Digesting the SEC’s climate proposal
What you should know now

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March 2022
— On March 21, 2022, the SEC issued proposed rule, The Enhancement and Standardization of Climate-Related Disclosures for Investors.
— Based on feedback received, the SEC is seeking to provide investors with more consistent, comparable and reliable information about how climate-related matters impact a company’s business and financial results over time.
— You have a chance to help shape the final rules, so consider responding to the proposal. Comments are due around May 20.
— Regardless of this proposal, compliance with existing requirements includes the 2010 climate-related guidance issued by the SEC staff.

— The proposal is comprehensive and complex, and would affect nearly all registrants. It is important to understand the impact on your organization.
— Although not in the scope of the proposal, the effects would likely filter down to private companies (read more).
— As the SEC progresses toward establishing final rules, so too do other regulatory bodies internationally. Understanding their interaction and applicability to your company will be important (see Q7).
— With change comes opportunity and this proposal is no exception. Considering how to unlock value within your organization, by understanding how the proposal may impact it, is an opportunity to enhance your company’s overall financial position now and for the long-term.

— We explore key aspects of the proposed rules, and provide observations to help you think about the proposal and the potential effects on your organization.
— Our commentary and observations are based on the proposal, which is subject to change as the Commission works toward final rules.
As a private company, why should you care?

**Upstream and downstream GHG emissions**
- Most registrants would disclose their Scope 3 GHG emissions if they are material or included in an emissions reduction target or goal (see Q5).
- Private companies that are part of a registrant’s value chain – upstream or downstream – may be required by their customer (or supplier) to detail their own GHG emissions.
- Therefore, private companies may need to develop data, technology and governance strategies similar to registrants in order to support a registrant’s Scope 3 emissions reporting.

**Identifying risks, taking advantage of opportunities**
- The proposed rules may help private companies identify new risks to mitigate or opportunities they can take advantage of.
- Private companies may be able to gain a competitive advantage with investors, customers and talent – especially when voluntarily choosing to disclose some or all of this information.
- The final rules will provide an opportunity for private companies to tell their story in a way that is comparable and consistent with how others are doing it.

**Market demand for climate-related information**
- Both public and private companies are coming under pressure from investors (e.g. major venture capitalists, private equity, pension funds), lenders, customers and others to improve their sustainability credentials and related reporting.
- Certain levels of climate-related reporting may become the norm for gaining access to capital, or the lack thereof may result in an increased cost of capital.
- Therefore, a private company may be called on – or may decide voluntarily – to comply with the final SEC rules.

**Public market access**
- The proposed rules also apply to companies filing registration statements, such as those required for an IPO (see Q9).
10 questions and answers to get you started

01 Who and what would be in scope?
02 What’s the proposal based on?
03 At a glance, what’s included where?
04 What financial statement disclosures are proposed?
05 What GHG emissions disclosures are proposed?
06 How does the proposal compare to the TCFD?
07 What is the relevance of international developments?
08 What is the proposed transition?
09 How would the proposal impact IPOs?
10 What do you need to do now?
1. Who and what would be in scope?

Nearly all SEC registrants

- Accelerated filers, large accelerated filers and non-accelerated filers.
- Smaller reporting companies; see Q5 and Q8 for limited relief.
- Emerging growth companies.
- Foreign private issuers.
- Companies filing registration statements, including IPOs (see Q9).

Information that is material

- The definition of materiality is consistent with the materiality concept already used by the SEC.
  - The focus is on climate risks that impact the company (outward-in pressures) plus GHG emissions (an inward-out pressure), but does not consider the full impact of a company’s business on its environment in the way that sustainability reporting does.
  - When making materiality judgments, companies would apply a short-, medium-, and long-term horizon to understand the potential significance of climate-related risks.
  - In addition, companies could choose to disclose climate-related opportunities and the related financial impact.
  - A bright-line materiality threshold of 1% would apply to financial statement disclosures (see Q4).

1) Assess identified and potential climate-related risks through your enterprise risk management process, and then determine whether they are material.

