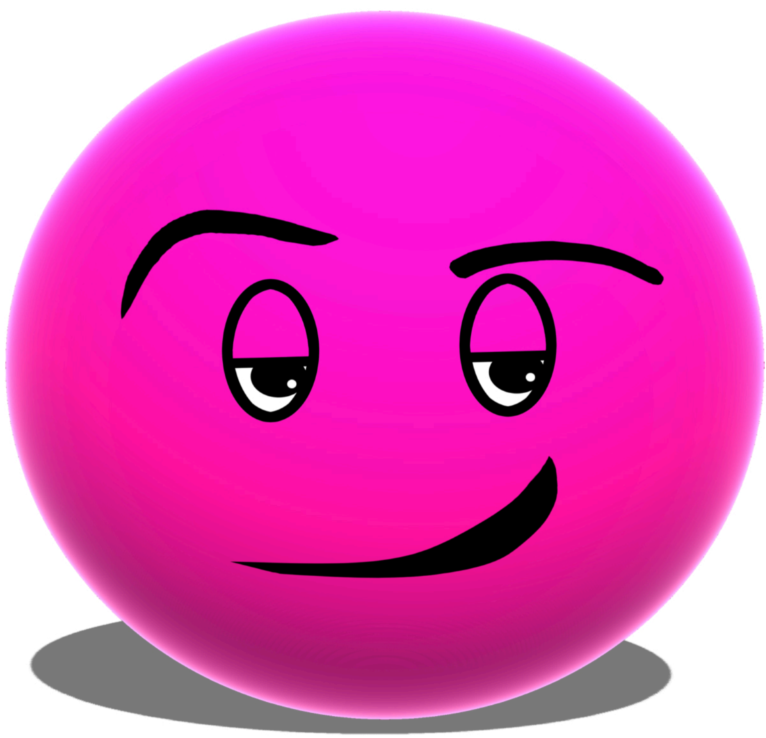
INSIDE OUT 8

FASHION'S IN-HOUSE COUNSEL SHARES SCHADENFREUDE



FRIDAY, FEBRUARY 10, 2023
9:30-10:45 AM

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FASHION'S IN-HOUSE COUNSEL SHARES SCHADENFREUDE

February 10, 2023

Reception: 9:00-9:30 AM
Panel: 9:30AM - 10:45AM

Fordham University School of Law
150 W. 62nd Street
Room 7-119
New York, NY 10023

SPEAKERS:

- **Nick Barnhorst,** General Counsel, Fresh
- **Angie Byun,** Principal, AB WORLD
- **Jana Checa Chong,** Senior Intellectual Property Counsel, Louis Vuitton
- **Lizzy Han,** Senior Counsel, Chanel
- **John Maltbie,** Director of Civil Enforcement, Intellectual Property, Louis Vuitton
- **Alice Pang**, Lead Intellectual Property Counsel, Ralph Lauren
- **Ariel Sodomsky,** Assistant General Counsel, Commercial Legal, Coty
- **Ashley Valdes,** Principal Counsel, Warby Parker, Warby Parker

MODERATOR:

- **Professor Susan Scafidi**, Founder & Director, Fashion Law Institute at Fordham

FASHION LAW
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INSIDE OUT 8

FASHION’S IN-HOUSE COUNSEL SHARES SCHADENFREUDE

Program Description

In-house counsel can rarely discuss their own cases or problems in public, but everyone is keeping an educated eye on others' issues. We've asked about the litigation, legislation, scandals, social issues, and other matters that our colleagues at fashion-related companies are glad are on someone else's desk and not their own, and we're eager to learn about what they're watching. Join us during New York Fashion Week for our 8th annual in-house counsel panel, "Inside Out 8: Fashion's in-house counsel shares schadenfreude"! This session will not be recorded.

SPEAKERS' BIOGRAPHIES

NICK BARNHORST

General Counsel, Fresh

Nick Barnhorst is General Counsel for Fresh, Inc., a leading luxury beauty and skin care company based in New York City. Mr. Barnhorst serves as Fresh's primary regulatory representative and advises the company on all legal matters, including global intellectual property protection, domestic litigation, and day-to-day operational matters. He previously served as Associate General Counsel for Sharp Electronics and spent eight years in private practice as a litigator and trademark practitioner. He is admitted to practice in New York and California. Mr. Barnhorst received a B.S. in Economics from the University of Pennsylvania, The Wharton School, and a J.D./MBA from Marquette University.

ANGIE BYUN

Principal, AB WORLD

Angie Byun is the principal of AB WORLD – a global consultancy representing leading U.S., Asian and international media, entertainment and luxury companies seeking to monetize their IP on new digital and social media platforms, expand their influence and reach new consumers through strategic cross-border business opportunities. Several of her current and past clients have included: BDG and W Media Group, TIME and TIME for Kids, Penske Media, Condé Nast, Panda Express and SuperOrdinary. Prior to starting AB WORLD, Angie was at Condé Nast for 13 years and held various executive level roles in new business development, sales and international licensing for brands like VOGUE, GQ, WIRED, and GOLF DIGEST – successfully launching and managing new editions, digital products, experiences, global advertising buys and over 100+ brand extensions in 30+ markets worldwide. As one of the most senior Asian American businesswomen in media, she is also actively involved in DEI initiatives and has a strong track record of leading diverse teams and bringing emerging brands and multicultural talent into the forefront of the media, entertainment, luxury and sports industry.

JANA CHECA CHONG

Senior Intellectual Property Counsel, Louis Vuitton

Jana Checa Chong currently serves as Senior Intellectual Property Counsel for Louis Vuitton and has been with the company since February 2014. In her current role, Jana is involved in the civil enforcement of the intellectual property rights of Louis Vuitton. Prior to joining Louis Vuitton, Jana was an associate attorney in the New York office of Gibson, Dunn & Crutcher LLP. Her practice focused on intellectual property litigation as well as white collar defense and investigations. As part of Jana's intellectual property practice, she had extensive experience representing brand owners in trademark infringement actions relating to internet-based counterfeiters. Jana received a Bachelor of Arts degree in International Affairs from the George Washington University and her Juris Doctor degree from Fordham University School of Law. While at Fordham Law, Jana served as Associate Editor on the *Fordham Law Review* and Managing Editor of the Fordham Moot Court Board. Additionally, she is an adjunct professor at the Fordham University School of Law where she co-teaches the Fashion Law Practicum.

LIZZY HAN

Senior Counsel, Chanel

Lizzy began her career at CHANEL as a legal intern while receiving her JD where she recognized her passion for the growing and ever-evolving online intellectual property space. She then continued her studies at the Fordham University School of Law for her LL.M in Intellectual Property and Information Technology. At Fordham, she was active with the Fashion Law Institute, and very interested in taking many of the fashion law courses offered. Lizzy spent the next 8 years at CHANEL focused on the Internet enforcement brand protection space before moving into the overall anti-counterfeit landscape including brick and mortar. She is currently Senior Counsel at Chanel, Inc., where she manages the US Anti-Counterfeit program.

JOHN MALTBIE

Director of Civil Enforcement, Intellectual Property, Louis Vuitton

John Maltbie has served as the Director of Civil Enforcement, Intellectual Property for Louis Vuitton Americas since October 2012. In that role, he oversees the intellectual property civil litigation and enforcement activities for some of the world's most famous luxury brands, including Louis Vuitton and Christian Dior. Prior to joining Louis Vuitton, John was an intellectual property associate at the law firm of Arnold & Porter LLP, among others, where he represented clients, including, Gucci, Alexander McQueen, Bottega Veneta, Nike, Adidas, Paramount Pictures, and Pernod Ricard, with respect to issues ranging from trademark prosecution and licensing to brand enforcement and anti-counterfeiting. John received a Bachelor of Arts degree from New York University and a Juris Doctor degree from Brooklyn Law School. He is admitted to the New York Bar. Additionally, he is an adjunct professor at Fordham Law School where he teaches Fashion Law Practicum.

ALICE PANG

Lead Intellectual Property Counsel, Ralph Lauren

Alice Pang joined Ralph Lauren in 2022 as Lead Intellectual Property Counsel. Prior to becoming in-house counsel, she served as an IP associate at McCarter & English's design, fashion, and luxury group for over nine years. She managed trademark and copyright portfolios, developed global brand protection and anti-counterfeiting programs for fashion, luxury and consumer product brands. Alice earned her JD from Cardozo School of Law, where she participated in Moot Court Honor Society and the Asian Pacific American Law Students Association. She graduated with a Bachelor of Arts in Political Science and Government from Syracuse University. Additionally, she has volunteered as an attorney for the Fashion Law Institute's Pop-Up Clinic.

ARIEL SODOMSKY

Assistant General Counsel, Commercial Legal, Coty

Ariel Sodomsky is Assistant General Counsel, Commercial Legal at Coty, where she works on various legal matters for Coty-owned and licensed brands including CoverGirl, Sally Hansen, Calvin Klein, Kylie Cosmetics, and Gucci. Prior to Coty, Ariel worked at Frankfurt Kurnit Klein & Selz in the Entertainment Group and at Creative Artists Agency in Television Business Affairs. Ariel earned her undergraduate degree from Cornell University and her law degree from Fordham University School of Law, where she was an active member of the Fashion Law Institute.

ASHLEY VALDES

Principal Counsel, Warby Parker

Ashley Valdes is Principal Counsel at Warby Parker, a direct to consumer eyewear company providing a full spectrum of vision services and high quality designer glasses. At Warby Parker, Ashley is responsible for reviewing and advising on the company's branding and marketing strategies, commercial contracts, and IP portfolio. Prior to joining Warby Parker, Ashley was an Associate with Hand, Baldachin & Associates LLP, a boutique firm which provided counsel to a variety of fashion, lifestyle and tech clients. Ashley graduated with a JD from Fordham Law School in 2016 with a concentration in Intellectual Property and Information law and has returned as an adjunct professor, teaching Fashion Retail Law.

Moderator:
PROFESSOR SUSAN SCAFIDI

Founder & Director, Fashion Law Institute at Fordham

Susan Scafidi is the first professor ever to offer a course in Fashion Law, and she is internationally recognized for her leadership in establishing the field. She has testified before the U.S. Congress regarding the proposed extension of legal protection to fashion designs and continues to work with government officials and stakeholders in the fashion industry on this and other issues. Her additional areas of expertise encompass property, intellectual property, cultural property, international law, and legal history.

Professor Scafidi founded and directs the Fashion Law Institute, the world's first center dedicated to the law and business of fashion. A nonprofit organization headquartered at Fordham Law School, the Fashion Law Institute was established with the generous support and advice of the Council of Fashion Designers of America and its then-president, Diane von Furstenberg. On behalf of the Fashion Law Institute and Fordham, Professor Scafidi also developed another global first: degrees in Fashion Law, an LLM for lawyers and an MSL for non-lawyers.

Prior to teaching at Fordham, Professor Scafidi was a tenured member of both the law and history faculties at SMU, and she has taught at a number of other schools, including Yale, Georgetown, and Cardozo. After graduating from Duke University and the Yale Law School, she pursued graduate study in legal history at Berkeley and the University of Chicago and clerked for a distinguished legal historian, Judge Morris S. Arnold of the Eighth Circuit Court of Appeals. In addition, she has served as an expert witness in cases including *Star Athletica v. Varsity*, the dispute over copyrighted designs on cheerleading uniforms that resulted in a Supreme Court victory for the plaintiff; *Navajo Nation v. Urban Outfitters*, which was resolved through a settlement that included the parties announcing plans to collaborate in the future; and other matters including litigants such as Gucci, Givenchy, and adidas.

Professor Scafidi is the author of *Who Owns Culture? Appropriation and Authenticity in American Law*, as well as articles in the areas of intellectual property, cultural property, and of course fashion law. She also created the first website on fashion law, *Counterfeit Chic*, which was recognized as one of the American Bar Association's top 100 blogs. Professor Scafidi is currently writing a book to be published by Yale University Press. In addition, she regularly speaks to legal, design, and academic audiences around the globe and has contributed analysis and commentary to hundreds of media reports on issues related to law and the fashion industry.

SELECTED READINGS

SELECTED READINGS

In keeping with the theme of "Inside Out 8: Fashion's in-house counsel shares schadenfreude," please enjoy the following readings referenced in and/or complementary to our panelists' remarks, in order of speaking:

NOT from the desk of **Alice Pang,** Lead Intellectual Property Counsel, Ralph Lauren:

> Order and Opinion, Hermès Int'l. v. Rothschild, No. 1:22-cv-00384-JSR (S.D.N.Y. Feb. 2, 2023) (denying summary judgment in "Metabirkin" case) (attached).
>
> Dhani Mau, *Making Sense of the Hermes v. Rothschild Metabirkins Verdict,* FASHIONISTA, Feb. 9, 2023, https://fashionista.com/2023/02/hermes-metabirkins-nft-lawsuit-explainer.
>
> Maghan McDowell, *Hermès wins case against Metabirkins over digital NFTs, Rothschild to appeal*, VOGUE BUSINESS, Feb. 8, 2023, https://www.voguebusiness.com/technology/hermes-wins-case-against-metabirkins-over-digital-nfts-rothschild-to-appeal.

NOT from the desk of **John Maltbie**, Director of Civil Enforcement, Intellectual Property, Louis Vuitton, or **Jana Checa Chong**, Senior Intellectual Property Counsel, Louis Vuitton:

> VIP Prods. LLC v. Jack Daniel's Props., Inc., 953 F.3d 1170 (9th Cir. 2020), *cert. granted*, 143 S. Ct. 476 (2022) (attached).

NOT from the desk of **Lizzy Han,** Senior Counsel, Chanel:

> Preliminary Injunction Order, Styles v. The Partnerships and Unincorporated Associations Identified on Schedule A, No. 1:23-cv-00137, (N.D. Ill. Jan. 10, 2023) (attached).

NOT from the desk of **Ariel Sodomsky**, Assistant General Counsel, Commercial Legal, Coty:

> Complaint, *Advance Magazine Publishers Inc. v. Aubrey Drake Graham, et al.*, (No. 1:22-cv-09517), 2022 WL 16791833 (S.D.N.Y. 2022) (attached).

NOT from the desk of **Angie Byun**, Principal, AB WORLD:

adidas terminates partnership with Ye immediately, adidas (October 25, 2022), https://www.adidas-group.com/media/filer_public/ad/3a/ad3a2389-959b-48ce-849b-0e8716be3824/20221025_adidasag_pressrelease_adidas_yeezy_en.pdf.

Miles Socha and Tianwei Zhang, *K-pop Stars Are Topping Fashion's Charts, Too*, WOMEN'S WEAR DAILY (April 26, 2021), https://wwd.com/fashion-news/designer-luxury/bts-louis-vuitton-blackpink-kpop-fashion-ambassadors-1234808647/.

Daisuke Wakabayashi and Tripp Mickle, *Tech Companies Slowly Shift Production Away From China*, NEW YORK TIMES (September 1, 2022), https://www.nytimes.com/2022/09/01/business/tech-companies-china.html.

NOT from the desk of **Ashley Valdes**, Principal Counsel, Warby Parker:

Pay Versus Performance, 17 C.F.R. §§ 229, 232, and 240 (October 11, 2022) (attached).

Press Release, Secs. and Exch. Comm'n, SEC Proposes Cybersecurity Risk Management Rules and Amendments for Registered Investment Advisers and Funds (February 9, 2022) (attached).

Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure, 87 Fed. Reg. 16590 (March 23, 2022) (attached).

Press Release, Secs. and Exch. Comm'n, SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors (March 21, 2022) (attached).

The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334 (April 11, 2022) (attached).

Rulemaking Petition to Require Public Companies to Disclose Investments in Their Workforce, Working Grp. on Hum. Cap. Acct. Disclosure (June 7, 2022), https://www.sec.gov/rules/petitions/2022/petn4-787.pdf

Press Release, Fed. Trade Comm'n, FTC Enforcement Action to Bar GoodRx from Sharing Consumers' Sensitive Health Info for Advertising (Feb. 1, 2023).

Amy Olivero & Cobun Zweifel-Keegan, *A Healthy Dose of Consent: Takeaways From the FTC's GoodRx Case*, IAPP (Feb. 8, 2023), https://iapp.org/news/a/a-healthy-dose-of-consent-takeaways-from-the-ftcs-goodrx-case/.

NOT from the desk of **Nick Barnhorst**, General Counsel, Fresh:

Priya Rao, *Sephora Responds to Claim Its Clean Beauty Programme Is Anything But*, BUSINESS OF FASHION (Feb. 2, 2023), https://www.businessoffashion.com/articles/beauty/sephora-defends-clean-beauty-programme/.

Complaint, Finster v. Sephora USA Inc., No. 6:22-cv-01187 (N.D.N.Y. Nov. 11, 2022) (attached).

Special thanks to Jordan Phelan, Fordham J.D. '23, Spencer Mooney, Fordham J.D. '23, and Kristen Pavlounis, Fordham J.D. '24 for assistance with collecting these readings.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

HERMÈS INTERNATIONAL and HERMÈS OF PARIS, INC., Plaintiffs, -against- MASON ROTHSCHILD, Defendant.	22-cv-384 (JSR) OPINION AND ORDER

JED S. RAKOFF, U.S.D.J.:

By Order dated December 30, 2022, the Court denied the parties' cross motions for summary judgment, with Opinion to follow. Here is that Opinion.

In their cross-motions for summary judgment, plaintiffs Hermès International and Hermès of Paris, Inc. (collectively "Hermès") and defendant Mason Rothschild ask the Court to determine two questions. First, whether the digital images underlying the non-fungible tokens ("NFTs") produced and sold by defendant Mason Rothschild depicting fur-covered Birkin handbags -- so-called "MetaBirkins" -- should be evaluated under the Rogers v. Grimaldi test for artistic works or the Gruner + Jahr test for general trademark infringement. Second, whether, under whichever test is applied, the MetaBirkins NFT images or related products infringe and/or dilute Hermès' trademarks pertaining to its Birkin handbag.[1] As to the first, threshold question, the Court reaffirms the determination it made in its earlier Order of May 18, 2022 that the plaintiffs' claims should be assessed under the two-part test articulated in Rogers v. Grimaldi, 875 F.2d 994 (2d Cir. 1989), for evaluating trademark infringement in artistic works. Dkt. 77, Order Denying Mot. to Dismiss ("Mot. Dismiss Order") at 11. As to the second question, the Court finds that there remain genuine issues of material fact that preclude summary judgment.

I. Factual Background[2]

Hermès is a luxury fashion brand known, among other things, for designing, producing, and marketing the "iconic" Birkin. Dkt. 74, Plfs.' Statement of Material Facts ("Plfs. SOMF") ¶ 2. Since 1986, Hermès has sold over $1 billion worth of these handbags in the United States, including over $100 million dollars' worth in the past ten years alone. Dkt. 69, Declaration of Nicolas Martin ("Martin Decl.") ¶ 10. Individual Birkin bags regularly sell for

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[1] The plaintiffs own trademark rights in the "Birkin" mark -- that is, the name of the bag itself -- and trade dress rights in the design of the Birkin handbag. Am. Compl. ¶¶ 34-36. Plaintiffs also bring cyber-squatting and unfair competition claims. See generally id.

[2] The following facts are taken from the parties' Rule 56.1 statements and supporting materials. Throughout this Opinion, the Court construes the facts in dispute most favorably to the party not moving for summary judgment with respect to whichever motion the Court is analyzing.

tens of thousands of dollars, with one fetching hundreds of thousands of dollars at Christie's, an art auction house. Plfs.' SOMF ¶ 58. As both parties recognize, the Birkin bag has also come to occupy a place of cultural importance as a symbol of wealth and exclusivity. Cf. Dkt. 84, Def's Counterstatement to Plfs. SOMF ¶ 3.

Defendant Mason Rothschild[3] is a self-described "marketing strategist" and "[e]ntrepreneur" who has launched two Birkin-related projects.[4] Dkt. 24, Amended Complaint ("Am. Compl.")

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[3] The defendant's legal name is Sonny Estival but he is referred to in this Opinion by his assumed name of Mason Rothschild, as he is in both parties' briefing papers. Am. Compl. ¶¶ 1, 8–9.

[4] There is substantial disagreement between the parties as to whether Rothschild himself created the digital images associated with the MetaBirkins project or whether another artist -- Mark Berden -- was responsible for designing and rendering them. On the one hand, Rothschild argues that he should be considered the NFT's progenitor: "[h]e had final approval" of all the digital images and, though "Mr. Berden functioned as a high-level studio assistant" who helped Rothschild create the digital images, Berden ultimately worked "at Rothschild's direction." Defendant's Counter-Statement to Plaintiff's Rule 56.1 Statement of Undisputed Facts ("Def. Counter-Statement to Plfs. SOMF") ¶ 35. The plaintiffs, on the other hand, submit that, to the extent the MetaBirkins are an artistic creation at all, Mr. Berden should be considered the artist. See Plfs. Br. in Support of Summary Judgment ("Plfs. Br. in Support") at 7. They allege that "Berden generated every image associated with the MetaBirkin NFTs" though "Rothschild did not provide Berden" with the requisite software, pay him a salary, or otherwise manage his hours. Id. This dispute, however, strikes the Court as legally irrelevant so far as the instant motions are concerned. Whether there is admissible evidence that the MetaBirkins are art -- and therefore, whether the Rogers test should apply -- does not turn on who designed the NFTs.

¶¶ 1, 8–9. First, in or around May 2021, Rothschild created a digital image he entitled "Baby Birkin," which depicted a 40-week-old fetus gestating inside a transparent Birkin handbag. Dkt. 72, Decl. of Megan Corrigan ("Corrigan Decl.") ¶¶ 70–71. Rothschild later sold the NFT linked to the "Baby Birkin" image for $23,500; it recently resold for $47,000. Id. ¶ 72. Then, a few months later, in December 2021, Rothschild created a collection of digital images titled "MetaBirkins," each of which depicted a unique image of a blurry faux-fur-covered Birkin handbag. Am. Compl. ¶¶ 37, 76, 79, Fig. 5 and Ex. Z. It is this "MetaBirkins" project that is the subject of this litigation.

As with his earlier "Baby Birkin" project, Rothschild used NFTs to sell the digital images to individual buyers. NFTs are digital records of ownership, typically recorded on a publicly accessible ledger known as a "blockchain." See Mot. Dismiss Order at 2. On the blockchain, an NFT functions as a sort of "digital deed" representing ownership in a physical or digital asset or assets. Here, each of the NFTs signified sole ownership of a particular "MetaBirkin," that is, a unique digital image of a Birkin handbag rendered by Rothschild.

Rothschild also commissioned computer engineers to operationalize a "smart contract" for each of the NFTs. A "smart contract" refers to a computer code that is also stored on the blockchain and that, among other things, determines the name of each of the NFTs, constrains how they can be sold or transferred, and controls which digital files are associated with each of the NFTs. See Dkt. 78, Decl. of Kevin D. Mentzer ("Mentzer Decl."), Ex. 1 at 9, 10, 16, 21 n.9, 24, 29.

Importantly, the "smart contract" is distinct from the NFT with which it is associated: the contract and the NFT can therefore be owned by two unrelated people or entities. Id. Indeed, Rothschild held onto the "smart contract" for each of the "MetaBirkin" NFTs even after the NFTs themselves had been sold to other buyers, which means he retains the power to change the image, title, or other attributes associated with the NFTs. See id. at 11, 16-17 & 29.

On December 2, 2021, Rothschild sold the rights to purchase the "MetaBirkin" NFTs before they were formally generated and placed on the blockchain -- or "minted" -- to one hundred purchasers through his website, https://metabirkins.com. Id., Ex. 1 at 9. Customers who browsed the website before the NFTs were sold and minted would see that each NFT was associated with a particular "MetaBirkins" digital image. Id. However, at the time the minting rights were sold, but before the "MetaBirkins" NFTs were formally minted and placed on the blockchain, a buyer viewing his purchase details on the MetaBirkins website would see that his NFT was now linked to a digital image of an object shrouded by a white cloth, not a unique "MetaBirkins" bag. Corrigan Decl., Ex.

21 at 227:16-228-3. Once the NFTs were minted on December 3, Rothschild -- using the "smart contract" -- replaced the "shrouded" object image with a unique "MetaBirkin" bag associated with the NFT, which continued to serve as the digital asset linked to each NFT for the duration of the period covered by this case. Id.

Around the same time, Rothschild contemplated "minting" more MetaBirkins NFTs to sell. Corrigan Decl., Ex. 29. In conversations with his associate, Mark Berden, he remarked that "[MetaBirkin NFTs] might be the next blue chip" and that they should consider producing another one hundred NFTs. Id. Later, he revised this figure upward to nine hundred, adding that the profits of these newly minted NFTs should be divided between the two, with $400,000 going to Rothschild and $100,000 to Berden. Id. Insisting that he was "sitting on a gold mine" and referring to himself as "a marketing king," Rothschild also discussed with his associates potential future digital projects centered on luxury products, such as watch NFTs called "MetaPateks" that would be modeled after the famous watches produced by Patek Philippe. Id., Ex. 33. In total, Rothschild and his associates produced one hundred MetaBirkins, which have, through June 2022, sold for over $1.1 million. Am. Compl. ¶ 120. On top of receiving a cut of those proceeds, Rothschild also received a creator fee for every re-sale of a MetaBirkin NFT, amounting to 7.5% of the total price of sale. Mentzler Decl., Ex. 1 at 5, 8-9.

In addition to the claims for infringement and dilution of its marks, Hermès asserts that Rothschild's project has disrupted their efforts to enter the NFT market and hindered its ability to profit in that space from the Birkin bag's well-known reputation. See Plfs. SOMF ¶¶ 109-112. Indeed, the company alleges that it has for years developed potential uses for NFTs as part of its overall business strategy. Rothschild's efforts to crowd it out of the NFT market, Hermès claims, places it at a competitive disadvantage: its plans to enter this market follow on the efforts of several top fashion brands -- including Gucci, Louis Vuitton, and Balenciaga -- to develop NFT strategies that would allow them to market their goods to a wider audience. Id. ¶ 113.

II. Procedural Background

Hermès brought this trademark action against Rothschild on January 14, 2022, shortly after notifying the defendant of their allegations in a December 16, 2021 cease and desist letter. See Dkt. 1, Complaint. Plaintiffs press four sets of allegations in their Amended Complaint. First, they claim that the MetaBirkins NFTs infringe Hermès' trademarks in the word "Birkin" and in the design and iconography of the handbag.[5] Second, they claim that

[5] Although Hermès maintains that Rothschild's misappropriation of the Birkin bag's "trade dress and imagery" are "aggravating factors" in this litigation, they assert that "it was Rothschild's unauthorized use of the Birkin name for [his] NFTs that . . . gave rise to this action" and is thus the focus of the parties' briefing. See Plfs. Br. in Support at 3.

Rothschild's alleged appropriation of the "Birkin" mark diluted and damaged the distinctive quality and goodwill associated with the mark. Third, they claim that Rothschild's use of a website domain name -- https://metabirkins.com -- constituted cybersquatting, in that it was confusingly similar to the "Birkin" mark, and therefore "harmed . . . and dilute[d]" the mark's distinctiveness and the goodwill associated with it. And fourth, they claim that Rothschild's use of its trademarks constitutes unfair competition under both federal and state law.

III. Discussion

A. Hermès' Trademark Infringement Claims

At the outset, the Court must decide which of the two frameworks for assessing trademark infringement applies to the claims in this case: the "Rogers" test or the "Gruner + Jahr" test.

Courts in this circuit and elsewhere[6] have long applied a two-tiered approach to trademark infringement claims. Alleged trademark infringement in works of "artistic expression" are to be evaluated under the speech-protective test set forth in Rogers v. Grimaldi, 875 F.2d 994, 1000 (2d. Cir. 1989). Claimed infringement

[6] The Third, Fifth, Sixth, Ninth, and Eleventh Circuits have largely adopted the Rogers test. See e.g., Seale v. Gramercy Pictures, 949 F. Supp. 331 (E.D. Pa. 1996), aff'd without opinion, 156 F.3d 1225 (3d Cir. 1998); Westchester Media v. PRL USA Holdings, Inc., 214 F.3d 658 (5th Cir. 2000; ETW Corp. v. Jireh Publ'g, 332 F.3d 915, 937 (6th Cir. 2003); Gordon v. Drape Creative, Inc., 909 F.3d 257, 269-70 (9th Cir. 2018).

in all other works -- that is, those that are instead "primarily intended to serve a commercial purpose" -- are subject to the Gruner + Jahr test, which largely involves assessing whether a defendant's use of something akin to plaintiff's trademark confused customers as to the source of the work or product. See Gruner + Jahr USA Pub., a Div. of Gruner + Jahr Printing & Pub. Co. v. Meredith Corp., 991 F.2d 1072 (2d Cir. 1993).[7]

The plaintiff contends that, because "Rothschild had no discernable artistic intent or expression in promoting and selling [the MetaBirkins NFTs]," it is the test outlined in Gruner + Jahr for evaluating alleged trademark infringement in general that should apply. See 991 F.2d 1072, 1074 (2d Cir. 1993); Dkt. 77, Plf. Br. Mot. Summ. J. at 23. The defendant, by contrast, urges the Court to affirm its previous ruling (made, however, just on the pleadings) that the Rogers test for creative works applies because the digital images associated with the MetaBirkins NFTs "could constitute a form of artistic expression." Mot. Dismiss

[7] The Second Circuit fashioned the Rogers test with the understanding that trademark law has the potential to "intrude on First Amendment values" by discouraging the use of certain trademarks in expressive works." AM General LLC v. Activision Blizzard, Inc., 450 F. Supp. 3d 467, 477 (S.D.N.Y. 2020). The test ensures, among other things, that "a markholder cannot shield itself from criticism by forbidding the use of its name in commentaries critical of its conduct." Lamparello v. Falwell, 420 F.3d 309, 318 (4th Cir. 2005).

Order at 11. This Court agrees with the defendant: it is the Rogers test that still applies here on summary judgment.

1. What Works Are "Artistic" and Therefore Deserving of First Amendment Protection Under the Rogers Test?

Deciding which of these tests to apply on summary judgment first requires defining the set of works that are "artistic" and therefore deserving of First Amendment protection. See Rogers, 875 F.2d at 1000. Rogers itself had no occasion to elaborate on which works qualified as "artistic" because the work at issue there -- a Federico Fellini film parodying Fred Astaire and Ginger Rogers -- was "indisputably" one of "artistic expression" and therefore presumptively "deserv[ing of] protection." Id. at 997; see also Rogers v. Grimaldi, 695 F. Supp. 112, 120-121 (S.D.N.Y. 1988) (juxtaposing "artistic expression" with "commercial speech . . . intended primarily to persuade the public to consume something . . . or to convey the false impression that [a] plaintiff was somehow involved with or had endorsed the product."). Later cases in the Second Circuit have done little to further define "artistic expression." See, e.g., Cliff Notes, Inc. v. Bantam Doubleday Dell Pub. Group, Inc., 886 F.2d 490, 495 (2d Cir. 1989) (stating that "the Rogers balancing approach is generally applicable to Lanham Act claims against works of artistic expression," a category which includes "parody"); United We Stand Am., Inc. v. United We Stand, Am. N.Y., Inc., 128 F.3d 86, 93 (2d

Cir. 1997) (explaining that the First Amendment protects the use of trademarks to further "commentary, comedy, parody, news reporting, or criticism," among other things).

Decisions from our fellow district courts are somewhat more helpful in shedding light on what constitutes "artistic expression." Most of these courts have held that the Rogers test applies wherever the work is plainly expressive and the plaintiff's trademark is "not [used as] a source identifier." See, e.g., Champion v. Moda Operandi, Inc., 561 F. Supp. 3d 419, 434 (S.D.N.Y. 2021) (quoting Yankee Pub. Inc. v. News Am. Pub. Inc., 809 F. Supp. 267, 276 (S.D.N.Y. 1992) (Leval, J.)) (noting that this represents "an expan[sion] of the Rogers test).

The gist of these holdings is that as long as the plaintiff's trademark is used to further plausibly expressive purposes, and not to mislead consumers about the origin of a product or suggest that the plaintiff endorsed or is affiliated with it, the First Amendment protects that use. See Yankee Pub. Inc., 809 F. Supp. at 276. Put another way, "[t]he First Amendment" in the trademark context "protects an individual's right to speak out against a mark holder, but it does not permit an individual to suggest that the mark holder is the one speaking." SMJ Grp., Inc. v. 417 Lafayette Restaurant LLC, 439 F. Supp. 2d 281, 291 (S.D.N.Y. 2006).

The touchstone of the inquiry, then, is whether the trademark was used to mislead the public about the origin of the product or the parties that endorse or are affiliated with it. To understand why, it helps to examine the purposes underlying trademark law and how those goals inform the scope of its protection. Trademark law is concerned with preventing consumer confusion and making it easier for consumers to make informed decisions about products on the market. See Elastic Wonder, Inc. v. Posey, 179 F. Supp. 3d 307, 316 (S.D.N.Y. 2016). More specifically, the reason that trademark law protects a mark holder's rights in certain "symbols, elements, or devices used to identify a product in the marketplace" is so that consumers can reliably determine the producer -- or origin -- of a particular good. See EMI Catalogue P'ship v. Hill, Holliday, Connors, Cosmopulos, Inc., 228 F.3d 56 (2d. Cir. 2000). This information is vital to ensuring that consumers can make informed purchases: it "makes consumers confident that they can identify brands they prefer," made by the manufacturers they prefer, "and can purchase those brands without being confused or misled" about the qualities of the goods they are purchasing. Two Pesos, Inc. v. Taco Cabana, Inc., 505 U.S. 763, 784 n.19 (1992) (Stevens, J., concurring).

Unlike copyright law (which implements Art. I, § 8, cl. 8 of the Constitution), trademark law is not intended to protect the owner's right in a creative product simply to encourage creative output, i.e., where there is no consumer confusion. See EMI Catalogue, 228 F.3d 56, 63 (2d Cir. 2000). In other words, trademark law, unlike copyright law, is not founded on a constitutional mandate, and therefore must be applied with caution where constitutionally protected speech is arguably involved.

2. The Rogers Test Governs This Case

Applying these principles, this Court determined in its Order denying the defendant's motion to dismiss that the Rogers test applies to Hermès' claims because, on the pleadings, Rothschild's MetaBirkins "could constitute a form of artistic expression." Mot. Dismiss Order at 11. Having now carefully examined the admissible evidence adduced on the instant summary judgment motions, the Court reaches the same conclusion as to the applicable test. This is because defendant has identified admissible evidence supporting its assertion that Rothschild's use of Hermès' marks did not function primarily as a source identifier that would mislead consumers into thinking that Hermès originated or otherwise endorsed the MetaBirkins collection, but rather as part of an artistically expressive project. See Champion, 561 F. Supp. 3d at 434.

Before proceeding, some clarity is needed on exactly what works are at issue. "Because the digital images are not permanent and can be easily replaced" through use of a smart contract, the plaintiff believes that the title "MetaBirkins" refers to the NFTs "separate and apart from the digital images" of faux-fur bags with which they are associated. See Plfs. Br. in Support at 9. Indeed, it is undisputed that the image associated with each of the NFTs before they were minted was a white shrouded object until Rothschild replaced that image with faux-fur Birkin bags through use of the NFTs' smart contracts. To this, Rothschild responds that the term "MetaBirkins" includes the digital images themselves because the descriptions that preceded the sales of the NFTs made clear to consumers that they were purchasing a digital handbag image and not just a digital deed divorced from that image.

Given the centrality of consumer confusion to trademark law generally, it is best to view this issue from the perspective of the prospective consumer. Individuals do not purchase NFTs to own a "digital deed" divorced from any other asset: they buy them precisely so that they can exclusively own the content associated with the NFT.

What is more, undisputed evidence in the record indicates that consumers did in fact understand themselves to be purchasing exclusive ownership of the digital image alongside the NFT. A screenshot of the MetaBirkins website before minting shows that prospective buyers would have been shopping for an NFT associated with the digital image of a Birkin bag, not a white shrouded object. See, e.g., Rothschild Decl ¶ 11. To be sure, since Rothschild held onto the smart contract, he had the technical ability to change the digital image associated with the NFT, essentially at will. But the fact that Rothschild could do so in the abstract is irrelevant to the undisputed facts of this case: that, for all but a day, the MetaBirkins NFTs were linked to an image of a unique digital handbag and that consumers understood themselves to be buying a deed to that handbag.

Thus, the title "MetaBirkins" should be understood to refer to both the NFT and the digital image with which it is associated. Indeed, a reasonable inference from the admissible evidence presented on these motions is that the relevant consumers did not distinguish the NFTs offered by Mr. Rothschild from the underlying MetaBirkins images associated with the NFTs and, instead, tended to use the term "MetaBirkins NFTs" to refer to both. See e.g., Dkt. 64, Decl. of Mason Rothschild ("Rothschild Decl.") ¶ 11.

"When resolving the somewhat competing protections of the Lanham Act and the First Amendment, courts have distinguished between uses of a mark 'for an expressive purpose' . . . and uses of a mark to identify the source of a message." SMJ Group, 439 F. Supp. 2d at 291. Because the admissible evidence introduced on the instant motions indicates that both kinds of uses were present, the Rogers test remains the applicable one as far as these motions are concerned. See Mot. Dismiss Order at 11.

