Securities Regulation Daily Wrap Up, ESG NEWS—SEC Chair Gensler tells U.S. Chamber climate disclosure gathering that agency will adhere to its legal authorities, (Oct 26, 2023)

By Mark S. Nelson, J.D.

Gensler also said staff could mull economic baselines given developments in California and Europe and that a federal climate risk disclosure rule upheld in court would be a good outcome for companies.

SEC Chair Gary Gensler joined Tom Quaadman, Executive Vice President of the CCMC, for a fireside chat on developments regarding climate disclosure regulations adopted or under consideration by the SEC, California, and European authorities at an event hosted by the U.S. Chamber of Commerce. The 30-minute discussion covered a range of topics, including the SEC's proposed rules for disclosing Scope 3 emissions, providing many climate risk disclosures in footnotes to financial statements, and the prospect that an SEC climate risk disclosure regulation could withstand legal challenge. The SEC proposed its climate risk disclosure regulation in March of 2022 and, after several delays involving glitches with the public comment process, was expected to adopt a final version of the regulation in October 2023, although that timeline appears to have slipped.

Preemption, California, and Blue/Red state divides. One of Quaadman's first questions for Gensler was how the SEC might adjust its proposed climate risk disclosure regulation in light of California Governor Gavin Newsom's signing into law a pair of climate disclosure laws that reach beyond the scope of the SEC's proposal and which also will impact both public and private companies.

Gensler said the SEC's remit is to deal with investors making investment decisions and that the SEC is a not a climate regulator. Gensler added that the SEC is grounded in its disclosure-based approach to regulation and the materiality of information to the reasonable investor. With respect to California, Gensler said only that the new laws may alter the number of companies (he said approximately 1,400 to 1,500) making climate disclosures and that that can change the economic baseline.

According to Gensler, who cited data on Russell 1000 companies, said 81 percent of those companies make some climate disclosures; he noted that fewer of those companies make disclosures about Scopes 1 and 2 emissions, and far fewer companies make disclosures about their Scope 3 emissions.

A follow-up question from Quaadman posed the question of what to do about the red state-blue state divide on climate, in which some states like California are set to impose legal requirements for climate disclosure and red states that may adopt laws barring such disclosures. Specifically, Quaadman asked if the SEC might consider including a preemption statement in a future climate risk disclosure regulation.

Gensler responded in a general manner that Congress, through the National Securities Markets Improvement Act of 1996, had already dealt with preemption issues related to federal securities laws.

By way of background, one of the SEC's most recent attempts to deal with the preemption issue in a regulation arose in the context of Regulation Best Interest (See p. 33435), which was adopted in June 2019 under the leadership of a different Administration. That regulation raised the standard broker-dealers must observe toward their retail clients to a level above the older suitability standard but not quite to the level of a full fiduciary standard of care, although the Regulation BI standard and the fiduciary standard have some points of overlap.

The SEC's Regulation BI adopting release first addressed the potential economic impact of differences between federal and state broker-dealer standards for retail investors. "To the extent that state-level law incorporates fiduciary principles similar to those reflected in Regulation Best Interest, the magnitude of the costs and benefits discussed

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below that stem from the application of those principles to broker-dealers will be correspondingly reduced," said the adopting release. "However, costs and benefits that arise from obligations under Regulation Best Interest that differ from obligations under state law, such as the Conflict of Interest Obligation, will be maintained."

In a footnote to the above passage, the SEC addressed the speculative nature of the interaction between federal and state broker-dealer regulations regarding retail investors. Said the adopting release: "Whether Regulation Best Interest would have a preemptive effect on any state law would be determined in future judicial proceedings, and would depend on the language and operation of the particular state law at issue. We considered whether we could determine the economic impact of possible, future state-law preemption on retail customers, but concluded that we cannot analyze the economic effects of the possible preemption of state law at this point because the factors that will shape those judicial determinations are too speculative."

It remains to be seen if the SEC today might draw from the Regulation BI experience in handling preemption issues that may arise in its climate risk disclosure rulemaking.

On the related question of equivalence with other countries' climate disclosure rules, Gensler reiterated a familiar refrain that the SEC does U.S. law and the agency abides by the interpretations U.S. courts give to the SEC's authorities. Gensler acknowledged that European climate rules would have a certain reach to U.S. companies, but he also noted these rules were not yet fully implemented.

When asked specifically by Quaadman about equivalence with European authorities, who insist on maintaining a double materiality standard, Gensler elaborated that if the SEC's rule can withstand court challenges, then there would be room to have discussions about equivalency. Otherwise, Gensler suggested that many U.S. companies would look to comply with climate disclosure rules in other jurisdictions.

With respect to the prospect of court challenges, Gensler repeatedly suggested that an SEC rule that is sustained by courts would be the best outcome of the agency's climate risk disclosure rulemaking. At the end of the fireside chat, Gensler said that the Chamber of Commerce's members should want the SEC to be successful in promulgating a climate risk disclosure regulation because such rules will help markets in ways beyond the SEC's 2010 guidance on climate risk. Specifically, Gensler repeatedly cited the proposed regulation's goal of achieving consistency and comparability of public company climate risk disclosures.

Notes to financial statements. Although the discussion of the SEC's proposed climate risk disclosures that would go into notes to financial statements was comparatively brief, any significant shift of those disclosures out of the notes to financial statements in a final version of the regulation could result in eased burdens for public companies subject to the regulation.

Quaadman noted that even investors have said that the proposed climate risk line-item analysis that would be required under Regulation S-X would not be much help to them. Gensler replied that the proposal involves a new footnote regarding current year affects of climate risks. He signaled that he was aware that many public comments cited the line-by-line analysis and the need to add up risks as a concern.

In a later question, Quaadman observed how materiality, as addressed by the SEC's climate risk disclosure proposal, could dwarf the requirements of Sarbanes-Oxley Act Section 404(b) regarding management's assessment of internal controls. Gensler answered that SEC staff are considering these issues, especially regarding footnotes, which goes to cost concerns.

Scope 3 emissions. With respect to public comments on other climate risk disclosure topics, Gensler explained that he sorts them into the categories of qualitative non-greenhouse gas (GHG) disclosures and GHG disclosures. On the latter subtopic, Gensler further subdivided public commenters into those who are concerned with Scope 3 emissions

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and those concerned with Scopes 1 and 2 emissions. Gensler mostly addressed Scope 3 emissions.

According to Gensler, investors are keen to have Scope 3 disclosures, while companies have raised a number of questions, doubts, and concerns. He noted that the proposed climate risk disclosure regulation contains a tiered approach to Scopes 1, 2, and 3. In response to a follow-up question from Quaadman about whether Scope 3 disclosures are relevant to the marketplace, Gensler said public comments by investors had explained that having an understanding of a company's supply chain helps investors to grasp a company's transition risk.

Gensler reminded the audience that the proposal requires Scope 3 disclosure only if such disclosure is material or a company commits to a target. He noted that a company could use estimates in order to satisfy the proposed disclosure obligation. However, Gensler acknowledged that public commenters had pushed back against the use of estimates because that might pressure public companies to then ask questions of their nonpublic company suppliers. Earlier in the discussion, Gensler had made the related observation that agricultural companies had voiced concerns about being caught up in the proposed Scope 3 disclosure regime.

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