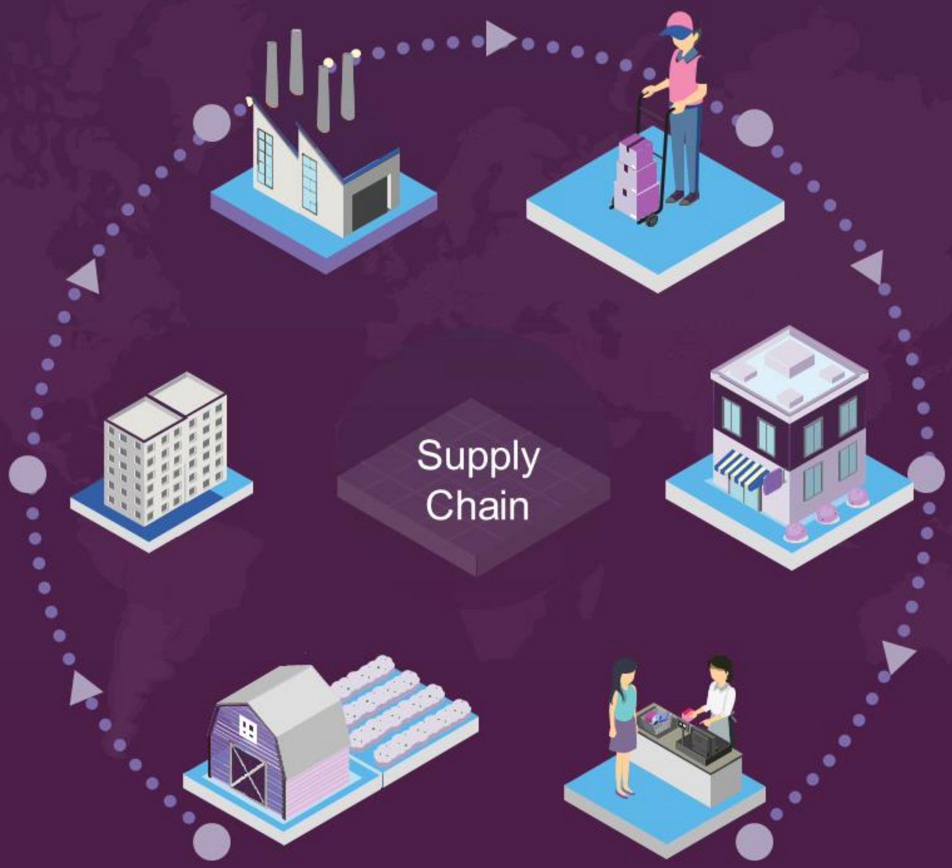
EVALUESERVE

Scope 3 Emissions Disclosure

US SEC Proposed Rule – Scenarios Expected in 2023



Background

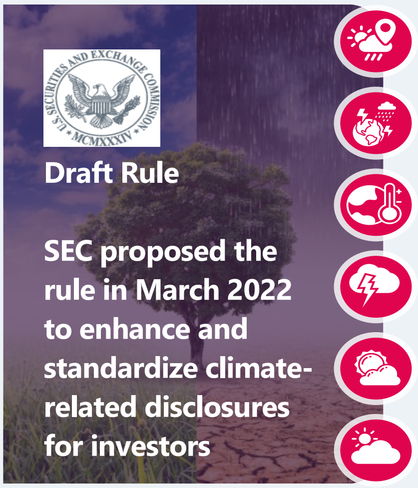
Under the Paris Agreement, countries across the world agreed to limit global warming to around 1.5 degrees C. The latest science suggests that limiting warming to 1.5 degrees C depends on CO_2 emissions reaching net-zero levels by 2050. Considering the urgency, an increasing number of national and local governments and business leaders are committing to reach net-zero emissions within their jurisdictions or businesses by 2050.

In line with this agreement, on March 21, 2022, the US Securities and Exchange Commission (SEC) proposed a rule to improve and standardize climate-related disclosures from public companies. The rule would require companies to disclose information about their greenhouse gas (GHG) emissions, specific financial statements, and qualitative and governance details in their registration statements and annual reports.

The SEC requested comments on the proposed rule and received mixed reactions from industries. While a few companies have supported the rule, many businesses have strongly opposed it. Currently, the SEC has been going through the comments and has not disclosed the date of releasing the final rule yet.

While the US is progressing toward making things formal, Europe is leading the race to make climate disclosures mandatory, starting 2025. The discussions on making sustainability reporting mandatory in APAC have also begun.

Increased focus on decarbonization encouraged SEC to suggest strong measures related to Scope 3 emissions reporting



Highlights

01 Disclose its governance of climate-related and relevant risk management processes

02 Disclose the potential material effects of climate-related risks on its business and consolidated financial statements

03 Include any identified climate-related risks affecting or likely to affect the registrant's strategy, business model, and outlook

04 Report the effect of climate-related events and transition activities on its consolidated financial statements and financial estimates and assumptions used in its financial statements

05 Reveal Scope 1 and Scope 2 metrics, both by disaggregated constituent greenhouse gases and in the aggregate, reported in absolute and intensity terms, which would require attestation reports for accelerated filers

06 Reveal Scope 3 emissions and intensity if either of the following two conditions is present:
If Scope 3 emissions are material to the company or
If the company has set an emissions target or goal that includes Scope 3 emissions

Source: SEC website

If earlier compliance dates are to be believed, then the mandatory compliance date for the adoption of the rule for a registrant would begin as early as 2023-24. However, it would further depend on the timing of the final release.