Indeed, the MetaBirkins images themselves, with their depiction of Birkin bags covered with fur, suggest that they were originated as a form of artistic expression. While there may have been some confusion in this respect, as plaintiffs argue, it should also be noted that, after Hermès sent to Rothschild a cease and desist letter outlining its allegations, Rothschild placed a prominent disclaimer on the MetaBirkins website stating that his project was "not affiliated, associated, authorized, endorsed by, or in any way officially connected with Hermès, or any of its subsidiaries or affiliates." Id. ¶ 25. Further, when several publications mistakenly reported an affiliation between Hermès and the MetaBirkins project,[8] the defendant's publicist, Kenneth Loo, reached out and asked that these publications issue corrections regarding the mistaken affiliation. Id. ¶¶ 122, 126-128. And though Rothschild sought to partner with Hermès on the project, after his attempts failed to bear fruit he did not represent to others that Hermès had agreed to work with him. Id.

Further still, evidence contemporaneous with the launch of the project suggests that Rothschild viewed the project as a vehicle to comment on the Birkin bag's influence on modern society. For instance, in an interview with Yahoo Finance dated December 6, 2021 -- ten days before Hermès sent its cease and desist letter to Rothschild outlining its allegations -- Rothschild characterized

[8] Elle UK published an article in which they reported that "Hermes had created the MetaBirkins NFT and referred to the MetaBirkins as a Birkin." See Plfs. SOMF ¶ 123. L'Officiel, a French fashion magazine, wrote that Hermes "partnered with" Rothschild to create "a new line of Birkin bags," and "another collection of Birkin NFTs." Corrigan Decl., Ex. 67 at 121; Ex 72. The New York Post stated that Hermes had "unveiled the MetaBirkin -- a VR version of its signature bag." Plfs. SOMF ¶ 128.

the NFT collection as "an experiment to see if [he] could create that same kind of illusion that [the Birkin bag] has in real life as a digital commodity."[9] Plfs. SOMF ¶ 168. The decision to make them faux-fur covered, he also explained, was an attempt to introduce "a little bit of irony" to the efforts of some fashion companies to "go fur-free." Id.

To be sure, Hermès has offered admissible evidence contradicting each of defendant's assertions and the evidence referenced above. For example, there is evidence introduced by plaintiffs from which a reasonable juror could conclude that Rothschild's claims that he viewed MetaBirkins as a largely artistic endeavor is a fabrication. For example, in discussions with investors, Rothschild observed that "he doesn't think people realize how much you can get away with in art by saying 'in the style of'" and boasted that he was "in the rare position to bully a multi-billion dollar corp[oration]." Plfs. SOMF ¶¶ 176, 178. Similarly, in one text message, Rothschild told associates that he wanted to make "big money" by "capital[izing] on the hype" in the media generated for the collection. Def. SOMF ¶ 200. And in another text message, Rothschild encouraged Mr. Berden to generate the

[9] In the same interview, Rothschild also elaborated on the communicative message behind his earlier "Baby Birkin" project, explaining that the decision "to put a baby in a Birkin and go through all stages of pregnancy" was an "artistic representation" that "play[ed] on the words baby and Birkin," which is "the most sought after Birkin size." Plfs. SOMF ¶ 168.

MetaBirkins NFTs "real fast" so that they could "print some money" from their sale, reassuring Berden that the "simple" digital images could later be "swapped out" for "better ones." Id. ¶ 218.

However, such evidence does little more than show that Rothschild's project was driven in part by pecuniary motives, a fact that does not bar application of the Rogers test. Whereas as a general matter "speech . . . primarily intended to serve a commercial purpose" falls outside the scope of the First Amendment, Rogers v. Grimaldi, 695 F. Supp. 112, 120-121 (S.D.N.Y. 1988), a court may not strip an artistic work of First Amendment protection merely because the artist seeks to market and sell his creative output. See Mot. Dismiss Order at 12 ("Rogers is not inapplicable simply because Rothschild sells the images -- the movie studio defendant in Rogers sold the film at issue."). Put another way, courts should not expect that the First Amendment applies only to the works of "starving artists" whose sole mission is to share their artistic vision with the world. Overall, the very fact that there is a genuine dispute of fact as to virtually every aspect of plaintiffs' claims only goes to show why summary judgment is not appropriate here, but not why the Rogers balancing test is not the right test against which to evaluate the parties' competing inferences.

3. The Parties' Motions for Summary Judgment As To the Rogers Factors Are Denied

While the Rogers test is therefore the governing framework for these motions, the Rogers test does not offer defendants unfettered license to infringe another's trademarks. See Rogers, 875 F.2d at 998 ("First Amendment concerns do not insulate titles of artistic works from all Lanham Act claims."). "Works of artistic expression . . . deserve protection," but they "are also sold in the commercial marketplace like other more utilitarian products, making the danger of consumer deception a legitimate concern that warrants some government regulation." Id. In certain instances, the public's interest in avoiding competitive exploitation or consumer confusion as to the source of a good outweighs whatever First Amendment concerns may be at stake.

The Rogers test incorporates these competing considerations. Specifically, an otherwise artistic work is not entitled to First Amendment protection under that test if the plaintiff can show that either (1) the use of its trademark in an expressive work was not "artistically relevant" to the underlying work or (2) the trademark is used to "explicitly mislead" the public as to the source or content of the underlying work. Id.

To determine whether either party is entitled to summary judgment under the Rogers test, then, the Court must inquire whether there remains a "genuine issue as to any . . . fact" material to meeting either of the prongs of the test. Because the Court concludes that genuine issues of material fact exist with respect to both these elements, it denies both parties' summary judgment motions in their entirety.

i. *The "Artistic Relevance" Factor*

The artistic relevance prong of the Rogers test "ensures that the defendant intended an artistic -- i.e., non-commercial association with the plaintiff's mark, as opposed to one in which the defendant intends to associate with the mark to exploit the mark's popularity and good will." Louis Vuitton Malletier S.A. v. Warner Bros. Ent. Inc., 868 F. Supp. 2d 172, 178 (S.D.N.Y. 2012). Under Rogers, however, a showing of artistic relevance is easily satisfied: it is met "unless the [use of the mark] has no artistic relevance to the underlying work whatsoever," and was instead chosen merely "to exploit the publicity value of [the plaintiff's mark or brand]." Rogers, 875 F.2d at 1001 (emphasis in original).

Still, "the level of relevance" is not "zero." E.S.S. Ent. 2000, Inc. v. Rock Star Videos, Inc., 547 F.3d 1095, 1100 (9th Cir. 2008); see Rogers, 875 F.2d at 1001 (cautioning that the artistic relevance prong is not met where the relevant trademark was "chosen just to exploit the publicity value of [the plaintiffs'] mark"). In such a case, the defendant invokes the First Amendment as pretext for his real objective -- to unfairly profit from the "popularity and goodwill" that the plaintiff had worked hard to cultivate. Louis Vuitton Malletier S.A. v. Warner Bros. Ent. Inc., 868 F. Supp. 2d 172, 178 (S.D.N.Y. 2012).

Here, there is a genuine factual dispute as to whether Rothschild's decision to center his work around the Birkin bag stemmed from genuine artistic expression or, rather, from an unlawful intent to cash in on a highly exclusive and uniquely valuable brand name.

Hermès argues that Rothschild invoked the First Amendment as a defense only after it had sent a cease and desist letter on December 16, 2021. In their view, Rothschild's comments to investors that "he doesn't think people realize how much you can get away with in art by saying 'in the style of'" and that he was "in the rare position to bully a multi-billion dollar corp[oration]" are probative of an intent to exploit. See Plfs. SOMF ¶¶ 176, 178.

Rothschild, by contrast, maintains that the project's expressive purpose was clear from its inception. See Def. SOMF ¶17 (citing to testimony by Rothschild that the MetaBirkins NFT was "part of his artistic experiment to see how people with money and influence who drive the culture would respond to" the MetaBirkins and "whether they actually would ascribe value to the ephemeral MetaBirkins" in the same way they attached value to the physical Birkin bags"). Because the facts in dispute on this issue are both material and genuine -- such that their resolution one way or the other could be relevant to the outcome of the litigation -- summary judgment for either party is inappropriate here.

More generally, whether a defendant's use of a plaintiff's trademark is "artistically relevant" to their work is "a mixed question of law and fact" involving "the application of [the Rogers test] to a particular set of facts." Richardson v. New York State Dep't Corr. Serv., 180 F.3d 426, 437 (2d Cir. 1999) (citations and internal quotations omitted). "Such mixed questions are especially well-suited for jury determination and summary judgment may be granted only when reasonable minds could not differ on the issue." Id. Because reasonable individuals could reach different conclusions on the "artistic relevance" factor, the Court denies both parties' summary judgment motions on it.

ii. *The "Explicitly Misleading" Factor*

Even where the use of a trademark bears "some artistic relevance" to an underlying artistic work, the First Amendment does not protect such use if it "explicitly misleads as to the source or the content of the work." Twin Peaks Prods., Inc. v. Publications Int'l, Ltd., 996 F.2d 1366, 1379 (2d Cir. 1993). A work is "explicitly misleading" if it "induces members of the public to believe" that it was created or otherwise authorized by the plaintiff. Id. "This determination must be made, in the first instance, by application of the venerable Polaroid factors," with the important qualification that the "likelihood of confusion" assessed under these factors "must be particularly compelling to outweigh the First Amendment interest recognized in Rogers." Id.

Put another way, the most important difference between the Rogers consumer confusion inquiry and the classic consumer confusion test is that consumer confusion under Rogers must be clear and unambiguous to override the weighty First Amendment interests at stake. Id.

The Second Circuit's decision in Polaroid Corp v. Polaroid Elecs. Corp, 287 F.2d 492 (2d Cir. 1961), set forth eight factors that courts (and juries) should weigh to assess whether the defendant's use of a plaintiff's trademark is explicitly misleading. Applied here, the relevant considerations are: (1) the strength of Hermès' mark, with a stronger mark being entitled to more protection; (2) the similarity between Hermès' "Birkin" mark and the "MetaBirkins" mark; (3) whether the public exhibited actual confusion about Hermès' affiliation with Rothschild's MetaBirkins collection; (4) the likelihood that Hermès will "bridge the gap" by moving into the NFT space; (5) the competitive proximity of the products in the marketplace; (6) whether Rothschild exhibited bad faith in using Hermès' mark; (7) the respective quality of the MetaBirkin and Birkin marks; and, finally, (8) the sophistication of the relevant consumers.

As the sheer length of this list should communicate, "the Polaroid factors require a fact-intensive, context-specific analysis presented on a full record." Uber Inc. v. Uber Techs., Inc., 521 F. Supp. 3d 455 (S.D.N.Y. 2021). One may expect, then, that in most cases involving Rogers there would remain genuine issues of material fact with respect to many or most of its factors, even at the late stages of litigation.

That is the case here. To take just one factor, the parties disagree vehemently over whether consumers were confused about Hermès' association with the MetaBirkins project. Indeed, Hermès commissioned a study that found a 18.7% net confusion rate among potential consumers of NFTs. Alongside this aggregate data, the plaintiff points to anecdotal evidence of social media users and the media that allegedly shows actual confusion over the fashion company's role in the project.[10] Rothschild, for his part, objects to the study's method and argues that the social media posts are not evidence of actual confusion. Because there remain substantial factual disagreements between the parties with respect to many -- if not most -- of the eight factors, any of which could be dispositive to the outcome, the Court declines to grant summary judgment for either party on this issue.

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[10] For example, one user on Twitter commented "Finally an NFT my wife can get on board with! Would LOVE to get her this Birken [sic] for Christmas!" Plfs. SOMF ¶ 132. Another that: "I need this Birkin for the wifey! Please whitelist me sir. #WAGMI #MetaBirkins." Id. ¶ 133. A third that: "Birkin NFT is the future of fashion." Id. ¶ 134. One begged Rothschild to "whitelist him" so that he could "own his first Birkin." Id. ¶ 146. Though consumers may have been confused about Hermes's association, merely using the shorthand "Birkin" to refer to the NFTs is consistent with a theory that there was no such confusion.

B. Hermès' Other Claims

As the Court explained in its motion to dismiss ruling, Hermès' remaining claims for, inter alia, trademark dilution and cybersquatting, rise or fall depending on the ultimate resolution of the Rogers test. See Mot. Dismiss Order at 19-20; see also Deere & Co. v. MTD Prods., Inc., 41 F.3d 39, 44 (2d Cir. 1994) (citing Rogers, 875 F.2d at 1000) ("The risk [of] some dilution of the identifying or selling power of the mark is generally tolerated in the interest of maintaining broad opportunities for expression."); United We Stand Am., Inc. v. United We Stand Am. N.Y., Inc., 128 F.3d 86, 91 (2d Cir. 1997) ("[E]ven if plaintiff suffered some trademark dilution, defendants' right under the First Amendment to use plaintiff's mark to communicate the message might prevail over plaintiff's rights under the trademark law to avoid all dilution.") Because the Rogers issue has yet to be resolved, summary judgment on these claims is inappropriate on that ground alone.

Beyond that, however, the Court finds that genuine issues of material fact remain with respect to these claims as well. For instance, liability under the cybersquatting statute turns on whether the defendant "has a bad faith intent to profit from that mark." See 15 U.S.C. § 1125(d)(1)(A)(i). And whether Rothschild acted in "bad faith," in turn, depends on facts that are plainly in dispute. On one side, Rothschild argues that he acted in good faith because he allegedly made efforts -- described above -- to disassociate Hermès from the MetaBirkins project. On the other, Hermès insists that Rothschild's naked attempts to profit from the Birkin mark clearly show that he has acted in bad faith with respect to his use of the Birkin mark. Plfs. SOMF ¶¶ 176, 178. Such issues, like the others described above, are for the jury to decide.

IV. Conclusion

For the reasons discussed above, the parties' cross-motions for summary judgment are denied in their entirety.

SO ORDERED.

New York, NY
February 2, 2023

JED S. RAKOFF, U.S.D.J.

MAKING SENSE OF THE HERMÈS V. ROTHSCHILD METABIRKINS VERDICT

We asked experts for an explainer even the Web3-illiterate will understand.

DHANI MAU • 4 HOURS AGO

Photo: Edward Berthelot/Getty Images

On Wednesday, a Manhattan federal jury ruled in favor of Hermès in its lawsuit against artist Mason Rothschild over his collection of NFT versions of Birkin bags — "MetaBirkins," as they were officially dubbed. The jurors found that these digital artworks violated the iconic French luxury brand's trademark rights and were likely to confuse consumers, awarding Hermès $133,000 in damages.

One of the first lawsuits of its kind, concerning a burgeoning industry that many (myself included) don't fully understand, it's getting a lot of chatter online, with some wondering if the verdict spells the end of NFTs-as-art.

Confused yet? So was I, so I consulted a couple of experts who know a lot about the issues at hand — intellectual property law, trademarks, fashion and NFTs — and asked them to explain it all to me like I'm five. Below, a hopefully easy-to-understand breakdown of the verdict and what it really means for the future of digital art and fashion IP.

WHAT DID MASON ROTHSCHILD DO?

In May of 2021, Rothschild, a digital artist (and co-founder of Los Angeles concept shop Terminal 27), released his first Hermès-inspired digital artwork: The Baby Birkin featured a fetus gestating in a transparent Birkin bag and sold for $23,500 as an NFT, a "non-fungible token" that represents authentic ownership of a digital asset on a blockchain (meaning no physical version of this item exists). There was more to come, Rothschild promised.

"That controversial piece depicted a fetus as a Birkin bag, creating buzz for the larger collection of 100, and its high sale price drove speculation on the value of the MetaBirkin collection," explains Rembrandt Flores, founder of 8Commas, a web3 amplification consultancy.

In December of that year, he followed up that buzzy debut with a new collection of 100 "MetaBirkins." These colorful, fuzzy digital renderings of Hermès Birkin bags were revealed via platforms like Twitter and Discord and put up for sale as NFTs. Per Business of Fashion, they were priced at 0.1 ETH (ETH being the cryptocurrency for the Ethereum blockchain) equivalent at the time to about $450. After the initial sales, the owners of these tokens were free to trade them like stocks, with their value fluctuating based on demand and rarity — one went for as much as $46,000.

WHY WAS IT CONCERNING?

Experts were quick to question whether such NFTs could stand up against intellectual property law and Hermès' was quick to publicly condemn the project (even before taking legal action), telling the Financial Times shortly after the launch, "These NFTs infringe upon the intellectual property and trademark rights of Hermès and are an example of fake Hermès products in the metaverse."

"If Rothschild had stopped with 'Baby Birkin,' Hermès might not have sued," explains Professor Susan Scafidi, founder and director of the Fashion Law Institute at Fordham Law School. "Artists often use famous logos in pop-art-style paintings and other traditional artistic media, and the brand owners rarely object to one-off, expressive creations. Rothschild, however, didn't stop."

Rothschild, who rendered the MetaBirkins in "faux fur" (again, these pictures were never real in the first place), told BoF they were, "my artistic take on an icon, my remix."

"I think that Mason believed that he had two rules protecting him, one being the First Amendment, 'Free Speech,' and the second being an exception to copyright and trademark law called 'Fair Use,' says Flores.

"Many artistic works that incorporate others' trademarks can claim free speech protection — as long as consumers aren't misled into thinking those works are affiliated with the brand," explains Scafidi.

WHY DID HERMES SUE — AND WIN?

The Hermès Birkin is one of very few fashion items that are recognizable enough to be legally trademarked — both the word "Birkin" and the bag's shape are protected. When Rothschild sold his 100 MetaBirkins, indicating plans to launch hundreds more, Hermès was not going to look the other way.

"At that point, Hermès objected, since Rothchild's actions looked less like free speech and more like the kind of commercial free-riding that could damage the image of Hermès," says Scafidi. "The attention to the Metabirkins could also prevent Hermès from developing its own digital art and NFT strategy, something that had already proved very lucrative for other fashion houses. Dolce & Gabbana, for example, in 2021 created a collection of 9 NFTs that sold along with physical items for almost $6m." Gucci, Givenchy and Burberry have also released NFTs.

"It's not every day that fashion can make millions on a whole new product category, and the lawsuit by Hermès was intended to make sure that if anyone was going to profit from NFTs associated with its products, it would be the company itself," Scafidi continues.

Hermès is a powerful, well-protected company, but there was still no guarantee it would prevail, especially once the case went to trial.

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"Hermès took a risk in bringing this case before a jury, which could have decided instead that the MetaBirkins were artistic expression and that consumers were not confused as to their association with the brand," says Scafidi. "Instead, the company argued that Rothschild was engaged in ordinary trademark infringement under the pretext of making art, and the jury apparently agreed — in their eyes, Rothschild was no starving artist, just a tech-savvy opportunist, even if his target was a luxury brand. In other words, Hermès got a New York jury that knew its bags from its BS."

"The biggest reason why Hermes prevailed gets to the heart of why these laws are in place," offers Flores. "Brand builders spend decades refining their products, courting customers, and building a logo that can be trusted for quality and unique value. They protect these brands by filing for trademarks so that they can rely on the court system to back them up whenever someone is selling using their name. Since Mason used Hermès' iconic product, their name, and sold his collection for money to buyers, his defenses weren't enough to persuade the court that he wasn't trading on their brand with his artwork."

WHY IS THIS ALL A BIG DEAL?

"Every new medium or form of retail has its signature trademark lawsuit, and the Metabirkin case is that lawsuit for art and NFTs," says Scafidi. "Every fashion lawyer in the world has been watching this case, and today was a red-letter day in the brand protection world."

It's one of the first lawsuits of its kind, and thus, its verdict sets a precedent. Some onlookers, particularly those in opposition to the ruling, worry about the fact that a jury decided Rothschild's NFTs didn't qualify for protection under free speech, determining that such digital artworks should be seen as commodities rather than art. Per the *New York Times*, one of Rothschild's lawyers, called it a "great day for big brands" and a "terrible day for artists and the First Amendment."

WHAT DOES THIS MEAN FOR THE FUTURE OF NFTS AND DIGITAL ART?

"The future of fashion NFTs depends on the art market and whether consumers would rather spend money on images of handbags or the real thing, but this victory for one intellectual property owner clears the way for brands to challenge at least uncreative commercial use of their trademarks in the digital realm," says Scafidi, who believes that "true artistic or expressive uses" of a brand's intellectual property could still escape similar lawsuits.

"This going to set precedent for all NFTs in the future, but with this could mean more litigation protecting art/IP ahead," says Flores. "It opens the door for other lawsuits such as Nike v. StockX and brings the conversation back to the NFT community about what IP means, even if these collections are 100% digital"

There's also the question of what, if any, responsibility NFT marketplaces (where NFTs like the MetaBirkins are sold online) have.

"NFT marketplaces rarely monitor projects and have taken a hands-off approach generally," notes Flores. "We may see greater pressure on NFT marketplaces to comply with takedown requests of trademarked and copyrighted projects."

WHAT SHOULD BRANDS AND ARTISTS TAKE AWAY FROM IT?

"Any brand that has artistic aspirations but has not yet registered its trademarks in the class relevant to NFTs should do so immediately," advises Scafidi.

Meanwhile, "artists should proceed with caution when incorporating others' trademarks into their work, asking themselves what statement they're making and whether the trademark is relevant to that artistic expression. It's also important for artists who use others' trademarks to make an effort to ensure that consumers won't think their work is affiliated with the brand, a common assumption in the age of frequent fashion/art collabs."

Flores advocates for more education and communication between both parties — i.e., fashion brands working with digital artists in an official capacity to explore the NFT world.

"This is a call to legacy brands to understand what is happening with this next generation. They are comfortable with collecting exclusive things digitally and want to see their favorite products and brand names wherever they go," he says. "Brands should encourage community collaborations and have a way to help plan for and reward user-generated content and artistic works that help shine light on their products. Many brands pay huge sums to films, musicians, and sports organizations for product placement. Getting a top brand into web3 and metaverse should be approached in a similar way. I would love to see more brands such as Tommy Hilfiger, Dior and Fenty Beauty lean in to web3, but work with a team that understands the space so they can enter the right way."

WHAT HAPPENS NEXT?

As for the battle between Hermès and Rothschild, specifically, the latter can still appeal the decision. "What happened today was wrong. What happened today will continue to happen if we don't continue to fight," Rothschild wrote on Twitter Wednesday. "This is far from over."

However, Scafidi argues that, "since the judge's earlier rulings on which kind of trademark infringement standard to apply generally favored Rothchild, he would have a difficult time arguing that the jury verdict should be overturned."

It's also likely we'll continue to see similar litigation pop up. Currently, all eyes are on Nike's lawsuit against StockX: The resale platform known for selling sneakers like commodities launched a collection of NFT versions of Nike sneakers in early 2022 without the brand's approval or involvement; Nike argues that StockX "almost exclusively used Nike's marks to launch its Vault NFTs because it knew that doing so would garner attention, drive sales and confuse consumers into believing that Nike collaborated with StockX on the Vault NFTs," per the filing.

"Trademarks are perhaps the most valuable assets of a fashion house — designers come and go, boutiques open and close — but, with apologies to De Beers, a trademark is forever," says Scafidi. "At the same time, trademarks can become powerful symbols, compelling to both artists and con artists, from counterfeiters to techies minting NFTs. As long as brands have to defend their trademarks against others who want to exploit them, we will see similar cases arise."

TECHNOLOGY

Hermès wins case against Metabirkins over digital NFTs, Rothschild to appeal

The eight-day trial concluded on Tuesday in New York, with a jury ruling that Rothschild has infringed on the trademark protections of luxury brand Hermès. *Vogue Business* can exclusively reveal that Rothschild plans to appeal the jury's decision.

BY MAGHAN MCDOWELL

February 8, 2023


HERMÈS
PARIS
MADE IN FRANCE

Photo: Edward Berthelot/Getty Images

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A jury trial in the Southern district of New York today has ruled that artist Mason Rothschild has infringed on the trademark protections of luxury brand Hermès, and that his 100 "Metabirkins" NFTs are not artistic commentary, and thus not protected by the First Amendment of the US Constitution.

This decision is the first to address the relationship between digital art, NFTs and the physical fashion it replicates. Hermès argued that NFTs were a new product category, and Rothschild argued that there is no such thing as a digital twin. Already, Rothschild is planning to appeal the decision: "Mason and his legal team have indicated that they will appeal the jury's decision. No further information on appeal is available at this time," according to a statement from his publicist, Chapter 2 co-founder and CEO Kenneth Loo.

This decision is thus an endorsement of the value of digital goods and NFTs, suggesting that even digital representations of luxury goods have meaningful value even if they don't perform the original function of, say, carrying one's belongings or clothing one's physical body. In this case, this communicates that a luxury handbag's purpose is just as much about cultural status, whether that's in the physical world or metaverse spaces. This could be a boon for Web3 developers and brands hoping to justify high prices for digital goods.

The nine-person jury found Rothschild liable for trademark infringement, trademark dilution and "cybersquatting" (the practice of using a name in bad faith with the intent of making a profit) and awarded Hermès $133,000 in total damages (an estimation that at least includes the amount he is thought to have earned from the works) on 8 February, the third day of deliberations.

In a statement, Rothschild said: "Take nine people off the street right now and ask them to tell you what art is, but the kicker is whatever they say will now become the undisputed truth. That's what happened today. A multi-billion-dollar luxury fashion house who says they 'care' about art and artists but feel they have the right to choose what art is and who is an artist. Not because of what they create but because their [curriculum vitae] doesn't scream artist with a pedigree from a world-class art school. That's what happened today. A broken justice system that doesn't allow an art expert to speak on art but allows economists to speak on it. That's what happened today. What happened today was wrong. What happened today will continue to happen if we don't continue to fight." He added, "This is far from over."

"This goes back to what is an NFT, what is art and how artists will begin to classify that," says Shermin Lakha, founder and managing attorney of intellectual property firm Lvlup Legal, who has been attending the proceedings. "It's interesting for future artists who comment on social constructs in terms of branding and imagery; they will have to be really careful." Overall, she says, this will be a landmark case on how NFTs are used by artists, and good news for brands, as this essentially classified the works as "knockoff Hermés", she says. This decision will help enforce marks in the metaverse going forward, she adds.

On 7 January, the jury was instructed to determine if Rothschild was liable for any one of Hermès's three claims, and if he was found to be liable, whether he was protected by the First Amendment nonetheless. It concluded that he was not.

"The jury's decision makes clear that the First Amendment does not provide entrepreneurs with carte blanche to trade on the good will of brand owners," says Felicia J Boyd, US head of IP brands at global law firm Norton Rose Fulbright.

"Today's verdict for Hermès is a landmark victory. It signals that the NFT market is not a legal free-for-all — simply waving the flag of fair use will not automatically exempt you from liability for using someone else's IP," says Jeff Trexler, associate director of Fordham University's Fashion Law Institute. "Fashion brands have already been learning from this case how to protect their IP in this space even more effectively. Even before the verdict, it highlighted the value in seizing the first-mover advantage. In the IP metaverse, everything is evidence."

Photo: Mason Rothschild

Judge Jed Rakoff did not immediately publicly comment on the ruling. A spokesperson for Rothschild said he was working on a statement immediately following the verdict. Hermès did not respond to a request for comment. Experts expect that Rothschild will appeal the decision, and some speculate that, if he does, the case could eventually reach the Supreme Court.

The trial is the culmination of a conflict that started in August of 2021, pitting Web3 experiments and digital products against heritage luxury fashion. Los Angeles-based Rothschild released 100 digital "Metabirkin" NFTs, which parlayed Hermès's iconic leather handbag into a digital collectible in 2021. The luxury brand filed a lawsuit in January 2022 stating that the Birkin-like images, and associated NFTs, infringe on its trademark protections. In testimony, it revealed that the project also interfered with its own plans to release NFTs. Rothschild maintained that the works were artistic commentary protected by the First Amendment of the US Constitution.

The trial lasted just longer than a week, after Rakoff rejected motions for summary judgement from both sides. On Thursday, 2 February, he issued his explanation of why the lawsuit should go to trial. "There is a genuine factual dispute as to whether Rothschild's decision to centre his work around the Birkin bag stemmed from genuine artistic expression or, rather, from an unlawful intent to cash in on a highly exclusive and uniquely valuable brand name," Rakoff wrote. The opinion stated that "the title 'Metabirkins' should be understood to refer to both the NFT and the digital image with which it is associated".

The trial was ultimately evaluated under the so-called "Rogers test", which refers to a 1989 case between Hollywood star Ginger Rogers and producer Alberto Grimaldi. The test essentially says that a trademark protection stands if the trademark has no artistic relevance to the underlying work, or if the work explicitly misleads as to the source or content of the work. Hermès and Rothschild disagreed on whether there was consumer confusion; a survey commissioned by Hermès found that 18.7 per cent of the NFT audience were confused, while 3.6 per cent of luxury handbag consumers were confused.

The trial revealed that when the Metabirkins were released, Hermès was already in progress of prototyping various NFT projects, and that this project hampered those plans. In closing remarks, Hermès stated that the metaverse is the future of fashion, and that it was working on digital products that may be for NFTs, says Lakha. (After the lawsuit, it submitted trademark applications for classes related to digital goods in August 2022.)

> In the IP metaverse, everything is evidence."

Hermès had requested that Rothschild pay the brand any profits he made from the project, which it estimated was $231,055.76. The project did about $1.1 million in transaction volume while live (it's since been taken down from Opensea), including secondary sales. This means that he did not make all this in profit, as he only makes incremental revenue on secondary sales. The estimated 95 sold went for the equivalent of about $450 on the primary market; Rothschild kept a handful of pieces for himself, according to his team. After the project was released in December 2021, the floor price reached ETH 8, which at the time was the equivalent of about $32,000.
Hermès also commissioned Harvard Business School professor of business administration and A16Z Crypto research partner Scott Kominers to present evidence that when the Metabirkins project clarified that it was not associated with the luxury brand its name referenced, the floor price of the project decreased. This particular witness made waves in the courtroom when it was revealed that he charged $1,500 per hour for consulting services and $2,000 per hour for testimony, and has worked more than 100 hours on this case, Lakha says, which would mean Hermès paid more than $150,000 for one expert testimony alone.

Notably, Judge Rakoff ruled that the testimony from Andy Warhol expert Blake Gopnik was to be excluded. Gopnik's perspective was widely referenced in Rothschild's earlier motion for summary judgement, and was a key detail in comparing Rothschild's works to Warhol's "business art", which comments on the intersection of art and commerce. The judge's ruling argued that art history isn't based on reliable data or a clear methodology.

The Supreme Court's upcoming rulings in the Warhol Foundation and Jack Daniels cases might make an appeal inevitable, Trexler says. While the Warhol case involves copyright and the Jack Daniels case concerns humorous expression, at their core they both address the same fundamental issue: how the First Amendment relates to intellectual property and art, he says. "I could see Rothschild's team appealing, especially if the Supreme Court tilts toward artistic expression and fair use" in those cases, he says.

Trexler adds that the "David and Goliath" approach, in which a single humble artist is up against a major corporate entity, was somewhat harder to pull off here than, say, in the recent case of Thom Browne and Adidas, he says, given the hype over the NFT market during Metabirkins's release.

An ongoing legal battle would put Hermès in an uncomfortable position, because it is essentially compelled to continue to pursue this dispute with an artist, Lakha says. In closing arguments, Hermès reiterated that it went through the trouble to protect 180 years as a brand, and 42 years of the Birkin bag, and that Rothschild wouldn't stop otherwise, Lakha reports. It compared this dispute to that of a bee sting, suggesting that one offence isn't as harmful as multiple offences, which could stand to eventually destroy the brand — thus suggesting that pursuing legal action is an effort to take a public stand to protect its marks.

"How much further is Hermès going to take this in terms of costs and publicity?" Lakha says. "What is the intention behind this? If they lose and continue to lose, what does that do for the brand?"

Additional reporting by Madeleine Schulz

Comments, questions or feedback? Email us at feedback@voguebusiness.com.

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BY MAGHAN MCDOWELL

VIP PRODUCTS LLC, an Arizona limited liability company, Plaintiff-Counter-Defendant-Appellant,

v.

JACK DANIEL'S PROPERTIES, INC., a Delaware corporation, Defendant-Counter-Plaintiff-Appellee.

No. 18-16012

United States Court of Appeals, Ninth Circuit.

Argued and Submitted February 7, 2020 Arizona State University, Phoenix

Filed March 31, 2020

Background: Dog toy seller brought action seeking declaratory judgment that its "Bad Spaniels Silly Squeaker" toy did not infringe whiskey manufacturer's "Jack Daniel's" trademark or, in alternative, that manufacturer's trade dress and bottle design were not entitled to trademark protection. Manufacturer filed counterclaim alleging trademark infringement and dilution. The United States District Court for the District of Arizona, Stephen M. McNamee, Senior District Judge, entered summary judgment in manufacturer's favor on the issues of aesthetic functionality and distinctiveness, 2016 WL 5408313, and, following bench trial, entered judgment in manufacturer's favor, 291 F.Supp.3d 891. Seller appealed.

Holdings: The Court of Appeals, Hurwitz, Circuit Judge, held that:

(1) manufacturer's trade dress and bottle design were entitled to trademark protection;

(2) seller failed to establish nominative fair use defense;

(3) dog toy was expressive work protected by First Amendment; and

(4) dog toy did not dilute manufacturer's mark by tarnishment.

Affirmed in part, reversed in part, vacated in part, and remanded.

Appeal from the United States District Court for the District of Arizona, Stephen M. McNamee, District Judge, Presiding, D.C. No. 2:14-cv-02057-SMM

David G. Bray (argued), David N. Ferrucci, and Holly M. Zoe, Dickinson Wright PLLC, Phoenix, Arizona, for Plaintiff-Counter-Defendant-Appellant.

D. Peter Harvey (argued), Harvey & Company, San Francisco, California; Isaac S. Crum, Rusing Lopez & Lizardi PLLC, Tucson, Arizona; for Defendant-Counter-Plaintiff-Appellee.

Before: A. WALLACE TASHIMA, ANDREW D. HURWITZ, and ERIC D. MILLER, Circuit Judges.

OPINION

HURWITZ, Circuit Judge:

VIP Products sells the "Bad Spaniels Silly Squeaker" dog toy, which resembles a bottle of Jack Daniel's Old No. 7 Black Label Tennessee Whiskey, but has lighthearted, dog-related alterations. For example, the name "Jack Daniel's" is replaced with "Bad Spaniels," "Old No. 7" with "Old No. 2," and alcohol content descriptions with "43% POO BY VOL." and "100% SMELLY." After Jack Daniel's Properties, Inc. ("JDPI") demanded that VIP cease selling the toy, VIP filed this action, seeking a declaration that the toy did not infringe JDPI's trademark rights or, in the alternative, that Jack Daniel's trade dress and bottle design were not entitled to trademark protection. JDPI counterclaimed, asserting trademark infringement and dilution. After ruling on cross-motions for summary judgment and conducting a four-day bench trial, the district court found in favor of JDPI and issued a permanent injunction enjoining VIP from manufacturing and selling the Bad Spaniels toy.

We affirm the district court's summary judgment in favor of JDPI on the issues of aesthetic functionality and distinctiveness. However, because the Bad Spaniels dog toy is an expressive work entitled to First Amendment protection, we reverse the district court's judgment on the dilution claim, vacate the judgment on trademark infringement, and remand for further proceedings.

I

A. Factual Background

VIP designs, markets, and sells "Silly Squeakers," rubber dog toys that resemble the bottles of various well-known beverages, but with dog-related twists. One Silly Squeaker, for example, resembles a Mountain Dew bottle, but is labeled "Mountain Drool." VIP's purported goal in creating Silly Squeakers was to "reflect" "on the humanization of the dog in our lives," and to comment on "corporations [that] take themselves very seriously." Over a million Silly Squeakers were sold from 2007 to 2017.

In July of 2013, VIP introduced the Bad Spaniels squeaker toy. The toy is roughly in the shape of a Jack Daniel's bottle and has an image of a spaniel over the words "Bad Spaniels." The Jack Daniel's label says, "Old No. 7 Brand Tennessee Sour Mash Whiskey;" the label on the Bad Spaniels toy instead has the phrase "the Old No. 2, on your Tennessee Carpet." A tag affixed to the Bad Spaniels toy states that the "product is not affiliated with Jack Daniel Distillery."

B. Procedural History

In 2014, JDPI "demand[ed] that VIP cease all further sales of the Bad Spaniels toy." VIP responded by filing this action, seeking a declaration that the Bad Spaniels toy "does not infringe or dilute any claimed trademark rights" of JDPI and that Jack Daniel's trade dress and bottle design are not entitled to trademark protection. The complaint also sought cancellation of the Patent and Trademark Office registration for Jack Daniel's bottle design. JDPI counterclaimed, alleging state and federal claims for infringement of JDPI's trademarks and trade dress, *see* 15 U.S.C. §§ 1114(1), 1125(a)(1); A.R.S. §§ 44-1451, *et seq.*, and dilution by tarnishment of the trademarks and trade dress, *see* 15 U.S.C. § 1125(c); A.R.S. § 44-1448.01.

VIP moved for summary judgment, and JDPI cross-moved for partial summary judgment. The district court denied VIP's motion and granted JDPI's. The district court held that VIP was not entitled to the defenses of nominative and First Amendment fair use. The district court rejected the nominative fair use defense because VIP "did not use JDPI's identical marks or trade dress in its Bad Spaniels toy." The district court rejected JDPI's First Amendment defense because the trade dress and bottle design were used "to promote a somewhat non-expressive, commercial product."