2) Even if you have already completed a materiality assessment for ESG reporting, consider dusting it off to ensure it still holds weight based on the proposal.

3) Managing your own ESG story is important. Consider whether voluntarily disclosing climate-related opportunities could help.
2. What’s the proposal based on?

**Built on leading climate frameworks**

- The proposal incorporates the concepts and many disclosures of the TCFD framework (see Q6):
  - Commonly used by companies, and widely endorsed by investors, regulators and standard setters.
- The proposal incorporates the vocabulary of the GHG Protocol (see Q5):
  - In practice, the most common reference point for the calculation of GHG emissions.

**Trending toward international compatibility**

- Leveraging these widely used and endorsed frameworks/standards is intended to:
  - Achieve a balance between eliciting better disclosure and limiting compliance costs.
  - Support global consistency; several countries have proposed TCFD-aligned mandatory climate risk disclosures and it is heavily leveraged by the ISSB (see Q7).

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1) If you have already adopted TCFD, compare your disclosures to those proposed.

2) If you are in the process of implementing TCFD, don’t stop. The pervasiveness of the TCFD throughout the global regulatory landscape makes all aspects of its recommendations important.

3) If you are measuring GHG emissions but not (fully) applying the GHG Protocol, determine the areas in which you are non-compliant.
3. At a glance, what’s included where?

### Disclosures filed, not furnished

- In a new note to the audited financial statements, disclose certain climate-related metrics and related disclosures (see Q4).
  - Metrics would be subject to audit and in the scope of the company’s internal control over financial reporting.
- In a separate ‘climate-related disclosure’ section of the annual report or registration statement – or by reference from another section (e.g. MD&A) – disclose GHG emissions and certain information about material climate-related risks (See Q5 and Q6).
  - Assurance over GHG emissions would be required in some cases (see Q5 and Q8).
- In quarterly reporting, disclose any material changes to the disclosures provided in the annual report or registration statement.

### Comparatives

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<td>GHG emissions</td>
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### Annual report or registration statement

- **Financial statements**
- **Separate section (climate-related disclosure) or incorporate by reference from another section**
- **GHG emissions**
- **Specified metrics and disclosures**
- **TCFD-like disclosures**
- **Other components of a sustainability report (outside scope)**

1) You would need to prepare disclosures based on the same cadence and timing as your annual report.

2) If you already prepare a sustainability report, consider how your existing climate-related reporting processes would need to change, and what additional controls you might need.

3) If this is all new to you, we recommend that you begin by learning more from KPMG IMPACT, The Decarbonization Journey.

4) Discuss with your financial statement auditor how this could impact your annual audit process.
4. What financial statement disclosures are proposed?

**Financial metrics**
1) Separately for each line item in the financial statements – and separately for physical risks and transition risks – disclose total negative impacts and total positive impacts.
2) Separately for the physical risks and transition risks driving the disclosure in (1), disclose expenditure incurred and expensed vs capitalized.
3) Disclose contextual information that explains the metrics in (1) and (2), including significant inputs and assumptions, and policy decisions in calculating the metric.

**Bright-line materiality for financial metrics**
— Disclose if the total amount of all impacts exceeds 1% of the related line items of the consolidated income statement, balance sheet or cash flow statement.
— Impact would be measured in absolute value – positives and negatives would not be offset.

**Financial estimates and assumptions**
— Disclose exposures to risks and uncertainties associated with climate-related risks that impacted the development of the estimates and assumptions used in preparing the financial statements.

### Example triggers:
- Extreme heat
- Flooding
- Wildfires
- Sea level rise
- Regulation
- Actions to reduce emissions
- Drought
- Drought
- Regulation
- Actions to reduce emissions
- Drought
- Optional: Same information as (1) and (2) for opportunities
5. What GHG emissions disclosures are proposed?

