BLUEDOT CAPITAL

ESG and impact investing advisory with the goals of risk management and value enhancement

Blue Dot Capital is a sustainable finance consultancy. We partner with financial services firms to support the end-to-end development and execution of ESG and impact investing programs, capabilities, and products.

Our clients and partners include asset managers, alternative investment managers, family offices, and data providers.

Future-Proofing
Investment Decisions

Key Takeaways:

SEC CLIMATE-RELATED DISCLOSURES

On March 21, the Securities and Exchange Commission (SEC or the Commission) proposed sweeping rules intended to enhance and standardize climate-related disclosures to address investor needs.

This marks the most significant action the SEC has taken on the issue since the 2010 interpretive guidance on climate-related disclosures.

Content of the Proposed Disclosures

The proposed rules would require a registrant to disclose information about:

- The **oversight and governance of climate-related risks** by the registrant's board and management;
- How any climate-related risks identified by the registrant have had or are likely to have a **material impact** on its business and consolidated financial statements, which may manifest over the short-, medium-, or long-term;
- How any identified climate-related risks have affected or are likely to affect the registrant's **strategy, business model, and outlook;**
- The registrant's processes for identifying, assessing, and managing climate-related risks and whether any such processes are integrated into the registrant's **overall risk management system or processes;**
- If the registrant has adopted a **transition plan** as part of its climate-related risk management strategy, a description of the plan, including the **relevant metrics and targets** used to identify and manage any physical and transition risks;
- If the registrant uses **scenario analysis** to assess the resilience of its business strategy to climate-related risks, a description of the scenarios used, as well as the parameters, assumptions, analytical choices, and **projected principal financial impacts;**
- If a registrant uses an **internal carbon price**, information about the price and how it is set;
- The impact of **climate-related events** (severe weather events and other natural conditions) and **transition activities** on the line items of a registrant's **consolidated financial statements**, as well as the financial estimates and assumptions used in the financial statements;
- The registrant's direct GHG emissions **(Scope 1)** and indirect GHG emissions from purchased electricity and other forms of energy **(Scope 2)**, separately disclosed, expressed both by disaggregated constituent greenhouse gases and in the aggregate, and in **absolute terms, not including offsets**, and in terms of **intensity** (per unit of economic value or production);

- Indirect emissions from upstream and downstream activities in a registrant's value chain **(Scope 3)**, if material, or if the registrant has set a GHG emissions target or goal that includes Scope 3 emissions, in absolute terms, not including offsets, and in terms of intensity; and
- If the registrant has publicly set **climate-related targets or goals**, information about:
  - The scope of activities and emissions included in the target, the defined time horizon by which the target is intended to be achieved, and any interim targets;
  - How the registrant intends to meet its climate-related targets or goals;
  - Relevant data to indicate whether the registrant is making progress toward meeting the target or goal and how such progress has been achieved, with updates each fiscal year; and
  - If carbon offsets or renewable energy certificates ("RECs") have been used as part of the registrant's plan to achieve climate-related targets or goals, certain information about the carbon offsets or RECs, including the amount of carbon reduction represented by the offsets or the amount of generated renewable energy represented by the RECs.
- When responding to any of the proposed rules' provisions concerning governance, strategy, and risk management, a registrant may also disclose information concerning any identified **climate-related opportunities.**
- The proposed rules would require a registrant (including a foreign private issuer) to provide the climate-related disclosure in its registration statements and Exchange Act annual reports, for example on **Form 10-K**. Accelerated or large accelerated filers must obtain an **attestation report** from an independent attestation service provider covering, at a minimum, Scopes 1 and 2 emissions disclosure.

The public comment period will be open for 60 days.

Blue Dot Takeaways

- Disclosure is a means to an end, not an end in itself. The proposed rules are intended to establish the conditions for greater consistency, comparability, and reliability when it comes to reported emissions and registrants' management and governance of climate-related risks. There will be an initial learning curve, as investors seek to successfully derive actionable insights from the substantial amount of data the disclosures will generate. Over time, however, as SEC chief economist Jessica Wachter noted in her remarks, consistent and comparable disclosures should lead to lower costs for investors and create an "information externality" whereby greater availability of information on the business impacts of climate risks will allow investors to better understand these risk factors for similar firms.

- The rules will create significant pressure on investors and service providers to operationalize the information disclosed, including the development of new products and risk assessment frameworks that incorporate the additional data. However, investors should not necessarily expect the new rules to result in greater consistency and comparability from ESG data and ratings providers. Over the near to medium term, the significant variability in issuer disclosures, particularly related to governance and risk management processes is likely to persist.

- Scope 3 disclosures will be the focus of intense scrutiny. The new rules state that registrants will have to disclose Scope 3 emissions if material or if a registrant has established emission reduction goals that include Scope 3. While Scope 3 will not be subject to the same verification and assurance requirements as Scope 1 and Scope 2 emissions, companies that have made a net-zero pledge that include reductions in Scope 3 emissions will now be reporting progress in periodic reports, such as a 10-K.

  - Expanding on the determination of materiality of Scope 3 emissions, the Commission has weighed options including setting quantitative thresholds (% of total emissions), taking an industry-specific approach, etc.

- In her statement regarding what she hopes will be addressed during the comment period, Commissioner Lee raised the question of whether there should be an assurance carve-out for Scope 3 at all, or whether the broad safe harbor provision for Scope 3 should be conditional. The answer to these questions and the Commission's treatment of Scope 3 will have implications for registrants that have made net-zero commitments.
- For registrants that are financial institutions (banks, investment management firms, etc.) the proposal mandates guidelines on disclosure of financed emissions (category 15). The new rules' treatment of financed emissions will have significant implications for the members and supporters of the Net-Zero Banking Alliance, the Net Zero Asset Managers initiative, and the Net-Zero Asset Owner Alliance.
- Scope 3 emissions disclosure will cascade down to greater demand for reliable emissions data from companies' suppliers, including private companies.

- Accelerated and large accelerated filers need to obtain an attestation report from an independent attestation provider regarding the integrity of Scope 1 and 2 emissions disclosures. However, GHG emissions would not be subject to the existing framework for attestation of internal controls that independent accountants provide during their audits of the financial statements. Investors will likely scrutinize the internal controls and levels of oversight involved in emissions calculations given the different attestation frameworks applied to emission disclosures under the new rules.

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