The district court also found as a matter of law that Jack Daniel's trade dress and bottle design were distinctive, non-generic, and nonfunctional, and therefore entitled to trademark protection. This left for trial only JDPI's dilution by tarnishment claims and whether JDPI could establish the likelihood of confusion for trademark infringement. *See Kendall-Jackson Winery, Ltd. v. E. & J. Gallo Winery*, 150 F.3d 1042, 1046–47 (9th Cir. 1998) ("To state an infringement claim . . . a plaintiff must meet three basic elements: (1) distinctiveness, (2) nonfunctionality, and (3) likelihood of confusion.").

After a four-day bench trial, the district court found that JDPI had established dilution by tarnishment and infringement of JDPI's trademarks and trade dress. The court permanently enjoined VIP "from sourcing, manufacturing, advertising, promoting, displaying, shipping, importing, offering for sale, selling or distributing the Bad Spaniels dog toy."

II

[1, 2] We have jurisdiction of VIP's appeal under 28 U.S.C. § 1291. We review the grant of summary judgment and the district court's conclusions of law following a bench trial de novo. *See Lenz v. Universal Music Corp.*, 815 F.3d 1145, 1150 (9th Cir. 2016); *Dolman v. Agee*, 157 F.3d 708, 711 (9th Cir. 1998). The "district court's findings of fact following a bench trial are reviewed for clear error." *Id.* at 711.

A. Aesthetic Functionality and Distinctiveness

To obtain trademark protection, a product's trade dress or design must be nonfunctional and distinctive. *See Wal-Mart Stores, Inc. v. Samara Bros., Inc.*, 529 U.S. 205, 210, 120 S.Ct. 1339, 146 L.Ed.2d 182 (2000); *Talking Rain Beverage Co., Inc. v. S. Beach Beverage Co.*, 349 F.3d 601, 603 (9th Cir. 2003). "[T]he proper inquiry is not whether individual features of a product are functional or nondistinctive but whether the whole collection of features taken together are functional or nondistinctive." *Kendall-Jackson Winery*, 150 F.3d at 1050.

[3] The district court correctly found Jack Daniel's trade dress and bottle design are distinctive and aesthetically nonfunctional. Although whiskey companies use many of the individual elements employed by JDPI on their bottles, the Jack Daniel's trade dress "is a combination [of] bottle and label elements," including "the Jack Daniel's and Old No. 7 word marks," and the district court correctly found that these elements *taken together* are both nonfunctional and distinctive. *See Tie Tech, Inc. v. Kinedyne Corp.*, 296 F.3d 778, 785 (9th Cir. 2002) (stating that " 'an assurance that a particular entity made, sponsored, or endorsed a product,' ... if incorporated into the product's design by virtue of arbitrary embellishment" is not functional (quoting *Vuitton Et Fils S.A. v. J. Young Enters., Inc.*, 644 F.2d 769, 774 (9th Cir. 1981))).

VIP also failed to rebut the presumption of nonfunctionality and distinctiveness of the Jack Daniel's bottle design, which is covered by Trademark Registration No. 4,106,178. *See Tie Tech*, 296 F.3d at 783 ("[T]he plaintiff in an infringement action with a registered mark is given the prima facie or presumptive advantage on the issue of validity, thus shifting the burden of production to the defendant to prove otherwise."). None of the evidence cited by VIP demonstrates that, "taken together," the elements of the bottle design registration—including "an embossed signature design comprised of the word 'JACK DANIEL' "—are functional or nondistinctive. The district court therefore correctly rejected VIP's request for cancellation of the registered mark.

B. Nominative Fair Use Defense

[4] The district court also correctly rejected VIP's nominative fair use defense. Although the Bad Spaniels toy resembles JDPI's trade dress and bottle design, there are significant differences between them, most notably the image of a spaniel and the phrases on the Bad Spaniels label. These differences preclude a finding of nominative fair use. *See Playboy Enters., Inc. v. Welles*, 279 F.3d 796, 801 (9th Cir. 2002); *E.S.S. Entm't 2000, Inc. v. Rock Star Videos, Inc.*, 547 F.3d 1095, 1099 (9th Cir. 2008) (finding nominative fair use defense did not apply where mark was "not identical to the plaintiff's" mark).

C. First Amendment Defense

[5] "In general, claims of trademark infringement under the Lanham Act are governed by a likelihood-of-confusion test," *Twentieth Century Fox Television v. Empire Distribution, Inc.*, 875 F.3d 1192, 1196 (9th Cir. 2017), which seeks to strike the appropriate balance between the First Amendment and trademark rights, *see Gordon v. Drape Creative, Inc.*, 909 F.3d 257, 264 (9th Cir. 2018). The likelihood-of-confusion test requires that the plaintiff have "a valid, protectable trademark" and defendant's "use of the mark is likely to cause confusion." *S. Cal. Darts Ass'n v. Zaffina*, 762 F.3d 921, 929 (9th Cir. 2014) (quoting *Applied Info. Scis. Corp. v. eBAY, Inc.*, 511 F.3d 966, 969 (9th Cir. 2007)).

[6] When "artistic expression is at issue," however, the general likelihood-of-confusion test "fails to account for the full weight of the public's interest in free expression." *Gordon*, 909 F.3d at 264 (quoting *Mattel, Inc. v. MCA Records*, 296 F.3d 894, 900 (9th Cir. 2002)). Accordingly, we have held that the Lanham Act only applies to expressive works if the plaintiff establishes one of the two requirements in the test set forth in *Rogers v. Grimaldi*, 875 F.2d 994 (2d Cir. 1989). *See MCA Records*, 296 F.3d at 902 (adopting *Rogers* test for use of a trademark in the title of an expressive work); *see also Gordon*, 909 F.3d at 267 (noting that after *MCA Records*, this Court "extended the *Rogers* test beyond a title"). *Rogers* requires the plaintiff to show that the defendant's use of the mark is either (1) "not artistically relevant to the underlying work" or (2) "explicitly misleads consumers as to the source or content of the work." *Gordon*, 909 F.3d at 265.

In determining whether a work is expressive, we analyze whether the work is "communicating ideas or expressing points of view." *MCA Records*, 296 F.3d at 900 (quoting *L.L. Bean, Inc. v. Drake Publishers, Inc.*, 811 F.2d 26, 29 (1st Cir. 1987)). A work need not be the "expressive equal of *Anna Karenina* or *Citizen Kane*" to satisfy this requirement, *Brown v. Elec. Arts, Inc.*, 724 F.3d 1235, 1241 (9th Cir. 2013), and is not rendered non-expressive simply because it is sold commercially, *see MCA Records*, 296 F.3d at 906–07.

We recently had "little difficulty" concluding that greeting cards, which combined the trademarked phrases "Honey Badger Don't Care" and "Honey Badger Don't Give a S - - -" alongside announcements of events such as Halloween and a birthday, were "expressive works" entitled to First Amendment protection. *Gordon*, 909 F.3d at 261–63, 268. Even if the cards did not show great "creative artistry," they were protected under the First Amendment because the cards "convey[ed] a humorous message through the juxtaposition of an event of some significance—a birthday, Halloween, an election—with the honey badger's aggressive assertion of apathy." *Id.* at 268–69.

[7] Like the greeting cards in *Gordon*, the Bad Spaniels dog toy, although surely not the equivalent of the *Mona Lisa*, is an expressive work. *See Empire Distribution*, 875 F.3d at 1196 ("We decide this legal question de novo."). The toy communicates a "humorous message," *see Gordon*, 909 at 268–69,, using word play to alter the serious phrase that appears on a Jack Daniel's bottle—"Old No. 7 Brand"—with a silly message—"The Old No. 2." The effect is "a simple" message conveyed by "juxtaposing the irreverent representation of the trademark with the idealized image created by the mark's owner." *L.L. Bean, Inc.*, 811 F.2d at 34 (affording First Amendment protection to a message "that business and product images need not always be taken too seriously"). Unlike the book in *Dr. Seuss Enterprises, L.P. v. Penguin Books USA, Inc.*, 109 F.3d 1394 (9th Cir. 1997), which made "no effort to create a transformative work with 'new expression, meaning, or message,' " Bad Spaniels comments humorously on precisely those elements that Jack Daniels seeks to enforce here. *Id.* at 1401 (quoting *Campbell v. Acuff-Rose Music, Inc.*, 510 U.S. 569, 578, 580, 114 S.Ct. 1164, 127 L.Ed.2d 500 (1994)). The fact that VIP chose to convey this humorous message through a dog toy is irrelevant. *See Hurley v. Irish-Am. Gay, Lesbian & Bisexual Grp. of Bos.*, 515 U.S. 557, 569, 115 S.Ct. 2338, 132 L.Ed.2d 487 (1995) ("[T]he Constitution looks beyond written or spoken words as mediums of expression.").

The Fourth Circuit's decision in *Louis Vuitton Malletier S.A. v. Haute Diggity Dog, LLC*, 507 F.3d 252 (4th Cir. 2007), supports our conclusion. That opinion held that dog toys which "loosely resemble[d]" small Louis Vuitton handbags were "successful parodies of LVM handbags and the LVM marks and trade dress" and therefore did not infringe the LVM trademark.[1] *Id.* at 258, 260, 263. The Fourth Circuit reasoned that although "[t]he dog toy is shaped roughly like a handbag; its name 'Chewy Vuiton' sounds like and rhymes with LOUIS VUITTON; its monogram CV mimics LVM's LV mark; the repetitious design clearly imitates the design on the LVM handbag; and the coloring is similar," "no one can doubt . . . that the 'Chewy Vuiton' dog toy is not the 'idealized image' of the mark created by LVM." *Id.* at 260. No different conclusion is possible here.

Because Bad Spaniels is an expressive work, the district court erred in finding

1. The Fourth Circuit decision was based on likelihood of confusion, not the First Amendment, *see id.* at 259–60, as it had not yet adopted the *Rogers* test, *see Radiance Found., Inc. v. NAACP*, 786 F.3d 316, 329 (4th Cir. 2015) (later applying it).

trademark infringement without first requiring JDPI to satisfy at least one of the two *Rogers* prongs. *See Gordon*, 909 F.3d at 265; *see also E.S.S. Entm't 2000*, 547 F.3d at 1101 (stating that "the First Amendment defense applies equally to . . . state law claims as to [a] Lanham Act claim"). We therefore vacate the district court's finding of infringement and remand for a determination by that court in the first instance of whether JDPI can satisfy a prong of the *Rogers* test.[2]

D. Trademark Dilution by Tarnishment

[8] When the use of a mark is "noncommercial," there can be no dilution by tarnishment. 15 U.S.C. § 1125(c)(3)(C); *see* A.R.S. § 44-1448.01(C)(2). Speech is noncommercial "if it does more than propose a commercial transaction," *Nissan Motor Co. v. Nissan Comput. Corp.*, 378 F.3d 1002, 1017 (9th Cir. 2004) (quoting *MCA Records*, 296 F.3d at 906), and contains some "protected expression," *MCA Records*, 296 F.3d at 906. Thus, use of a mark may be "noncommercial" even if used to "sell" a product. *See Nissan Motor Co.*, 378 F.3d at 1017; *MCA Records*, 296 F.3d at 906.

[9] Although VIP used JDPI's trade dress and bottle design to sell Bad Spaniels, they were also used to convey a humorous message. That message, as set forth in Part II.C above, is protected by the First Amendment. VIP therefore was entitled to judgment in its favor on the federal and state law dilution claims. *See Nissan Motor Co.*, 378 F.3d at 1017; *MCA Records*, 296 F.3d at 906.

III

We affirm the district court's summary judgment in favor of JDPI on the issues of aesthetic functionality and distinctiveness, affirm the judgment as to the validity of JDPI's registered mark, reverse the judgment on the issue of dilution, vacate the judgment after trial on the issue of infringement, and remand for further proceedings. The permanent injunction is vacated.[3]

AFFIRMED IN PART, REVERSED IN PART, VACATED IN PART, AND REMANDED. Each party to bear its own costs.

2. If the plaintiff satisfies one of the *Rogers* elements, "it still must prove that its trademark has been infringed by showing that the defendant's use of the mark is likely to cause confusion." *See Gordon*, 909 F.3d at 265; *see also Louis Vuitton Malletier*, 507 F.3d at 260 (noting that the application of likelihood-of-confusion factors "depend[s] to a great extent on whether its products and marks are successful parodies").

3. Because we hold that VIP was entitled to judgment in its favor on the trademark dilution claims and that the judgment in favor of VIP on the infringement claims must be vacated, we do not address VIP's alternative challenges to these claims. And, because we vacate the permanent injunction, we do not address VIP's argument that the district court erred in not limiting the scope of the permanent injunction.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

HARRY STYLES, Plaintiff, v. THE PARTNERSHIPS and UNINCORPORATED ASSOCIATIONS IDENTIFIED ON SCHEDULE "A", Defendants.	Case No. 23-cv-00137 **Judge Franklin U. Valderrama** **Magistrate Judge Gabriel A. Fuentes**

PRELIMINARY INJUNCTION ORDER

THIS CAUSE being before the Court on Plaintiff Harry Styles' ("Harry Styles" or "Plaintiff") Motion for Entry of a Preliminary Injunction as to Defendant Nos. 6-140 and 154-200, and this Court having heard the evidence before it hereby GRANTS Plaintiff's Motion for Entry of a Preliminary Injunction as follows against the defendants identified in Schedule A attached hereto (collectively, the "Defendants") and using the fully interactive, e-commerce stores[1] operating under the seller aliases identified in Schedule A (collectively, the "Seller Aliases).

The Court finds that it has personal jurisdiction over the Defendants based on Plaintiff's unrebutted assertions that the Defendants directly target their business activities toward consumers in the United States, including Illinois. Specifically, Plaintiff has provided a basis to conclude that Defendants have targeted sales to Illinois residents by setting up and operating e-commerce stores that target United States consumers using one or more Seller Aliases, offer shipping to the United States, including Illinois, accept payment in U.S. dollars, and/or funds from U.S. bank accounts, and have sold products using infringing and counterfeit versions of the

[1] The e-commerce store URLs are listed on Schedule A hereto under the Online Marketplaces.

HARRY STYLES Trademarks to Illinois residents. In this case, Plaintiff has presented screenshot evidence that each Defendant e-commerce store is reaching out to do business with Illinois residents by operating one or more commercial, interactive internet stores through which Illinois residents can and do purchase products using counterfeit versions of the HARRY STYLES Trademarks. See Exhibit 2 to the Declaration of Emily Holt [R. 16], which includes screenshot evidence confirming that each Defendant internet store does stand ready, willing and able to ship its counterfeit goods to customers in Illinois bearing infringing and/or counterfeit versions of the HARRY STYLES Trademarks. A list of the HARRY STYLES Trademarks is included in the below chart.

REGISTRATION NUMBER	REGISTERED TRADEMARK	INTERNATIONAL CLASSES
5,688,195	HARRY STYLES	For: Pre-recorded CDs, DVDs, digital audio tapes, digital audio cassettes, high definition video discs, mini-discs, video records, video tapes, video cassettes, video discs and flash drives featuring music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; sound, music, image, data and video recordings recorded on CDs, DVDs, digital audio tapes, digital audio cassettes, high definition video discs, mini-discs, video records, video tapes, video cassettes, video discs and flash drives featuring music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; multimedia productions recorded on CD, DVD, DAT, DAC, HD discs, 3D discs, mini-discs, records, tapes, cassettes, discs and flash drives, or downloadable from the Internet, all featuring music,

		musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; motion picture films featuring drama, comedy, action, adventure, animation and documentaries; television films and programmes recorded on CDs, DVDs, digital audio tapes, digital audio cassettes, high definition video discs, mini-discs, video records, video tapes, video cassettes, video discs and flash drives featuring music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; visual recordings and audiovisual recordings featuring animations; 3D motion picture films, television films and programmes, and animations, all recorded on CDs, DVDs, digital audio tapes, digital audio cassettes, high definition video discs, mini-discs, video records, video tapes, video cassettes, video discs and flash drives featuring music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; radio programmes recorded on CDs, DVDs, digital audio tapes, digital audio cassettes, high definition video discs, mini-discs, video records, video tapes, video cassettes, video discs and flash drives featuring music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; pre-recorded recording materials used for storage and transmission of digital and analogue data, images, sounds and recordings, namely, CDs, DVDs, digital audio tapes, digital audio cassettes, high definition video

		discs, mini-discs, video records, video tapes, video cassettes, video discs and flash drives featuring music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; pre-recorded audio and/or video media, CDs, CDRs, DVDs, DVDRs, DATs, DACs, HD discs, 3D discs, mini-discs, records, tapes, cassettes, discs and flash drives featuring music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; pre-recorded laser-read discs for reproducing, storing, transmitting and playing sound, images, music, data or video featuring music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; pre-recorded optical-read discs for recording, reproducing, storing, transmitting and playing sound, images, music, data or video featuring music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; pre-recorded USB flash drives for recording, reproducing, storing, transmitting and playing sound, images, music, data or video featuring music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; downloadable media, namely, audio, image, data and video files provided from the Internet featuring

		music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; downloadable audio or sound files in MP3 format; audio and/or video files in electronic format provided from the Internet featuring music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; downloadable video files in MP4 format featuring music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; downloadable MP4 videos featuring music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; application software for mobile devices, tablet computers, mobile computers, handheld computers and smartphones, namely, mobile gaming and content applications for mobile devices, tablet computers, mobile computers, handheld computers and smartphones; mouse pads; downloadable digital music or sound files provided from the Internet featuring music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; downloadable digital video, image, film and TV files and programmes provided from the Internet featuring music, musical recordings, musical performances, musical entertainers, motion picture films,

		artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; downloadable digital video, image, film and TV files and programmes provided from MP4 web sites on the Internet featuring music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; refrigerator magnets; downloadable electronic media in the nature of books, newsletters, magazines, periodicals and newspapers in the fields of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; publications downloaded in electronic form from the Internet in the nature of books, newsletters, magazines, periodicals and newspapers in the fields of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; downloadable electronic publications provided from databases or the Internet in the nature of books, newsletters, magazines, periodicals and newspapers in the fields of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; e-books, namely, electronic books downloadable from the Internet in the fields of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows,

		drama, comedy, action, adventure, animation and documentaries; audio books on CD, mini-disc, record, cassette, disc or flash drives in the fields of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; talking children's books; downloadable printed matter in electronic form in the nature of books, magazines, brochures, periodicals, catalogues, newsletters and newspapers, all in the fields of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; downloadable electronic publications in the nature of magazines, periodicals and newspapers in the fields of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; downloadable photographs and stills in electronic form; downloadable photographs and still images; sunglasses; eyewear; photographic and photography apparatus; photographic cameras in class 009. For: Printed matter, namely, magazines, newspapers, newsletters, books, brochures, flyers, pamphlets, posters, decals, bumper stickers, postcards, pictures, diaries, souvenir event programs, printed event and concert tickets, printed event and printed concert VIP tickets, laminated tickets and laminated VIP tickets, calendars, photographs, signed photographs, picture books, songbooks, sheet music, cardboard and paper badges, paper flags, record, tape, cassette, CD, CDR, DVD, DVDR, DAT, DAC, HD and 3D disc paper labels, inserts and inlays in printed matter, all featuring information relating to or in the field of music, musical recordings, musical performances, musical

		entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, game shows, drama, comedy, action, adventure, animation and documentaries; photographs featuring or in the field of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, game shows, drama, comedy, action, adventure, animation and documentaries; stationery; artists' materials, namely, pens, ballpoint pens, fountain pens, pencils, drafting rulers, erasers, pencil sharpeners, and pen and pencil cases; paint brushes; instructional and teaching material, namely, printed rules of play for playing board games, card games, travel games, electronic games and puzzles in class 016. For: Clothing, namely, T-shirts, shirts, jackets, sweatshirts, hooded tops, hooded sweatshirts, pullovers, jumpers, shorts, boxer shorts, boxer briefs, underwear, underclothes, under garments, socks, scarves, dressing gowns, pyjamas, dungarees, braces, ties, lingerie, hosiery, bathing costumes, bathing suits, bathing trunks, bathrobes, gloves, jeans, kilts, nightwear, pajamas, trouser suits, slacks, sleeping garments, sleepwear, suits, swim wear, swimsuits, trousers, tuxedos and waistcoats, legging, jeggings, namely, pants that are partially jeans and partially leggings, baby bibs not of paper, baby bodysuits; baby bottoms, baby tops, baby rompers, belts, Bermuda shorts, bikinis, blazers, blouses, body shapers, bomber jackets, bras, briefs, cagoules, camisoles, cargo pants, coats, costumes for use in role-playing games, costumes for use in children's dress up play, crop pants, crop tops, dance costumes, dresses, dressing gowns, housecoats, dungarees, ear bands, ear muffs, ear warmers, evening dresses, evening gowns, foundation garments worn around the midsection or thighs to keep the stomach in and create a slimming effect, G-strings, Halloween costumes, infant and toddler one piece clothing, infant sleepers, infantwear, knee highs, knickers, ladies' underwear, skirts, miniskirts, negligees, night gowns,

		nightshirts, nightgowns, nighties, nightwear, panties, pants, stockings, suspenders, play suits, polo shirts, rain wear, school uniforms, tankinis, thongs and tights, footwear, namely, footwear for men, footwear for women, footwear not for sports, shoes, canvas shoes, sneakers, boots, slippers and flip-flops, beach footwear, beach shoes, boots, booties, dance shoes, dance slippers, moccasins, pumps, headgear, namely, hats, caps, beanies, skull caps, skullies, bandanas and berets, children's headwear, hats for infants, babies, toddlers and children in class 025. For: Entertainment in the nature of participation in musical recordings, musical performances, performances by a musical groups and members thereof, celebrity interviews, performance of spoken word, participation in artistic performances, participation in concerts, appearances by a celebrity, appearances by a professional entertainer, participation in gameshows, participation in drama, participation in comedy, participation in action, participation in adventure, participation in animation, participation in documentaries, and participation in fashion shows, and entertainer services, namely, live, televised and movie appearances by a singer, performing artist and professional entertainer; music writing; music composition; song writing; score writing; score composition; composition of soundtracks; writing of soundtracks; music production services; production of music, musical recordings, musical performances and concerts; music concert services; performance of, and participation in, music, musical recordings, musical performances and concerts; music concert services; production and distribution services in the field of sound and/or visual recordings and entertainment; audio production services, namely, creating and producing music, musical recordings, musical events, festivals, musical performances and musical concerts; provision and production of, and participation in, live entertainment, live performances and live shows; production of audio/visual presentations, namely, creating and producing music, musical recordings, musical events, festivals, musical performances and musical concerts; arranging of music

		performances, music shows and musical entertainment; services providing entertainment in the form of live musical performances; performance of musicals; arranging and production of musical events; arrangement and performance of dance, music and drama; radio and television entertainment services, namely, live and pre-recorded appearances by a singer, performing artist and professional entertainer; audio and video recording services; rental of sound and video recordings and sound and video recording apparatus; organisation of entertainment performances via radio and television; organisation of competitions, namely, entertainment in the nature of competitions in the field of music where entry is by personal attendance, mail, email, telephone, text message or via the Internet; production, post-production, presentation, distribution and rental of television and radio programmes, of films and of sound and video recordings; recording studio services; production and post-production of entertainment; production and post-production services in relation to films, television programmes, radio programmes, animations, audio, video and cinematographic recordings; audio, music, film and video creation, writing, scripting, directing, production, post-production, mixing, re-mixing, editing and recording services; creation, writing, scripting, directing, production, post-production, recording, mixing, re-mixing and editing studio services in the field of music, video, films, television programmes, radio programmes, animations and cinematographic recordings; audio production and post-production services; video production and post-production services; motion picture film production and post-production services; animation production and post-production services; television programme production and post-production services; production and post-production of sound recordings; providing on-line non-downloadable publications in the nature of magazines, periodicals and newspapers featuring or in the field of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy,

		action, adventure, animation and documentaries; providing digital sound, music, data and video recordings, not downloadable, from the Internet featuring or in the field of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; providing digital sound, music, data and video recordings, not downloadable, from MP3 and MP4 Internet websites featuring or in the field of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; providing digital sound recordings, not downloadable, from the Internet; providing digital sound recordings, not downloadable, from MP3 Internet websites featuring or in the field of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; providing digital music and sound recordings, not downloadable, from the Internet featuring or in the field of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; providing digital music and sound recordings, not downloadable, from MP3 Internet websites featuring or in the field of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; providing digital video, image, film, animation, radio and TV recordings and

		programmes, and cinematographic recordings, not downloadable, from the Internet featuring or in the field of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; providing digital video, image, film, animation, radio and TV recordings and programmes, and cinematographic recordings, not downloadable, from MP4 Internet websites featuring or in the field of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation and documentaries; provision of information relating to production and post-production services in the field of music, video, films, animations, television programmes, radio programmes and cinematographic recordings; photography services; on-line library services, namely, providing electronic library services featuring photographs and pictures via an on-line computer network; photographic film editing; photographic composition for others; modelling for artists; performance of sport, and skills related to sport; sports tuition, namely training in the field of physical education; sports training services; coaching in the field of sports; sports entertainment services; arranging and organisation of and participation in sport and sporting activities, events, competitions and tournaments; publication of books; music publishing services; publishing of musical works; publishing services; song publishing; publication of lyrics of songs in book and sheet form; publication of music and music books; provision of information relating to music, musical recordings and musical entertainment; organisation of fashion shows for entertainment purposes in class 041.
5,876,867	HARRY STYLES TREAT	For: Badges of precious metal; precious metals and their alloys; jewellery, precious stones; horological and chronometric instruments in class 016.

	PEOPLE WITH KINDNESS	For: Journals, namely, printed journals in the field of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation, documentaries, fashion, health, beauty and lifestyle; notebooks; printed matter, namely, magazines, newspapers, newsletters, books, brochures, flyers, pamphlets, posters, decals, bumper stickers, postcards, pictures, diaries, souvenir event programs, printed event and concert tickets, printed event and printed concert VIP tickets, laminated printed event and concert tickets and laminated VIP printed event and concert tickets, calendars, photographs, signed photographs, picture books, songbooks, sheet music, cardboard and paper badges, paper flags, record, tape, cassette, CD, CDR, DVD, DVDR, DAT, DAC, HD and 3D disc paper labels, inserts and inlays, all featuring information in the field of music, musical recordings, musical performances, musical entertainers, motion picture films, artistic performances, concerts, appearances by a celebrity or celebrities, appearances by a professional entertainer, gameshows, drama, comedy, action, adventure, animation, documentaries, fashion, health, beauty and lifestyle; stationery in class 016. For: Tote bags; leather and imitations of leather; trunks, being luggage, and travelling bags; umbrellas, parasols in class 018. For: Clothing, namely, T-shirts, shirts, jackets, sweatshirts, hooded tops, hooded sweatshirts, pullovers, jumpers, shorts, boxer shorts, boxer briefs, underwear, underclothes, under garments, socks, scarves, dressing gowns, pyjamas, dungarees, suspenders, ties as clothing, lingerie, hosiery, bathrobes, gloves, jeans, kilts, nightwear, slacks, sleeping garments, sleepwear, suits, swim wear, swimsuits, trousers, tuxedos and waistcoats, leggings, jeggings, namely, pants that are partially jeans and partially leggings, baby clothing,

		namely, baby sleeping garments, baby sleepwear, baby bibs not of paper, baby bodysuits, baby bottoms, baby tops, baby romper suits, infant and toddler one piece clothing, infant sleepers, infantwear, and baby play suits, belts, blazers, blouses, body shapers, bomber jackets, cagoules, camisoles, cargo pants, coats, crop pants, crop tops, dresses, ear bands, ear muffs, ear warmers, skirts, tankinis, footwear, namely, footwear for men, namely, athletic footwear and casual footwear, footwear for women, namely, athletic footwear and casual footwear, footwear not for sports, shoes, canvas shoes, sneakers, headgear, namely, hats, caps being headwear, beanies in class 025. For: Hair bands; ornamental novelty badges; embroidered badges, namely, ornamental novelty badges; badges for wear, not of precious metal, namely, ornamental novelty badges; ornamental novelty badges, ornamental novelty buttons and ornamental novelty pins; belt buckles; clothing buttons; novelty buttons; embroidered badges in the nature of ornamental novelty badges, embroidered emblems and embroidered patches for clothing; laces for footwear; ornamental cloth patches in class 026.

THIS COURT FURTHER FINDS that injunctive relief previously granted in the Temporary Restraining Order ("TRO") should remain in place through the pendency of this litigation and that issuing this Preliminary Injunction is warranted under Federal Rule of Civil Procedure 65. Evidence submitted in support of this Motion and in support of Plaintiff's previously granted Motion for Entry of a Temporary Restraining Order establishes that Plaintiff has demonstrated a likelihood of success on the merits; that no remedy at law exists; and that Plaintiff will suffer irreparable harm if the injunction is not granted. Specifically, Plaintiff has proved a *prima facie* case of trademark infringement because (1) the HARRY STYLES Trademarks are distinctive marks and are registered with the U.S. Patent and Trademark Office on the Principal Register, (2) Defendants are not licensed or authorized to use any of the HARRY

STYLES Trademarks, and (3) Defendants' use of the HARRY STYLES Trademarks is causing a likelihood of confusion as to the origin or sponsorship of Defendants' products with Plaintiff. Furthermore, Defendants' continued and unauthorized use of the HARRY STYLES Trademarks irreparably harms Plaintiff through diminished goodwill and brand confidence, damage to Plaintiff's reputation, loss of exclusivity, and loss of future sales. Monetary damages fail to address such damage and, therefore, Plaintiff has an inadequate remedy at law. Moreover, the public interest is served by entry of this Preliminary Injunction to dispel the public confusion created by Defendants' actions. As such, this Court orders that:

1. Defendants, their affiliates, officers, agents, servants, employees, attorneys, confederates, and all persons acting for, with, by, through, under or in active concert with them be preliminarily enjoined and restrained from:
   a. using the HARRY STYLES Trademarks or any reproductions, counterfeit copies or colorable imitations thereof in any manner in connection with the distribution, marketing, advertising, offering for sale, or sale of any product that is not a genuine Harry Styles product or not authorized by Plaintiff to be sold in connection with the HARRY STYLES Trademarks;
   b. passing off, inducing, or enabling others to sell or pass off any product as a genuine Harry Styles product or any other product produced by Plaintiff, that is not Plaintiff's or not produced under the authorization, control or supervision of Plaintiff and approved by Plaintiff for sale under the HARRY STYLES Trademarks;
   c. committing any acts calculated to cause consumers to believe that Defendants' Unauthorized Harry Styles Products are those sold under the authorization, control or

supervision of Plaintiff, or are sponsored by, approved by, or otherwise connected with Plaintiff; and

d. further infringing the HARRY STYLES Trademarks and damaging Harry Styles' goodwill; and

e. manufacturing, shipping, delivering, holding for sale, transferring or otherwise moving, storing, distributing, returning, or otherwise disposing of, in any manner, products or inventory not manufactured by or for Plaintiff, nor authorized by Plaintiff to be sold or offered for sale, and which bear any of Plaintiff's trademark, including the HARRY STYLES Trademarks, or reproductions, counterfeit copies or colorable imitations thereof.

2. Upon Plaintiff's request, any third party with actual notice of this Order who is providing services for any of the Defendants, or in connection with any of the Online Marketplaces, including, without limitation, any online marketplace platforms such as eBay, Inc. ("eBay"), AliExpress, Alibaba Group Holding Ltd. ("Alibaba"), Amazon.com, Inc. ("Amazon"), ContextLogic Inc. d/b/a Wish.com ("Wish.com"), Walmart Inc. ("Walmart"), Etsy, Inc. ("Etsy"), and DHgate, (collectively, the "Third Party Providers") shall, within seven (7) calendar days after receipt of such notice, provide to Plaintiff expedited discovery, including copies of all documents and records in such person's or entity's possession or control relating to:

a. the identities and locations of Defendants, their affiliates, officers, agents, servants, employees, confederates, attorneys, and any persons acting in concert or participation with them, including all known contact information and all associated e-mail addresses;

b. the nature of Defendants' operations and all associated sales, methods of payment for services and financial information, including, without limitation, identifying information associated with the Online Marketplaces and Defendants' financial accounts, as well as providing a full accounting of Defendants' sales and listing history related to their Online Marketplaces; and

c. any financial accounts owned or controlled by Defendants, including their affiliates, officers, agents, servants, employees, confederates, attorneys, and any persons acting in concert or participation with them, including such accounts residing with or under the control of any banks, savings and loan associations, payment processors or other financial institutions including, without limitation, PayPal, Inc. ("PayPal"), eBay, Alipay, Alibaba, Ant Financial Services Group ("Ant Financial"), Amazon Pay, Wish.com, Walmart, Etsy, DHgate, or other merchant account providers, payment providers, third party processors, and credit card associations (e.g., MasterCard and VISA).

3. Upon Plaintiff's request, those with notice of the injunction, including the Third Party Providers as defined in Paragraph 2, shall within seven (7) calendar days after receipt of such notice, disable and cease displaying any advertisements used by or associated with Defendants in connection with the sale of counterfeit and infringing goods using the HARRY STYLES Trademarks.

4. Defendants shall be temporarily and preliminarily restrained and enjoined from transferring or disposing of any money or other of Defendants' assets until further ordered by this Court.

5. Any Third Party Providers, including PayPal, eBay, Alipay, Alibaba, Ant Financial, Wish.com, Walmart, Etsy, and Amazon Pay, shall, within seven (7) calendar days of receipt of this Order:

   a. locate all accounts and funds connected to Defendants and the Seller Aliases, Online Marketplaces, including, but not limited to, any financial accounts connected to the information listed in Schedule A hereto; and

   b. restrain and enjoin any such accounts or funds from transferring or disposing of any money or other of Defendants' assets until further ordered by this Court.

6. Plaintiff is authorized to issue expedited written discovery to Defendants, pursuant to Federal Rules of Civil Procedure 33, 34 and 36, related to:

   a. the identities and locations of Defendants, their affiliates, officers, agents, servants, employees, confederates, attorneys, and any persons acting in concert or participation with them, including all known contact information, including any and all associated e-mail addresses; and

   b. the nature of Defendants' operations and all associated sales, methods of payment for services and financial information, including, without limitation, identifying information associated with the Online Marketplaces, and Defendants' financial accounts, as well as providing a full accounting of Defendants' sales and listing history related to their Online Marketplaces.

   Plaintiff is authorized to issue any such expedited discovery requests via e-mail. Defendants shall respond to any such discovery requests within three (3) business days of being served via e-mail.

7. Plaintiff may provide notice of these proceedings to Defendants, including service of process pursuant to Fed. R. Civ. P. 4(f)(3) and any future motions, by electronically publishing a link to the Complaint, this Order and other relevant documents on a website and by sending an e-mail with a link to said website to Defendants. The Clerk of the Court is directed to issue a single original summons in the name of "The Partnerships and all other Defendants identified in the Complaint" that shall apply to all Defendants. The combination of providing notice via electronic publication or e-mail, along with any notice that Defendants receive from payment processors, shall constitute notice reasonably calculated under all circumstances to apprise Defendants of the pendency of the action and afford them the opportunity to present their objections.

8. Schedule A to the Complaint [2], Exhibit 2 to the Declaration of Emily Holt [16], and the TRO [22] are unsealed.

9. Any Defendants that are subject to this Order may appear and move to dissolve or modify the Order as permitted by and in accordance with the Federal Rules of Civil Procedure and Northern District of Illinois Local Rules.

10. The $10,000 bond posted by Plaintiff shall remain with the Court until a Final disposition of this case or until this Preliminary Injunction is terminated.

IT IS SO ORDERED.

