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What a Proposed SEC Rule on Climate Risk Disclosure Could Mean for Your Board

By Steven M. Rothstein

The past two years have been a vivid example of how a systemic risk—the COVID-19 pandemic—can cause enormous disruption for some and, for others, enormous opportunity.

But as significant as the pandemic has been, climate risk has the potential to be even more disruptive and damaging. In 2021 alone, weather and climate disasters in the United States caused an estimated $145 billion in economic losses. The need to address climate risk exposure is with us today, not in the future. It is both urgent and pervasive.

However, as the adage goes, you can only manage what you can measure. Companies and investors need access to industry data that is consistent, accurate, and reliable, and the current state of voluntary climate disclosure does not meet this standard. Some companies already offer climate disclosure plans—in fact, 92 percent of S&P 500 companies published a sustainability report in 2020—but each uses its own methodology. Without consistency in reporting, how can management identify climate risks and opportunities? How can investors compare the company's approach to that of its competitors to ensure their investment approach is properly informed?

To that end, the US Securities and Exchange Commission (SEC) released a proposed rule in late March to ensure investors, directors, employees, and other stakeholders have a common basis for climate information. The proposal is based on recommendations from the Task Force on Climate-related Financial Disclosures (TCFD), which highlights the role of board oversight of climate-related risks and opportunities.

If the final rule tracks with the proposal, the SEC will require disclosure about board governance of climate-related risks and, if a company desires, relevant opportunities. Here are three initial takeaways for directors:

1. **Boards should be asking their management teams how their companies integrate their environmental, social, and governance (ESG) strategies into their overall company strategies, risk management processes, and financial oversight.** The days of ESG strategy as something separate from corporate strategy are over. If climate-related goals are part of this ESG strategy (which is something that all boards should, at a minimum, be asking about), boards should also be overseeing progress against such goals.
2. **Once boards are clear about their companies' climate strategy, they should consider if their oversight work should be delegated to an appropriate board committee and be set forth clearly in that committee's charter.** Oversight work could be delegated to one or more committees, including nominating and governance, audit, risk, or public affairs and sustainability. If a board decides to oversee climate-related opportunities as well as risks, it may want to consider delegating that oversight work to another committee, such as a finance committee. However, leaving this oversight at the full-board level could also be appropriate for certain companies.
3. **Companies and boards should not be shy about disclosing enough information to make their case for having a climate- or sustainability-competent board to oversee their related risks and opportunities.** As *2022 Ceres Guidance for Engaging on Climate Risk Governance and Voting on Directors* (also informed by the 11 TCFD recommendations) describes in more detail, companies should publicly disclose how their boards are climate competent. This could be done through such things as board matrices and director biographies that support the experience and expertise listed in those matrices. No one director will make a climate-competent board. Rather, a board should assess and be able to explain how the different directors' experiences contribute to thoughtful discussions at board meetings and meaningful connections with the company's long-term strategy, given the unique climate risks and opportunities that a particular company faces.

Next Steps for Board Directors

When the SEC was established 88 years ago, our country did not have standardized requirements for financial reporting in place. Public US companies did not always file balance sheets or other common financial statements, with many arguing this would be burdensome, expensive, and complicated.

As the result of thoughtful work over many years, standardized financial reporting is now required, enabling market participants to get the consistent financial information that is necessary for an active and vibrant marketplace. In a comparable way, this proposed SEC rule will remedy the current lack of standardized transparency in climate-related risk disclosure.

This is a complicated issue with many nuances, such as on the role of materiality and indirect emissions data, but directors would be wise to familiarize themselves with these broad ideas.

The comment period on the SEC's proposed rule closes on May 20—you can submit your comment here. Consider the long-term strategic interest of the company you serve. Will it be better off with consistent information from others in the industry? Will it benefit from a full picture of climate-related financial risks? If so, protect your company and other companies as we face a decisive decade for climate risk.

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