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Climate Risk and Disclosure: Does Your Company Have a Climate Hub?

April 21, 2021

This article was originally published in Wiley's The WELL blog.

The last two weeks have brought with them a number of important climate-related announcements directed toward the financial markets. For example, the $2.2 trillion American Jobs Plan includes sizable investments in renewable energy, energy transmission infrastructure, and electric vehicles (EVs). There are early signals of growing support for carbon and methane emissions pricing, as well as reports by some automakers on discontinuing any further advancement of the internal combustion engine. It is hard to deny that the automobile as we know it is "going the way of the dinosaur" when California and General Motors agree on phasing out new gas-powered new vehicle sales by 2035.

In addition, the Securities and Exchange Commission (SEC) is exploring new ways to hold businesses accountable, by asking for public comment on revising the agency's 2010 guidance on corporate disclosures related to climate change. Members of the public have until June 13 to submit comments. The SEC's 2010 guidance can be found here. A wide variety of options are on the table. The SEC's list of suggested topics for comment indicates that the SEC is considering a broad brush approach that is not limited to updating public disclosure requirements in annual reports or periodic filings. The SEC is seeking comments on such topics as:

- *"[w]hen and how . . . such disclosures [should be provided,"*
- *whether disclosures should include specific metrics,*
- *whether they should be phased in over time,*

Authors

Martha E. Marrapese
Partner
202.719.7156
mmarrapese@wiley.law

Practice Areas

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- *what standards should govern these disclosures, including whether industry participants should be allowed to develop their own standards, or whether the SEC should draw on existing frameworks, and*
- *whether the SEC or some other body should be tasked with updating disclosure requirements over time.*

As part of re-imagining SEC reporting, the kinds of climate-related risks that trigger disclosure may expand. Traditionally, the 2010 guidance describes reporting considerations that include legislation and regulations governing climate change, international accords, changes in market demand for goods or services, and physical risks associated with climate change. Currently, any of these activities may trigger disclosure obligations under SEC rules. The SEC is seeking input on additional parameters, such as whether registrants should report greenhouse gas emissions or signal their greenhouse gas reduction goals, and whether climate change-related impacts affect the cost of capital.

As climate policies advance, the SEC has also signaled interest in ensuring that enforcement mechanisms stay current and it is seeking comment on how disclosures should be enforced or assessed, such as through an audit mechanism, or certification by CEO, CFO or other corporate officer. The changes ahead may not be limited to effects on publicly-traded companies. Privately-held companies may also be affected by future SEC actions. The SEC asked for comment on whether it should address disclosures by these companies through exempt offerings or oversight of investment advisors and funds.

Green investing is also heading to new heights. The Commodity Futures Trading Commission (CFTC) has established a Climate Risk Unit that will be tasked with focusing on "the role of derivatives in understanding, pricing, and addressing climate-related risk and transitioning to a low-carbon economy." Historically, cap and trade has demonstrated that derivatives exchanges have a private governance role in environmental protection. According to the CFTC, these exchanges may be further influential through "incorporating sustainability elements into existing contracts" and "by developing new derivatives contracts to hedge climate-related risks." The Climate Risk Unit is tasked with studying those developments, as well as engaging in domestic and international standard setting. Companies that already participate actively in derivatives exchanges should pay special attention to future activities in the Climate Risk Unit, as well as companies that are considering using climate-related derivatives as part of their own risk mitigation strategies.

White House and Treasury initiatives round out the financial picture on climate. We will reportedly see an Executive Order emerge soon to advance the mandatory disclosure of financial risks associated with climate change that the SEC is contemplating. In addition, Secretary Yellen has repeatedly signaled support toward efforts to require disclosure of climate risks in public remarks. There's a new "Climate Hub" at Treasury that reports directly to the Secretary that will evaluate ways to advance investment in a net-zero economy and assess large institutional investment exposure to the effects of climate change. Managing risk is not new to financial markets and private governance has played an increasingly important role in achieving environmental protection goals beyond those set by governments. All in all, Stephen Covey's quote on accountability - that it breeds "response-ability" – may aptly characterize the course that financial regulators are charting on climate.