DATED: January 27, 2023

Franklin U. Valderrama
United States District Judge

Harry Styles v. The Partnerships and Unincorporated Associations Identified on Schedule "A" - Case No. 23-cv-00137

Schedule A

Defendant Online Marketplaces		
No	URL	Name / Seller Alias
1	EXCEPTED	EXCEPTED
2	EXCEPTED	EXCEPTED
3	EXCEPTED	EXCEPTED
4	EXCEPTED	EXCEPTED
5	EXCEPTED	EXCEPTED
6	amazon.com/sp?seller=A8I7SK45FJ8K3	3Lposter
7	amazon.com/sp?seller=A10SUQBB57ZH3W	A10SUQBB57ZH3W
8	amazon.com/sp?seller=A16Z54ZX17D3YX	A16Z54ZX17D3YX
9	amazon.com/sp?seller=A2B8NX8YV17H2I	A2B8NX8YV17H2I
10	amazon.com/sp?seller=A2SNLN5KJDM2UL	A2SNLN5KJDM2UL
11	amazon.com/sp?seller=A3CDE8UJRGSICE	A3CDE8UJRGSICE
12	amazon.com/sp?seller=A3CW8XOAW1A23D	A3CW8XOAW1A23D
13	amazon.com/sp?seller=A3FFSNHINFU5F9	A3FFSNHINFU5F9
14	amazon.com/sp?seller=A69N19XTLYTBN	A69N19XTLYTBN
15	amazon.com/sp?seller=A7G2I8U7QM779	A7G2I8U7QM779
16	amazon.com/sp?seller=AYKFMQVIDU4A7	Ahubaba Store
17	amazon.com/sp?seller=AK4PA1VNK8V3S	AK4PA1VNK8V3S
18	amazon.com/sp?seller=AQRJVVRLF73SY	ANERZA
19	amazon.com/sp?seller=A3MUW4DVDRRP8W	Anime Fans Blanket Shop

20	amazon.com/sp?seller=A3OTY9V7X80TTG	anqingmanjiashangmaoyouxiangongsi
21	amazon.com/sp?seller=A3U01PDLSBZZC1	anqingshuchangshangmaoyouxiangongsi
22	amazon.com/sp?seller=A2HRDYVTIC5XPZ	Babymiu
23	amazon.com/sp?seller=A31I7ERYMEX8JP	bangjuesishangmao
24	amazon.com/sp?seller=A3Q41I71B68XRG	BENBIYO
25	amazon.com/sp?seller=A57NPEHN3V30R	binzhouzilinbaihuoyouxian
26	amazon.com/sp?seller=A2FIQFXWZZSEPX	Blitz Store
27	amazon.com/sp?seller=A23ZR3NGPIGMKF	Byuzou
28	amazon.com/sp?seller=A1JKZNUTNNUDVD	chaiyaozhongdejinpindian
29	amazon.com/sp?seller=ALJM3DJD6WS09	Cheng Du Se Li Se Shang Mao You Xian Gong Si
30	amazon.com/sp?seller=A3QL2CZIFZ9TZE	chengdunanchenyushangmaoyouxiangongsi
31	amazon.com/sp?seller=A30DXOBPOHIOIT	chengtingtingSFR
32	amazon.com/sp?seller=ABCI9401F08R7	CJ Gift
33	amazon.com/sp?seller=A4QEDEA16BZ6G	COOLCOOLDE
34	amazon.com/sp?seller=A3DYM4UHJZ1UKF	Corrida
35	amazon.com/sp?seller=A3RAFNE88Q6GJP	DFSGWEYWQ
36	amazon.com/sp?seller=A2UGTL2XRREXRO	DiLIANGLANG
37	amazon.com/sp?seller=A3D4OPZRP5XUYD	dong Bas
38	amazon.com/sp?seller=A5WJJPHM5JK21	DongGuanShiQinJuFuZhuangYouXianGongSi
39	amazon.com/sp?seller=A1SWOIYBWTD8S8	EDATON-US
40	amazon.com/sp?seller=A1QH94EK64WSWA	Fancymax

41	amazon.com/sp?seller=A3AEYY3IYPXOXT	Fred Tonty
42	amazon.com/sp?seller=A2Z6FT1I55AHI4	fuqingshishizhuchentianfuzhuangshanghang
43	amazon.com/sp?seller=A207436EYGCHR G	GM LBXX
44	amazon.com/sp?seller=A2RKFVIZL6JL38	Grtuspr
45	amazon.com/sp?seller=AQXW3LVYK9D5 U	guoxiaoxiaojh
46	amazon.com/sp?seller=AS5B4OI2AU2DQ	GZWEICAN US
47	amazon.com/sp?seller=A2BJ7A6GF8ILM1	haikouyibodianzixjeciaoshouyouxiangongsi
48	amazon.com/sp?seller=A2PDKNZYFG7TC B	Hainew
49	amazon.com/sp?seller=A11IVED3OLQFX D	Hehaoyang
50	amazon.com/sp?seller=A2IFAY7GHDJRLZ	Hejiaxin
51	amazon.com/sp?seller=A1XDV0UXLGEFT D	hexinghong
52	amazon.com/sp?seller=A2IWCSC5OOZDA W	HeZeJingChenBianMinBaiHuoYouXianGongSi
53	amazon.com/sp?seller=A3EVU01LVCT9A H	hu tan shang mao
54	amazon.com/sp?seller=A4CDOS0NULFQ2	huaduhandedian
55	amazon.com/sp?seller=A5Q3Z81BSZUK2	huanglhuangluboubo
56	amazon.com/sp?seller=AIUE5ZHT2K6XR	huataoAMZ
57	amazon.com/sp?seller=A1LV3L1I8582WE	Human Cave Decoration
58	amazon.com/sp?seller=A26VBA8NADL9D A	Jiaxing Yongjiangmaoyi Co.,Ltd
59	amazon.com/sp?seller=A1ZFTX0E0MYFE Q	jinanliaojianglihuazhuanpin
60	amazon.com/sp?seller=A138QLLL22JX2G	jiujiangbaobeizhimaoyiyouxiangongsi
61	amazon.com/sp?seller=A1URZFVFQQ5BZ F	JiuJiangHongGuZhaoMaoYiYouXianGongSi

62	amazon.com/sp?seller=A2C27YSGM2I16K	jiujiangsongounamaoyiyouxiangongsi
63	amazon.com/sp?seller=A1QU139V2X41J Q	JiuJiangYangChaoFenMaoYiYouXianGongSi
64	amazon.com/sp?seller=A1KSDMZ7B29D8 E	Lanpengshangmao
65	amazon.com/sp?seller=AHL8J5B56SJ8S	lianyinghaibao
66	amazon.com/sp?seller=A1N4S8NE0AZSYZ	LiDongDongXinXiJiShu
67	amazon.com/sp?seller=A215W2EIMKEPN 9	Lidoou
68	amazon.com/sp?seller=A48RFS9N65JCP	lihaoransj
69	amazon.com/sp?seller=A2ZURXDOG4XT2 E	linchunhuiriyongpinshangdian
70	amazon.com/sp?seller=A2XC4S3M87H88 O	lingaohexubendianzikejiyouxiangongsi
71	amazon.com/sp?seller=A28PBY8IV1GAJD	lingluodianzi
72	amazon.com/sp?seller=A2HV5ONH0TI05 3	litesam
73	amazon.com/sp?seller=A2THUAYPTN298 Z	Liudianjin
74	amazon.com/sp?seller=AVQ21B9XQEF80	Long Guo5
75	amazon.com/sp?seller=A38QHT7LTAROY R	maitengwangluokeji
76	amazon.com/sp?seller=A34BPIGEB3NF4Z	mamingyang-us
77	amazon.com/sp?seller=A3V63SUTIVDZET	mengyaus
78	amazon.com/sp?seller=AAH0EXRPOIEY	MOLI Store
79	amazon.com/sp?seller=A1W0NFKQSZQSY P	ngqujielijun4maoyiyouxi
80	amazon.com/sp?seller=A363470PYD792F	Night Light Decorations
81	amazon.com/sp?seller=A22FXPDDWU0H Z4	Orange jewels
82	amazon.com/sp?seller=AUZ0XIC7KUZWV	panyingrui shop

83	amazon.com/sp?seller=A3PQ50Z67HM7AP	perfecone
84	amazon.com/sp?seller=A2LHY6ZGJ7GBO2	PIONEER97
85	amazon.com/sp?seller=A13ZJ1XQKF0QUW	POTSHIP
86	amazon.com/sp?seller=AL2CD9SA6RBIM	putiandanya
87	amazon.com/sp?seller=A1VB4RYR2Y4AK7	putianshihanjiangqukeyinxingxinriyongpindian
88	amazon.com/sp?seller=A352HMGVDUEKOW	putianshilichengququnqunboriyongpindian
89	amazon.com/sp?seller=A1YQQXCBMRXDOF	qianlimumingriyongpin
90	amazon.com/sp?seller=A3PWTBA31B0QWQ	QL lamp store
91	amazon.com/sp?seller=AZU7U8G4NGBAD	ROONA store
92	amazon.com/sp?seller=A3BWHEXV63WMTT	sanyaxinyuxinshangmaoyouxiangongsi
93	amazon.com/sp?seller=A284OIFEY4RDDS	sanyayaxishangmaoyouxiangongsi
94	amazon.com/sp?seller=A1YIWIPNSYLKZA	sdacxznmjykiok
95	amazon.com/sp?seller=A2XL5XS4W5CEUX	shanxipeihuiyiwangluokejiyouxiangongsi
96	amazon.com/sp?seller=A2I06RD5GPD2U2	shanxizhoufangkejiyouxiangongsi
97	amazon.com/sp?seller=A2NAJOIMO1X378	shengtaishangmaohang
98	amazon.com/sp?seller=A1WOTKHBB0EMTN	shenpengdianzishangwu
99	amazon.com/sp?seller=A3PV1WMNPZSIVW	shpenbe
100	amazon.com/sp?seller=A1OUG5TACQZ46K	Shuangchong Direct
101	amazon.com/sp?seller=A3K84HAV16AUEG	shuangliuquxiangyunianshangmaobu
102	amazon.com/sp?seller=A2TVVJPWIEA6H7	Sicily2021
103	amazon.com/sp?seller=A2IG7MB2FQJZLA	songqingningdedian

104	amazon.com/sp?seller=A1NW7125G6HZ72	songyuanshihaoruikejiyouxiangongs
105	amazon.com/sp?seller=A26KO4CCDMWBB2	Star Idoi Store US
106	amazon.com/sp?seller=A2N7CTKTF2IF2Z	Summaryerstore
107	amazon.com/sp?seller=A2VR8FZW0Z0HDB	szs-Eur
108	amazon.com/sp?seller=AC4VUDQYL4TE	TianShufan
109	amazon.com/sp?seller=A20ZKM829GP0PS	tingtingshopbeauty
110	amazon.com/sp?seller=A3NRZEZYJ0N0J1	VAVINCI
111	amazon.com/sp?seller=A17BHVXHGYC8R	Wancy
112	amazon.com/sp?seller=A2AG6EP741KQZH	wangdeganggangruxubaihuodian
113	amazon.com/sp?seller=A2VL26X2RO1YMZ	WangUS
114	amazon.com/sp?seller=A1BVG53HW3PBLN	wangxiaowei8
115	amazon.com/sp?seller=A2Q0JDJ41TCU77	wangyanjiededian
116	amazon.com/sp?seller=A2AOY26ESOS2GF	wangyuk
117	amazon.com/sp?seller=A3B97XSI380D7B	wangzhenbo9
118	amazon.com/sp?seller=A3QTYD7TW730J9	weihongtao
119	amazon.com/sp?seller=A2ZTLZO0AKYJKU	wenchangshiyanrankejiyouxiangongsi5291
120	amazon.com/sp?seller=A36B4A8KFVZXEX	wenchangzhaoruxinwangluokejiyouxiangongsi
121	amazon.com/sp?seller=AMLADDWMYZ6NH	Wjmhi
122	amazon.com/sp?seller=A3LJBUKHLWVXQX	wogjoawigjowagjeowjgo666
123	amazon.com/sp?seller=A1K96LTR9Z7V27	WuGuoHaoDSJFKJDJGLKFDSJKGDFL
124	amazon.com/sp?seller=A3M330DDFX4MFE	xia men Art oil painting

125	amazon.com/sp?seller=A2T9N3VYTEPTRO	xiamen2020_6
126	amazon.com/sp?seller=A2ANAJ36W5QC45	XIAOYU PE
127	amazon.com/sp?seller=A3913W3ESZKPPW	xiejianguoskdh
128	amazon.com/sp?seller=AVTYHD7N0MECN	xinghangyan
129	amazon.com/sp?seller=A2MIB5ZIMVSXSC	XingTaiFengZhanShangMaoYouXianGongSi
130	amazon.com/sp?seller=A35FFHCNCM5UNO	xuepozeshangmao
131	amazon.com/sp?seller=A1BYZ2E28BNZFY	yichangbiancaishangmaoyouxiangongsi
132	amazon.com/sp?seller=A3IOMEMKVOQ714	YIfuly
133	amazon.com/sp?seller=A26QHQMVBPEYHF	zhancuifeng
134	amazon.com/sp?seller=A2R052AGKRI1HY	zhangchnegyudedian
135	amazon.com/sp?seller=A2NHV20DADE03J	zhangdi7
136	amazon.com/sp?seller=A354LTBSN7EFSQ	zhangmeibin
137	amazon.com/sp?seller=A28MBPBV8HSAK7	ZhangXueDianZiShangWu
138	amazon.com/sp?seller=A17BXD11KZ2EB8	zhengkaidong
139	amazon.com/sp?seller=A19QEXBN55XF8I	Zihanine
140	amazon.com/sp?seller=A5JGDY85CP35R	zouchengshiluqiangjianzhulaowuyouxiangongsi
141	EXCEPTED	EXCEPTED
142	EXCEPTED	EXCEPTED
143	EXCEPTED	EXCEPTED
144	EXCEPTED	EXCEPTED
145	EXCEPTED	EXCEPTED
146	EXCEPTED	EXCEPTED
147	EXCEPTED	EXCEPTED
148	EXCEPTED	EXCEPTED
149	EXCEPTED	EXCEPTED
150	EXCEPTED	EXCEPTED
151	EXCEPTED	EXCEPTED

152	EXCEPTED	EXCEPTED
153	EXCEPTED	EXCEPTED
154	ebay.com/usr/xiaomieluo	xiaomieluo
155	walmart.com/seller/101297849	anqingkuhedianzishangwu
156	walmart.com/seller/101277308	Back Modern Times Life
157	walmart.com/seller/101268903	deanxianjishuoshangmaoyouxiangongsi
158	walmart.com/seller/101270550	Fengfu Co.Ltd
159	walmart.com/seller/101262075	Fengpan Trading Co., Ltd
160	walmart.com/seller/101264095	gelaosidun
161	walmart.com/seller/101284625	Home Warehouse Co.,Ltd
162	walmart.com/seller/101268490	Jiemei Co.Ltd
163	walmart.com/seller/101288225	kunmingnacijunshangmaoyouxiangongsi
164	walmart.com/seller/101290253	longkoushiruyudeshuichufang
165	walmart.com/seller/101281251	QIQIHAERSHIXINQIANSHUNDIANZISHANGWUYOUXIANGONGSI
166	walmart.com/seller/101282441	Shenzhen Sitan Trading Co., Ltd
167	walmart.com/seller/101270821	sichuanyundinghaichuangdianzishangwuyouxiangongsi
168	walmart.com/seller/101263144	Vogue Home Co.,Ltd
169	walmart.com/seller/101270675	WenChangShiYangWaQunKeJiYouXianGongSi
170	walmart.com/seller/101289853	wuzhishanzailixishangmao
171	walmart.com/seller/101136409	XIUYING Technology Co., Ltd.
172	walmart.com/seller/101280273	YUNCHENGJUNHANDIANZISHANGWUYOUXIANGONGSI
173	wish.com/merchant/601fcae5bb7a1390794bbc6d	028rf
174	wish.com/merchant/6020fc0671884d37b1c46e7d	Bully Breed Company
175	wish.com/merchant/5de3e34529e78610d1dd6b2c	Calmmmm
176	wish.com/merchant/5fca714a5f618ff167a01f3d	ctcvxke shop
177	wish.com/merchant/602a29d4c99522e04592151b	erect home furnishing
178	wish.com/merchant/6179b126753814a699fd010f	Fitness proxuct
179	wish.com/merchant/5f376e887fbb26f1dea2ad4d	Funeryio pants
180	wish.com/merchant/59b6afb4439a98111c1c4e97	hdhb7378
181	wish.com/merchant/5d980fa2c095e170839988d9	huangjuan666666

182	wish.com/merchant/602a6c547314d40b038b553b	INF Tapestry
183	wish.com/merchant/6048148c30fa4b021a498d2b	iriscaicai shop
184	wish.com/merchant/5b2320437752c87af2b96266	Lamp decoration of shang Jia Yi
185	wish.com/merchant/5fdc7acc06784c3da73ca6eb	liudashuai7424
186	wish.com/merchant/5d4fa22d1527544714ad5026	love you 3000
187	wish.com/merchant/5e8c288a39b09024d86eab9e	lup8005shop
188	wish.com/merchant/601c1e59b34276f6c372f0a6	Mauser
189	wish.com/merchant/5e23fbfc3a003e3feaadbd6c	nvllll
190	wish.com/merchant/580b5c292ed2791955678c86	Top.tt.bo
191	wish.com/merchant/5dd1381daa4d894c0fd4498f	tPQb0ia3
192	wish.com/merchant/5fdf8f5417ba952b191f3881	treefoptr
193	wish.com/merchant/602a8dcbfdb2c87acf1554d2	underrcai throwing
194	wish.com/merchant/616144d036328e444ee0b662	wangshimai6180
195	wish.com/merchant/5d58d92633f0b43680be9446	Yiwujingxi
196	wish.com/merchant/60444aec8c6a521670213828	yuxiang0738
197	wish.com/merchant/60447a813633ef9cf754cbfc	zhaohao9565
198	wish.com/merchant/58c3eb6cc92c372cfd269181	zhichaonanyemen
199	wish.com/merchant/5e6dd60629e7863262dd6d89	ZhongwoliedongsWs
200	wish.com/merchant/601187cb68ee4be2b7020ad5	zsttttt

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

ADVANCE MAGAZINE PUBLISHERS INC. d/b/a CONDÉ NAST, *Plaintiff*, v. AUBREY DRAKE GRAHAM p/k/a DRAKE, SHÉYAA BIN ABRAHAM-JOSEPH p/k/a 21 SAVAGE, and HILTZIK STRATEGIES, LLC, *Defendants*.	X : : : : : : X	No. _______________ **COMPLAINT**

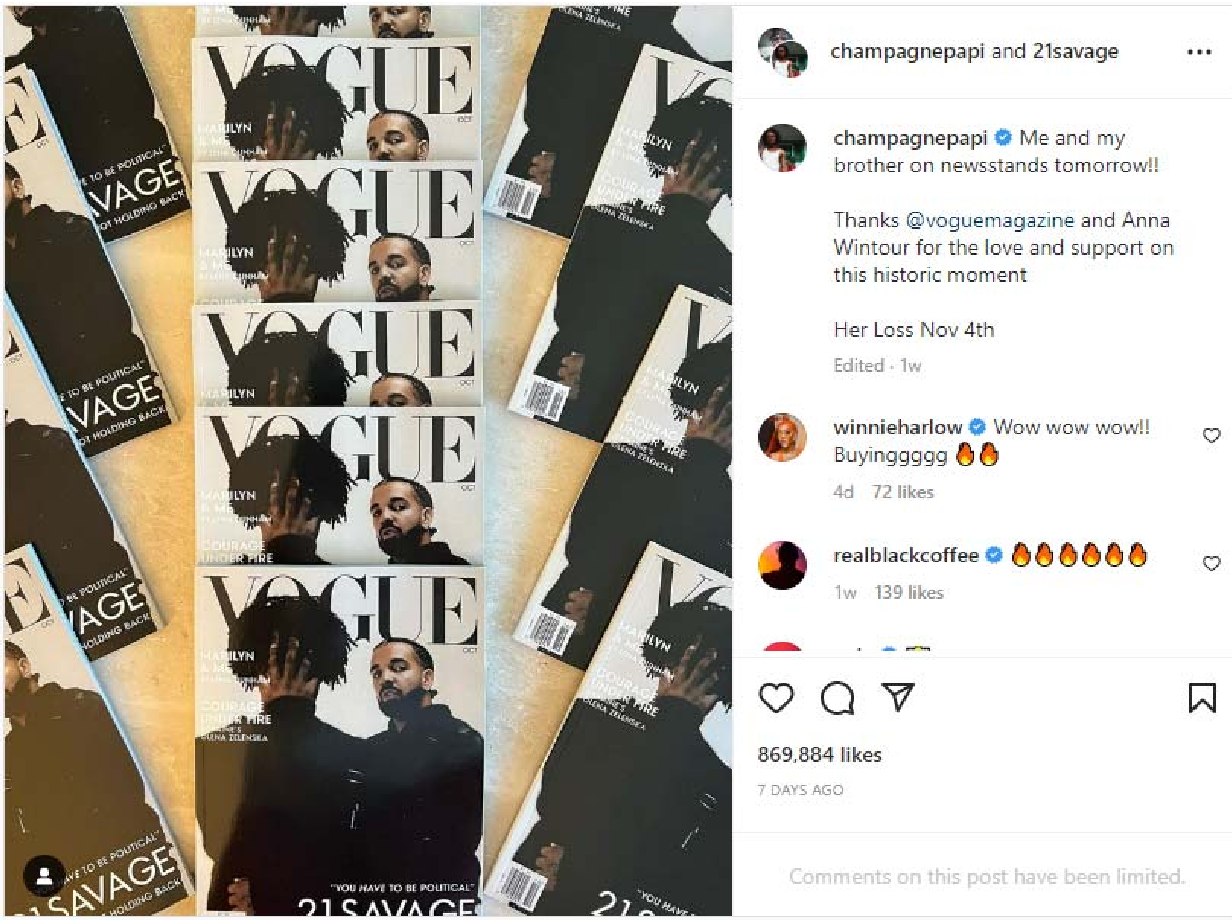
Plaintiff Advance Magazine Publishers Inc. d/b/a Condé Nast ("Condé Nast"), as and for its Complaint against Defendants Aubrey Drake Graham p/k/a Drake ("Drake"), Shéyaa Bin Abraham-Joseph p/k/a 21 Savage ("21 Savage") and Hiltzik Strategies, LLC ("Hiltzik Strategies"), alleges as follows:

NATURE OF THE ACTION

1. Condé Nast is the owner of *Vogue* magazine, one of the longest-running and widely recognized fashion publications in the world, as well as the VOGUE trademarks that the magazine's tens of millions of print and online readers and the broader public associate exclusively with *Vogue*. This action arises out of a widespread promotional campaign recently launched by world-famous musical artists Drake and 21 Savage, built entirely on the use of the VOGUE marks and the premise that Drake and 21 Savage would be featured on the cover of *Vogue*'s next issue as a means of promoting Defendants' newly released album *Her Loss*.

2. All of this is false. And none of it has been authorized by Condé Nast. In furtherance of their deceptive campaign, Defendants have gone so far as to create a counterfeit issue of *Vogue* magazine—distributing copies in North America's largest metropolitan areas,

plastering posters of the counterfeit cover along streets and buildings throughout these cities, and disseminating images of the unauthorized counterfeit magazine to the more than 135 million social media users who actively follow Drake and 21 Savage on social media along with an untold number of others who have viewed false social media posts like this:



3. To enhance the appearance of authenticity, the rollout of this false campaign deliberately mimicked the promotional activities undertaken and encouraged by Condé Nast in advance of the release of each issue of *Vogue*, which, like Defendants' false campaign, is accompanied by the placement of posters of the upcoming cover in central locations throughout major metropolitan areas, and social media posts from the cover model(s), as illustrated below with respect to September 2022 issue:

4. Not surprisingly in light of the deliberately deceptive intent, rather than offer any indication that Defendants' supposed cover was of a counterfeit magazine, Defendants' social media posts on both Instagram and Twitter instead are accompanied by the following explicitly false statements: "**Me and my brother on newsstands tomorrow!! Thanks @voguemagazine and Anna Wintour for the love and support on this historic moment. Her Loss Nov 4th**."

5. *Vogue* magazine and its Editor-in-Chief Anna Wintour have had no involvement in *Her Loss* or its promotion, and have not endorsed it in any way. Nor did Condé Nast authorize, much less support, the creation and widespread dissemination of a counterfeit issue of *Vogue*, or a counterfeit version of perhaps one of the most carefully curated covers in all of the publication business in service of promoting Defendants' new album.

6. That Defendants would knowingly violate Condé Nast's rights in this manner underscores the tremendous value that a cover feature in *Vogue* magazine carries, here, to amplify

sales of an album that was to be released days after Defendants commenced their deceptive campaign. This of course was Defendants' aim.

7. The confusion among the public is unmistakable. Immediately following Defendants' deceptive social media posts, numerous media outlets published stories with titles like *Drake & 21 Savage Land Vogue Cover Ahead Of Collab Album 'Her Loss'*, *Drake and 21 Savage are Vogue's new cover stars*, and *Drake & 21 Savage Make History On The Cover Of 'Vogue'*. The reporting in these articles underscores the confusion caused by Defendants' deceptive campaign, including, for example, the following:

> While they've since confirmed that we'll be hearing the highly anticipated album this coming Friday (November 4), in the meantime, Drizzy [*i.e.* Drake] has shared the exciting news that he and the Saint Laurent Don will be the ones to grace the cover of the latest issue of *Vogue*, landing on newsstands today (October 31). … The accompanying cover story has yet to be released, but when it is, you can rest assured it will be loaded with all kinds of juicy information about the prolific rhymers and their work – both past, present, and future.

8. User comments on the Internet also reflect this confusion, and the widespread belief that the counterfeit issue and counterfeit cover disseminated by Defendants were real:

- "Looking forward to picking this one up! @voguemagazine"
- "FINALLY OMG!!! like bffr...A FASHION ICON"
- "Something is telling me this will be a classic"
- "just wait until they talk about the album in the magazine tomorrow and they reflect on features"
- "you think it's gonna sell out before i can get to it tomorrow afternoon?"
- "Excited to read what they say about the project"
- "This project gonna be special. You not covering Vogue for some thrown together tape BS. (One can hope anyway)"
- "It's real. Also magazines can have multiple covers"

9. Since as early as October 31, Condé Nast and its counsel engaged with Defendants repeatedly to demand that they cease their infringing activities and take appropriate remedial measures to curtail further public confusion, before the release of Defendants' album on November 4. Nothing was done, with Defendants continuing to benefit from the infringing social media posts that would take seconds to take down. Defendants' flippant disregard for Condé Nast's rights have left it with no choice but to commence this action and seek the immediate injunctive relief requested herein, together with any and all available monetary remedies to deter the type of flagrant infringements and false advertising in which Defendants have engaged.

THE PARTIES

10. Plaintiff Condé Nast is a New York corporation with its principal place of business at One World Trade Center, New York, NY 10007, and is the owner of *Vogue* magazine.

11. Upon information and belief, Defendant Aubrey Drake Graham p/k/a "Drake" is an individual residing in Beverly Hills, California.

12. Upon information and belief, Defendant Shéyaa Bin Abraham-Joseph p/k/a "21 Savage" is an individual residing in Alpharetta, Georgia.

13. Upon information and belief, Defendant Hiltzik Strategies is a New York limited liability company with its principal place of business at 99 Madison Avenue, 17th Floor, New York, New York 10016.

JURISDICTION AND VENUE

14. This Court has jurisdiction over this action pursuant to 28 U.S.C. § 1331 and 28 U.S.C. § 1338, and 28 U.S.C. § 1367, as this case arises under the Lanham Act, 15 U.S.C. § 1051 *et seq*., and the state law claims arise under the same operative facts.

15. The Court has personal jurisdiction over Defendants because, among other things, each Defendant may be found in New York, does systematic and continuous business in New York and/or has performed acts directed at and causing harm in New York which give rise to this action.

16. Venue is proper in this District pursuant to 28 U.S.C. § 1391(b).

FACTS RELEVANT TO ALL CLAIMS

PLAINTIFF'S LONGSTANDING USE AND REGISTRATION OF THE VOGUE TRADEMARK

17. Condé Nast and its predecessors have adopted and continuously used in commerce the well-known trademark VOGUE as the title of a fashion magazine since at least as early as 1892, and have operated a corresponding website (www.vogue.com) since at least as early as 1998. In the 130 years since its first publication, *Vogue* magazine has become one of the most widely recognized and revered fashion publications in the world.

18. Condé Nast owns more than sixty active and valid U.S. registrations for trademarks comprised of the word "Vogue" and/or its well-known logo, with the earliest dating back to 1908 (U.S. Reg. No. 0,069,530) for use in connection with magazines. Others include Reg. No. 0,125,542, issued May 20, 1919, for the well-known logo for the VOGUE trademark, Reg. Nos. 0,504,006, 1,336,659, 2,592,452, 3,069,976, 4,138,408, 4,964,883, 4,964,884, 5,915,018, 6,324,126 and many others (collectively, the "Vogue Mark"). True and correct copies of the foregoing registrations are annexed hereto collectively as **Exhibit A**.

19. Condé Nast and its predecessors have expended considerable time, resources, and effort in promoting the VOGUE Mark and developing substantial goodwill associated therewith throughout the United States during the 130-year history of its use in association with *Vogue* magazine. Due to the continual use of the VOGUE Mark by Condé Nast and its predecessors over

that period, the VOGUE Mark has come to indicate a single source of goods and services. And its specific stylization has long been well established:

VOGUE

20. The general public instantly recognizes and associates the VOGUE Mark with *Vogue* magazine. So widespread is public knowledge of the magazine that *Vogue* was described by book critic Caroline Weber in a December 2006 edition of *The New York Times* as "the world's most influential fashion magazine."

21. The United States edition of *Vogue* magazine is read by over 9 million people each month. The corresponding U.S. website receives approximately 18 million unique visitors each month.

22. In addition to its magazine and website, Condé Nast uses the VOGUE Mark on social media accounts associated with *Vogue* magazine, including Instagram, Twitter, Facebook and Pinterest. Underscoring its reach, *Vogue* magazine has over 70 million social media followers, including over 41 million followers on Instagram (@voguemagazine), 15 million followers on Twitter (@voguemagazine), and nearly 10 million followers on Facebook (@Vogue Magazine).

23. As a result of the longstanding and continuous use of the VOGUE Mark, the VOGUE Mark has acquired substantial goodwill and reputation and has become famous, as multiple courts have recognized in the past.

24. A representative example of Condé Nast's easily recognizable *Vogue* magazine, using the VOGUE mark, is reflected on the cover of the current November 2022 issue:

DEFENDANTS' FALSE, DECEPTIVE AND UNAUTHORIZED USES OF THE VOGUE MARK TO PROMOTE THEIR NEW ALBUM *HER LOSS*

25. Defendants' deceptive promotional campaign deliberately seeks to capitalize, and has capitalized, on the substantial goodwill and value associated with the VOGUE Mark to promote and drive up sales of Defendants' recently released album *Her Loss* (the "Album"), without Condé Nast's authorization.

26. The Album was released on November 4. On October 30, five days in advance of the Album's release, a Twitter account associated with Drake (@drakerelated) posted the

following image of the counterfeit magazine (the "Counterfeit Magazine"), showing the counterfeit cover (the "Counterfeit Cover"):

27. The image was captioned with this announcement (attached as **Exhibit B**):

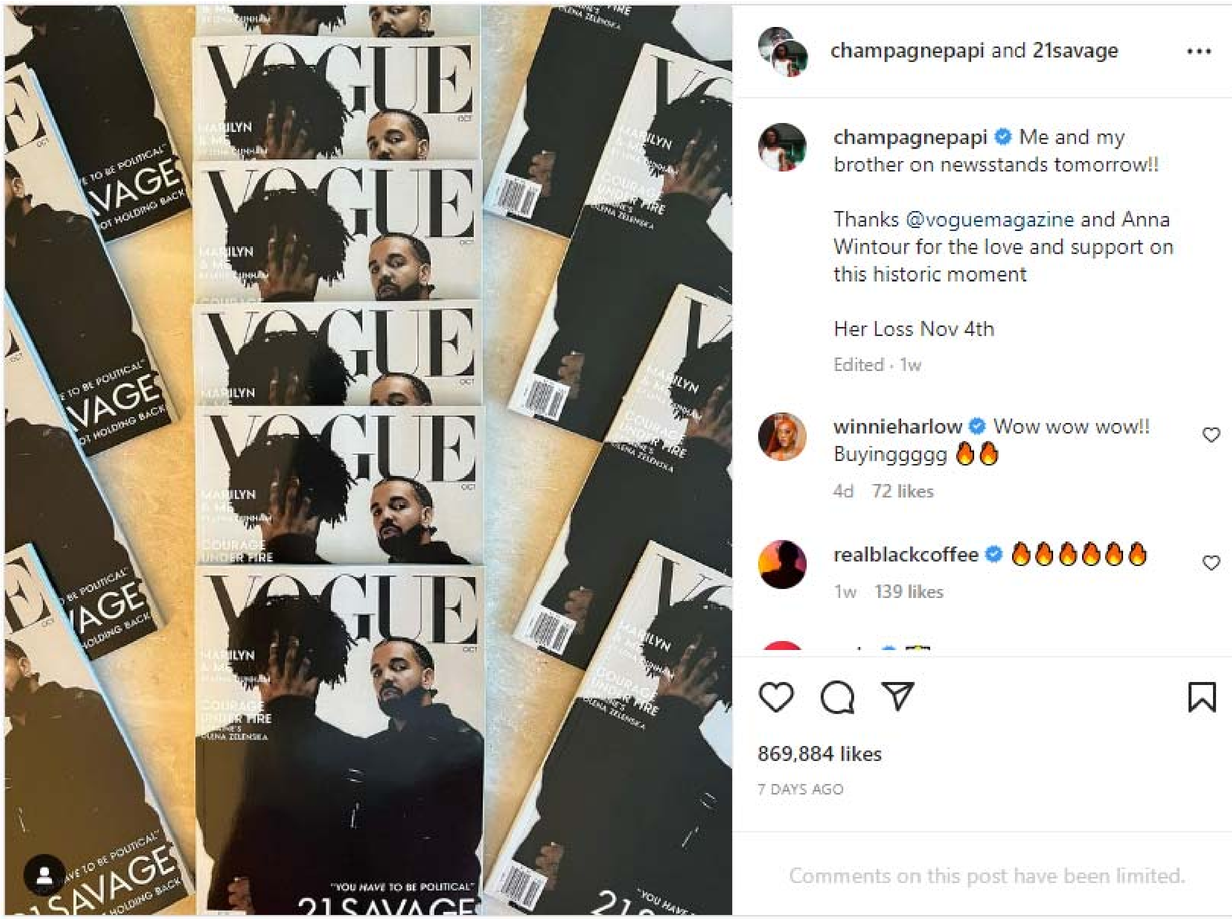
Drake Related
@drakerelated

Newsstands tomorrow @Drake @21savage

Thanks to @voguemagazine and Anna Wintour for the love and support on this historic moment

#HerLoss Nov 4th

28. Shortly thereafter, both Drake and 21 Savage posted the identically worded announcement on their own Instagram pages (attached as **Exhibit C**), with the identical arrangement showing the Counterfeit Cover:



29. Neither Condé Nast nor Anna Wintour authorized the creation of the Counterfeit Magazine, the dissemination of images of the Counterfeit Cover, the use of the VOGUE Mark, or the use of its Editor-in-Chief Anna Wintour's name in this or any other manner.

30. The unauthorized dissemination of images of the Counterfeit Cover continued thereafter. Later on October 30, the Drake Related Twitter account released the following image (attached as **Exhibit D**), juxtaposing an image of the Counterfeit Cover with real issues of *Vogue* and other fashion magazines to further enhance the appearance of authenticity:

Drake Related
@drakerelated

7:21 PM · Oct 30, 2022 · Twitter for iPhone

31. The following morning at 10:40 am EDT, Defendant Hiltzik Strategies—upon information and belief, Defendants' public relations firm retained to promote *Her Loss*—sent out an email blast to an untold number of blind copy recipients advising that, "To celebrate Drake's Vogue cover and his joint album HER LOSS, Street teams will be handing out copies of the magazine Monday Afternoon in select cities across America."

32. Approximately one hour later, at 11:44 am EDT, Condé Nast's Global Counsel for IP and Content Integrity, Christopher Donnellan, responded to Hiltzik Strategies by email

(attached as **Exhibit E**), making clear that Defendants' infringing activities were not authorized, and demanding that Defendants "immediately cease and desist this unauthorized use of the Vogue trademark by removing the Instagram post, ceasing any distribution of this 'magazine,' and issuing a public statement clarifying that this was not an actual cover of Vogue."

33. Hiltzik Strategies replied with the perfunctory response: "Thank you for the email, letting you know that it was was [*sic*] received." (*See* Ex. E). Rather than take any of the remedial actions demanded by Condé Nast, Defendants thereafter intensified the unauthorized and deceptive advertising campaign.

34. Following Defendants' receipt of Condé Nast's demand, the Drake Related Twitter account posted the multitude of locations at which the Counterfeit Magazine would be distributed in New York, Los Angeles, Atlanta, Miami, Houston and Toronto (attached collectively as **Exhibit F**), including, for example, the following locations just in New York and Los Angeles:

- Columbia University, Broadway & W 116th St
- W 125th St & Malcolm X Blvd, New York, NY 10027
- Canal St & Lafayette St, New York, NY 10013
- West 34th St & 8th Ave, Manhattan, NY 10123
- 4th Ave & Pacific St, Brooklyn, NY 11217
- Flatbush Av – Brooklyn College, Brooklyn, NY 11217
- 417 E Fordham Rd, The Bronx, NY 10458
- Dyckman St & Broadway, New York, NY 10034
- 179th St, Jamaica, NY 11432
- Forest Hills 71 Ave Station, Queens, NY 11375
- Kosher News, 370 N Fairfax Ave, Los Angeles, CA 90036
- Al's Newstand, 216 S Beverly Dr, Beverly Hills, CA 90212
- Farmers Market USPS, 6333 W 3rd St #818, Los Angeles, CA 90036
- The Locals News Stand, 217 W 6th St, Los Angeles, CA 90014
- Malibu J's Gift Shop, 1515 Ocean Ave, Santa Monica, CA 90401
- Century World News, 10597 W Pico Blvd

35. Posts on social media propagated, showing copies of the Counterfeit Magazine that individuals had procured, including the following post on November 1:

5TH
@5thave_native

Perks of livin in NYC exclusive drake x 21 vogue mag 🔥

3:24 PM · Nov 1, 2022 · Twitter for iPhone

36. A review of the Counterfeit Magazine itself reveals that it is a complete, professionally reprinted reproduction of the October issue of Vogue, with unauthorized adaptations made in service of promoting Defendants' Album.[1]

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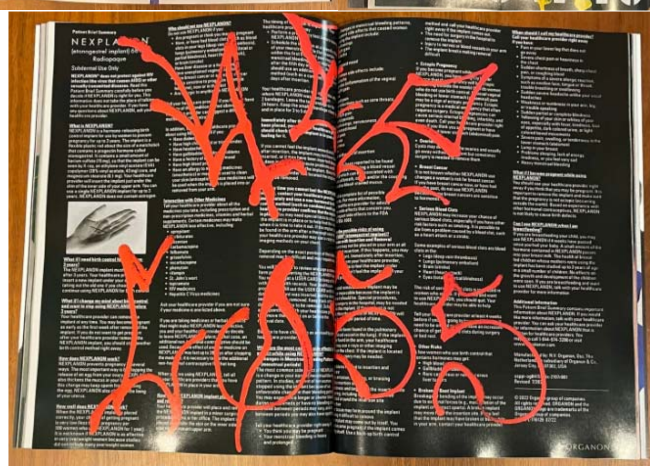
[1] Condé Nast has filed an application for copyright registration for the October issue that Defendants have infringed, and intends to file an amended complaint after registration is secured.