While responses received by SEC have been positive overall, associations have highlighted industry-specific challenges

Due to high public interest, the SEC extended the comment period for the proposal until June 17, 2022. The general public has submitted more than 3,400 individual and over 10,000 standard letters. Commenters comprise various entities (such as corporations, trade and industry associations, non-governmental organizations, and investors), asset managers, and private citizens.

Associations that support the commission's efforts to harmonize GHG reporting requirements, some of them are already participating in market-based efforts voluntarily, through GHG Protocol and the Task Force on Climate-Related Disclosure (TCFD). While industries agree that investors should have access to climate risk information when making investment decisions, however, emphasized expanding the safe harbor for reporting Scope 3 emissions, reducing the compliance cost of companies with the rule and the potential drawbacks of requiring additional reporting on climate targets. Other challenges highlighted are the availability, consistency, and authenticity of data and know-how related to sustainability, guidelines, and reporting frameworks.

The associations supporting the intentions behind the proposed rule argued that only publicly traded registrants will be affected by the proposed rule. If a registrant must obtain data on emissions from its supply chain partners to comply with the Scope 3 disclosure requirement, it will naturally come under the purview. It may require those non-registrant entities to undertake time, manpower, and costs to track and calculate their emissions to share them with the appropriate registrants.

Industries have also argued that SEC should require registrants to disclose climate matters publicly rather than filing them to limit excessive liability exposure, while some have questioned SEC's authority to make rules.

What other regions/countries are doing?

On January 5, 2023, the Corporate Sustainability Reporting Directive (CSRD), approved by the EU Council, entered into force. CSRD requires all large European companies or companies with operations in Europe or companies listed on regulated markets that currently report according to the Non-Financial Reporting Directive (NFRD) to report and publish more detailed information on sustainability matters, including all direct and indirect emissions.

Comparison

Attributes	SEC climate disclosure US	EFRAG ESRS Europe
Coverage	All publicly reporting companies under the SEC's jurisdiction in the US, except for Canadian issuers filing annual reports on Form 40-F and asset-backed issuers	All large companies in the EU subject to CSRD and listed companies on EU - regulated markets, except listed microenterprises
Phase-in time	2023–26	The anticipated phase -in period from 2023–26
Likely date of first report	Initial reports expected in 2024	First reports expected by 2024
Acceptance of alternate reporting	No guidance in the proposed rule, and SEC is analyzing public comments for alternative reporting options	Other frameworks can be used in addition to ESRS
Level of prescriptiveness	Detailed disclosure is required if the company has set targets and goals	Line-item disclosures, metrics, impacts, and sample formats and scenario analysis
Climate-related risks and Opportunities corporates need to identify	Climate-related risks will likely have a material impact on the company's business model / strategy and financial statements	Sector- and entity -specific material sustainability effects, risks, and opportunities

Source: SEC, European Commission

While there is no single rule mandating climate-related disclosures in APAC, GRI, SDG, and TCFD recommendations are gaining widespread recognition in APAC, as many countries are adopting the framework as the basis for ESG reporting regulations.

In Hong Kong and Singapore, similar ESG reporting requirements are coming into effect, which will have implications for companies across APAC.

SEC Proposed rule – Potential scenarios

It is speculated that the SEC may disclose it by late 2023. Based on the criticality of the climate disclosure and the feedback given to the SEC by various entities, there could be three possible scenarios:

SEC's climate-related disclosure

	1	2	3
Scenarios	**Disclose in 2023-24; Mandatory filing would be pushed to next year**	**Disclose & File in 2023-24**	**No Mandatory Disclosure in 2023-24**
Probability	**Most Likely**	**Less Likely**	**Least Likely**
Expectations	**Introduced** with minor amendments, **requiring companies to disclose** Scope 3 emissions **but need not file them**	Introduced with major changes; requiring companies **to disclose and file Scope 3 emissions** in financial statements	**Disclosure and filling pushed to subsequent years**
Implications	**Companies:** The ones **who have not started scope 3 estimations need to act fast**	**For SEC:** Legal action by organizations questioning SEC's authority. **For Companies:** Plan for estimation and auditing (too short timeline)	**For SEC:** Environmental activists & Governmental bodies will strictly oppose. **For Companies:** Will have a year or two to set-up the framework for scope 3 emissions

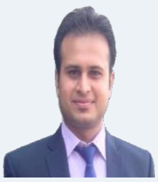
Source: Evalueserve Analysis, The Wall Street Journal, Politico, Trader's magazine, ESG Today

The bottom line

The draft SEC rule was expected to get finalized by December 2022. However, it may be delayed until the end of 2023. Sooner or later, the SEC will publish the final rule requiring companies to at least begin disclosing Scope 3 emissions and related disclosures, and then start filling climate-related matters. Disclosing Scope 3 emissions will likely become mandatory in most scenarios. Hence, companies are suggested to take initial steps toward decarbonization and proactively embark on the Scope 3 journey to set high benchmarks for peers.

The road to net-zero emissions is not a one-time project. It is a journey that every company has to travel along with its employees and customers. As regular updates/amendments keep coming, companies should collaborate with an intelligence partner who can steer it through the journey, starting from analyzing timely updates related to Scope 3 rules, guidelines, and frameworks to preparing an implementation plan for Scope 3 estimation, ensuring data readiness, sharing stakeholder knowledge, identifying emission hotspots, setting reduction targets, and tracking progress.

About the Author:



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