Blogs
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This is the latest in our series of blogs breaking down the SEC's new climate risk disclosure rules.

We're starting with Regulation S-K Item 1502, Strategy. For the full text, see pages 853 through 856 of the **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(d) of Regulation S-K, which covers two different topics that are both about the financial impacts of climate-related risks. Under Item 1502(d)(1), a company is required to disclose how its climate-related risks described in response to Item 1502(a) have materially impacted - or are reasonably likely to materially impact - its business, results of operations, or financial condition. Under Item 1502(d)(2), companies are required to describe quantitatively and qualitatively the material expenditures incurred and material impacts on financial estimates and assumptions that, in management's assessment, directly result from activities to mitigate or adapt to climate-related risks, including adoption of new technologies or processes.

Here are six considerations in drafting disclosure responsive to Item 1502(d):

1. **Item 1502(d)(1) Elicits MD&A-Like Discussion.** As noted on pages 120-121 of the adopting release, Item 1502(d)(1) is aimed at providing an MD&A-like component to the climate-risk strategy rules. The disclosure intended to be elicited is supposed to be more MD&A-like than that found in the notes to the financial statements.

2. **Materiality Qualifiers on Item 1502(d)(1).** Like other sections of Item 1502, there are materiality qualifiers on impacts and *reasonably likely impacts* of climate related risks. This forward-looking disclosure requirement tracks MD&A, requiring management to make disclosure decisions that can be quite challenging.

3. **Connection to Item 1504(b)(4) Material Impacts on Strategy, Business Model and Outlook.** The expenditures disclosure requirement in Item 1502(d)(2) ties to disclosure elicited by Item 1504(b)(4) regarding climate-related risk mitigation and adaptation activities. That is one of the topics in the non-exclusive list of strategy, business model and outlook considerations addressed under that item.

4. **Materiality Qualifier on Item 1502(d)(2).** This Item requires consideration of both quantitative and qualitative disclosures regarding *material* expenditures. The materiality limitation means that disclosure may not address all of the metrics required to be included in the notes to the financial statements, especially in light of the de minimis limitations on those disclosure requirements.

5. **Determining Expenditures Incurred as Direct Result of Mitigation or Adaptation Activities.** As noted on pages 121-122 of the adopting release, this disclosure requirement was changed from the originally proposed requirement to discuss all of the financial metrics required by new Regulation S-X Article 14.

   The intent in revising the requirement was to focus the discussion, allowing readers to assess how the company is managing its disclosed risk, and the financial impact of the risk activities. However, the rule as revised creates another disclosure challenge, requiring management to assess which expenditures incurred, and which material impacts on financial estimates and assumptions, directly result from mitigation or adaptation activities. On pages 123-124 of the adopting release, the SEC acknowledges that material expenditures might not neatly tie to climate-related risks.

   For example, a company buying new energy efficient machinery might have multiple types of reasons for such acquisition. While the SEC notes that the materiality qualifier and ability to provide qualitative explanation about management's determinations regarding what expenditures to include should alleviate concerns about this disclosure, it will likely be challenging for companies to identify with any precision how to make these disclosures.

6. **Extended Compliance Date for Quantitative and Qualitative Disclosure.** Item 1502(d)(2) - but not (d)(1) - is one of the items that is called out for longer implementation in the adopting release. For each type of filer, the compliance date for this item is one fiscal year after the bulk of the Regulation S-K and Regulation S-X requirements (e.g., for fiscal years beginning in 2026 for large accelerated filers). This

will likely be a relief for many companies in light of the disclosure challenges noted above.

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