37. Some pages have no modifications, constituting an exact reproduction of Condé Nast's copyrightable content. Other pages are modified to superimpose promotional logos for Defendants' Album. Others include images of Anna Wintour that were not in the real issue, and in one case was doctored to interpose an image of Drake. Examples are shown below:





38. Anna Wintour did not authorize the use of her image to promote Defendants' Album. Upon information and belief, other than Defendants themselves, none of the other dozens of individuals whose images were in the authentic October issue of *Vogue*, and are now depicted in the Counterfeit Magazine, authorized the use of their images to promote Defendants' Album.

39. Defendants also placed blown-up print posters of the Counterfeit Cover at various locations throughout these cities, including prominently throughout New York City:

40. The Counterfeit Cover—as depicted in these posters, on Defendants' social media posts described herein, and on the face of the Counterfeit Magazine—provides no indication that it is anything other than the cover of an authentic *Vogue* issue.

THE RESULTING PUBLIC DECEPTION AND CONFUSION

41. Not surprisingly, widespread public confusion that the Counterfeit Cover and Counterfeit Magazine were authentic immediately followed. Erroneous press accounts were issued, including the following (attached collectively as **Exhibit G**):

- **Yahoo News**[2] posted a Revolt article titled *Drake and 21 Savage land on the cover of 'Vogue'*, erroneously reporting: "**This Friday (Nov. 4), Drake and 21 Savage will unveil their joint album, Her Loss, to the masses. Before that takes place,**

[2] *See* https://www.yahoo.com/video/drake-21-savage-land-cover-121225115.html?guccounter=1&guce_referrer=aHR0cHM6Ly93d3cuZ29vZ2xlLmNvbS8&guce_referrer_sig=AQAAABOaYOGhPbZdCdqNR42OvsMAho4pjfhDKuBYg2jbkXDFaZOvkPmMUbLHsCUgID_5nqmGQOfAs2RZ37R0ptUN98Opcd7osNUOkLanLXj1gzeRcfSdNSCuccF5RWe0BzzY5CGRKIiBJqvm0-F7vLmURxpHw7bwwGX9laXHVALXAft.

the chart-topping duo revealed that they've landed on the cover of Vogue's latest issue."

- **All Hop Hop**[3] posted an article titled *Drake & 21 Savage Land Vogue Cover Ahead Of Collab Album 'Her Loss'*, erroneously reporting: "**While Drake and 21 Savage delayed the release of their upcoming surprise album *Her Loss* earlier this week, the rollout continues with the two rappers appearing on the cover of iconic fashion bible *Vogue*.**"

- **HipHopDX**[4] posted an article titled *DRAKE & 21 SAVAGE COVER 'VOGUE' MAGAZINE AHEAD OF 'HER LOSS' ALBUM*, erroneously reporting: "**Drake and 21 Savage have covered the latest issue of *Vogue* alongside one another as their *Her Loss* joint project is set to arrive later this week. The fashion magazine cover hit stands on Monday (October 31) featuring the pair of rappers draped in black threads with 21 keeping his face covered with his hand.**"

- **View the Vibe**[5] posted an article titled *Drake and 21 Savage are Vogue's new cover stars*, erroneously reporting: "**Drake and 21 Savage's new album Her Loss is not the only thing that's coming out this week. The rapper posted that the duo is Vogue's October cover star. … This special edition of Vogue's October issue will be available at various locations across New York City. … Having the rappers on the cover of Vogue is definitely different for Vogue.**"

- **HotNewHipHop**[6] posted an article titled *Drake & 21 Savage Make History On The Cover Of "Vogue"*, erroneously reporting: "**While they've since confirmed that we'll be hearing the highly anticipated album this coming Friday (November 4), in the meantime, Drizzy [i.e. Drake] has shared the exciting news that he and the Saint Laurent Don will be the ones to grace the cover of the latest issue of *Vogue*, landing on newsstands today (October 31). … The accompanying cover story has yet to be released, but when it is, you can rest assured it will be loaded with all kinds of juicy information about the prolific rhymers and their work – both past, present, and future.**"

42. The Wikipedia entry for the "List of *Vogue* (US) cover models" (*see* https://en.wikipedia.org/wiki/List_of_Vogue_(US)_cover_models#2022) was updated to further

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[3] *See* https://allhiphop.com/news/drake-21-savage-land-vogue-cover/.

[4] *See* https://hiphopdx.com/news/drake-21-savage-her-loss-vogue.

[5] *See* https://viewthevibe.com/drake-and-21-savage-are-vogues-new-cover-stars/.

[6] *See* https://www.hotnewhiphop.com/445575-drake-21-savage-make-history-on-the-cover-of-vogue.

reflect and propagate the public's erroneous belief that Drake and 21 Savage were cover models on an authentic issue of *Vogue* magazine:

2022 [edit]

Issue	Cover model	Photographer
January	Olivia Wilde	Annie Leibovitz
February	HoYeon Jung	Harley Weir
March	Kim Kardashian	Carlijn Jacobs
April	Bella Hadid	Ethan James Green
May	Rihanna	Annie Leibovitz
June / July	Dua Lipa	Tyler Mitchell
August	Emma Corrin	Jamie Hawkesworth
September	Serena Williams	Luis Alberto Rodriguez
October	Jennifer Lawrence	Tina Barney
November	Michaela Coel	Malick Bodian
December	Drake 21 Savage	

43. Public confusion is further reflected in user comments posted on various websites and social media posts, including the following:

- "Looking forward to picking this one up! @voguemagazine"
- "FINALLY OMG!!! like bffr...A FASHION ICON"
- "Something is telling me this will be a classic"
- "just wait until they talk about the album in the magazine tomorrow and they reflect on features"
- "you think it's gonna sell out before i can get to it tomorrow afternoon?"
- "Excited to read what they say about the project"
- "This project gonna be special. You not covering Vogue for some thrown together tape BS. (One can hope anyway)"
- "It's real. Also magazines can have multiple covers"

DEFENDANTS' CONTINUING VIOLATION OF CONDÉ NAST'S RIGHTS

44. Following its initial cessation demand on October 31, Condé Nast has attempted to resolve this matter amicably, including through counsel, predicated on the threshold requirement that Defendants take the necessary remedial measures to cease their infringing activities and remove the infringing materials from circulation.

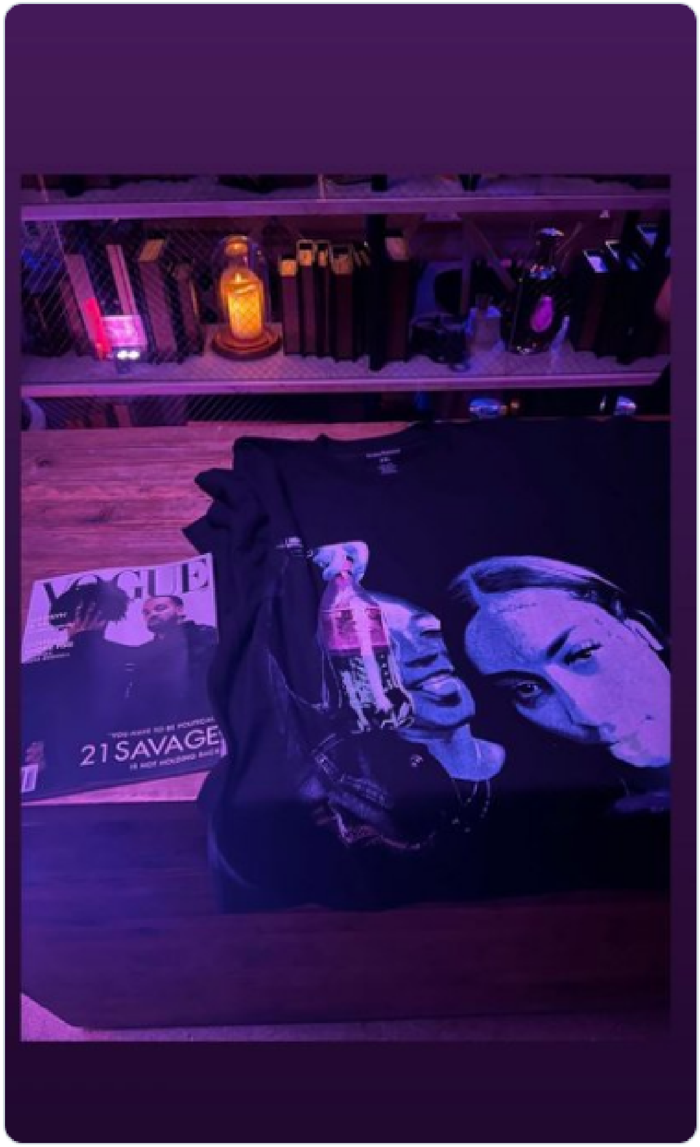
45. Defendants have refused, preferring to continue to exploit the VOGUE Mark (and Anna Wintour's name and image) to drive up sales of the Album through the social media posts depicting the Counterfeit Cover—with the explicitly false statements attesting to Condé Nast's and its Editor-in-Chief Anna Wintour's endorsement—the continued display of the posters showing the Counterfeit Cover in some of the largest metropolitan areas in North America, and the continued distribution of the Counterfeit Magazines.

46. As of the date of this filing, all of the infringing posts remain available online, including on the social media accounts maintained by and/or associated with Drake and 21 Savage. Posters of the Counterfeit Cover continue to be plastered throughout New York, Los Angeles, Atlanta, Miami, Houston and Toronto. And, upon information and belief, copies of the Counterfeit Magazine continue to be available for sale in these locations.

47. Not only have Defendants refused to remove and cease dissemination of the infringing materials, but they have doubled down with new displays of the Counterfeit Cover, days after Condé Nast's initial demand (attached as **Exhibit H**):

Drake Direct
@DrakeDirect_

Drake via his IG story



Drizzy

5:41 AM · Nov 4, 2022 · Twitter for iPhone

<u>FIRST CLAIM</u>
TRADEMARK INFRINGEMENT / COUNTERFEITING (15 U.S.C. § 1114)

48. Condé Nast repeats and re-alleges the allegations contained in the preceding paragraphs as if fully set forth herein.

49. Section 32(1) of the Lanham Act, 15 U.S.C. § 1114(1), imposes liability against "[a]ny person who shall, without the consent of the registrant -- (a) use in commerce any reproduction, counterfeit, copy, or colorable imitation of a registered mark in connection with the sale, offering for sale, distribution, or advertising of any goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive; or (b) reproduce, counterfeit, copy, or colorably imitate a registered mark and apply such reproduction, counterfeit, copy, or colorable imitation to labels, signs, prints, packages, wrappers, receptacles or advertisements intended to be used in commerce upon or in connection with the sale, offering for sale, distribution, or advertising of goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive[.]"

50. Condé Nast is the owner of the valid and incontestable VOGUE Mark, as described above.

51. Defendants' use of Condé Nast's registered VOGUE Mark and colorable imitations thereof in connection with their online presence and the advertising and promotion of their goods and services in commerce, including in connection with the Counterfeit Cover, Counterfeit Magazine and Defendants' Album, is likely to cause confusion, and to cause mistake, and to deceive, in violation of § 32(1) of the Lanham Act, 15 U.S.C. § 1114(1).

52. Defendants' use of the registered VOGUE Mark and colorable imitations thereof constitutes willful trademark infringement under § 32(1) of the Lanham Act, 15 U.S.C. § 1114(1).

53. By reason of Defendants' willful use of the counterfeit VOGUE Mark in connection with the promotion and distribution of the Album and the Counterfeit Magazine, Condé Nast is entitled, at its election, to recovery of (i) treble Defendants' profits from the sales of the Album and the Counterfeit Magazine, or treble Plaintiff's damages, whichever is greater (15 U.S.C. § 1117(b)); or (ii) statutory damages of up to $4,000,000 (15 U.S.C. § 1117(c)(2)); or (iii)

Defendants' profits and Plaintiff's damages, increased subject to the principles of equity, together with the costs of this action (15 U.S.C. § 1117(a)).

54. Defendants' infringements have caused, and unless restrained by this Court will continue to cause, immediate and irreparable injury to Condé Nast's property and business, entitling Condé Nast to injunctive relief (15 U.S.C. § 1116), including, without limitation, an order directing the removal and destruction of all physical copies of the Counterfeit Cover and Counterfeit Magazine.

55. Defendants' intentional, deliberate, and willful use of the VOGUE Mark and colorable imitations thereof in connection with the Counterfeit Cover, Counterfeit Magazine and Album, with knowledge of Condé Nast's rights in the registered VOGUE Mark, renders this case exceptional, entitling Condé Nast to an award of reasonable attorneys' fees incurred in connection with this action.

SECOND CLAIM
FALSE DESIGNATION OF ORIGIN / UNFAIR COMPETITION
(15 U.S.C. § 1125(a))

56. Condé Nast repeats and re-alleges the allegations contained in the preceding paragraphs as if fully set forth herein.

57. Section 43(a)(1) of the Lanham Act, 15 U.S.C. § 1125(a)(1), imposes liability against "[a]ny person who, on or in connection with any good or services, … uses in commerce any word, term, name, symbol, … or any false designation of origin, … which – (A) is likely to cause confusion, or to cause mistake, or to deceive … as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person[.]"

58. Defendants' use of the VOGUE Mark falsely suggests that Condé is the source of, has authorized, is associated with and/or has endorsed the Counterfeit Cover, the Counterfeit Magazine and Album, and is likely to deceive the relevant trade and public into believing that

these materials are authorized, associated with and/or endorsed or approved by, or provided in affiliation with, Condé Nast, in violation of 15 U.S.C. § 1125(a).

59. By reason of Defendants' willful use of the counterfeit VOGUE Mark in connection with the promotion and distribution of the Album and the Counterfeit Magazine, Condé Nast is entitled to recovery of Defendants' profits and Plaintiff's damages, increased subject to the principles of equity, together with the costs of this action (15 U.S.C. § 1117(a)).

60. Defendants' conduct has caused, and unless restrained by this Court will continue to cause, immediate and irreparable injury to Condé Nast's property and business, entitling Condé Nast to injunctive relief (15 U.S.C. § 1116), including, without limitation, an order directing the removal and destruction of all physical copies of the Counterfeit Cover and Counterfeit Magazine.

61. Defendants' intentional, deliberate, and willful use of the VOGUE Mark and colorable imitations thereof in connection with the Counterfeit Cover, Counterfeit Magazine and Album, with knowledge of Condé Nast's rights in the registered VOGUE Mark, renders this case exceptional, entitling Condé Nast to an award of reasonable attorneys' fees incurred in connection with this action.

THIRD CLAIM
DILUTION (15 U.S.C. § 1125(c))

62. Condé Nast repeats and re-alleges the allegations contained in the preceding paragraphs as if fully set forth herein.

63. The VOGUE Mark is distinctive and famous within the meaning of 15 U.S.C. § 1125(c) by virtue of its inherent and acquired distinctiveness; the long duration and wide extent of the VOGUE Mark's use; the long duration, wide extent, and wide geographic reach of advertising and publicity of the VOGUE Mark; the large volume and wide geographic extent of sales of goods

and services offered under the VOGUE Mark; the high degree of actual recognition of the VOGUE Mark; and the longstanding federal registrations of the VOGUE Mark.

64. Defendants have used the VOGUE Mark in commerce in connection with the sale and distribution of the Counterfeit Magazine and Defendants' Album, for Defendants' commercial gain.

65. Defendants' use of the VOGUE Mark is likely to cause dilution by blurring and/or tarnishment, by creating a false association between Defendants and *Vogue* magazine, impairing the distinctiveness of the VOGUE mark, and impairing the reputation and goodwill associated with the VOGUE Mark.

66. Defendants' use of the VOGUE Mark was willfully intended to trade on the recognition of the famous VOGUE Mark and/or willfully intended to harm the reputation of the famous VOGUE Mark, such that Condé Nast is entitled to recovery of Defendants' profits and Plaintiff's damages, increased subject to the principles of equity, together with the costs of this action (15 U.S.C. § 1117(a)).

67. Defendants' infringements have caused, and unless restrained by this Court will continue to cause, immediate and irreparable injury to Condé Nast's property and business, entitling Condé Nast to injunctive relief (15 U.S.C. § 1116), including, without limitation, an order directing the removal and destruction of all physical copies of the Counterfeit Cover and Counterfeit Magazine.

68. Defendants' intentional, deliberate, and willful use of the VOGUE Mark and colorable imitations thereof in connection with the Counterfeit Cover, Counterfeit Magazine and Album, with knowledge of Condé Nast's rights in the registered VOGUE Mark, renders this case exceptional, entitling Condé Nast to an award of reasonable attorneys' fees incurred in connection with this action.

FOURTH CLAIM
FALSE ADVERTISING (15 U.S.C. § 1125(a))

69. Condé Nast repeats and re-alleges the allegations contained in the preceding paragraphs as if fully set forth herein.

70. Defendants have made false, deceptive, and misleading representations in their commercial advertising concerning the nature, characteristics, and qualities of their goods, services, and commercial activities, in violation of Section 43(a)(1)(B) of the Lanham Act, 15 U.S.C. § 1125(a)(1)(B).

71. Defendants' false, deceptive, and misleading descriptions and representations—including that the Counterfeit Magazine and Counterfeit Cover are authentic, and that Condé Nast created, approved and/or endorsed the creation and dissemination of these materials—have deceived and are likely to deceive consumers.

72. Defendants' false, deceptive, and misleading statements to promote sales of their Album and Counterfeit Magazine have damaged the goodwill and reputation that the VOGUE Mark has acquired over the 130-year period of its continuous use in connection with *Vogue* magazine, and caused economic injury to Condé Nast by, *inter alia*, diverting and/or suppressing sales of genuine issues of *Vogue*.

73. Defendants' false and misleading statements and representations concerning the Counterfeit Magazine and Counterfeit Cover to market the Album are willful, deliberate, intentional and in bad faith.

74. By reason of the foregoing, Condé Nast is entitled to recovery of Defendants' profits and Plaintiff's damages, increased subject to the principles of equity, together with the costs of this action (15 U.S.C. § 1117(a)).

75. Defendants' conduct has caused, and unless restrained by this Court will continue to cause, immediate and irreparable injury to Condé Nast's property and business, entitling Condé Nast to injunctive relief (15 U.S.C. § 1116).

76. Defendants' knowingly false statements and representations concerning the Counterfeit Magazine and Counterfeit Cover renders this case exceptional, entitling Plaintiff to an award of reasonable attorneys' fees incurred in connection with this action.

FIFTH CLAIM
VIOLATION OF N.Y. GEN. BUS. LAW § 360-k

77. Condé Nast repeats and re-alleges the allegations contained in the preceding paragraphs as if fully set forth herein.

78. Condé Nast is the owner of the valid and subsisting VOGUE Mark, as described above, which has been duly registered in New York.

79. Defendants' use of the counterfeit VOGUE Mark and colorable imitations thereof in connection with the advertising, sale and distribution of their goods and services, including the Counterfeit Magazine and their Album, is likely to cause confusion, and to cause mistake, and to deceive, in violation of N.Y. Gen. Bus. Law § 360-k.

80. For the reasons described herein, Defendants' acts of infringement are willful, intentional and deliberate, and have been committed with knowledge of Condé Nast's rights with respect to the VOGUE Mark, and in bad faith.

81. By reason of Defendants' willful use of the counterfeit VOGUE Mark in connection with the promotion and distribution of the Album and the Counterfeit Magazine, Condé Nast is entitled to recovery of treble profits and damages, together with reasonable attorneys' fees, pursuant to N.Y. Gen. Bus. Law § 360-m.

82. Defendants' infringements have caused, and unless restrained by this Court will continue to cause, immediate and irreparable injury to Condé Nast's property and business, entitling Condé Nast to injunctive relief, including, without limitation, an order directing the removal and destruction of all physical copies of the Counterfeit Cover and Counterfeit Magazine.

SIXTH CLAIM
COMMON LAW TRADEMARK INFRINGEMENT / UNFAIR COMPETITION

83. Condé Nast repeats and re-alleges the allegations contained in the preceding paragraphs as if fully set forth herein.

84. Condé Nast has acquired rights to the VOGUE Mark through its use over the course of *Vogue* magazine's 130-year history.

85. Defendants' misappropriation and use of the counterfeit VOGUE Mark and colorable imitations thereof in connection with the advertising, sale and distribution of their goods and services, including the Counterfeit Magazine and their Album, is likely to cause confusion, and to cause mistake, and to deceive, in violation of Condé Nast's common law rights with respect to the VOGUE Mark.

86. For the reasons described herein, Defendants' acts of infringement are willful, intentional and deliberate, and have been committed with knowledge of Condé Nast's rights with respect to the VOGUE Mark, and in bad faith.

87. By reason of the foregoing, Condé Nast is entitled to an award of damages, including exemplary and punitive damages, in an amount to be determined at trial.

88. Defendants' infringements have caused, and unless restrained by this Court will continue to cause, immediate and irreparable injury to Condé Nast's property and business, entitling Condé Nast to injunctive relief, including, without limitation, an order directing the removal and destruction of all physical copies of the Counterfeit Cover and Counterfeit Magazine.

SEVENTH CLAIM
VIOLATION OF N.Y. GEN. BUS. LAW §§ 349 AND 350

89. Condé Nast repeats and re-alleges the allegations contained in the preceding paragraphs as if fully set forth herein.

90. Defendants' false, misleading, and deceptive statements, representations and advertising concerning the Counterfeit Cover and Counterfeit Magazine, and Condé Nast's endorsement thereof, constitute deceptive business practices in violation of N.Y. Gen. Bus. Law § 349.

91. Defendants' false, misleading, and deceptive statements and representations of fact are directed toward consumers, and have resulted in harm to the public interest in New York and nationwide through the deception of the millions of consumers who have been deceived thereby.

92. By reason of Defendants' conduct, Condé Nast has suffered injury in fact in an amount to be proven at trial.

93. Defendants' conduct is and, at all relevant times, has been willful, deliberate, intentional, and in bad faith.

94. By reason of the foregoing, Condé Nast is thus entitled to award of damages, including exemplary and punitive damages, in an amount to be determined at trial.

95. Defendants' conduct has caused, and unless restrained by the Court will continue to cause, irreparable injury to Condé Nast and to members of the public, and should be enjoined.

PRAYER FOR RELIEF

WHEREFORE, Plaintiff Condé Nast respectfully requests the following relief:

a. Temporary, preliminary and permanent injunctive relief

i. enjoining and restraining Defendants, their agents, or anyone working for, in concert with or on behalf of any of the Defendants, and each of their officers, agents, servants, employees, and attorneys, and all other persons who are in active concert or participation with Defendants (the "Restrained Parties"), from making, using, displaying, disseminating, or distributing: (i) copies or images of the Counterfeit Magazine or Counterfeit Cover; (ii) the VOGUE Mark, or any mark that is confusingly similar to, or a derivation or colorable imitation of, the VOGUE Mark, for commercial purposes, including, without limitation, to advertise, market, or promote the album *Her Loss*; (iii) Wintour's name, image or likeness for commercial purposes, including, without limitation, to advertise, market, or promote the album *Her Loss*; and/or (iv) any false or misleading statements or misrepresentations concerning the Counterfeit Magazine, the Counterfeit Cover and/or Drake and 21 Savage's participation or appearance in *Vogue* magazine (collectively, the "Enjoined Content").

ii. directing Defendants to take down and remove from public display and circulation: (i) all existing Internet and social media posts on all websites and social media accounts within Defendants' ownership, control, or direction, which contain or reflect the Enjoined Content; and (ii) all existing physical copies of the Counterfeit Cover and/or the Counterfeit Magazine, in all locations, that were placed, displayed or circulated by or at the direction the Restrained Parties.

b. An Order directing the Restrained Parties to deliver up for destruction all physical copies of any and all Enjoined Content, including, without limitation, all goods, labels, signs, prints, packages, wrappers, receptacles or advertisements depicting the Counterfeit Magazine and/or the Counterfeit Cover.

c. On the First, Second, Third and Fourth Claims, an award, at Plaintiff's election, of (i) treble Defendants' profits from the sales of the Album and the Counterfeit Magazine, or treble Plaintiff's damages, whichever is greater; (ii) statutory damages of up to $4,000,000; or (iii) Defendants' profits and Plaintiff's damages, increased subject to the principles of equity, in an amount to be determined at trial.

d. On the Fifth Claim, an award of treble Defendants' profits and Plaintiff's damages, in an amount to be determined at trial.

e. On the Sixth and Seventh Claims, an award of damages, including exemplary and punitive damages, in an amount to be determined at trial.

f. An award of costs and reasonable attorneys' fees.

g. Pre-judgment and post-judgment interest.

h. Such other and further relief as the Court deems just and proper.

Dated: November 7, 2022
New York, New York

LOEB & LOEB LLP

By: */s/ Wook Hwang*

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Conformed to Federal Register version

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 229, 232, and 240

[Release Nos. 34-95607; File No. S7-07-15]

RIN 3235-AL00

Pay Versus Performance

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is adopting amendments to implement Section 14(i) ("Section 14(i)") of the Securities Exchange Act of 1934 ("Exchange Act"), as added by Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). Section 14(i) directs the Commission to adopt rules requiring registrants to provide disclosure of pay versus performance. The disclosure is required in proxy or information statements in which executive compensation disclosure is required. The disclosure requirements do not apply to emerging growth companies, registered investment companies, or foreign private issuers.

DATES: *Effective date*: This final rule is effective on October 11, 2022.

Compliance date: Companies (other than emerging growth companies, registered investment companies, or foreign private issuers) must begin to comply with these disclosure requirements in proxy and information statements that are required to include Item 402 of Regulation S-K (as defined below) disclosure for fiscal years ending on or after December 16, 2022.

FOR FURTHER INFORMATION CONTACT: John Byrne, Special Counsel, Office of Small Business Policy, at (202) 551-3460, Division of Corporation Finance.

SUPPLEMENTARY INFORMATION: The Commission is adopting an amendment to add new paragraph (v) to 17 CFR 229.402 ("Item 402 of Regulation S-K"); and amending 17 CFR 232.405 ("Item 405 of Regulation S-T"), 17 CFR 240.14a-101 ("Schedule 14A"), and 17 CFR 240.14c-101 ("Schedule 14C"), each under the Exchange Act.

Table of Contents

I. INTRODUCTION

A. Background

Section 953(a) of the Dodd-Frank Act[1] ("Section 953(a)") added Section 14(i)[2] to the Exchange Act.[3] Section 14(i) mandates that the Commission shall, by rule, require each issuer to disclose in any proxy or consent solicitation material for an annual meeting of the shareholders of the issuer a clear description of any compensation required to be disclosed by the issuer under Item 402 of Regulation S-K (or any successor thereto), including, for any issuer other than an emerging growth company, information that shows the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions. Section 14(i) also states that an issuer may include a graphic representation of the information required to be disclosed.

As a part of the Dodd-Frank Act legislative process, in a 2010 report, the Senate Committee on Banking, Housing and Urban Affairs stated that the disclosure required under Section 14(i) "may take many forms."[4] In addition, the report indicated that the relationship between executive pay and performance has become a "significant concern of shareholders,"

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1 Pub. L. 111-203, 124 Stat. 1376 (2010).

2 15 U.S.C. 78n(i).

3 15 U.S.C. 78a *et seq.* Subsequent to the addition of Section 14(i) to the Exchange Act, Section 102(a)(2) of the Jumpstart Our Business Startups Act amended Section 14(i) to exclude registrants that are "emerging growth companies" from the pay-versus-performance disclosure requirements. Pub. L. 112-106, 126 Stat. 306 (2012).

4 Report of the Senate Committee on Banking, Housing and Urban Affairs to accompany S. 3217, S. REP. NO. 111-176, at 135 (2010) ("Senate Report"). The report stated with respect to Section 953(a): "This disclosure about the relationship between executive compensation and the financial performance of the issuer may include a clear graphic comparison of the amount of executive compensation and the financial performance of the issuer or return to investors and may take many forms."

and that the required disclosure should "add to corporate responsibility," as registrants will be required to provide clearer executive pay disclosures.[5]

In 2015, the Commission proposed a new rule to implement Section 953(a) by creating a new requirement in Item 402 of Regulation S-K. The proposed new item would require a registrant to provide a clear description of (1) the relationship between executive compensation actually paid to the registrant's named executive officers ("NEOs") (including the registrant's principal executive officer (or persons acting in a similar capacity during the last completed fiscal year) ("PEO")) and the cumulative total shareholder return ("TSR") of the registrant, and (2) the relationship between the registrant's TSR and the TSR of a peer group chosen by the registrant, over each of the registrant's five most recently completed fiscal years.[6] The comment period for the Proposing Release was reopened in 2022 to permit commenters to further analyze and comment upon the proposed rules in light of developments since the publication of the Proposing Release and our further consideration of the Section 953(a) mandate.[7] In the Reopening Release, we stated that we were considering, and requested public comment on, certain additional disclosure requirements that may better implement the Section 953(a) mandate by providing investors with additional decision-relevant data.[8]

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5 *Id.*

6 *See Pay Versus Performance,* Release No. 34-74835 (Apr. 29, 2015) [80 FR 26329 (May 7, 2015)] ("Proposing Release").

7 This reopening of the comment period was set out in *Reopening of Comment Period for Pay Versus Performance* Release No. 34-94074 (Jan. 27, 2022) [87 FR 5939 (Feb. 2, 2022)] ("Reopening Release").

8 A comment letter from two members of Congress raised concerns about the Reopening Release. *See* letter from Sen. Pat Toomey and Sen. Richard Shelby, dated Feb. 1, 2022 ("Toomey/Shelby"). Specifically, the letter criticized the Commission for reopening the comment period on the Proposing Release and seeking comment on a number of regulatory alternatives without updating the cost-benefit analysis and analysis required by the Paperwork Reduction Act and the Regulatory Flexibility Act. The letter asserted that the approach taken in the Reopening Release significantly impaired the public's ability to comment thoughtfully on the proposals and was inconsistent with the Administrative Procedure Act. In response to these concerns, we note that the Reopening Release included a robust discussion of the additional disclosures under

We believe the disclosure mandated by Section 953(a) is intended to provide investors with more transparent, readily comparable, and understandable disclosure of a registrant's executive compensation, so that they may better assess a registrant's executive compensation program when making voting decisions, for example when exercising their rights to cast advisory votes on executive compensation under Exchange Act Section 14A or electing directors.[9] This belief is supported by the fact that Section 953(a) was enacted contemporaneously with other executive compensation-related provisions in the Dodd-Frank Act that are "designed to address shareholder rights and executive compensation practices."[10] These included Section 951 of the Dodd-Frank Act, which enacted new Exchange Act Section 14A,[11] and Section 953(b) of the Dodd-Frank Act. These provisions required, respectively, that, not less than every three years, a separate resolution be put to a non-binding shareholder vote to approve compensation of executives;[12]and that registrants provide disclosure of the ratio of the

consideration and solicited comment on specific aspects of those disclosures. The Reopening Release also discussed the potential benefits and costs of the additional disclosures, including their impact on efficiency, competition and capital formation. Finally, the Reopening Release discussed how the additional disclosures might affect smaller registrants and solicited comment on approaches that would minimize the impact on smaller registrants, such as exempting smaller reporting companies from certain aspects of the additional disclosures. Given the discussion included in the Proposing Release and subsequent Reopening Release, we believe the final rules satisfy the requirements of the Administrative Procedure Act and other applicable statutes. Moreover, we received numerous comments from members of the public on the additional disclosures described in the Reopening Release, including comments on the economic effects of the additional disclosure, and we have considered those comments in adopting the final rules and made certain changes in response.

9 *See generally* Proposing Release at Section I.

10 Dodd-Frank Act, H.R. Rep. 111-157, at 827 (2010).

11 15 U.S.C. 78n-1.

12 Pursuant to the mandate in Section 14A of the Exchange Act, we adopted rules requiring a shareholder advisory vote to approve the compensation of a registrant's NEOs, as disclosed pursuant to Item 402 of Regulation S-K, at an annual or other meeting of shareholders at which directors will be elected and for which such executive compensation disclosure is required under Commission rules. *See Shareholder Approval of Executive Compensation and Golden Parachute Compensation*, Release No. 33-9178 (Jan. 25, 2011) [76 FR 6010] (Feb. 2, 2011).

median annual total compensation of employees to the annual total compensation of the chief executive officer.[13]

We believe the disclosure mandated by Section 14(i) will allow investors to assess a registrant's executive compensation actually paid relative to its financial performance more readily and at a lower cost than under the existing executive compensation disclosure regime. Under Item 402 of Regulation S-K, which specifies the information that must be included when the applicable form or schedule requires executive compensation disclosure, specific information regarding financial performance is already required, including in the Performance Graph in 17 CFR 229.201(e) ("Item 201(e) of Regulation S-K"), the Supplementary Financial Information in 17 CFR 229.302 (Item 302), and Management's Discussion and Analysis of Financial Condition and Results of Operations in 17 CFR 220.303 (Item 303). In addition, Item 402 of Regulation S-K also requires detailed disclosure of executive compensation and principles-based disclosure requirements regarding the relationship between pay and performance.[14]

There is no single place, however, where issuers must provide investors with direct comparisons of an executive's pay with their company's performance, and specifically financial performance, particularly if investors are interested in that comparison over a timespan longer

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13 In 2015, we adopted rules to implement Section 953(b) of the Dodd-Frank Act. *See Pay Ratio Disclosure*, Release No. 33-9877 (Aug. 5, 2015) [80 FR 50103] (Aug. 18, 2015).

14 The Compensation Discussion and Analysis ("CD&A") required by 17 CFR 229.402(b) ("Item 402(b) of Regulation S-K") requires registrants to provide an explanation of "all material elements of the registrant's compensation of the named executive officers." 17 CFR 229.402(b)(1). With respect to performance, Item 402(b)(2) of Regulation S-K includes non-exclusive examples of information that may be material, including (i) specific items of corporate performance taken into account in setting compensation policies and making compensation decisions; (ii) how specific forms of compensation are structured and implemented to reflect these items of the registrant's performance; and (iii) how specific forms of compensation are structured and implemented to reflect the NEO's individual performance and/or individual contribution to these items of the registrant's performance. 17 CFR 229.402(b)(2)(v) through (vii).

than the most recent reporting period. Existing disclosures generally provide the necessary components to make these comparisons, including data required for calculations that aid in these comparisons, but doing so may be time-consuming and costly. We believe this information is important to investors in evaluating executive compensation, and that disclosures about executive compensation may be most meaningful to investors when placed in the context of the company's financial performance.[15] Indeed, we are aware that certain third parties (*e.g.*, proxy advisors or compensation consultants) perform such analyses and charge clients for access to the resulting data.[16] Requiring registrants to compute and report this information will make this information equally accessible to all investors in a consistent manner.

By specifically referencing disclosure of "information that shows the relationship between executive compensation actually paid and … financial performance of the issuer," Section 14(i) calls for information that will supplement management's discussion of material elements of executive compensation in the CD&A. In addition, we believe this disclosure will provide investors with important and decision-useful information for comparison purposes in one place when they evaluate a registrant's executive compensation practices and policies, including for purposes of the shareholder advisory vote on executive compensation, votes on other compensation matters, director elections, or when making investment decisions.[17]

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15 *See infra* Section V.C.2.

16 *See infra* Section V.B.2.

17 For example, academic researchers find that the salience and readability of disclosures about executive compensation affect say-on-pay votes. *See, e.g.*, Danial Hemmings, Lynn Hodgkinson, & Gwion Williams, *It's OK to Pay Well, if You Write Well: The Effects of Remuneration Disclosure Readability*, 47 J. BUS. FIN. & ACCOUNTING 547 (2020); and Reggy Hooghiemstra, Yu Flora Kuang, & Bo Qin, *Does Obfuscating Excessive CEO Pay Work? The Influence of Remuneration Report Readability on Say-on-Pay Votes*, 47 ACCOUNTING & BUS. RES. 695 (2017).

Section 14(i) did not expressly prescribe the manner in which issuers would disclose the required information and we have exercised our discretion to provide for a consistent format that we believe furthers the statutory objectives of making pay-versus-performance data clear and easy for investors to evaluate. Standardizing the format and presentation of data, in particular quantitative metrics, to promote such ease of use requires incremental costs for issuers. We have elected not to pursue a wholly principles-based approach because, among other reasons, such a route would limit comparability across issuers and within issuers' filings over time, as well as increasing the possibility that some issuers would choose to report only the most favorable information. In addition, as we describe more extensively below, the final rules require that issuers calculate the value of certain equity and pension awards in more detail than would have been required in the proposed rule. These changes, in our view, will result in disclosures that more accurately represent the time when the awards change in value, which is important for investors to be able to assess whether such changes correspond to company performance over the appropriate time period.

