" and "Claim and Coverage Developments."
SHERWIN WILLIAMS COMPANY	4/28/10	Lack of disclosures relating to climate change.	Explain what consideration the company gave to the SEC's 2010 interpretive guidance.	Acknowledged the 2010 guidance but said that no "recently enacted or proposed climate change legislation . . . would have a material effect."
STRONGHOLD DIGITAL MINING	10/13/21	Statements by the company: ▪ Operates an "environmentally-beneficial coal refuse power generation facility," ▪ Is a "Tier II Alternative Energy Source (equivalent to large-scale hydropower)," and ▪ Will be "environmentally-beneficial and sustainable."	▪ "Address the negative environmental impact of burning coal refuse for power generation." ▪ "Include potential regulatory and legislative risk related to climate change." ▪ "Clearly indicate that coal refuse is not a renewable resource."	Added requested disclosures and clarified that coal refuse is not a renewable resource.

Management Discussion & Analysis

The 2010 guidance and 2021 letter focus considerably more attention on the management discussion & analysis (MD&A) section than on risk factors. While the 2010 guidance spent just a paragraph discussing risk factors, for instance, it spends more than a full page on MD&A. One might assume, based on the length of the analysis alone, that the SEC sees the MD&A section as being, in most cases, the more appropriate section of the two for climate change-related disclosure.

Regulation S-K's requirements on MD&A disclosure, like its requirements on risk factors, do not speak specifically to climate change. Nonetheless, the 2010 guidance lays out Reg S-K's general framework for MD&A disclosure in detail. The guidance notes:

- The purpose of MD&A disclosure, to help investors "assess the financial condition and results of operations of the registrant," and in particular its "prospects for the future";
- That the SEC does not call for specific data points in MD&A disclosure, but rather asks issuers to apply a broad principle requiring them to disclose information likely to have a "material effect" on their business; and
- The two-step calculus by which issuers should determine whether information qualifies as "material" (only if the response to both is yes):
  - Is it reasonably likely to happen?
  - In the event it does happen, would it be reasonably likely to have a "material effect on the registrant's financial condition or results of operations"?

"INDIRECT CONSEQUENCES OF CLIMATE-RELATED REGULATION OR BUSINESS TRENDS"

2021 SAMPLE LETTER MD&A SECTION	APPEARS IN 2010 INTERPRETIVE GUIDANCE?
"Decreased demands for goods or services that produce significant greenhouse gas emissions"	Yes
"Increased demand for goods that result in lower emissions than competing products"	Yes
"Increased competition to develop innovative new products that result in lower emissions"	Yes
"Increased demand for generation and transmission of energy from alternative energy sources"	Yes
"Any anticipated reputational risks resulting from operations or products that produce material greenhouse gas emissions"	Yes

"PHYSICAL EFFECTS OF CLIMATE CHANGE"

2021 SAMPLE LETTER MD&A SECTION	APPEARS IN 2010 INTERPRETIVE GUIDANCE?
"Severity of weather"	Yes
"Quantification of material weather-related damages to your property or operations"	Yes
"Potential for indirect weather-related impacts that have affected or may affect your major customers or suppliers"	Yes
"Decreased agricultural production capacity in areas affected by drought or other weather-related changes"	Yes
"Weather-related impacts on the cost or availability of insurance"	Yes

The 2010 guidance goes on to identify several climate-related topics, such as environmental legislation, that may trigger disclosure obligations under Regulation S-K. It's more helpful in telling issuers what to disclose, however, than where to disclose it. It does not affirmatively state, for instance, that the MD&A section is the appropriate place to discuss those topics. But the 2021 comment letter suggests that is the case. It reproduces many of the factors identified in the 2010 guidance in sample comments to the MD&A section.

If the SEC had issued more comment letters on climate disclosure over the last decade, we might have a more definite sense of whether it expects issuers to address those topics in the MD&A section or elsewhere. As it is, precious few climate-related comment letters focus on the MD&A section. Two that specifically mention MD&A disclosure—a 2010 letter to Amtrust Financial Services and a 2014 letter to CNOOC, the Chinese government-owned petroleum company—suggest some degree of interchangeability between the risk factor and MD&A sections.

General Comments

The "general" section is another where companies have discussed climate-related subjects, and where the SEC has addressed climate-related disclosure obligations. While the "general" topic is a broad one, the 2021 sample letter includes just one comment under that heading. It addresses a highly specific scenario: where a company has provided more expansive climate-related disclosure in its corporate social responsibility report than its SEC filings. The SEC's sample letter asks the hypothetical company to "advise us what consideration you gave" to providing similar disclosure to the SEC.

