[Blogs]
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Public Chatter

The SEC's Climate Proposal: Assessing "Transition Risks"

Following up on **[Broc's blog about disclosure of "physical risks,"]** in parsing the **[SEC's proposing release for climate disclosure]**, the SEC's proposal would elicit disclosure about "transition risks." 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.

Definition of "Transition Risk" On page 58 of the SEC's proposing release, "transition risks" are defined to mean the actual or potential negative impacts on a company's financial statements, business operations, or value chains attributable to regulatory, technological, and market changes to address the mitigation of - or adaptation to - climate-related risks. Transition risks would include increased costs attributable to climate-related changes in law or policy, reduced market demand for carbon-intensive products leading to decreased sales, prices, or profits for such products, the devaluation or abandonment of assets, risk of legal liability and litigation defense costs, competitive pressures associated with the adoption of new technologies, reputational impacts (including those stemming from a company's customers or business counterparties) that might trigger changes to market behavior, changes in consumer preferences or behavior, or changes in a company's behavior. The SEC notes that a company that has significant operations in a jurisdiction that has made a GHG emissions reduction commitment would likely be exposed to transition risks related to the implementation of the commitment.

What to Disclose About Transition Risks As noted on page 62 of the SEC's proposing release, proposed new Item 1502(a) of Regulation S-K would require companies to describe the nature of their transition risks, including whether these risks relate to regulatory, technological, market (including changing consumer, business counterparty, and investor preferences), liability, reputational, or other transition-related factors, and how those factors impact the company. The proposing release lays out these examples: - Automobile manufacturer might describe how market factors, such as changing consumer and investor preferences for low-emission vehicles, have impacted or will likely impact its production choices, operational capabilities, and future expenditures. - Energy producer might describe how regulatory and reputational factors have impacted or are likely to impact its operational activities, reserve valuations, and investments in renewable energy. - Industrial manufacturer might describe how investments in innovative technologies, such as carbon capture and storage, have impacted or are likely to impact its consolidated financial statements, such as by increasing its capital expenditures.

"Impacts from the Value Chain": Disclosure of Third-Party Impacts on a Company's Transition Risks As mentioned above, transition risks are defined in the proposed rules to include the actual - or potential - negative impacts on a company's "value chains." Value chain is defined to include upstream activities (like materials sourcing, materials processing, and supplier activities) and downstream activities (like transportation and distribution, processing of products, use of products and end of life treatment of products). This proposal represents a fairly significant departure from typical SEC disclosure requirements - requiring a company to disclose potential negative impacts of climate change transitions *from third parties* that are upstream and downstream from the company. Although the overall proposed rule (Item 1502) is limited only to climate-related risks that are "reasonably likely to have a material impact" on the company, the need to include a discussion of the negative impacts on "value chains" could create a significant disclosure burden. The proposing release seeks comments on whether negative impacts on a company's value chain should be included in the definition of climate-related risks. Companies and investors may want to consider commenting on this item.

Voluntary Disclosure of "Climate-Related Opportunities" Many companies are already considering the opportunities that might arise during their transition to a world filled with climate events. The proposed rules define "climate-related opportunities" to mean the actual - or potential - positive impacts of climate-related conditions and events on a company's financial statements, business operations, or value chains, as a whole. Starting on page 62 of the proposing release, the SEC describes how companies might address strategic planning for these opportunities in their disclosures under proposed new Items 1502(a), 1503(a), and 1503(c)(3). I say "might address" because the SEC does emphasize that disclosure of climate-related opportunities is a voluntary disclosure. It is optional because of concerns that making this disclosure mandatory could have anti-competitive effects in some instances. However, if a company does decide to voluntarily make this disclosure, then the SEC's rules kick in to ensure consistency of disclosure across companies.

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"?** 5. **The SEC's Climate Proposal: Assessing "Physical Risks"**

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