We received many comment letters in response to the Proposing Release and the Reopening Release. After taking into consideration these public comments, we are adopting the proposed rules, together with certain of the supplemental disclosure requirements considered in the Reopening Release, with some modifications to reflect public comment. As discussed in more detail below, the final rules require registrants to present disclosure that reflects the specific situation of the registrant with respect to pay-versus-performance, and while also providing pay-versus-performance disclosure that can be readily compared across registrants.

B. Overview of Final Amendments

The amendments add new 17 CFR 229.402(v) ("Item 402(v) of Regulation S-K"), which requires registrants to describe the relationship between the executive compensation actually paid by the registrant and the financial performance of the registrant over the time horizon of the disclosure. Item 402(v) of Regulation S-K requires disclosure of the cumulative TSR of the registrant (substantially as defined in Item 201(e) of Regulation S-K),[18] the TSR of the registrant's peer group, the registrant's net income, and a measure chosen by the registrant and specific to the registrant ("Company-Selected Measure") as the measures of financial performance.

The final rules require the following tabular disclosures, with the asterisked items indicating portions of the final rules from which smaller reporting companies ("SRCs")[19] are exempt:[20]

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18 Item 201(e) of Regulation S-K sets forth the specific disclosure requirements for the issuer's stock performance graph, which is required to be included in the annual report to security holders provided for by 17 CFR 240.14a-3 and 240.14c-3. The Item provides that cumulative TSR is calculated by dividing the sum of the cumulative amount of dividends for the measurement period, assuming dividend reinvestment, and the difference between the registrant's share price at the end and the beginning of the measurement period; by the share price at the beginning of the measurement period.

19 A "smaller reporting company" means, in the case of issuers required to file reports under Sections 13(a) or 15(d) of the Exchange Act, an issuer that is not an investment company, an asset-backed issuer, or a majority-owned subsidiary of a parent that is not a smaller reporting company and that: (1) had a public float of less than $250 million (as of the last business day of the issuer's most recently completed second fiscal quarter); or (2) had annual revenues of less than $100 million (as of the most recently completed fiscal year for which audited financial statements are available) and either: (i) no public float (as of the last business day of the issuer's most recently completed second fiscal quarter); or (ii) a public float of less than $700 million (as of the last business day of the issuer's most recently completed second fiscal quarter). 17 CFR 240.12b-2; and 17 CFR 229.10. Business development companies ("BDCs"), which are a type of closed-end investment company that is not registered under the Investment Company Act, do not fall within the SRC definition, and thus do not qualify for the scaled disclosures that we are adopting for SRCs. *See infra* Section II.G (discussing our considerations with respect to SRC disclosure requirements).

20 The title of column (i) of the table, "Company-Selected Measure," would be replaced with the name of the registrant's most important measure, and that column would include the numerically quantifiable performance of the issuer under such measure for each covered fiscal year. For example, if the Company-Selected Measure for the most recent fiscal year was total revenue, the company would title the column "Total Revenue" and disclose its quantified total revenue performance in each covered fiscal year.

Year	Summary Compensation Table Total for PEO	Compensation Actually Paid to PEO	Average Summary Compensation Table Total for Non-PEO NEOs	Average Compensation Actually Paid to Non-PEO NEOs	Value of Initial Fixed $100 Investment Based On:		Net Income	[Company-Selected Measure]*
					Total Shareholder Return	Peer Group Total Shareholder Return*		
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)
Y1								
Y2								
Y3								
Y4*								
Y5*								

In addition, registrants are required to use the information in the above table to provide clear descriptions of the relationships between compensation actually paid and three measures of financial performance, as follows: describe the relationship between (a) the executive compensation actually paid to the registrant's PEO and (b) the average of the executive compensation actually paid to the registrant's remaining NEOs to (i) the cumulative TSR of the registrant, (ii) the net income of the registrant, and (iii) the registrant's Company-Selected Measure, in each case over the registrant's five most recently completed fiscal years. Registrants are also required to provide a clear description of the relationship between the registrant's TSR and the TSR of a peer group chosen by the registrant, also over the registrant's five most recently completed fiscal years. Registrants have flexibility as to the format in which to present the descriptions of these relationships, whether graphical, narrative, or a combination of the two. Registrants will also have the flexibility to decide whether to group any of these relationship disclosures together when presenting their clear description disclosure, but any combined description of multiple relationships must be "clear." SRCs will only be required to present such clear descriptions with respect to the measures they are required to include in the table and for their three, rather than five, most recently completed fiscal years.

A registrant that is not an SRC also will be required to provide an unranked list of the most important financial performance measures used by the registrant to link executive compensation actually paid to the registrant's NEOs during the last fiscal year to company performance. Although, as discussed below, registrants may include non-financial performance measures in this list, they must select the Company-Selected Measure from the financial performance measures included in this list, and it must be the financial performance measure that in the registrant's assessment represents the most important performance measure (that is not otherwise required to be disclosed in the table) used by the registrant to link compensation actually paid to the registrant's NEOs, for the most recently completed fiscal year, to company performance.[21]

As discussed below, the final rules permit registrants to voluntarily provide supplemental measures of compensation or financial performance (in the table or in other disclosure), and other supplemental disclosures, so long as any such measure or disclosure is clearly identified as supplemental, not misleading, and not presented with greater prominence than the required disclosure.[22]

The final rules apply to all reporting companies except foreign private issuers, registered investment companies, and emerging growth companies ("EGCs").[23] As proposed, BDCs will

21 Registrants that do not use any financial performance measures to link executive compensation actually paid to company performance, or that only use measures already required to be disclosed in the table, would not be required to disclose a Company-Selected Measure or its relationship to executive compensation actually paid.

22 *See infra* Section II.F.3.

23 "Emerging growth company" means an issuer that had total annual gross revenues of less than $1.07 billion during its most recently completed fiscal year. An issuer that is an emerging growth company as of the first day of that fiscal year shall continue to be deemed an emerging growth company until the earliest of: (i) the

be treated in the same manner as issuers other than registered investment companies and, therefore, be subject to the disclosure requirement of new Item 402(v) of Regulation S-K.

II. DISCUSSION OF FINAL AMENDMENTS

A. New Item 402(v) of Regulation S-K

1. Application and Operation of Item 402(v) of Regulation S-K

i. Proposed Amendments

We proposed including the pay-versus-performance disclosure in a new Item 402(v) of Regulation S-K, as Section 14(i) explicitly refers to Item 402 of Regulation S-K as the reference point for the executive compensation to be addressed by the new disclosure relating compensation to performance. We proposed requiring registrants to include the Item 402(v) of Regulation S-K disclosure in any proxy or information statement for which disclosure under Item 402 of Regulation S-K is required.[24] By including the requirement in Item 402 of Regulation S-K and requiring this disclosure in proxy statements on Schedule 14A and in information statements on Schedule 14C, shareholders would have available the pay-versus-performance disclosure, along with all other executive compensation disclosures

last day of the fiscal year of the issuer during which it had total annual gross revenues of $1.07 billion or more; (ii) the last day of the fiscal year of the issuer following the fifth anniversary of the date of the first sale of common equity securities of the issuer pursuant to an effective registration statement under the Securities Act of 1933 [15 U.S.C. 77a *et seq.*]; (iii) the date on which such issuer has, during the previous three year period, issued more than $1 billion in non-convertible debt; or (iv) the date on which such issuer is deemed to be a large accelerated filer. 17 CFR 240.12b-2. Section 102(a)(2) of the Jumpstart Our Business Startups Act amended Section 14(i) to exclude registrants that are EGCs from the pay-versus-performance disclosure requirements. Pub. L. 112-106, 126 Stat. 306 (2012). In accordance with this provision, the Commission did not propose to require EGCs to provide pay-versus-performance disclosure.

[24] The disclosure called for under Item 402 of Regulation S-K is required under Item 8 of Schedule 14A, and Item 1 of Schedule 14C. Schedule 14C correlates with the items of Schedule 14A to generally require the disclosure of information called for by Schedule 14A to the extent that the item would be applicable to any matter to be acted on at a meeting if proxies were to be solicited. Schedule 14C implements Exchange Act Section 14(c) [15 U.S.C. 78n(c)] ("Section 14(c)"), which created disclosure obligations for registrants that choose not to, or otherwise do not, solicit proxies, consents, or other authorizations from some or all of their security holders entitled to vote.

called for by Item 402 of Regulation S-K, in circumstances in which shareholder action is to be taken with regard to executive compensation or an election of directors.

Because the language of Section 14(i) calling for the disclosure to be provided in solicitation material for an annual meeting of the shareholders suggests that the disclosure was intended to be provided in conjunction with a shareholder vote, we proposed limiting the requirement to provide these disclosures to a registrant's proxy or information statement, instead of in all filings where disclosure under Item 402 of Regulation S-K is required (which would also include a registrant's Form 10-K[25] and Securities Act[26] registration statements). In addition, as proposed, the information would not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

ii. Comments

Some commenters generally supported the proposed approach,[27] with one noting that including the disclosure in proxy and information statements would provide "relevant information at a time when (a) it is most useful to shareowners and (b) shareowners are equipped to act on the information if they are so inclined."[28] One commenter suggested that the Commission limit the requirement to include the pay-versus-performance information to proxy statements only, noting that any other document could just make reference to the proxy

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[25] 17 CFR 249.310.

[26] 15 U.S.C. 77a *et seq.*

[27] *See* letters from Federal Home Loan Banks, dated July 2, 2015 ("FHL Banks"); Financial Services Roundtable, dated July 6, 2015 ("FSR"); and Ohio Public Employees Retirement System, dated July 6, 2015 ("OPERS"). Comment letters received in response to the Proposing Release and Reopening Release are available at https://www.sec.gov/comments/s7-07-15/s70715.htm.

[28] Letter from OPERS.

statement;[29] while another commenter suggested the pay-versus-performance information "should be included in all materials/filings that discuss compensation."[30]

iii. Final Amendments

As proposed, we are adopting the requirement to include the new Item 402(v) of Regulation S-K disclosure in any proxy or information statement for which disclosure under Item 402 of Regulation S-K is required. As noted by commenters[31] and in the Proposing Release, placing the pay-versus-performance information in proxy statements and information statements will provide shareholders with the pay-versus-performance disclosure (along with all other executive compensation disclosures called for by Item 402 of Regulation S-K) in circumstances in which shareholder action is to be taken with regard to an election of directors or executive compensation. We are not requiring the pay-versus-performance disclosure in other filings where disclosure under Item 402 of Regulation S-K is required, as we believe that, taken in context, the language of Section 14(i) calling for registrants to provide the disclosure "in any proxy or consent solicitation material for an annual meeting of the shareholders" suggests that the information was intended to be presented in conjunction with a shareholder vote.

2. Format and Location of Disclosure

i. Proposed Amendments

Section 14(i) requires us to adopt rules requiring disclosure of "information" that shows the relationship between executive compensation actually paid and registrant financial performance, but it does not specify the format or location of that disclosure. We proposed allowing registrants to decide where in the proxy or information statement to provide the

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29 *See* letter from Hermes Investment Management, dated July 7, 2015 ("Hermes").

30 Letter from Regis Quirin, dated June 24, 2015 ("Quirin").

31 *See* letters from FHL Banks and OPERS.

required disclosure. Although the new disclosure item would show the historical relationship between executive pay and registrant financial performance, and may provide a useful point of comparison for the analysis provided in the CD&A, the Proposing Release indicated that it would be appropriate to provide flexibility for registrants in determining where in the proxy or information statement to provide the disclosure.

We proposed requiring registrants to provide a standardized table containing the values of:

- The total PEO compensation reported in the Summary Compensation Table;
- The value of executive compensation actually paid to the PEO;
- For NEOs (other than the PEO), the average total compensation reported in the Summary Compensation Table;
- The value of the average executive compensation actually paid to the NEOs (other than the PEO);
- The value of a fixed investment scaled by cumulative TSR, for the registrant; and
- The value of a fixed investment scaled by cumulative TSR for the selected peer group.

For the amounts disclosed as executive compensation actually paid, we proposed requiring footnote disclosure of the amounts that were deducted from, and added to, the Summary Compensation Table total compensation amounts to calculate the executive compensation actually paid,[32] and footnote disclosure of vesting date valuation assumptions.

Because the statute specifically references disclosure of the relationship between executive compensation actually paid and registrant's financial performance, we proposed

[32] *See infra* Section II.C (discussing the adjustments proposed to be made to the Summary Compensation Table total compensation to calculate executive compensation actually paid).

requiring registrants, using the values presented in the table, to describe (1) the relationship between the executive compensation actually paid and registrant TSR, and (2) the relationship between registrant TSR and peer group TSR. The disclosure about the relationship would follow the table and could be described as a narrative, graphically, or a combination of the two.

In the Reopening Release, we requested comment on requiring the tabular disclosure to include disclosure of income or loss before income tax expense,[33] net income, and a Company-Selected Measure. We also requested comment on requiring registrants to provide a clear description of the relationship of each of these additional measures to executive compensation actually paid, but, consistent with the relationship descriptions proposed with respect to TSR and peer group TSR, allowing the registrant to choose the format used to present the relationship, such as a graphical or narrative description (or a combination of the two).

We also proposed that the disclosure be provided in interactive data format using machine-readable eXtensible Business Reporting Language ("XBRL"). Specifically, the proposal would require registrants to tag separately the values disclosed in the required table, and to separately block-text tag the required relationship disclosure and the footnote disclosures.[34] In the Reopening Release, we requested comment on whether we should require registrants also to tag specific data points (such as quantitative amounts) within the footnote

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[33] In the Reopening Release we used the term "pre-tax net income," but are using the phrase "income or loss before income tax expense" in this release, to be consistent with the language in 17 CFR Part 210 ("Regulation S-X").

[34] Specifically, the proposed approach would require registrants to provide the interactive data as an exhibit to the definitive proxy or information statement filed with the Commission, in addition to appearing with and in the same format as the rest of the disclosure provided pursuant to proposed Item 402(v) of Regulation S-K; and to prepare their interactive data using the list of tags the Commission specifies and submit them with any supporting files the EDGAR Filer Manual prescribes.

disclosures that would be block-text tagged, and to use Inline XBRL rather than XBRL to tag their pay-versus-performance disclosure.[35]

ii. Comments

Commenters were divided over whether we should require registrants to include the pay-versus-performance disclosure in the CD&A,[36] or allow registrants to decide where in the proxy or information statement to provide the required disclosure, as proposed.[37] Commenters in favor of allowing registrants to decide where to provide the disclosure argued that including the disclosure in the CD&A could cause confusion, as registrants do not necessarily consider the information included in the pay-versus-performance disclosure when making decisions about executive compensation. Those in favor of locating the disclosure in the CD&A stated that locating the disclosure alongside other executive compensation disclosure would make the disclosure easier to locate for investors and provide investors the ability to more easily assess the pay-versus-performance disclosure.

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35 Subsequent to the proposal, the Commission adopted rules replacing XBRL tagging requirements for registrant financial statements with Inline XBRL tagging requirements. Inline XBRL embeds the machine-readable tags in the human-readable document itself, rather than in a separate exhibit. *See Inline XBRL Filing of Tagged Data*, Release No. 33-10514 (June 28, 2018) [83 FR 40846 (Aug. 16, 2018)]. In 2020, the Commission adopted rules requiring BDCs to tag their financial statements and certain prospectus disclosures in Inline XBRL. *See Securities Offering Reform for Closed-End Investment Companies*, Release No. IC-33836 (Apr. 8, 2020) [85 FR 33290 (June 1, 2020)]. The following year, the Commission required operating companies, BDCs, and non-interval registered closed-end funds to tag their filing fee exhibits on certain forms in Inline XBRL. *See Filing Fee Disclosure and Payment Methods Modernization*, Release No. 33-10997 (Oct. 13, 2021) [86 FR 70166 (Dec. 9, 2021)].

36 *See* letters from California Public Employees Retirement System Investment Office, dated July 6, 2015 (“CalPERS 2015”); CFA Institute, dated July 6, 2015 (“CFA”); Farient Advisors LLC, dated July 6, 2015 (“Farient”); and Teachers Insurance Annuity Association of America, dated July 6, 2015 (“TIAA”).

37 *See* letters from Compensation Advisory Partners, dated July 2, 2015 (“CAP”); Celanese Corp., dated June 12, 2015 (“Celanese”); Frederic W. Cook & Co., dated June 24, 2015 (“Cook”); Steven Hall ad Partners, dated July 6, 2015 (“Hall”); and Pearl, Myers and Partners, dated July 6, 2015 (“Pearl”). *See also* letter from Axcelis Technologies, Inc., dated Jan. 31, 2022 (suggesting that pay and performance data for all companies should be made available on a new Commission website, rather than in individual registrant disclosures).

Commenters were also divided on the proposal to require the disclosure in a tabular format. Some commenters generally supported the proposed tabular disclosure,[38] while others opposed the tabular format, suggesting it was overly simplistic and would require significant supplemental disclosures.[39]

We received significant comment on the specific performance measures to be included in the table, as discussed in Section II.E below. With respect to the other information proposed to be provided in the tabular format, one commenter suggested dividing the table to separate the TSR disclosure from the compensation actually paid disclosure.[40] In addition, some commenters opposed requiring disclosure of the total compensation from the Summary Compensation Table,[41] with one stating that "including the SCT data would result in redundancy, would add a second figure which is not representative of compensation actually paid, and could result in possible confusion to shareholders."[42] However, other commenters supported the inclusion of the Summary Compensation Table total compensation figures,[43] with one suggesting that including the Summary Compensation Table figures would help investors understand the

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38 *See* letters from AllianceBernstein L.P., dated Mar. 4, 2022 ("AB"); As You Sow, dated July 2, 2015 ("As You Sow 2015"); CAP; Farient; Hermes; and OPERS.

39 *See* letters from Aspen Institute's Business and Society Program, dated July 6, 2015 ("Aspen"); Celanese; Center on Executive Compensation, dated July 6, 2015 ("CEC 2015"); Corporate Governance Coalition for Investor Value, dated July 23, 2015 ("Coalition"); Honeywell International Inc., dated July 2, 2015 ("Honeywell"); International Bancshares Corp., dated June 29, 2015 ("IBC 2015"); McGuireWoods LLP and Brownstein Hyatt Farber Schreck, LLP, dated Mar. 4, 2022 ("McGuireWoods"); and National Association of Manufacturers, dated July 6, 2015 ("NAM 2015").

40 *See* letter from AON Hewitt, dated July 6, 2015 ("AON").

41 *See* letters from CEC 2015; Exxon Mobil Corp., dated June 23, 2015 ("Exxon"); Hall; McGuireWoods; Pay Governance LLC, dated June 30, 2015 ("PG 2015"); Pearl; Technical Compensation Advisors, dated July 6, 2015 ("TCA 2015"); and Technical Compensation Advisors, dated. Mar. 4, 2022 ("TCA 2022").

42 Letter from PG 2015.

43 *See* letters from American Federation of Labor and Congress of Industrial Organizations, dated June 30, 2015 ("AFL-CIO 2015"); CalPERS 2015; and CAP.

pay-versus-performance disclosure alongside the Summary Compensation Table disclosure when evaluating a registrant's annual compensation decisions,[44] and another noting that the Summary Compensation Table figures "will help to clarify potential differences between reported compensation and compensation actually paid."[45]

A number of commenters suggested that we require or allow graphical disclosures. Some commenters suggested requiring graphical disclosure,[46] while one specifically supported giving registrants the flexibility to choose whether to include graphical disclosure.[47] A few of these commenters suggested requiring inclusion of the performance graph required in Item 201(e) of Regulation S-K, or a modified version of that graph.[48] In addition, a few commenters suggested the Commission mandate formatting requirements for graphical disclosure, if graphical disclosure is permitted.[49] One commenter suggested that we replace the tabular disclosure requirement with a graphical disclosure requirement depicting TSR and

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44 *See* letter from AFL-CIO 2015.

45 Letter from CAP.

46 *See* letters from AFL-CIO 2015 (stating that a graph would be especially useful if it disclosed (1) the change between executive compensation actually paid and the Summary Compensation Table figure and (2) the TSRs of both the registrant and a peer group over all five disclosure years); CalPERS 2015 (suggesting line graphs be required in addition to tabular and narrative disclosures); Council of Institutional Investors, dated June 25, 2015 ("CII 2015") (suggesting the Commission require registrants to disclose, at a minimum, "a graph providing executive compensation actually paid and change in TSR on parallel axes and plotting compensation and TSR over the required time period"); Corning Inc., dated June 12, 2015 ("Corning") (suggesting requiring the graph included in Item 201(e) of Regulation S-K); OPERS (suggesting requiring a line graph, showing TSR coupled with a corresponding line showing the executive compensation as a group); and Shareholder Value Advisors, dated July 6, 2015 ("SVA") (suggesting requiring the inclusion of a scatterplot).

47 *See* letter from Hall.

48 *See* letters from Allison Transmission Holdings, Inc., dated July 6, 2015 ("Allison"); and Corning. *But see* letters from CAP; Center for Capital Markets Competitiveness, dated June 30, 2015 ("CCMC 2015"); Davis Polk and Wardwell LLP, dated July 2, 2015 ("Davis Polk 2015"); and McGuireWoods (each opposing the inclusion of the performance graph).

49 *See* letters from Hermes and PG 2015. *But see* letter from Hall (recommending allowing registrants to choose their own graphical disclosure).

compensation actually paid,[50] while another commenter stated that a prescribed graphical format would facilitate comparability.[51]

One commenter generally supported the requirement to provide a clear description of the relationship between the measures disclosed in the table and executive compensation, stating that a "simple-to-understand approach would be particularly valuable to investors."[52] Another commenter, who supported requiring disclosure only of one (or more) Company-Selected Measure(s), indicated that registrants should be required to provide a clear description of the relationship between the Company-Selected Measure(s) in the table and executive compensation.[53]

Commenters were divided on the proposed XBRL tagging requirement. Of the commenters who opposed the requirement,[54] some made alternative suggestions such as only requiring block-tagging,[55] only requiring tagging of the information in the table,[56] delaying the implementation of the tagging requirement,[57] or permitting but not requiring tagging.[58] One commenter stated the Commission should proceed "cautiously" to ensure that the cost of

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50 *See* letter from Meridian Compensation Partners, dated July 6, 2015 ("Meridian").

51 *See* letter from OPERS.

52 *See* letter from Principles for Responsible Investment, dated Mar. 4, 2022 ("PRI").

53 *See* letter from National Association of Manufacturers, dated Mar. 4, 2022 ("NAM 2022").

54 *See* letters from CCMC 2015; CEC 2015; Celanese; Davis Polk 2015; Jon Faulkner, dated May 4, 2015 ("Faulkner"); FedEx Corp., dated July 6, 2015 ("FedEx 2015"); Hyster-Yale Materials Handling Inc., dated June 10, 2015 ('Hyster-Yale"); IBC 2015; McGuireWoods; NACCO Industries, Inc., dated June 9, 2015 ("NACCO"); Pearl; Society for Corporate Governance, dated Mar. 10, 2022 ("SCG"); and Society of Corporate Secretaries and Governance Professionals, dated July 7, 2015 ("SCSGP").

55 *See* letter from Pearl.

56 *See* letters from Hyster-Yale and NACCO.

57 *See* letters from Mercer, dated July 6, 2015 ("Mercer") and NACCO.

58 *See* letter from CII 2015.

tagging does not outweigh the benefits,[59] while another suggested the Commission should provide data on how many investors use XBRL disclosures before implementing the requirement.[60] However, a number of commenters supported the XBRL requirement,[61] with one suggesting that tagging should be required for the actual metrics registrants use to determine executive compensation.[62]

In response to the Reopening Release request for comment regarding Inline XBRL, a number of commenters suggested requiring all registrants to use Inline XBRL to tag their pay–versus-performance disclosure, including the tagging of specific data points within the footnote disclosures that would be block-text tagged.[63] One commenter directly opposed requiring the use of the Inline XBRL (as considered in the Reopening Release),[64] while another commenter, who generally opposed an XBRL tagging requirement, stated that, if XBRL tagging is required, Inline XBRL tagging should be permitted.[65] One commenter suggested the Commission give time for registrants to implement any XBRL requirements, due to the "stylized" nature of proxy statements, and that there may be a learning curve because registrant staff preparing the proxy

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59 *See* letter from National Investor Relations Institute, dated July 10, 2015 ("NIRI 2015").

60 *See* letter from CCMC 2015.

61 *See* letters from AFL-CIO 2015; CalPERS 2015; Public Citizen, dated July 6, 2015 ("Public Citizen 2015"); and State Board of Administration of Florida, dated July 6, 2015 ("SBA-FL"). *See also* CII 2015 (agreeing with the Commission's rationale for requiring tagging, and not opposing the Commission requiring XBRL tagging, but suggesting that "permitting, rather than requiring, registrants to tag data when registrant-specific extensions are necessary may be more appropriate").

62 *See* letter from AFL-CIO 2015.

63 *See* letters from Council of Institutional Investors, dated Feb. 24, 2022 ("CII 2022"); Steven Huddart, dated Mar. 4, 2022 ("Huddart"); International Corporate Governance Network, dated Mar. 4, 2022 ("ICGN"); and XBRL US, dated Mar. 4, 2022 ("XBRL US").

64 *See* letter from Davis Polk and Wardwell LLP, dated Mar. 4, 2022 ("Davis Polk 2022") (noting that, while the use of Inline XBRL "could increase the ability of investors to compare across filers,…the initial compliance costs, the quality and the extent of use of XBRL data by investors would not justify the cost of creating XBRL data in company filings," and therefore specifically recommending not requiring the use of Inline XBRL).

65 *See* letter from McGuireWoods.

statement may be different from the staff preparing documents that are subject to current tagging requirements.[66]

iii. Final Amendments

The final rules provide registrants flexibility in determining where in the proxy or information statement to provide the disclosure required, as proposed. We believe, as noted in the Proposing Release and by some commenters, that mandating registrants to include the disclosure in the CD&A may cause confusion by suggesting that the registrant considered the pay-versus-performance relationship in its compensation decisions, which may or may not be the case.

We are adopting the tabular disclosure format, as proposed, with the addition of two new financial performance measures –net income and the Company-Selected Measure – as considered in the Reopening Release. Each of these financial performance measures is discussed in more detail below.[67] We are not persuaded by commenters who characterized the tabular disclosure requirement as overly simplistic. The simplicity of the tabular disclosure should allow investors to more easily understand and analyze the relationship between pay and performance. In addition, registrants can supplement the tabular disclosure, so long as any additional disclosure is clearly identified as supplemental, not misleading, and not presented with greater prominence than the required disclosure. We also believe the simplicity of the tabular disclosure matches the requirement in Section 14(i) that registrants provide a "clear description" of their pay-versus-performance, and, consistent with Section 14(i), will better

[66] *See* letter from XBRL US.

[67] *See infra* Sections II.D.1 (discussing TSR and peer group TSR); II.D.2 (discussing net income); and II.D.4 (discussing the Company-Selected Measure).

allow investors to compare disclosures within companies over time and across companies, making the disclosure more useful.

We are adopting the requirement to include the Summary Compensation Table total compensation amounts for the PEO and the average (*i.e.,* mean) of the remaining NEOs, as proposed. Those amounts will appear in columns (c) and (e) of the Pay Versus Performance table, respectively. We believe including these figures as proposed will provide useful information to investors, especially as the "actually paid" figures are directly related to those figures. Requiring disclosure of the Summary Compensation Table measure of total compensation together with executive compensation actually paid will provide shareholders with disclosure of two measures in one single table and, we believe, will facilitate comparisons of the two measures of a registrant's executive compensation to the registrant's performance.[68] For example, to the extent that some shareholders may be interested in considering the relationship of performance with a measure of pay that excludes changes in the value of equity awards, they would be able to refer to the Summary Compensation Table measure of total compensation alongside executive compensation actually paid in the tabular disclosure. As proposed, the final rules will require registrants to provide footnote disclosure of the amounts that are deducted from, and added to, the Summary Compensation Table total compensation amounts reported in columns (c) and (e) to calculate the executive compensation actually paid amounts reported in columns (d) and (f), respectively. We believe any confusion created by the inclusion of the Summary Compensation Table totals in the table will be mitigated by this required footnote disclosure.

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[68] For example, placing the Summary Compensation Table and actually paid figures side-by-side may make it easier for investors to follow the footnote disclosures in which the registrant explains how compensation actually paid differs from the Summary Compensation Table amounts.

As proposed, registrants must also provide a narrative, graphical, or combined narrative and graphical description of the relationships between executive compensation actually paid and the registrant's TSR, and between the registrant's TSR and peer group TSR. We believe the disclosure of the relationship between executive compensation actually paid and TSR will satisfy the language of Section 14(i) that registrants disclose the "relationship" between executive compensation and registrant performance. Further, as noted in the Proposing Release, we believe disclosure about the relationship between registrant TSR and peer group TSR may provide a useful point of comparison to assess the relationship between the registrant's executive compensation actually paid and its financial performance compared to the performance of its peers during the same time period.[69]

In light of the addition of two new performance measures to the table, we are also adopting a requirement that registrants provide a clear description of the relationships between executive compensation actually paid and net income, and between executive compensation actually paid and the Company-Selected Measure. These descriptions may also be provided in narrative, graphical, or combined narrative and graphical format. Since some of these measures and relationships may be more important to some companies or investors than others, we believe including disclosure about each of these relationships will provide investors with a more complete picture of how pay relates to performance.

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[69] Peer comparisons are a component companies often use to assess the performance of their executives. *See, e.g.*, John Bizjak, Swaminathan Kalpathy, Zhichuan Frank Li, & Brian Young, *The Choice of Peers for Relative Performance Evaluation in Executive Compensation*, 26 REV. FIN. __ (forthcoming 2022), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2833309 (finding that, in a sample of the largest 750 U.S. companies (by market capitalization), "over 50%" of companies in 2017 used performance awards based on performance relative to a peer group, "comprising approximately one-third of the value of total compensation").

We believe permitting, but not mandating, graphical disclosure is consistent with an acknowledgement in the Senate Report that there could be many ways to disclose the relationship between executive compensation and financial performance of the registrant,[70] and the specific language of Section 14(i), which provides the pay-versus-performance disclosures "may" include graphic representations. We encourage registrants to present this disclosure in the format that most clearly provides information to investors about the relationships, based on the nature of each measure and how it is associated with executive compensation actually paid. As discussed in the Proposing Release, the required relationship disclosure could include, for example, a graph providing executive compensation actually paid and change in the financial performance measure(s) (TSR, net income, or Company-Selected Measure) on parallel axes and plotting compensation and such measure(s) over the required time period. Alternatively, the required relationship disclosure could include narrative or tabular disclosure showing the percentage change over each year of the required time period in both executive compensation actually paid and the financial performance measure(s) together with a brief discussion of how those changes are related. The required table, along with the required relationship disclosures, should provide investors with clear information from which to determine the relationship between executive compensation actually paid and some basic facets of registrant financial performance. In addition, although the presentation format used by different registrants to demonstrate the relationship between executive compensation actually paid and the financial performance measures included in the table pursuant to Item 402(v) of Regulation S-K may vary, these more variable descriptions may allow investors to understand more easily the registrant's perspective on these required relationship disclosures.

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70 *See supra* note 4 and accompanying text.

The final rules require registrants to separately tag each value disclosed in the table, block-text tag the footnote and relationship disclosure, and tag specific data points (such as quantitative amounts) within the footnote disclosures, all in Inline XBRL. We recognize that, as noted by commenters,[71] the requirement that registrants use Inline XBRL will increase costs for registrants. However, we believe these costs will be incremental, as registrants are subject to Inline XBRL tagging requirements for other Commission disclosures.[72] In addition, we believe that requiring the data to be structured will lower the cost to investors of collecting this information, permit data to be analyzed more quickly, and facilitate comparisons among public companies, all of which justify the incremental cost to registrants. We also believe that the registrants who will be subject to the pay-versus-performance rule are familiar with Inline XBRL,[73] and for that reason do not believe additional data about the complexity of Inline XBRL, or a phase-in period for the application of the requirement (other than as proposed for SRCs, as discussed below[74]), are necessary. With respect to comments questioning the utility of a structured data language, we note that investors and market participants have gained experience with XBRL and Inline XBRL filings since the time of the Proposing Release, and that there is increased evidence that data in these formats is useful to investors.[75]

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[71] *See, e.g.*, letter from Davis Polk 2022.

[72] *See supra* note 35 (noting that subsequent to issuing the Proposing Release, the Commission adopted rules replacing XBRL tagging requirements for registrant financial statements with Inline XBRL tagging requirements). *See also Inline XBRL Filing of Tagged Data*, Release No. 33-10514 (June 28, 2018) [83 FR 40846 (Aug. 16, 2018)].

[73] *See infra* Section V.C.4.ii.

[74] *See infra* Section II.G.iii.

[75] *See infra* Section V.C.4.ii.

B. Executives Covered

1. Proposed Amendments

Under the approach included in the Proposing Release, registrants other than SRCs would have been required to provide disclosure about "named executive officers," as defined in 17 CFR 229.402(a)(3);[76] and SRCs would have been required to provide disclosure about "named executive officers," as defined in 17 CFR 229.402(m).[77] These are the executive officers for whom, under our current rules, compensation disclosure is required under Item 402 of Regulation S-K, including in the Summary Compensation Table and the other executive compensation disclosure requirements. Specifically, we proposed requiring registrants to separately disclose compensation information for the PEO, and as an average for the remaining NEOs. We also proposed that, if more than one person served as the PEO of the registrant in any year, the disclosure for those multiple PEOs would be aggregated for that year, because this reflects the total amount that was paid by the registrant for the services of a PEO.

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[76] 17 CFR 229.402(a)(3) defines the NEOs for whom Item 402 of Regulation S-K executive compensation is required as (1) all individuals serving as the registrant's PEO during the last completed fiscal year, regardless of compensation level, (2) all individuals serving as the registrant's principal financial officer or acting in a similar capacity during the last completed fiscal year ("PFO"), regardless of compensation level, (3) the registrant's three most highly compensated executive officers other than the PEO and PFO who were serving as executive officers at the end of the last completed fiscal year, and (4) up to two additional individuals for whom Item 402 of Regulation S-K disclosure would have been provided but for the fact that the individual was not serving as an executive officer of the registrant at the end of the last completed fiscal year. Because the pay-versus-performance disclosure was proposed as new paragraph (v) to Item 402 of Regulation S-K, the disclosure also would be required for the NEOs.

[77] For SRCs, 17 CFR 229.402(m)(2) defines the NEOs for whom Item 402 of Regulation S-K executive compensation is required as (1) all individuals serving as the smaller reporting company's PEO during the last completed fiscal year, regardless of compensation level, (2) the smaller reporting company's two most highly compensated executive officers other than the PEO who were serving as executive officers at the end of the last completed fiscal year, and (3) up to two additional individuals for whom Item 402 of Regulation S-K disclosure would have been provided but for the fact that the individual was not serving as an executive officer of the smaller reporting company at the end of the last completed fiscal year.

2. Comments

A number of commenters supported requiring Item 402(v) of Regulation S-K to cover both PEOs and NEOs.[78] These commenters noted that requiring Item 402(v) of Regulation S-K to cover PEOs and NEOs would be consistent with the disclosure in the Summary Compensation Table,[79] and what Congress intended;[80] and would provide investors with useful information about the registrant's compensation practices more broadly.[81] However, a number of other commenters suggested we limit the disclosure to PEOs.[82] Such commenters raised concerns about the inclusion of non-PEO NEOs, including that: NEO groups may vary considerably from year to year;[83] NEOs are more likely to have business-segment-based compensation, the performance of which might not be reflective of the registrant's overall performance;[84] and not all NEOs are in positions to affect overall company performance.[85] Commenters also stated that PEOs are under the most scrutiny from investors[86] and are the only

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78 *See* letters from CalPERS 2015; CII 2015; CFA; Hay Group, Inc., dated July 6, 2015 ("Hay"); David Hook, dated May 3, 2015 ("Hook"); OPERS; National Association of Corporate Directors, dated July 10, 2015 ("NACD 2015"); National Association of Corporate Directors, dated Mar. 10, 2022 ("NACD 2022"); and TIAA.

79 *See* letters from CalPERS 2015; CFA; and Hay.

80 *See* letter from CII 2015.

81 *See* letter from CII 2015; CFA; OPERS; and TIAA.

82 *See* letters from AON; BorgWarner Inc., dated Aug. 20, 2015 ("BorgWarner"); CAP; CEC 2015; CCMC 2015; Celanese; Coalition; Corning; Davis Polk 2015; Exxon; FedEx 2015; FSR; Hall; Hodak Value Investors, dated July 2, 2015 ("Hodak"); Honeywell; Hyster-Yale; McGuireWoods; Mercer; NACCO; NIRI 2015; National Investor Relations Institute, dated Mar. 4, 2022 ("NIRI 2022"); Pearl; PNC Financial Services Group, dated July 6, 2015 ("PNC"); TCA 2015; TCA 2022; and WorldatWork, July 6, 2015 ("WorldatWork").

83 *See* letters from CCMC 2015; CEC 2015; Exxon; FSR; Meridian; Pearl; and PNC.

84 *See* letters from Celanese; FSR; and PNC.

85 *See* letters from CCMC 2015 and Coalition.