That comment could signal a change in thinking from 2010 when the SEC's interpretive guidance was quite comfortable with the idea that a company might choose to disclose more to other audiences than it would to the SEC:

> Although some information relating to greenhouse gas emissions and climate change is disclosed in SEC filings**, much more information is publicly available outside of public company disclosure** documents filed with the SEC **as a result of voluntary disclosure initiatives** or other regulatory requirements.
> *— 75 Fed. Reg. 6292 (emphasis added).*

MD&A OR RISK FACTOR?

The SEC's letter to Amtrust, a property and casualty insurer, asked it to consider discussing "how climate changes may impact your company's business." The SEC posed a similarly worded comment to CNOOC.

Neither comment should not have been surprising. Months before the Amtrust letter went out, the SEC's 2010 interpretive guidance had cited the "physical impacts of climate change" as a topic that issuers may have to disclose. Of particular relevance to Amtrust, the guidance specifically called out "increased insurance claims" as a potentially material consequence of severe whether associated with climate change.

The letters asked the issuers to consider adding "**a risk factor and/or MD&A disclosure**" on the topic, perhaps indicating fluidity between the two sections. Regardless, Amtrust batted away the suggestion, noting that property insurance (the line of its business mostly likely to be affected by climate change) accounted for a small portion of its premiums and loss reserves. In a fuller exchange, CNOOC pointed to sections in its filing where it had addressed the impacts of both environmental regulation and extreme weather on its operations.

Regardless, an Intelligize search indicates that the SEC has not issued any actual comments questioning a difference in the degree of disclosure between a company's CSR report and its SEC filings.

Since mid-2021, the SEC has issued at least three comment letters focused on disclosure in the general section. All of them ask companies to justify or remove positive statements they made about their own environmental record, including claims of carbon neutrality.

COMPANY	STATEMENT(S) QUESTIONED	RESPONSE
ALLBIRDS, INC.	The green EVA used in Allbirds' SweetFoam removes 1.2 tonnes of CO2e from the atmosphere per tonne of material produced.	Added disclosures describing the methodologies upon which its statement is based.
	Allbirds has been carbon neutral through the use of offsets since 2019.	
	Allbirds shoes have a carbon footprint 30% less than its estimated carbon footprint for a standard pair of sneakers.	
	In 2020, Allbirds reduced the weighted average carbon footprint of its top 10 products by 8.5% compared to 2019.	
WARBY PARKER	The company operates with net-zero carbon emissions.	Removed.
	The company is a carbon-neutral business.	Provided fuller description of carbon offsets.
OLAPLEX HOLDINGS, INC.	From 2015-21, Olaplex "prevented approximately 23 million pounds of greenhouse gas from being emitted into the environment, conserved approximately 37 million gallons of water, and saved approximately 29,000 trees from deforestation.	Figures are based on "the amount of paper" it would have used absent "initiatives to reduce the amount of packaging used for its products."

ANADARKO'S CDP REPORT

In 2016, the SEC did press Anadarko Petroleum Corporation on potential substantive inconsistencies between its CDP report and its SEC filings. Anadarko's CDP report indicated that environmental regulation and physical impacts of climate change were both likely to occur, and that both would impact the company's operations. The SEC asked the company to square those assessments with the fact that its proxy statement stated that "regulatory risks around air and GHG emissions" would have "no significant unmanageable impacts."

In response, Anadarko pointed to the SEC's materiality calculus, discussed above. It said that while it determined that climate change regulation was reasonably likely, it also determined that it was not reasonably likely to have a material effect on the company. Thus, Anadarko felt no need to disclose anything beyond a risk factor in its 10-K flagging the potential for costly environmental protection legislation.

Conclusion

Perhaps it should not surprise us that the SEC's 2010 statement on climate change has proved so durable. The interpretive guidance did not speak in great specifics. In that way, it is consistent with the philosophy behind principles-based rules, which have the advantage of standing firm even while facts and circumstances change.

Indeed, the SEC's comment letters on climate-related disclosure between 2010 and today might reflect more about how public companies have changed than how the SEC has. In the different world of 2010, companies and brands were more likely to shy away from the topic of climate change. By 2021, widespread acceptance of the environmental reality had inclined companies to more eagerly attest to their "green" credentials. The SEC's enforcement pattern has changed, in turn, from one focused on omissions of disclosure to commissions of inaccurate reporting.

This history will certainly inform widely anticipated new climate disclosure rules, if and when they come. Until then, the words that the SEC wrote in 2010 will remain operative.

Methodology

The data in this report is based on comment letters addressing climate change issues on filings between January 1, 2010, and December 31, 2021. We examined comment letters related to 1933 Act and 1934 Act filings and ignored any comment letters directed at funds.

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