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The SEC's Climate Rules: Item 1502(a)'s Climate-Related Risks



This is the first in a series of blogs we will be posting breaking down the SEC's new climate disclosure rules.

We're starting with Regulation S-K Item 1502, Strategy. For the full text, see pages 853 through 856 of the [SEC's adopting release](#). This is the section of the new rules that requires discussion of climate-related risks, including how these risks impact the business and how the company considers these risks in planning its business and strategy. Items 1502(e) through (g) also have specific disclosure requirements that will be relevant for companies that have adopted transition plans, use scenario analysis or use an internal carbon price.

Today's blog addresses Item 1502(a), which calls for companies to describe any climate-related risks that have materially impacted – or are reasonably likely to have a material impact on – the company, including on its strategy, results of operations, or financial condition.

Here are five key concepts to consider in drafting disclosure responsive to Item 1502(a):

1. **Not the Same as Risk Factor Disclosure.** On page 89 of the adopting release, the SEC made clear that traditional "risk factor" disclosure doesn't suffice to fulfill this new disclosure obligation. The intent is to elicit more detailed information to "help investors better understand a registrant's assessment of whether its business is, or is reasonably likely to be, exposed to a material climate-related risk."
2. **Materiality Qualifiers.** Only risks that have materially impacted or are reasonably likely to materially impact the company are required. On page 105 of the adopting release, the SEC notes that companies should apply the same materiality analysis as required under long-standing case law and practice.
3. **Describe Whether Risk is Likely in Short-Term and Long-Term.** When describing these material risks, companies must describe whether such risks are reasonably likely to manifest in the short-term (i.e., the next 12 months) and separately in the long-term (i.e., beyond the next 12 months).

4. **"Climate-Related Risks" Include "Physical" and "Transition" Risks.** The applicable definitions are included in Regulation S-K Item 1500. The definition of climate-related risks includes physical and transition risks.

Physical risks include *acute risks* – which are "event-driven" and related to weather events like hurricanes or wildfires – and *chronic risks* – which relate to longer term weather patterns and related effects such as decreased habitability of land. On page 95 of the adopting release, the SEC stresses that disclosures regarding physical risks are likely to change over time as facts and circumstances evolve.

Transitions risks are negative impacts attributable to regulatory, technological, and market changes to address the mitigation of, or adaptation to, climate-related risks. These might include things like costs attributable to changes in law or policy, or reduced market demand for carbon-intensive products. On page 93 of the adopting release, the SEC notes that the examples included in the rules are "non-exclusive" and that a company will need to include any material transition risks that are relevant to the company "based on its particular facts and circumstances."

5. **Disclose Information Necessary to Understanding the Risk's Nature and Company's Exposure.** Under Item 1502(a) of Regulation S-K, companies must disclose for physical and transition risks "information necessary to an understanding of the nature of the risk presented and the extent of the registrant's exposure to the risk."

For physical risks, the non-exclusive list of potential disclosures includes whether the risk may be categorized as acute or chronic, and the geographic location and nature of the properties, processes, or operations subject to the physical risk.

For transition risks, the non-exclusive list includes whether the risk relates to regulatory, technological, market, or other transition-related factors, and how those factors impact the registrant. The text of Item 1502(a) specifically calls out that for companies that have significant operations in a jurisdiction that has made a GHG emissions reduction commitment, they should consider whether they may be exposed to a material transition risk related to the implementation of the commitment. This is a good example of the type of thing to consider in identifying potential transition risks.

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