86 *See* letters from CCMC 2015; CEC 2015; Corning; Davis Polk 2015; FSR; NIRI 2015; NIRI 2022; Pearl; PNC; TCA 2015; and WorldatWork.

executives comparable across companies;[87] and that requiring disclosure of non-PEO NEOs would create an increased reporting burden.[88] In addition, one commenter expressed belief that Section 14(i) did not require the pay-versus-performance disclosures to include non-PEO NEOs.[89]

Commenters were generally opposed to the proposal's approach of aggregating multiple PEOs for years when a registrant had more than one individual serve as PEO.[90] These commenters proposed a number of alternatives to aggregation, including: allowing separate disclosure for each PEO;[91] only requiring aggregation for external successors;[92] only disclosing the compensation of the PEO serving at the end of the year (either annualized[93] or not[94]); requiring disclosure of the outgoing PEO only;[95] only aggregating payments for services rendered as PEO;[96] requiring aggregated and disaggregated disclosures;[97] or excluding any disclosures in years where the registrant has multiple PEOs.[98] Additionally, a number of

87 *See* letter from TCA 2015.

88 *See* letters from Davis Polk 2015 and WorldatWork.

89 *See* letter from Coalition.

90 *See* letters from AFL-CIO 2015; BorgWarner; Business Roundtable, dated July 6, 2015 ("BRT"); CCMC 2015; Coalition; Celanese; FedEx 2015; FSR; Hall; Honeywell; IBC 2015; McGuireWoods; Mercer; PG 2015; Pearl; TCA 2015; and TCA 2022.

91 *See* letters from AFL-CIO 2015; BorgWarner; CCMC 2015; FedEx 2015; Honeywell; SCSGP; TCA 2015; and TIAA.

92 *See* letters from Cook and Pearl.

93 *See* letters from FSR and Mercer.

94 *See* letters from Mercer.

95 *See* letters from Hodak and PG 2015.

96 *See* letters from AON and SCSGP.

97 *See* letters from As You Sow 2015 and Hermes.

98 *See* letter from McGuireWoods.

commenters opposed including signing and severance bonuses, either generally,[99] or if the compensation of multiple PEOs were to be aggregated,[100] while some other commenters more specifically stated that these bonuses were reasons not to aggregate PEO compensation.[101]

A few commenters also opposed using the average NEO compensation in the table,[102] while others supported average NEO compensation.[103] A number of other commenters did not expressly oppose the use of average NEO compensation, but stated that this type of disclosure would provide little investor insight,[104] could confuse investors,[105] or would limit comparability.[106] Two commenters suggested requiring separate disclosure for each NEO.[107]

3. Final Amendments

We are adopting requirements for registrants to disclose information pertaining to both NEOs and PEOs in their Item 402(v) of Regulation S-K disclosure, as proposed. As noted in the Proposing Release, Section 14(i) does not specify which executives must be included in the pay-versus-performance disclosure. While we are mindful of concerns raised by commenters that individual NEOs may be in positions less likely to affect overall company performance than the PEO, may have more varied performance measures driving their compensation (including because NEOs within a company have different roles), can vary from year to year, and are less

99 *See* letters from FedEx 2015 and SCSGP.

100 *See* letters from CCMC 2015; Celanese; and Davis Polk 2015.

101 *See* letters from FSR and Honeywell.

102 *See* letters from CEC 2015; Coalition; and Meridian.

103 *See* letters from NACD 2015 and Pearl (generally opposing the disclosure of NEO compensation, but stating that it should be aggregated if required to be disclosed).

104 *See* letter from Honeywell.

105 *See* letter from IBC 2015.

106 *See* letter from Meridian.

107 *See* letters from Loring, Wolcott & Coolidge, dated Mar. 4, 2022 (“LWC”) and OPERS.

comparable across registrants (with respect to compensation), we believe that Congress intended for the rules to provide disclosure about both PEOs and the remaining NEOs because Section 14(i) specifically refers to "compensation required to be disclosed by the issuer under [Item 402 of Regulation S-K]," and Item 402 requires disclosure of NEO compensation. Further, while we agree that investors are typically most interested in the compensation of the PEO, as indicated by commenters,[108] investors also are interested in how the incentives of NEOs relate to company performance, and our rationale of simplifying and reducing costs for investors who monitor executive performance therefore extends to NEOs.

We are also adopting, as proposed, the requirement that registrants provide separate disclosure of the PEO's compensation. We believe this is appropriate because, as noted by commenters, investors frequently have more interest in PEO compensation, PEOs are generally more comparable across companies, and PEOs are frequently in a position to impact performance more than any other NEO.

Similarly, we are adopting as proposed a requirement to include an average of compensation for the remaining NEOs. We disagree with commenters that suggested that average NEO compensation would provide little investor insight, could confuse investors, or would limit comparability. Rather, we believe disclosure of the relationship of performance to average NEO compensation will be more meaningful to shareholders than individual or aggregate NEO compensation. Because a registrant's individual NEOs may change from year to year, we believe that the disclosure of the average NEO compensation will make it easier for investors to compare the registrant's pay-versus-performance disclosure over time. Further, we believe disclosure of compensation for all NEOs (consisting of the PEO, and the remaining

[108] *See supra* note 86 and accompanying text.

NEOs in the aggregate) aligns with our understanding of the intent of Congress that all NEOs be included in the pay-versus-performance disclosure. In addition, we are adopting a requirement that registrants identify in footnote disclosure the individual NEOs whose compensation amounts are included in the average for each year, so that investors can consider whether changes in the average compensation reported from year to year were due to compositional changes in the included NEOs. We believe this will alleviate concerns raised by commenters that the aggregation of NEOs could confuse investors.

Although some commenters opposed our proposal to require an average of NEO compensation and suggested that we instead require the disclosure of compensation for each of the NEOs as separate columns in the table, we believe that approach could result in a lengthy and potentially confusing table, due to the fact that in any year there are multiple NEOs and, as noted by several commenters,[109] there can be frequent turnover in a registrant's NEOs from year to year. In addition, we are not permitting registrants to remove signing bonuses, severance bonuses, and other one-time payments from the amount of executive compensation actually paid, because, although those figures may not represent the executive's compensation in a 'typical' year where no such payment is made, they do reflect amounts that are "actually paid" to the executives. Even if such payments are not ordinarily recurring with respect to a particular executive, shareholders voting on executive compensation or directors may wish to take into account the company resources devoted to such payments in light of the company's performance.

In a change from the proposal, in response to comments, the final rules do not require aggregating the compensation of PEOs in years when a registrant had multiple PEOs. Instead,

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[109] *See supra* note 83.

the final rules require that, in those years, registrants include separate Summary Compensation Table total compensation and executive compensation actually paid columns for each PEO. For example, the below table shows the disclosure that would be required when there were two PEOs in "Year 2":

Year	Summary Compensation Table Total for First PEO	Summary Compensation Table Total for Second PEO	Compensation Actually Paid to First PEO	Compensation Actually Paid to Second PEO	Average Summary Compensation Table Total for non-PEO NEOs	Average Compensation Actually Paid to non-PEO NEOs	Value of Initial Fixed $100 Investment Based On:		Net Income	[Company-Selected Measure]
							Total Shareholder Return	Peer Group Total Shareholder Return		
(a)	(b)	(b)	(c)	(c)	(d)	(e)	(f)	(g)	(h)	(i))
Y1	N/A	$	N/A	$	$	$	$	$	$	$
Y2	$	$	$	$	$	$	$	$	$	$
Y3	$	N/A	$	N/A	$	$	$	$	$	$
Y4	$	N/A	$	N/A	$	$	$	$	$	$
Y5	$	N/A	$	N/A	$	$	$	$	$	$

We believe including separate disclosure for each PEO, as recommended by some commenters,[110] would address commenters' concerns that aggregating PEO disclosure could lead to confusing or misleading disclosure.[111] In the case of multiple PEOs in a single year, this approach would make the table itself slightly longer, but it would have the added benefit of distinguishing the compensation paid to separate PEOs both visually and in the structured data, instead of presenting a potentially confusing aggregated figure in the table and only having discussion of the separate PEOs in footnote and narrative disclosure.

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[110] *See supra* note 91.

[111] We note that a registrant may elect to provide additional information about its PEO or PEOs, such as the amount of time during the year each individual served as PEO, if the registrant believes that information would provide relevant context to investors.

C. Determination of Executive Compensation Actually Paid

We proposed that "executive compensation actually paid" under Item 402(v) of Regulation S-K would be total compensation as reported in the Summary Compensation Table, modified to adjust the amounts included for pension benefits and equity awards. In both the Proposing and Reopening Releases, we requested comment on the proposed approaches to calculating these amounts, and whether the proposed definition appropriately captures the concept of "executive compensation actually paid," and in the Proposing Release we offered an economic analysis of an alternative approach to calculating equity awards. We received significant comment, as discussed below, on the proposed approaches to calculating the amounts of pension benefits and equity awards to be included as "actually paid." In addition, several commenters to the Proposing Release noted that the definition of compensation actually paid as proposed may result in some misalignment between the time period to which pay is attributed and the time period in which the associated performance is reported.[112] After considering the statutory language and the comments received, we are adopting final rules for calculating the amounts reported for pension benefits and equity awards that are modifications of our proposed approach, including, as discussed further below, requiring equity awards to be revalued more frequently than as proposed. We believe that these approaches will more accurately reflect executive compensation actually paid, as required by Section 14(i), and mitigate commenter concerns about timing mismatches by more closely associating compensation with the period of the corresponding performance.

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[112] *See, e.g.*, letters from Allison; Celanese; CEC 2015; Cook; Coalition; Farient; Faulkner; FSR; Honeywell; NACCO; NACD 2015; NAM 2015; Pearl; Ross Stores, Inc. dated June 26, 2015 ("Ross"); SVA; SBA-FL; TIAA; TCA 2015; and WorldatWork.

Although Section 14(i) refers to compensation required to be disclosed under Item 402 of Regulation S-K, it also uses the phrase "actually paid," which differs from disclosure required under Item 402 of "compensation awarded to, earned by or paid to" the NEOs. Because Congress was aware of the language of Item 402 at the time of the Dodd-Frank Act, and adopted text that did not mirror the language of that provision, we believe that Congress intended executive compensation "actually paid" to be an amount distinct from the total compensation as reported under Item 402 because it used a term not otherwise referenced in Item 402. As such, we believe using as a starting point the total compensation that registrants already are required to report in the Summary Compensation Table and making adjustments to some of those figures is appropriate to give effect to the statutory language and reflect executive compensation that is "actually paid."[113] Commenters generally agreed that adjustments to the Summary Compensation Table total were appropriate to determine "executive compensation actually paid,"[114] noting that there are some items reportable in the Summary Compensation Table total that are not reflective of compensation "actually paid";[115] or more generally

[113] A few commenters on the proposed rules sought clarity on the disclosure required in circumstances where a registrant recovers (or "claws back") any portion of an executive officer's compensation. *See* letters from Hyster-Yale; IBC 2015; and NACCO. *See also* letters from BRT and NACD 2015 (noting that the proposed rules did not account for claw-backs). Consistent with the approach currently taken by registrants when reporting claw-backs in the Summary Compensation Table, when any portion of an executive officer's compensation for a fiscal year that is included in the table is clawed back, the amounts of executive compensation disclosed in response to Item 402(v) as the Summary Compensation Table Total and as the Compensation Actually Paid initially reported for such year should be adjusted to reflect the effects of the claw-back, with footnote disclosure of the amount(s) recovered, when applicable.

[114] *See, e.g.*, letters from AON; CAP; CEC 2015; Exxon; FedEx 2015; FSR; Hall; Honeywell; Hyster-Yale; KPMG LLP, dated July 1, 2015 ("KPMG"); Meridian; NACCO; NACD 2015; PG 2015; Public Citizen 2015; SCSGP; SVA; TCA 2015; TCA 2022; TIAA; Towers Watson, dated July 6, 2015 ("Towers"); and WorldatWork. *But see* letter from IBC 2015 (stating that "the Summary Compensation Table already required by Regulation S-K is sufficient").

[115] *See* letters from AON; CAP; CEC 2015; FedEx 2015; Hall; Honeywell; KPMG; Meridian; NACD 2015; Public Citizen 2015; SCSGP; SVA; TIAA; Towers; and WorldatWork.

suggesting that the Summary Compensation Table total is not reflective of "executive compensation actually paid."[116]

1. Deduction of Change in Actuarial Present Value and Addition of Actuarially Determined Service Cost and Prior Service Cost

i. Proposed Amendments

We proposed requiring registrants to deduct the change in actuarial present value of all defined benefit and actuarial pension plans[117] from the Summary Compensation Table total compensation figure, and to add back the actuarially determined service cost for services rendered by the executive during the applicable year,[118] when calculating executive compensation actually paid. We proposed removing the change in actuarial present value of these plans in order to avoid potential volatility associated with revaluing previously accumulated benefits with changes in actuarial inputs and assumptions. However, as discussed in the Proposing Release, we believed that including the service cost from the applicable year was appropriate because it more closely reflected compensation "actually paid" during that year, in that it could be seen as an estimate of the value that would be set aside by the registrant to fund the benefits payable in retirement for the service provided during the applicable year. We also stated that we believed that using the actuarially determined service cost, instead of the

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[116] *See* letters from CEC 2015; Exxon; FSR (stating that "Congress did not intend that compensation [actually paid] would be determined by reference to the Summary Compensation Table"); Hall; Hyster-Yale (suggesting an approach where companies are permitted to define "actually paid" independently, and then reconcile those amounts with the Summary Compensation Table totals); NACCO (same); PG 2015; SVA; TCA 2015; and TCA 2022.

[117] The change in actuarial present value, generally, reflects the difference between the actuarial present value of accumulated benefits at the end of the fiscal year and at the end of the prior fiscal year.

[118] Service cost is defined in FASB ASC Topic 715 as the actuarial present value of benefits attributed by the pension plan's benefit formula to services rendered by the employee during the period. The measurement of service cost reflects certain assumptions, including future compensation levels to the extent provided by the pension plan's benefit formula.

Summary Compensation Table pension measure, may increase comparability across registrants of the amounts “actually paid” under both defined benefit and defined contribution plans. For defined contribution plans, the Summary Compensation Table requires disclosure of registrant contributions or other allocations to vested and unvested defined contribution plans for the applicable fiscal year,[119] which will also be included in computing compensation actually paid for purposes of the new disclosure.

In the Reopening Release, we stated that some commenters had noticed challenges with using the pension service cost approach to determining the value of pension benefits “actually paid,” and requested comment on whether there is an alternative measure of the change in pension value attributable to the applicable fiscal year that is better representative of the amount of pension benefits “actually paid.”

ii. Comments

Some commenters generally supported limiting the pension benefits included in executive compensation actually paid to service cost.[120] In addition, some commenters supported the proposed deduction of the change in actuarial present value of defined benefit and pension plans not attributable to the applicable year of service,[121] or generally supported the Commission’s choice to exclude the value associated with actuarial assumptions.[122]

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[119] 17 CFR 229.402(c)(2)(ix)(E).

[120] *See* letters from Chris Barnard, dated June 24, 2015 (“Barnard 2015”); Chris Barnard, dated Mar. 2, 2022 (“Barnard 2022”); CAP; Hall; Exxon; and WorldatWork.

[121] *See* letters from CAP; CEC 2015; Exxon; TIAA; and Towers.

[122] *See* letter from NACD 2015.

There were also a number of commenters who opposed the inclusion of pension service cost in executive compensation actually paid,[123] noting it may remain subject to vesting conditions and may not ever actually be paid;[124] has assumptions built in that would prevent comparability across registrants or distort the figure;[125] is not presently calculated on a per participant basis, so would add cost;[126] or generally that it does not equal compensation "actually paid."[127] However, a number of commenters who opposed the inclusion of service cost noted their view that it would be a better representation of compensation "actually paid" than the current Summary Compensation Table figure.[128] A few commenters suggested excluding changes in pension values entirely,[129] while some others suggested that the registrant should have the option to exclude service cost, if the executive is not vested in the pension benefits.[130]

A number of commenters suggested other ways to include pension amounts in executive compensation actually paid. Some commenters recommended an approach requiring registrants to calculate the change in pension value to equal the actuarial present value of the benefit earned during the year,[131] noting that it tracks the actual pattern of benefit increases resulting from pay

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123 *See* letters from AON; CCMC 2015; CEC 2015; Honeywell; IBC 2015; and NACCO.

124 *See* letters from Honeywell and Towers

125 *See* letters CCMC 2015; IBC 2015; and Towers.

126 *See* letters NACCO.

127 *See* letters CEC 2015.

128 *See* letters from AON; Honeywell; Pearl; and Towers.

129 *See* letters from Coalition; Honeywell; and Pearl (advocating a realized pay approach that would exclude all pension associated values).

130 *See* letters from AON (generally supporting the exclusion of all non-vested pension benefits); Hyster-Yale; and NACCO.

131 *See* letters from Mercer and Towers; *see also* letter from AON (suggesting the same, if pensions must be included in compensation actually paid). Other commenters recommended approaches similar to this approach. *See* letters from Barnard 2022 (recommending that we include the change in the actuarial present value of

increases and plan amendments,[132] and links directly to the existing approach and assumptions used for the Summary Compensation Table.[133] Another suggested multiplying the value of the pension increase during the year, net of any inflationary increase and contribution by the employee, by twenty.[134]

Some commenters requested clarification regarding the calculation of the service cost amount. Two commenters suggested alternatives to the application of FASB ASC Topic 715,[135] with one suggesting that the Commission instead clarify that the intended measurement is the change in pension values attributable to an additional year of service,[136] and the other suggesting the Commission use the accumulated benefit obligation service cost or the change in present value of accrued benefits, using the same assumptions at the beginning and end of each year.[137] Two commenters suggested the Commission eliminate the reference to the required use of future salary increases to estimate service cost, because it would require significant new data and reveal new information to investors,[138] with one also suggesting the Commission clarify

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pension benefits over the applicable fiscal year using the same economic assumptions as used in the calculation at the start of the applicable fiscal year); Exxon (recommending that we include the portion of the currently-reported change in pension values that is attributable to an additional year of service); and WorldatWork (same).

132 *See* letter from Mercer.

133 *See* letters from Mercer and Towers; *see also* letter from AON (suggesting the same, if pensions must be included in compensation actually paid).

134 *See* letter from Hermes (specifically suggesting the Commission follow the United Kingdom's method of multiplying the value of the increase in annual pension benefit, net of any inflationary increase and contribution by the employee, by twenty).

135 *See* letters from AON and Exxon.

136 *See* letter from Exxon.

137 *See* letter from AON (alternatively suggesting a third alternative of disclosing the present value, using year end assumptions, of the increase in accrued benefit during the year).

138 *See* letters from Towers and WorldatWork.

that the intended measurement is the change in pension values attributable to an additional year of service.[139]

Three commenters responded to our request for comment in the Reopening Release asking if there is an alternative measure of the change in pension value attributable to the applicable fiscal year that is better representative of the amount of pension benefits "actually paid." One suggested that the "value of dollars set aside to provide a pension benefit to an executive" be disclosed.[140] Another suggested that registrants should be required to disclose the "change in (increase) the actuarial present value of pension benefits over the applicable fiscal year using the same economic assumptions as used in the calculation at the start of the applicable fiscal year."[141] The third stated that pension benefits should be fully excluded from the "actually paid" amount, but also stated that service cost was "far more representative of the compensation received" than the change in actual present value amount included in the Summary Compensation Table total.[142]

iii. Final Amendments

With respect to pension compensation, we are adopting final rules largely as proposed with a modification in response to commenters' suggestion to also include the value of plan amendments in the calculation of compensation actually paid. The final rules will require registrants to deduct from the Summary Compensation Table total the aggregate change in the actuarial present value of all defined benefit and actuarial pension plans,[143] and add back the

[139] *See* letter from WorldatWork.

[140] Letter from ICGN.

[141] Letter from Barnard 2022.

[142] Letter from Aon Human Capital Solutions, dated Mar. 4, 2022 ("Aon HCS").

[143] As discussed below, smaller reporting companies would not need to deduct this amount or add the service cost because the Summary Compensation Table requirements for smaller reporting companies do not require disclosure of the change in actuarial present value. *See infra* Section II.G.3.

aggregate of two components: (1) actuarially determined service cost for services rendered by the executive during the applicable year, as proposed (the "service cost"); and (2) the entire cost of benefits granted in a plan amendment (or initiation) during the covered fiscal year that are attributed by the benefit formula to services rendered in periods prior to the plan amendment or initiation (the "prior service cost"), in each case, calculated in accordance with U.S. Generally Accepted Accounting Principles ("U.S. GAAP").[144]

As noted above, the change in actuarial present value, generally, reflects the difference between the actuarial present value of accumulated benefits at the end of the fiscal year and at the end of the prior fiscal year. The change in actuarial present value would be deducted only if the value is positive, and therefore included in the sum reported in column (h) of the Summary Compensation Table. Where such amount is negative (and therefore not reflected in the Summary Compensation Table and reported only in a footnote to column (h)), no amounts should be deducted for purposes of Item 402(v) of Regulation S-K.

The below table shows the changes from the proposed rules to the final rules with respect to pension compensation (specific changes are bolded and italicized):

	Proposed Rules	**Final Rules**
Deduct (from Summary Compensation Table total):	The aggregate change in the actuarial present value of all defined benefit and actuarial pension plans.	The aggregate change in the actuarial present value of all defined benefit and actuarial pension plans.
Add back:	Service cost.	***The aggregate of:*** ***(1)*** Service cost***; and*** ***(2) Prior service cost.***

[144] *See* FASB ASC Topic 715.

We believe that it is appropriate to include pension compensation in the calculation of compensation “actually paid.” The adopted approach in particular provides an appropriate measure for purposes of determining compensation “actually paid” during the applicable year because it reflects the benefits an executive may expect to receive based on additional service the executive provided during the year (or service cost), and it incorporates additional benefits attributable to changes in the pension contract between the executive and the company (or prior service cost). In many cases, this measure will approximate the value that would be set aside currently by the registrant to fund the pension benefits payable upon retirement for the service provided, and any plan amendments made, during the applicable year. In addition, the inclusion of pension compensation is consistent with other compensation disclosure requirements, such as Item 402(c) of Regulation S-K. These same rationales apply whether or not the pension amounts are vested. Consistent with the equity compensation adjustment, the pension adjustment will be included even when unvested until an officer leaves the company.

Another advantage to the approach we are adopting is that it is more closely associated with underlying information from the GAAP financial statements. In particular, the pension’s service cost and prior service cost, while not required to be reported separately and for a subset of employees, is computed in the process of calculating the aggregate service cost and prior service cost at the plan level. As a result, a registrant would not be required to collect significant new data or prepare a new calculation of the actuarial present value of the benefit earned during the year, but would rather calculate service cost and prior service cost for a subset of employees for which the underlying information is already available and subject to internal control over financial reporting. The direct relationship of this information to the amounts recognized in the audited financial statements may also provide an additional level of comfort to investors as to its accuracy and reliability. In addition, because this approach excludes changes that derive only from differences in the actuarial assumptions used to estimate the value of benefits already earned in prior periods, it will provide for a more meaningful comparison across registrants of the amounts "actually paid" under both defined benefit and defined contribution plans. Further, as noted above, commenters were generally more supportive of a service cost approach rather than an approach that would include the amount required to be disclosed in the Summary Compensation Table.[145]

One weakness in the proposed approach, identified by commenters,[146] was that the service cost approach would not fully account for changes in the value of an executive's expected benefit arising from plan amendments or initiations. Our modified approach as adopted addresses this concern by requiring that the registrant include, as a component of this item of compensation actually paid, the entire cost of benefits granted in a plan amendment (or initiation) that are attributed by the benefit formula to services rendered in periods prior to the plan amendment or initiation. Such prior service cost information is part of the underlying information required to account for a defined-benefit plan under U.S. GAAP.[147]

For purposes of the final rules, "prior service cost" also refers to any credit arising from a reduction in benefits related to services rendered in prior periods as a result of a negative plan amendment. We acknowledge that including the prior service credit associated with such a negative plan amendment would result in a reduction of compensation actually paid. We believe that such an outcome would be consistent with the statutory objective of capturing compensation actually paid, because the reduction in the accrued benefit reflects a reduction in

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145 *See supra* notes 120 and 128.

146 *See* letters from AON and Mercer; see also letters from AON; Towers; and WorldatWork.

147 *See* FASB ASC Topic 715.

compensation in the same manner that an increase in the accrued benefit reflects an increase in compensation.

Although one commenter also noted that service cost would exclude the costs related to unexpected compensation changes,[148] we are not adopting a modification in this regard. Under U.S. GAAP,[149] the effects on the projected benefit obligation of unexpected compensation changes (*i.e.*, changes from the estimated future compensation levels used in measuring service cost) are recorded in actuarial gain or loss. In considering whether to add another component to the tabular pension measure related to actuarial gain or loss due to unexpected compensation changes, we determined that the benefits of isolating these items from other actuarial gains and losses did not merit the costs and complexities associated with calculating the additional adjustment. However, we note that information about compensation changes should still generally be discernible by investors, as such compensation amounts would be included as other components of the compensation disclosed in the Item 402(v) of Regulation S-K table.

We are not persuaded that the other alternative approaches recommended by commenters[150] would more accurately reflect compensation "actually paid." Although some of the suggested alternatives could more fully account for changes in compensation levels by reflecting unexpected increases in pay as well as plan amendments,[151] we believe that the benefits discussed above with respect to the adopted approach, including its direct relationship to the values already calculated for the purpose of financial statement reporting, outweigh the

148 *See* letter from Mercer.

149 *See* FASB ASC Topic 715.

150 *See supra* notes 131–134 and accompanying text.

151 *See infra* Section V.C.4.iii.

potential benefits of the alternatives. Further, while we acknowledge there may be an additional cost to obtain the service cost and prior service cost information on a per participant basis, the other calculations suggested by commenters also would include additional costs since registrants are not currently performing those calculations in the manner suggested.[152] In the case of commenters who suggested that we omit all pension cost amounts, we disagree that their suggested approach would be a reasonable interpretation of compensation "actually paid." Although the approach we are adopting may not always perfectly reflect all potential changes in pension value, the resulting measure is considerably more accurate than a measure that treats the value of promised pension awards as zero when they may ultimately cost the registrant millions of dollars.

We are also requiring that the calculation of "service cost" and "prior service cost" be consistent with the definitions provided under U.S. GAAP.[153] As discussed above,[154] we acknowledge that some commenters suggested alternatives to the U.S. GAAP definition; however, we believe that this definition is appropriate because it reflects the service cost amount included in the financial statements, and therefore is familiar to registrants. The final rules require the entire amount of prior service cost related to a plan amendment to be included in the pension measure rather than the amortized portion of prior service cost recognized as part of periodic pension cost under U.S. GAAP for the year.

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152 *See* letters from AON; Barnard; Exxon; Hermes (suggesting multiplying the value of the pension increase during the year, net of any inflationary increase and contribution by the employee, by twenty); Mercer; Towers; and WorldatWork.

153 *See* FASB ASC Topic 715.

154 *See supra* notes 131–134 and accompanying text.

2. Inclusion of Above-Market or Preferential Earnings on Deferred Compensation That Is Not Tax Qualified

i. Proposed Amendments

Consistent with Summary Compensation Table disclosure requirements, we proposed that the executive compensation actually paid would include above-market or preferential earnings on deferred compensation that is not tax qualified.[155]

ii. Comments

Two commenters generally agreed with the proposed rules on disclosure of deferred compensation that is not tax qualified.[156] Two other commenters recommended permitting registrants to exclude unvested amounts of deferred compensation that is not tax qualified.[157]

iii. Final Amendments

We are adopting, as proposed, the requirement that executive compensation actually paid include above-market or preferential earnings on deferred compensation that is not tax qualified. We believe, as discussed in the Proposing Release, that excluding those amounts until their eventual payout would make the amount "actually paid" contingent on an NEO's choice to withdraw or take a distribution from their account, rather than the registrant's compensatory decision to pay the above-market return, which we do not believe would be an accurate representation of compensation "actually paid." As with pension awards, these amounts may be viewed to approximate the value that would be set aside currently by the registrant to satisfy its obligations in the future. In addition, excluding those amounts would be inconsistent with the

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155 These earnings are reported pursuant to 17 CFR 229.402(c)(2)(vii), or, for smaller reporting companies, 17 CFR 229.402(n)(2)(viii).

156 *See* letters from NACCO and TIAA.

157 *See* letters from Hyster-Yale and NACCO.

approach in the Summary Compensation Table, which requires disclosure of the underlying deferred amounts when earned.[158] We believe that, to the extent the Summary Compensation Table approach aligns with the statutory "actually paid" language and purpose of the disclosure, we should minimize adjustments to the Summary Compensation Table figures, in order to make disclosures easier to understand for investors and easier to produce for registrants.[159] To that end, we are also not permitting registrants to voluntarily exclude unvested amounts of deferred compensation that is not tax qualified, as we believe that could complicate investors' understanding of the disclosure, and would limit the comparability of the "actually paid" amounts across different registrants.[160]

3. Equity Awards

i. Proposed Amendments

We proposed that equity awards be considered "actually paid" on the date of vesting, and valued at fair value on that date, rather than fair value on the date of grant as required in the Summary Compensation Table. In proposing this approach, we noted that an executive does not have an unconditional right to an equity award before vesting, and therefore unvested options or other equity awards may not be "actually paid" prior to the vesting conditions being satisfied, which can be viewed as representing payment by the registrant. In addition, we noted that using the vesting date fair value would incorporate changes in the value of the equity awards from the

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158 *See* Instruction 1 to 17 CFR 229.402(c) and Instruction 1 to 17 CFR 229.402(n) (each providing that "[a]ny amounts deferred, whether pursuant to a plan established under section 401(k) of the Internal Revenue Code (26 U.S.C. 401(k)), or otherwise, shall be included in the appropriate column for the fiscal year in which earned").

159 *See* letters from Hyster-Yale and NACCO (both stating that "[t]he fewer adjustments that are made to the SCT earnings, the easier the new proxy table will be for investors to understand and for companies to produce.").

160 *See infra* Section II.C.3.iii (discussing the general approach taken in the final rules with respect to unvested amounts of compensation).

grant date to the vesting date, with that change being one of the key ways that pay is linked to registrant performance.

With respect to the calculation of the vesting date fair value, we noted that the vesting date fair value of stock awards is already disclosed (by registrants other than SRCs) in the Option Exercises and Stock Vested Table,[161] and that the vesting date fair value of option awards can be calculated using existing models and methodologies. Specifically, the proposed approach would require (i) the amounts reported pursuant to 17 CFR 229.402(c)(2)(v) and (vi) to be deducted from Summary Compensation Table total, and (ii) the vesting date fair value of stock awards and options (with or without stock appreciation rights), each computed in accordance with the fair value guidance under U.S. GAAP,[162] to be added. As proposed, a registrant would be required to disclose vesting date valuation assumptions if they are materially different from those disclosed in its financial statements as of the grant date.

In response to comments received on the Proposing Release (discussed below), we included a request for comment in the Reopening Release, noting commenters' concerns that there was a potential misalignment between the time period to which pay is attributed and the time period in which the associated performance is reported, and asking if there were other approaches that would alleviate this misalignment, or if the inclusion of the additional measures considered in the Reopening Release would affect this misalignment.

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[161] *See* 17 CFR 229.402(g)(2)(v).

[162] *See* FASB ASC Topic 718.

ii. Comments

We received a number of comments on both the proposal to use fair value methodology to value equity awards in the calculation of executive compensation actually paid, and on the proposal to value such awards as of the vesting date.

Some commenters supported the proposed fair value methodology.[163] However, a number of commenters opposed the approach,[164] noting that the calculation of fair value is time consuming and expensive, particularly when many separate fair value calculations would be required, as in the case of awards that are on a pro-rata vesting schedule or with multiple tranches in a given year;[165] few companies have familiarity with valuing options that have been outstanding for several years;[166] the assumptions that are included in fair value calculations are company-specific and therefore would reduce comparability;[167] and that the fact that assumptions and projections are included in fair value calculations is inconsistent with the concept of "actually paid."[168] As an alternative to fair value, a number of commenters suggested the Commission require options to be valued at their intrinsic value,[169] or permit registrants to

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163 *See* letters from AFL-CIO 2015; CII 2015; The Predistribution Initiative and Responsible Asset Allocator Initiative, dated Mar. 4, 2022 ("PDI"); and TIAA.

164 *See* letters from BRT; CEC 2015; Celanese; Cook; FSR; Honeywell; Meridian; and PG 2015.

165 *See* letters from CAP; Cook; KPMG; and WorldatWork.

166 *See* letter from CAP.

167 *See* letter from IBC 2015.

168 *See* letters from CEC 2015; Meridian; and SCSGP.

169 *See* letters from CEC 2015 (supporting the use of intrinsic value if the Commission requires vesting date reporting); Celanese (supporting the use of intrinsic value if the Commission requires vesting date valuation); Coalition (supporting the use of intrinsic value if the commenter's preferred principles-based approach to the pay-versus-performance disclosure was not adopted); Corning; Hall; Honeywell (supporting the use of intrinsic value if the commenter's preferred principles-based approach to the pay-versus-performance disclosure was not adopted); Mercer; Meridian; Pearl (supporting the use of intrinsic value if the Commission does not adopt a realizable pay methodology) PG 2015; SCG; SCSGP; TCA 2015 (supporting the use of intrinsic value if the commenter's preferred principles-based approach to the pay-versus-performance disclosure was not adopted); and WorldatWork. Many of these commenters had slightly different concepts of

choose between disclosure of fair value and intrinsic value (with the non-chosen value being provided in footnote disclosure).[170] These commenters argued that intrinsic value is easier and cheaper to calculate;[171] aligns with the value that the executives would receive upon immediate exercise;[172] and does not include the valuation assumptions that accompany the fair value methodology.[173] Some commenters suggested that if the final rules did not use intrinsic value, they should instead use fair value with certain safe harbors or simplified assumptions that would reduce the effort required to compute the valuation.[174]

Some commenters supported valuing equity at the vesting date,[175] stating that valuing equity at the vesting date will incorporate the grant date fair value and changes until vesting (which "represent a direct channel, and one of the primary means, through which pay is linked to registrant performance"), but will not include post-vesting changes (which "generally reflect investment decisions made by the executive rather than compensation decisions made by the registrant");[176] will avoid "underestimating the actual compensation received by executives," which could occur if grant date reporting was required;[177] and "better reflect[s] the value ultimately delivered to executives."[178] Some commenters specifically opposed exercise date

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how options should be valued, but they all generally supported using intrinsic value, or the difference between the exercise price and the market price.

170 *See* letter from Hall.

171 *See* letters from Corning and Davis Polk 2015.

172 *See* letter from Corning.

173 *See* letter from Davis Polk 2015.

174 *See* letters from Mercer; TCA 2015 and TCA 2022. *See also* letter from Infinite Equity, dated Mar. 3, 2022 ("Infinite") (suggesting that certain existing safe harbors should be acceptable for the new disclosures).

175 *See* letters from AFL-CIO 2015; CII 2015; Honeywell; PDI; and TIAA.

176 *See* letter from CII 2015.

177 *See* letter from PDI.

178 *See* letter from TIAA.

valuation,[179] while others supported requiring the vesting date valuation of stock awards, but the exercise date valuation of options[180] or requiring the vesting date valuation of performance-based awards, but the grant date valuation of time-based awards.[181] Some commenters opposed vesting date valuation,[182] with one arguing that valuing options at vesting date would be misleading because executives do not generally include the option value in their income at the time of vesting.[183] As alternatives, commenters suggested: valuing awards at the end of a multi-year period, such as a three-year period;[184] valuing equity at grant date but reversing the value at the vesting date for awards that fail to vest;[185] revaluing outstanding equity awards annually;[186] or revaluing all equity granted during a period at the end of the most recent completed fiscal year.[187]

A number of commenters opposed the reporting of equity as of the vesting date.[188] Some of these commenters noted that vesting date reporting of equity would lead to a timing misalignment between actual performance and executive compensation actually paid, as the performance that "earned" the equity would have occurred between the grant date and the

179 *See* letters from AFL-CIO 2015; CII 2015; and Honeywell.

180 *See* letters from Coalition (specifically recommending that compensation be deemed "actually paid" when reported on Form W-2 for income tax purposes, which they state would include vested stock awards and amounts received in connection with exercised options); Hall; and Mercer.

181 *See* letter from McGuireWoods.

182 *See* letters from Celanese; CCMC 2015; Cook; and NACD 2015.

183 *See* letter from Cook.

184 *See* letter from Farient.

185 *See* letter from SVA.

186 *See* letters from Hodak; Farient; Infinite; TCA 2015; and TCA 2022.

187 *See* letter from CAP; PG 2015; and PG 2022.

188 *See* letters from CAP; Celanese; CCMC 2015; Cook; FSR; McGuireWoods; NACCO; NACD 2015; NAM 2022; Ross; SVA; and TIAA. *But see* Hermes (expressly supporting vesting date reporting of equity).

vesting date, but only the total amounts of equity would be reported on the vesting date.[189] However, two commenters, who acknowledged the misalignment, indicated that there was no other approach that would eliminate all misalignment.[190]

Several commenters requested clarifications about the proposed approach. A few commenters expressed that reporting equity on the vesting date creates uncertainty in application, and either sought clarification regarding the vesting date or the meaning of when "all applicable vesting conditions were satisfied."[191] One commenter suggested that an award should be considered vested on the date the executive is able to monetize the award,[192] while another suggested that awards should only be considered "actually paid" when restrictions on equity lapse, even if already vested.[193] Two commenters also made suggestions that awards should be considered vested when the associated performance period is completed, even if the vesting of the award is still subject to board certification.[194]

Commenters suggested a number of alternatives to vesting date reporting of equity, including: grant date reporting;[195] exercise date reporting;[196] exercise date reporting of the equity's intrinsic value;[197] principles-based reporting (*i.e.*, allowing companies to make their

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189 *See* letters from CEC 2015; Celanese; CCMC 2015; Cook; Faulkner; FSR; Hyster-Yale; NACCO; PG 2015; Pearl; Ross; SBA-FL; SVA; TIAA; TCA 2015; and WorldatWork.