Scopes 1 and 2 with assurance; Scope 3 in many cases
- Definitions are based on the GHG Protocol.
- Disclose Scope 1 and Scope 2 GHG emissions
  - Assurance required for larger companies, but phased (see Q8).
- Disclose Scope 3 GHG emissions if material or included in an emissions reduction target or goal.
  - By significant category of upstream activity (e.g. purchased goods and services, business travel) and downstream activity (e.g. transportation of products sold, investments).
- Disclose in both absolute and intensity (e.g. per unit of production) terms, excluding any purchased or generated offsets.
- Disclose methodology, significant inputs and significant assumptions used in calculations.

Disclosure relief
- Annual GHG emissions could be estimated based on actual data for the first three fiscal quarters and an estimate of Q4. Once Q4 data is available, material differences would be disclosed in a subsequent filing.
- Smaller reporting companies would be exempt from Scope 3 disclosures.
- Other registrants would have a safe harbor from certain forms of liability in connection with Scope 3 disclosures.

1) Evaluate your current processes and controls around your climate and carbon data.
2) Prioritize Scopes 1 and 2 emissions – earlier adoption and required for all companies, plus assurance required for larger companies.
3) Assess whether you can connect data insights with technology to operationalize your decarbonization strategy.
4) Consider engaging with third parties in your value chain to understand available data for material Scope 3 activity categories.
6. How does the proposal compare to the TCFD?

Qualitative disclosures similar to TCFD
- Not identical, but there is broad alignment to TCFD pillars of governance, strategy and risk management.
- This structure is also generally consistent with the SEC’s recent proposal on cybersecurity reporting and disclosures.

Increased transparency
- Companies will need to be prepared to disclose information like the names of board committees and members responsible for oversight of climate-related matters, and whether they have expertise in climate-related risks.
- Any existing transition plans and climate-related targets or goals (even internal) will be subject to disclosure, including progress.

Safe harbor for transition plans
- Forward-looking statements made as part of the transition plan would be eligible for the liability safe harbor, provided all applicable conditions are met.

Disclose in all cases
- Governance and oversight of climate-related risks by the board and management.
- Risk management processes for identifying, assessing and managing climate-related risks.
- Physical risk related to acute climate-related disasters, chronic risks, and transition risk related to moving to a lower carbon economy.

Disclose if the company uses
- Climate targets or goals, including scope, unit of measurement, time horizon and progress to date.
- Description of adopted transition plan, including relevant metrics and targets used to identify and manage risks, plus progress.
- Description of scenarios, parameters and assumptions used, analytical choices, and any projected financial impacts under each scenario.
- Amount of carbon reduction represented by offsets or amount of renewable energy generated by RECs and other REC information.
- Certain information about internal carbon pricing, including the price in units of reporting currency per metric ton of CO₂e and reason for selecting the pricing used.

1) You would need to make certain disclosures only if you use the underlying tool (e.g. scenario analysis) in your climate strategy.
2) However, the mere lack of disclosure may indicate to investors how sophisticated your plan is as compared to your peers. It may also raise a red flag for investors and other stakeholders demanding action on climate change.
3) Although most of these disclosures would be qualitative, do not lose sight of the processes and controls that would nonetheless be needed.
7. What is the relevance of international developments?

**Beyond reporting requirements**

- Access to capital and funding may require adherence to certain regulatory requirements other than the final SEC rules.
- In addition, regardless of regulation and domicile, companies are coming under pressure from investors, lenders, customers and others to improve their sustainability credentials and related reporting.
- Non-compliance may adversely impact access to markets and limit opportunities.

**The benefits of global baseline disclosures**

- Global collaboration provides opportunities to reduce complexity and achieve greater consistency in ESG reporting.
- The proposal is not identical to the climate disclosures exposure draft published by the ISSB on March 31, but there appears to be significant commonality in the industry-agnostic disclosures.
- In addition, other countries (e.g. the UK, Japan) do or will require compliance with the TCFD framework (see Q6).
- However, other international developments may not converge, most notably the proposed Corporate Sustainability Reporting Directive in the European Union.

1) You need to understand the different reporting regimes that are likely to affect you.

2) If you would have to apply multiple bases of climate reporting, identify the 'lowest common denominator' for each requirement.

3) Consider whether you would apply that requirement at the consolidated level or only at the entity level for which it is relevant.

