Prepare to Report Climate Risks

Pressure mounts on companies to increase required disclosures.

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Publicly traded companies are required, under Securities and Exchange Commission (SEC) regulations, to disclose known and contingent material liabilities to ensure investors have reliable information on which to base their investment decisions. Increasingly, investor groups, nongovernment organizations (NGO), and others demand companies assess and disclose their financial risks from climate change. Following are recent developments advising that companies carefully consider how best to address their SEC climate change disclosure obligations.

Targeting Greenhouse Gases

There's no serious question that climate change is real. The Supreme Court directed the U.S. Environmental Protection Agency (EPA) to determine whether greenhouse gas emissions threaten public health and welfare within Section 202(a) of the Clean Air Act in Massachusetts v. EPA, 549 U.S. 497 (2007). Earlier this year, EPA issued a proposed "endangerment finding" accompanied by an extensive Technical Support Document (see http://epa.gov/climatechange/endangerment/downloads/TSD_Endangerment.pdf) containing its analysis of the effects of greenhouse gas emissions.

"Pressure on industries with energy-sensitive operations and green house gas emissions will likely increase."

They include substantial economic effects such as crop losses associated with flooding and diminished farmer profits linked to delayed spring planting; forest losses due to warmer temperatures and elevated insect activity; property losses; significant losses in the energy sector; increasing cost associated with water infrastructure; and adverse affects on tourism, among others. EPA issued a final rule in October 2009 requiring large sources of greenhouse gas emissions to report them to EPA each year beginning in 2010.

SEC Disclosure Obligations

Various aspects of climate-related information fall under several SEC Regulation S-K provisions, including: Item 101: Description of Business; Item 103: Legal Proceedings; and, in particular, Item 303: Management's Discussion and Analysis of Financial Conditions and Results of Operations (MD&A).

Investor Network on Climate Risk, a Ceres project that's a broad coalition of the nation's largest institutional investors, asset managers, and NGOs, in September 2007 filed a petition seeking SEC guidance to clarify corporations' obligation to disclose material information about risks and opportunities they face regarding climate change. Investor Network filed a supplemental petition on November 23, 2009, renewing its request that the SEC require companies to disclose greenhouse gas emissions and associated risks.

The group argued that the new EPA reporting rule, Supreme Court decision, pending legislation, and other developments constitute a ‘known trend” within Regulation S-K Item 303. It requires disclosure of any such known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales, revenues or income from continuing operations. If the registrant knows of events that will cause a material change in the relationship between costs and revenues (such as known future increases in costs of labor or materials, price increases or inventory adjustments), the change in the relationship shall be disclosed.

Investor Network argues that climate-related information falls squarely within this description, and therefore must be disclosed. It isn’t alone. The National Association of Insurance Commissioners (NAIC), consisting of chief insurance regulatory officials of all 50 states, the District of Columbia, and five U.S. Territories in March 2009 required that insurance companies having in excess of $500 million in premiums disclose to regulators and the public financial risks they face from climate change and how they intend to respond to those risks.

Similarly, a number of bills have been introduced in Congress to direct the SEC to issue climate change disclosure rules. They seek to compel the SEC to issue rules within two years that mandate disclosure of risks relating to financial exposure companies face due to greenhouse gas emissions and potential economic impacts of global warming.

Raising the Intensity

It’s unclear whether the SEC will respond or whether legislative mandates or other regulatory and social imperatives will result when the SEC issues rules or guidance on climate change reporting. What’s clear is that the number and intensity of climate change disclosure initiatives are increasing and some would argue the new regulatory developments previously noted make the case under Regulation S-K Item 303. Reporting companies must stay abreast of these developments and carefully evaluate disclosure rules against company operations. Industries with energy-intensive operations and significant greenhouse gas emissions should be especially mindful of these requirements as the pressure to report will likely increase and focus most intently on them.

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