Blogs
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The SEC's Climate Proposal: Assessing "Physical Risks"

In parsing the **SEC's proposing release for climate disclosure**, there are a fair number of new concepts for securities lawyers to get their arms around – and we will get around to covering those in this blog. But let's start with something that appears easy, at least on its face – assessing the risks posed by climate on a company's physical operations and properties. Note that when companies disclose a climate-related risk, they will need to identify whether the risk is a "physical risk" or a "transition risk" (and then disclose the company's plans to mitigate - or adapt - to that risk). In **this blog,** we delve into "transition risks."

Breaking Down "Physical Risks" Into "Acute" and "Chronic" Categories The SEC's proposing release digs into this "physical risk" analysis starting on page 55 (this is all part of proposed Item 1502(a) and (b) of Regulation S-K). The SEC breaks the concept of "physical risk" into two: "acute risks" and "chronic risks." And they are defined as: - "Acute risks" are event-driven risks related to shorter-term extreme weather events, such as hurricanes, floods, and tornadoes. - "Chronic risks" are risks that the business may face as a result of longer-term weather patterns and related effects, such as sustained higher temperatures, sea level rise, drought, and increased wildfires, as well as related effects such as decreased arability of farmland, decreased habitability of land, and decreased availability of fresh water. The SEC believes that many companies have already experienced physical risks. And under its proposal, companies would be required to describe the nature of the physical risk, including whether it may be categorized as an acute or chronic risk. That's easy enough to do.

Identifying Locations (Including ZIP Codes) of Those Physical Risks With a Likely Material Impact But here comes one that could wind up being more challenging. If a physical risk has had – or is likely to have – a material impact on a company's business or financial statements, the proposal would require the company to identify the location of the properties, processes, or operations subject to the physical risk. For companies with limited physical operations that might be easy to do. For companies with a more widespread operations, that could be a real bear. Let's drill down. Companies would be required to provide the ZIP code for the location of the properties, processes or operations (or if a location doesn't have a ZIP code, a similar subnational postal zone or geographic location). Investors should weigh in during the comment process about how useful a table or list of ZIP codes might be for them.

Disclosures Specific to Water-Related Physical Risks For companies with water-related acute physical risks, the SEC's proposal would require disclosure of the percentage of buildings, plants or properties (square meters or acres) that are located in flood hazard areas, in addition to their location. If a material risk relates to the location of assets in regions of high-water stress, that company would need to make additional disclosures. The proposing release offers the examples of increased temperatures and changes in weather patterns that result in water scarcity and regulatory restrictions on water usage that results in increased expenses to find alternative sources of water or a possible need to curtail operations. If the location with high water stress presents a material risk, the proposed rules would require disclosure of the amount of assets (e.g., book value and as a percentage of total assets) located in such regions in addition to their location – as well as disclosure of the percentage of the company's total water usage from water withdrawn in those regions.

Disclosures Specific to Temperature-Related Physical Risks Of course, increased temperatures could also materially impact companies in other ways. The proposing release offers the example of the construction industry and how the physical risk of increased heatwaves affects the ability of personnel to safely work outdoors, which could result in a cessation - or delay - of operations. Another example are companies operating in wildfire-prone areas that could be exposed to potential disruption of operations, destruction of property and relocation of personnel. And those in the real estate sector might need to disclose the likelihood that sea levels rise faster than expected.

The Parade of Horribles There is a real parade of horribles that unfortunately are no longer uncommon in the world - and disclosure lawyers are going to need to become more attuned to climate developments in the world and consider that regardless of the industry that their company is in.

Here are our other blogs about the SEC's climate proposal so far: 1. **SEC Proposes Climate Disclosure Rules: 9 Things to Know** 2. **"How Much Is This Gonna Cost Us?" The SEC's Climate Economic Analysis** 3. **The SEC's Climate Proposal: Where Did We Wind Up With "Materiality"?** 4. **The SEC's Climate Proposal: When Should Scope 3 Emissions Be Considered "Material"?**

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