4) Develop or enhance processes to monitor regulatory activities with the broadest implications for your organization.
8. What is the proposed transition?

A phased transition is proposed

- An effective date will remain open until the SEC adopts the final rules.
- The proposal includes a phased transition and relief on the first compliance date.

Illustration assuming an effective date of December 2022 for the final rule and a registrant with a December 31 year-end

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<th>Small reporting company</th>
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<tr>
<td>Large Accelerated filer</td>
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DISCLOSURES

| Large Accelerated filer | FY 2023 Filed 2024 | FY 2024 Filed 2025 | FY 2025 Filed 2026 | FY 2026 Filed 2027 | FY 2027 Filed 2028 |

ASSURANCE on Scopes 1 & 2

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<th>Large Accelerated filer</th>
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<th>Limited assurance</th>
<th>Reasonable assurance</th>
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<tbody>
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<td>Limited assurance</td>
<td>Reasonable assurance</td>
</tr>
<tr>
<td>Other filers</td>
<td>None</td>
<td>Limited assurance</td>
<td>Reasonable assurance</td>
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1) The proposal would move vast amounts of disclosure and data previously scattered across websites, investor questionnaires, press releases, proxy statements and/or sustainability reports into Form 10-K and the audited financial statements.

2) Inventory all climate-related disclosures and goals that exist both within and outside of regulatory filing. Begin to work through your disclosure controls and procedures.

3) Using the phased transition as a guide, analyze what it would take operationally to comply with the proposal if it became final.
9. How would the proposal impact IPOs?

**No scope exception for IPOs**
- Generally, the same disclosures would apply to companies filing registration statements in connection with the registration of a security, a securities offering or an investment company.
- Subject to the same exemptions, all proposed disclosures would be required in registration statements:
  - Financial statement metrics and related disclosures (see Q4).
  - GHG emissions disclosures (see Q5).
  - TCFD-like disclosures (see Q6).

**Specific considerations for registration statements**
- Safe harbors on forward-looking information (see Q5 and Q6) would not be afforded to IPOs.
- A new registrant would not be required to obtain assurance over its GHG emissions (see Q5 and Q8) during an IPO.

1) The proposal would likely extend the time required – and level of effort needed – to prepare an IPO or a securities offering.

2) If you are contemplating an IPO in the next few years, consider how this proposal could impact your timing or approach while there is still time to react.

3) If you have an M&A strategy, consider how this proposal could impact your strategy and diligence process. Climate reporting readiness may become a more relevant attribute in identifying potential targets.
10. What do you need to do now?

1) Regardless of where you are on your climate reporting journey, this is your green light to start yours or enhance it further.

2) Even though the proposal is not final, prepare yourself now for what compliance could mean, and at the same time identify opportunities to drive a competitive advantage.

3) We believe in the bigger picture – ESG is an opportunity to unlock value and not simply a compliance exercise.
Abbreviations and key terms

GHG (greenhouse gas) emissions
- **Scope 1:** Direct GHG emissions from operations that are owned or controlled by a registrant.
- **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 a registrant.
- **Scope 3:** All indirect GHG emissions not otherwise included in a registrant’s Scope 2 emissions, which occur in the upstream and downstream activities of a registrant’s value chain.

CDP
Formerly the Carbon Disclosure Project

CDSB
Carbon Disclosure Standards Board, consolidated into the IFRS Foundation in January 2022

ESG
Environmental, Social, Governance

ISSB
International Sustainability Standards Board

TCFD
Task Force on Climate-related Financial Disclosures

SASB
Sustainability Accounting Standards Board

VRF
Value Reporting Foundation (which houses the Integrated Reporting Framework and the SASB Standards)

<IR>
Integrated Reporting Framework

GRI
Global Reporting Initiative

REC
Renewable energy certificate

CDSB
Carbon Disclosure Standards Board, consolidated into the IFRS Foundation in January 2022

GRI
Global Reporting Initiative

CDP
Formerly the Carbon Disclosure Project

<IR>
Integrated Reporting Framework

WEF
World Economic Forum and in particular the Stakeholder Capitalism Metrics
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