190 *See* letters from Aon HCS and Teamsters.

191 *See* letters from Cook; IBC 2015; Mercer; Pearl; and Towers.

192 *See* letters from Davis Polk 2015 and Davis Polk 2022.

193 *See* letter from CEC 2015.

194 *See* letters from Mercer and Towers.

195 *See* letters from CAP and NAM 2022.

196 *See* letters from CEC 2015; Coalition; and FSR.

197 Letter from Corning.

own modifications to the reporting date);[198] reporting "in the fiscal year for which the compensation was considered as paid";[199] and annual reporting, starting in the grant year, of the year-end fair value of the award, with annual reporting of any change in the fair value until, and including, the year of vesting.[200] Two commenters also suggested the Commission adopt the "2 ½ month rule," under which equity vesting in the first two and one half months of the calendar year would be attributed to the prior year.[201] One commenter stated that, because the proposed rules would move away from grant date fair value calculations for equity awards, it would be important that the disclosure include dividends paid on unvested equity or equivalents for a given year.[202]

A few commenters supported the proposed requirement that changes in the underlying assumptions for valuation that are materially different from those made in the financial statements as of the grant date must be disclosed, with one specifically supporting the proposed requirement,[203] one supporting requiring any changes from the assumptions in the current financial statements to be disclosed,[204] and two opposing the disclosure of changes in valuation assumptions.[205]

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198 *See* letter from Hall.

199 *See* letter from TIAA.

200 *See* letters from Infinite; TCA 2015; and TCA 2022. Other commenters made similar suggestions that vary slightly from this suggestion, including by using intrinsic rather than fair value for options, measuring pay over an aggregate time horizon rather than presenting data broken out by year, and revaluing vested as well as unvested equity holdings. *See* letters from CAP; Farient; Hodak; PG 2015; and Pay Governance, dated Mar. 3, 2022 ("PG 2022").

201 *See* letters from Hyster-Yale and NACCO.

202 *See* letter from TIAA.

203 *See* letter from CII 2015.

204 *See* letter from Towers.

205 *See* letters from Davis Polk 2015 and McGuireWoods.

In response to a request for comment in the Reopening Release, one commenter indicated that the additional performance measures considered in the Reopening Release would not exacerbate the timing misalignment,[206] while another stated the additional measures would not improve the misalignment.[207]

iii. Final Amendments

After consideration of the comments received, we are modifying our approach to the treatment of equity awards in relation to the total compensation reported in the Summary Compensation Table. While the final amendments continue to use "fair value" as the measure of the amount of an equity award, which is consistent with accounting in the financial statements, we are adjusting the date on which the award is valued in response to comments, so that the first fair value disclosure is made in the year of grant, and changes in value of the award are reported from year to year until the award is vested.[208] We believe this approach will better align the timing of the disclosure and valuation with when the award is actually "earned" by the executive, resulting in disclosure that more clearly shows the relationship between executive compensation and the registrant's performance.

In particular, the proposed rules would have required the deduction of the equity award amounts reported in the Summary Compensation Table total and the addition of:

- The vesting date fair value of stock awards and options (with or without stock appreciation rights), each computed in accordance with the fair value guidance under U.S. GAAP.

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206 *See* letter from Aon HCS.

207 *See* letter from McGuireWoods.

208 This approach was discussed as an implementation alternative in the Proposing Release. *See* Proposing Release at Section IV.C.3.c. Two commenters specifically noted this implementation alternative and were supportive of its adoption. *See* letters from Infinite; TCA 2015; and TCA 2022.

The final rules also require the deduction of the equity award amounts reported in the Summary Compensation Table total; however, instead of the addition of the vesting date fair value of stock awards and options, the final rules require the addition (or subtraction, as applicable) of the following:

- The year-end fair value of any equity awards granted in the covered fiscal year that are outstanding and unvested as of the end of the covered fiscal year;
- The amount of change as of the end of the covered fiscal year (from the end of the prior fiscal year) in fair value of any awards granted in prior years that are outstanding and unvested as of the end of the covered fiscal year;
- For awards that are granted and vest in the same covered fiscal year, the fair value as of the vesting date;[209]
- For awards granted in prior years that vest in the covered fiscal year, the amount equal to the change as of the vesting date (from the end of the prior fiscal year) in fair value;
- For awards granted in prior years that are determined to fail to meet the applicable vesting conditions during the covered fiscal year, a deduction for the amount equal to the fair value at the end of the prior fiscal year;[210] and
- The dollar value of any dividends or other earnings paid on stock or option awards in the covered fiscal year prior to the vesting date that are not otherwise reflected in the fair

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209 There is no adjustment for awards that are granted and determined not to vest in the same covered fiscal year because those awards result in no compensation actually paid.

210 For any of an executive’s equity awards that are determined to fail to vest, a negative amount equal to the fair value at the end of the prior fiscal year would be included as part of the executive’s compensation actually paid as of the date the registrant determines the award will not vest. This negative amount takes the cumulative reported value of that award to $0 since it did not vest.

value of such award or included in any other component of total compensation for the covered fiscal year.

We believe fair value is an appropriate measure for compensation "actually paid." Although fair value calculations, like all accounting estimates, do involve some subjective assumptions, we do not agree with commenters that stated that the assumptions and projections included in fair value calculations render such amounts inconsistent with the concept of "actually paid."[211] Fair value is an estimate of the amount by which an executive is compensated as a result of an award, and therefore represents a reasonable measure of that executive's "actual pa[y]." Specifically, the fair value of an option is a widely-used measure to estimate the total value of the asset, including both its value if exercised immediately ("intrinsic value") and the additional value created by the holder's contractual right to exercise at some time in the future ("time value" of the option). In our view it also represents a more accurate measure of actual pay than alternatives recommended by some commenters.

We are not adopting the approach suggested by some commenters that we use other measures such as intrinsic value. Intrinsic value would ignore the option value inherent in exercisable awards prior to exercise, including the option value inherent in an option award that is at-the-money or out-of-the-money (*i.e.*, the stock price is equal to or less than the strike price of the options), and therefore has zero intrinsic value. Intrinsic value (or any similar measure used to calculate compensation "actually paid") would also be a departure from the primary disclosures related to equity compensation, and the recognition and measurement of such compensation in the financial statements under U.S. GAAP, and we believe would not allow investors to as easily link and analyze "compensation actually paid" with the other information

[211] *See supra* note 168 and accompanying text.

they are receiving about executive compensation. Further, in 2004, the accounting for stock-based compensation in U.S. GAAP was revised to require fair value accounting.[212] In the revised accounting standard, it was noted that other equity instruments and the consideration the issuing entity receives in exchange for them are recognized in the financial statements based on the fair value of the instrument at the date issued. The fact that the equity instruments would be issued for goods or services rendered or to be performed did not seem to be a reason to measure the cost of the goods or services performed on a different basis. The standard further noted that most advocates of intrinsic value favored its use only at a grant date measurement, and noted that there are weaknesses in its use even in that case, such as treating most fixed share options as though they were a "free good."[213] However, even at the grant date, employee services received in exchange for share options are not free and there is value in the employee services performed and the related stock and stock options received.

Registrants and investors are already familiar with fair value calculations and the determination of the assumptions for such calculations through their use in existing Commission disclosure requirements as well as U.S. GAAP. For example, the Grants of Plan-Based Awards Table requires grant date fair value disclosure of each individual equity award granted during the last completed fiscal year.[214] U.S. GAAP requires information about grant date fair value for equity awards, including the weighted-average grant-date fair value of awards that were

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212 *See* FASB SFAS No. 123 (Revised 2004), *Accounting for Stock-Based Compensation* ("FAS 123R"), which was issued in December 2004 and superseded Accounting Bulletin Opinion No. 25, Accounting for Stock Issued to Employees, which was an intrinsic value approach to stock-based compensation. FAS 123R was codified in FASB ASC Topic 718.

213 *Id.*

214 *See* 17 CFR 229.402(d)(2)(vii) and Instruction 8 to 17 CFR 229.402(d).

granted, vested and forfeited during the year and a description of the significant assumptions used during the year to determine the fair value of share-based compensation awards.[215]

We do not agree with the suggestion from commenters that we consider an option or other award requiring exercise to be "actually paid" only upon its exercise, as we believe doing so would commingle the registrant's compensatory decision with the executive's investment decision about when to exercise and would allow executives to influence pay-versus-performance disclosure by controlling the fiscal year in which they receive the compensation. We additionally determined that year-over-year change in fair value better meets the statutory purposes than grant-date fair value, because valuing awards only at grant date fails to reflect increases in value to the executive after the grant date, during the period over which the compensation actually paid is earned. Even if year-over-year change in fair value is only a reasonable estimate, we believe it is far more accurate to include this estimate than to omit such increases in value entirely.

We have changed the reporting and valuation date requirements from the Proposing Release to first require the year-end reporting and valuation of awards granted during the fiscal year and then the year-over-year change in fair value of such awards until the vesting date (or the date the registrant determines the award will not vest).

We have made these changes to the reporting and valuation requirements to address commenters' concerns about potential misalignment between the time period to which pay is attributed and the time period in which the associated performance is reported, and the degree to which this would affect the usefulness of the disclosure. We believe that, compared to the vesting date valuation approach included in the Proposing Release, the adopted approach will

[215] *See* FASB ASC Topic 718-10-50-2.

more effectively allow registrants to describe the relationship between compensation and registrant performance, as the reported amounts of compensation will annually adjust based on the registrant's performance, among other things, in that year. In addition, we acknowledge commenters' observation that comparability may be somewhat reduced by the assumptions that are included in fair value calculations, which, as noted by a commenter, may differ from issuer to issuer. Because investors are already familiar with fair value as the measurement approach for equity awards under U.S. GAAP, they are aware of the reduced comparability that may occur due to the use of different assumptions from issuer to issuer. However, we believe that the use of a consistent measurement approach to equity compensation in the Summary Compensation Table, the financial statements, and the calculation of compensation "actually paid," along with the required disclosures about significant assumptions under U.S. GAAP in the final rules, allows for comparability with respect to an individual issuer's disclosures from year to year. Further, as discussed in the Proposing Release,[216] we believe that, overall, comparability regarding the awards included by registrants in the disclosure will be greater under the adopted approach than it would have been under the proposed approach, as volatility in executive compensation actually paid across the disclosure periods that is due simply to vesting patterns should decrease (as the amount of executive compensation actually paid will be adjusted each year as it is "earned" over the course of the vesting period).[217]

Investors will also be able to more easily understand the impact of performance on awards-based compensation over time, because under the final rules as adopted investors will be able to observe the amount by which the value of an executive's compensation changes each

[216] *See* Proposing Release, Section IV.C.3.c (considering the adopted approach as an implementation alternative).

[217] *See supra* note 210.

year, rather than only observing the value of that compensation in the year an award vests. Furthermore, we believe that the adopted approach in the final rules is similar to the concept of realizable pay, recommended by some commenters, as it reflects an attempt to measure the change in value of an executive's pay package after the grant date, as performance outcomes are experienced.

This approach to unvested equity compensation is consistent with the treatment of other unvested elements of compensation under the final rules, such as unvested pension benefits and contributions to unvested defined contribution plans. In each case, the adopted approach reflects this compensation as it is earned rather than at vesting. We believe the consistent use of this approach should reduce misalignment between the timing of when compensation is earned and when it is reported, and allow the disclosure to more clearly represent the relationship of pay with performance over time.

We also believe this revised approach for equity awards comports with the statutory term "executive compensation actually paid." While non-vested amounts of compensation could be considered unpaid due to their contingent nature, over time the values reported in connection with a particular award will aggregate to its ultimate value upon vesting. Aligning the compensation reporting more closely with when the compensation changes in value also provides investors with a clearer picture of "the relationship between executive compensation actually paid and the financial performance of the issuer." For example, where an award vests over a three-year period and the registrant's financial performance is positive in the first of those two years and negative in the third, reporting the full value of the award only in the vesting year may give investors the misleading impression that the executive was not rewarded for positive performance in years one and two and was rewarded despite negative performance in year three. In addition, the required reporting of the year-over-year change in fair value of such awards until the vesting date (or a deduction for prior reported amounts as of the date the registrant determines the award will not vest) will account for any amounts that fail to vest; will address concerns, noted by commenters, that grant date reporting undervalues compensation "actually paid"; and will not include those post-vesting changes that generally reflect the executives' investment decisions, not compensation.[218]

We recognize that requiring fair value calculations for each equity award at a date other than the grant date may be burdensome for some issuers, as noted by some commenters,[219] particularly those that have compensation programs with numerous and complex equity grants. However, in the final rules we are not adopting a safe harbor or simplified assumptions other than those generally accepted under U.S. GAAP, as suggested by some commenters.[220] Since accounting for share-based compensation in U.S. GAAP was revised in 2004 to require fair value accounting, [221] registrants have been accounting for equity compensation based on a fair value approach and must determine valuation assumptions every time a new award is granted. While commenters correctly noted that companies are not as familiar with the fair valuation of

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[218] Not all post-vesting date changes reflect the executives' investment decisions, as vested awards could remain subject to other restrictions (*e.g.*, anti-hedging restrictions or holding requirements) that would limit the investment decisions available to an executive.

[219] *See, e.g.*, letters from CAP (stating that "a fair value calculation for previously granted stock options at the time of vesting, registrants will undoubtedly encounter many complications," and noting that few companies have familiarity with valuing options that have been outstanding for several years); Cook (stating that "[c]alculating the fair value of stock options as of each vesting date will be a time-consuming and tedious process"); KPMG (stating that "the vesting date fair value of share options will be more difficult for companies than determining the grant date fair value of those awards"); and WorldatWork (describing the proposed vesting date fair value approach as "burdensome").

[220] *See supra* note 174 and accompanying text.

[221] *See supra* note 212 and accompanying text.

options after the grant date, U.S. GAAP requires the re-valuation of an award when modified,[222] so the concept of valuing a stock award before vesting is also not novel to registrants. As such, registrants are required to have internal controls and processes over the valuation of stock awards, including the assumptions used in determining fair value.[223] We believe that registrants will likely rely upon the existing fair value processes and internal controls for stock-based compensation, which should mitigate the concerns raised by commenters about assumptions. In addition, the option and contingent-equity valuation models are well-developed and related software solutions are widely available, which will further mitigate those additional burdens and concerns related to valuation approach and related inputs.

The final rules also require footnote disclosure of any valuation assumptions that materially differ from those disclosed at the time of grant, as in the proposal.[224] The proposal did not specify how to disclose the valuation assumptions. Similar to U.S. GAAP, when multiple awards are being valued in a given year, a registrant may disclose a range of the assumptions used or a weighted-average amount for each assumption. In addition, the fact that certain institutional investors and third parties (often proxy advisors or compensation consultants) are already incorporating similar computations in their own pay for performance analyses,[225] suggests that the adopted approach is already considered useful and operational by some investors.

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[222] *See* FASB ASC Topic 718-20-35.

[223] *See also* 17 CFR 240.13a-14, 13a-15, 15d-14 & 240.15d-15.

[224] For example, there may be a material difference in assumptions if the registrant has made changes to key assumptions that would have materially changed the grant date fair value if the assumption(s) applied as of grant date.

[225] *See infra* Section V.B.2.

Further, we are also requiring the dollar value of any dividends or other earnings paid on stock or option awards in the covered fiscal year prior to the vesting date to be included in the amount of executive compensation actually paid, if such amounts are not reflected in the fair value of such award or included in any other component of total compensation for the covered fiscal year. As noted by a commenter, the pay-for-performance disclosure should include dividends paid on unvested equity or equivalents "as a result of the move away from grant date fair value calculations for equity awards."[226] Under the Summary Compensation Table total, any such amounts would be typically included in the grant date fair value, as no such dividends or earnings would have been paid on that date. However, if any dividends or other earnings are paid on stock or option awards over time, these amounts would decrease future fair value amounts. This decrease would not be reflective of a decrease in the amount "actually paid" to the executive, to the contrary, the amount of the decrease would reflect actual dividends or earnings paid to the executive prior to the valuation. We believe these amounts are compensation "actually paid" and should be reflected in the disclosure.

D. Measures of Performance

1. Requirement to Disclose TSR and Peer Group TSR

i. Proposed Amendments

We proposed requiring all registrants subject to the proposed rule to use TSR as the measure of financial performance of the registrant for purposes of the required disclosure. In addition, we proposed requiring registrants that are not SRCs to disclose peer group TSR, using either the same peer group used for purposes of Item 201(e) of Regulation S-K or a peer group

226 *See* letter from TIAA.

used in the CD&A for purposes of disclosing registrants' compensation benchmarking practices.[227]

ii. Comments

Commenters were divided on the use of TSR as a required financial performance measure, with some commenters generally supportive,[228] and some generally opposed.[229] Additionally, some commenters opposed TSR being used as the sole measure of financial performance.[230]

Commenters in favor of including TSR as a required financial performance measure noted that TSR is well-understood by investors;[231] is widely used by companies in setting compensation;[232] is generally a fair representation of company performance;[233] will assist companies "in articulating and providing justification for their compensation practices";[234] will increase comparability;[235] and reflects stock price fluctuations that regularly occur in response

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227 *See* 17 CFR 229.402(b)(xiv).

228 *See* letters from Americans for Financial Reform Educational Fund, dated Mar. 18, 2022 ("AFREF"); Barnard 2015; Barnard 2022; BlackRock, dated July 2, 2015 ("BlackRock"); CalPERS 2015; CAP; CFA; CII 2015; Farient; Hook; Infinite; OPERS; Public Citizen 2015; and TIAA.

229 *See* letters from American Securities Association, dated Mar. 14, 2022 ("ASA"); Aspen; Better Markets, dated Mar. 4, 2022 ("Better Markets"); CCMC 2015; CEC 2015; Coalition; Cook; Dimensional Fund Advisors LP, dated Mar. 3, 2022 ("Dimensional"); FedEx 2015; FSR; Hay; Honeywell; International Bancshares Corp., dated Mar. 3, 2022 ("IBC 2022"); McGuireWoods; NAM 2015; NAM 2022; NIRI 2015; NIRI 2022; and SBA-FL.

230 *See* letters from BorgWarner; BRT; Celanese; Hall; Honeywell; Hyster-Yale; IBC 2015; ICGN; Mercer; NACCO; NACD 2015; NACD 2022; PG 2015; Pearl; PNC; PDI; Judy Samuelson, dated Mar. 4, 2022 ("Samuelson"); SCG; SCSGP; Simpson Thacher & Bartlett, dated July 6, 2015 ("Simpson Thacher"); and WorldatWork

231 *See* letters from Barnard 2015; Barnard 2022; CFA; and Farient.

232 *See* letters from Barnard 2015; Barnard 2022; BlackRock; CalPERS 2015; CFA; CII 2015; and Public Citizen 2015.

233 *See* letters from Barnard 2015; Barnard 2022; CII 2015; Farient; and OPERS.

234 *See* letter from CalPERS 2015.

235 *See* letters from Barnard 2015; Barnard 2022; CAP; CII 2015; Hodak; and TIAA.

to publicly known information and company leadership.[236] Commenters in favor of TSR also observed that requiring its disclosure is consistent with the language in Section 953(a) that the pay-versus-performance disclosure should "tak[e] into account any change in the value of the shares of stock and dividends of the issuer and any distributions."[237]

Commenters opposed to the use of TSR, generally or as the sole measure of performance, as well as a few commenters in favor of the use of TSR,[238] noted that TSR has specific limitations, including: not necessarily being used by the subject company to determine compensation;[239] being an unreliable performance measure for thinly-traded stocks;[240] incentivizing short-term performance at the expense of investors' long-term best interests[241] (which some commenters indicated could incentivize companies to incorporate strategies to inflate stock prices over the short term,[242] or to engage in buybacks[243]); requiring lengthy explanatory disclosures to explain any misalignments between compensation and TSR;[244] causing companies to adjust their compensation programs to more heavily rely on TSR;[245] being subject to fluctuations based on circumstances outside of the control of companies, industries,

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236 *See* letter from Infinite.

237 *See* letters from AFREF; CAP; CII 2015; and Public Citizen 2015.

238 *See* letters from AFREF; CalPERS 2015; CFA; and CII 2015.

239 *See* letters from CCMC 2015 and Coalition.

240 *See* letters from Hyster-Yale and NACCO.

241 *See* letters from AFREF; ASA; BlackRock; BRT; CCMC 2015; CEC 2015; Coalition; FedEx 2015; FSR; Hall; IBC 2015; IBC 2022; Mercer; NACCO; NACD 2015; NAM 2015; NIRI 2015; Samuelson; SCG; Simpson Thacher; and WorldatWork. *But see* letter from OPERS (stating that the use of TSR alone is not likely to drive short-term decision-making).

242 *See* letters from Better Markets; IBC 2022; McGuireWoods; NACCO; Pearl; and PDI.

243 *See* letters from AFREF; Better Markets; PDI; and Samuelson.

244 *See* letters from Aspen; Celanese; Coalition; Exxon; Hyster-Yale; NACCO; NAM 2015; NIRI 2015; NIRI 2022; and PNC.

245 *See* letters from CEC 2015; CCMC 2015; Hall; Hay; Hermes; FSR; George S. Georgiev, dated Mar. 4, 2022 ("Georgiev"); McGuireWoods; Mercer; Pearl; PNC; SCSGP; Simpson Thacher; and WorldatWork.

and executives;[246] and being affected by the granting and vesting of stock options.[247] In response to these concerns, some commenters (including commenters in favor of using TSR[248]), suggested permitting disclosure of other metrics alongside TSR.[249] Other commenters generally stated that there was no single performance measure that would align with the compensation plan of every registrant, and therefore suggested adopting a principles-based approach, allowing companies to choose their own performance measures.[250] Alternatively, a number of commenters suggested requiring registrants to disclose the actual metrics used in determining their executive compensation,[251] or revising Item 402 of Regulation S-K to require disclosure of "all" metrics actually used to determine NEO incentive compensation.[252]

A number of commenters raised questions or made comments regarding the calculation of TSR. A few commenters suggested that TSR should be presented as a percentage change

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246 *See* letters from AFL-CIO 2015; Aspen; CEC 2015; Dimensional; FSR; Hay; IBC 2015; IBC 2022; McGuireWoods; Mercer; NACCO; NIRI 2015; NIRI 2022; PDI; Pearl; Samuelson; and SBA-FL.

247 *See* letter from IBC 2022.

248 *See* letters from CalPERS 2015; CAP; CFA; CII 2015; Farient; OPERS; and TIAA.

249 *See* letters from CalPERS 2015; CAP; CFA; CII 2015; Davis Polk 2015; Davis Polk 2022 (stating that TSR should be the only required measure, but that we should permit registrants to voluntarily disclose other measures, particularly "[g]iven the complexity and importance of long-term incentive compensation"); Farient; Hall; Mercer; NIRI 2015; OPERS; Pearl; Sacred Heart University, dated July 7, 2015; Simpson Thacher; and TIAA. *But see* letter from IBC 2022 (stating, in response to the Reopening Release's considered additional net income, income or loss before income tax expense, and Company-Selected Measure measures, that the inclusion of additional metrics does not fix the fact that the inclusion of TSR "overstates" the importance of TSR).

250 *See* letters from BRT; Celanese; Exxon; Hall; Hay; Hyster-Yale; McGuireWoods; NACCO; PNC; SCG; SCSGP; and Simpson Thacher.

251 *See* letters from AFL-CIO 2015; CCMC 2015; FedEx 2015; Hook (supporting the proposal, but stating "I would like to see the metrics for comparison include focus on longer-term performance"); Public Citizen 2015 (specifically suggesting that the Commission "mandate a metric supplemental to the TSR of a company's own choosing that it contends would capture long-term performance"); and SBA-FL.

252 *See* letters from American Federation of Labor and Congress of Industrial Organizations, dated Mar. 2, 2022 ("AFL-CIO 2022"); AFREF; California Public Employees Retirement System Investment Office, dated Mar. 4, 2022 ("CalPERS 2022"); California State Teachers' Retirement System, dated Mar. 2, 2022 ("CalSTRS"); CII 2022; Georgiev; ICGN; and International Brotherhood of Teamsters, dated Mar. 3, 2022 ("Teamsters").

instead of an indexed dollar value.[253] Others generally raised questions about the method used for calculating TSR,[254] with some suggesting TSR should be calculated and disclosed as a one-year measure,[255] others suggesting that TSR should be calculated as a rolling average,[256] and a third group suggesting TSR be calculated as a cumulative average over the time period of the disclosure.[257] Other commenters suggested that we permit registrants to decide the time period used to calculate their TSR.[258]

Commenters were also divided on our proposal to require registrants, other than SRCs, to disclose peer group TSR. Some commenters supported requiring the inclusion of peer group TSR,[259] while others suggested peer group disclosure should be optional.[260] A number of other

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253 *See* letters from AON and Towers.

254 *See* letters from Anonymous, dated May 27, 2015; BorgWarner; CEC 2015; Cook; Hall; Honeywell; Mercer; PG 2015; Pearl; TCA 2015; and Towers.

255 *See* letters from Cook; Infinite (suggesting that a one-year TSR would be consistent with Item 201(e) of Regulation S-K, but that also including three-year and five-year TSRs may provide helpful context); TCA 2015; TCA 2022; and Towers. *But see* letter from Farient (opposing the calculation of TSR as a year-over-year measurement). *See also* Davis Polk 2015 (stating that, if the Commission requires an annual TSR, we should permit registrants to also disclose a multi-year TSR, because compensation may be based on multi-year performance).

256 *See* letters from AFREF (supporting a "five year cumulative and rolling average"); CEC 2015 (supporting the use of a three-year or five-year rolling average TSR); Honeywell (stating that a multi-year rolling TSR would be more meaningful); ICGN; NACD 2015 (recommending the Commission require a three-year or five-year TSR in addition to an annual TSR); and NACD 2022 (also recommending the Commission require a three-year or five-year TSR in addition to an annual TSR). *But see* letter from PG 2015 (noting that a five-year rolling TSR calculation would not be consistent with the Commissions intent).

257 *See* letters from Pearl (supporting a cumulative 5-year TSR measurement); PG 2015 (noting that a cumulative TSR would be consistent with the Commission's intent, but could "complicate[] comparisons by causing the starting point for TSR measurement to change each year"); and Teamsters.

258 *See* letters from BorgWarner; Davis Polk 2015; Davis Polk 2022 (suggesting that TSR should be calculated "in a manner that is consistent with the ways in which the compensation committee considers TSR in the pay setting process"); Exxon (generally opposing the use of TSR, but stating that, if we require its use, we should allow registrants to choose the time period for measuring cumulative TSR that best suits them); and NIRI 2015; *see also* letter from Huddart (suggesting each component of the PEO's compensation actually paid be associated with a requisite service period, and then requiring the calculation of TSR and peer group TSR over the requisite service period of the component of the PEO's compensation having the largest dollar value in a given year).

259 *See* letters from As You Sow 2015; CalPERS 2015; OPERS; and TIAA.

260 *See* letters from AON and Hay.

commenters opposed the requirement to disclose peer group TSR,[261] arguing peer group disclosure: is already disclosed in the performance graph required by Item 201(e) of Regulation S-K;[262] is beyond the mandate of the Dodd-Frank Act;[263] will confuse or mislead investors;[264] will be expensive and/or time-consuming for registrants to calculate;[265] is difficult for registrants to explain and would require lengthy disclosures;[266] is difficult to understand given that frequent changes in peer groups[267] and different market conditions or performance cycles affect different "peer" companies differently;[268] and creates issues relating to the difficulty for companies to find adequate peers, limiting the ability to make direct comparisons between registrants.[269] A number of commenters also opposed requiring weighted peer group TSR (weighted by market capitalization), as used in Item 201(e) of Regulation S-K.[270] In addition, one commenter suggested we permit multiple peer groups to be disclosed, if peer group TSR disclosure is required.[271]

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261 *See* letters from ActiveAllocator Activist Capital Advisors L.P., dated Feb. 3, 2022; CCMC 2015; CEC 2015; Celanese; Cook; Davis Polk 2015; FSR; Georgiev; Hyster-Yale; IBC 2015; IBC 2022; LWC; McGuireWoods; Meridian; NACCO; NAM 2015; NIRI 2015; NIRI 2022; Pearl; PNC; SCG; SCSGP; TCA 2015; TCA 2022; and WorldatWork

262 *See* letters from Exxon; Georgiev; Pearl; PNC; SBA-FL; and TCA 2015.

263 *See* letters from BRT; CEC 2015; Celanese; Davis Polk 2015; Exxon; FSR; Hay; Meridian; Pearl; PNC; and WorldatWork.

264 *See* letters from CEC 2015; Celanese; Davis Polk 2015; Georgiev; Hay; Hyster-Yale; LWC; NACCO; and PNC.

265 *See* letters from Celanese; Hyster-Yale; and NACCO.

266 *See* letters from BRT; CCMC 2015 (also noting that registrants may face public liability for assumptions made regarding a peer's performance); Davis Polk 2015 (similar); and SCSGP.

267 *See* letters from Hay; Hyster-Yale; and NACCO.

268 *See* letters CCMC 2015; Exxon; and Pearl.

269 *See* letters from Hay; Hyster-Yale; IBC 2015; FSR; NACCO; NAM 2015; and Pearl.

270 *See* letters from Allison; AON; Cook; Meridian; and Ross.

271 *See* letter from Pearl.

Commenters generally supported allowing registrants to have flexibility in setting their peer groups for the pay-versus-performance disclosure. Commenters had various suggestions as to how to achieve this flexibility, including allowing registrants to choose any peer group referenced in the CD&A;[272] allowing the use of the peer group from either Item 201(e) of Regulation S-K or the CD&A;[273] or allowing registrants to choose a peer group other than the Item 201(e) of Regulation S-K or CD&A peer groups.[274] These commenters generally supported requiring registrants to provide disclosure explaining the make-up of their peer group.[275] One commenter, however, opposed giving flexibility to registrants in setting their peer groups, and instead suggested requiring that the peer group should be the same as the peer group used in benchmarking executive compensation.[276]

Commenters raised questions about the impact of a registrant changing its peer group. Some commenters advocated for requiring additional disclosure in the event that a registrant changes its peer group,[277] including requiring the disclosure of comparative results of TSR for all peer groups used in the disclosed time period.[278] Others questioned what impact the change of a peer group would have on cumulative TSR,[279] with some commenters suggesting we only

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272 *See* letter from SCSGP.

273 *See* letter from Quirin.

274 *See* letters from Barnard 2015; Corning; and Towers (specifically supporting allowing registrants to use the peer group, if any, that is used in setting compensation).

275 *See* letters from Barnard 2015; Quirin; and SCSGP.

276 *See* letter from AFL-CIO 2015; *see also* letter from As You Sow 2015 (stating that "ideally" all registrants would use the benchmarking peer group in their pay-versus-performance disclosure).

277 *See* letters from AFL-CIO 2015; Hermes; and SBA-FL.

278 *See* letter from Hermes.

279 *See* letters from Cook and Pearl.

require disclosure of the current peer group.[280] One commenter suggested that, if annual TSR is used, the peer group in place in the respective year of disclosure should be the peer group used to calculate the peer group TSR for that year of disclosure.[281]

iii. Final Amendments

We are adopting the requirement, as proposed, that all registrants subject to the final rules use TSR, and that registrants (other than SRCs) use peer group TSR, as measures of performance. As noted in the Proposing Release, Section 14(i) does not mandate we require specific measures in the pay-versus-performance disclosure. However, the statute does provide that the disclosures should "tak[e] into account any change in the value of the shares of stock and dividends of the issuer and any distributions."[282] While we recognize commenters' concerns that TSR is not an equally useful measure for all registrants (as it is not necessarily used by all registrants to set compensation and is seen by some commenters to be an unreliable performance measure for thinly-traded stocks), is subject to fluctuations based on circumstances outside of the control of the registrant, and may be affected by the granting and vesting of stock options, we believe that TSR is consistent with that statutory language. In addition, we believe mandating a consistently calculated measure for all registrants will further the comparability of the pay-versus-performance disclosures across registrants, as noted by some commenters.[283] We acknowledge, as noted by some commenters, that some registrants may need to provide somewhat lengthy explanatory disclosures to explain any misalignments between compensation and TSR; however, we believe those disclosures are the types of disclosures intended by the

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280 *See* letters from Cook and Quirin.

281 *See* letter from Cook.

282 15 U.S.C. 78n(i).

283 *See supra* note 235.

language of Section 14(i), and will help investors understand the relationship between executive compensation actually paid and the registrant's performance.

We are not requiring registrants to disclose all measures they use to set executive compensation, as recommended by some commenters,[284] because we believe such a requirement would be a significant change from the current executive compensation disclosure requirements, and would be more appropriately considered by the Commission in a broader context not related to the Section 953(a) mandate. In addition, as noted below,[285] as with other mandated disclosures, registrants would be permitted to disclose additional measures of performance, so long as any additional disclosure is clearly identified as supplemental, not misleading and not presented with greater prominence than the required disclosure. While this does not provide registrants with the full flexibility of a principles based approach suggested by some commenters, we believe this ability to supplement the required disclosures will provide registrants with adequate discretion to provide sufficiently fulsome disclosure of the relationship between their performance and the compensation actually paid to their executives.

We also believe that absolute company performance alone, as reflected in TSR, may not be a sufficient basis for comparison between companies, and that peer group TSR will provide investors with more comprehensive information for assessing whether the registrant's performance was driven by factors common to its peers or instead by the registrant's own strategy and other choices. The final rules require a registrant to disclose weighted peer group TSR (weighted according to the respective issuers' stock market capitalization at the beginning of each period for which a return is indicated), using either the same peer group used for

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[284] *See supra* notes 251–252.

[285] *See infra* Section II.F.3.

purposes of Item 201(e) of Regulation S-K or a peer group used in the CD&A for purposes of disclosing registrants' compensation benchmarking practices. If the peer group is not a published industry or line-of-business index, the identity of the issuers composing the group must be disclosed in a footnote. A registrant that has previously disclosed the composition of issuers in its peer group in prior filings with the Commission would be permitted to comply with this requirement by incorporation by reference to those filings. We believe this would avoid the potential for duplicative disclosure. Consistent with the approach taken in Item 201(e) of Regulation S-K, as proposed, if a registrant changes the peer group used in its pay-versus-performance disclosure from the one used in the previous fiscal year, it will only be required to include tabular disclosure of peer group TSR for that new peer group (for all years in the table), but must explain, in a footnote, the reason for the change, and compare the registrant's TSR to that of both the old and the new group.[286] Some commenters advocated for more disclosure when a peer group changes (including requiring the disclosure of comparative results of TSR for all peer groups used in the disclosed time period), while other commenters suggested we only require disclosure of the current peer group. We believe the adopted approach strikes the appropriate balance of providing investors information when a peer group changes, while also not requiring overcomplicated disclosure. In addition, as proposed, we are requiring weighted peer group TSR, as calculated under Item 201(e) of Regulation S-K, as registrants are already familiar with this calculation.[287]

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[286] *See* 17 CFR 229.402(v)(2)(iv).

[287] To calculated weighted peer group TSR, the returns of each component issuer of the group must be weighted according to stock market capitalization at the beginning of each period for which a return is indicated. *See* Instruction 5 to Item 201(e) of Regulation S-K.

In response to commenters' questions about the calculation of TSR, we are clarifying the definition of "measurement period" in the final text of the rule. TSR will continue to be calculated on the same cumulative basis as is used in Item 201(e) of Regulation S-K, measured from the market close on the last trading day before the registrant's earliest fiscal year in the table through and including the end of the fiscal year for which TSR is being calculated (*i.e.*, the TSR for the first year in the table will represent the TSR over that first year, the TSR for the second year will represent the cumulative TSR over the first and the second years, *etc.*). We are also clarifying that both TSR and peer group TSR should be calculated based on a fixed investment of one hundred dollars at the measurement point. As noted by a commenter,[288] the TSR presented in the stock performance graph includes a starting investment amount on the y-axis, from which the subsequent TSR amounts are calculated. As the final rules mandate a tabular not graphical disclosure of TSR, we are clarifying that the TSR amounts should be calculated based on an initial fixed investment of one hundred dollars, to clarify for investors what amount is used to calculate the TSR figures, and to standardize the disclosure across registrants. We are not requiring, as suggested by some commenters, that TSR be calculated as a percentage change instead of a dollar value; be disclosed as a one-year measure; be calculated as a rolling average; or be calculated based on a time period chosen by the registrant as we believe all of those approaches would depart from the existing approach used in Item 201(e) of Regulation S-K, and therefore could be burdensome to registrants and confusing to investors. Similarly, we believe that permitting registrants to choose their own criteria for calculating their

[288] *See* letter from CAP (noting that "TSR is indexed based on a $100 investment while compensation is reported in dollars so the scales are fundamentally different" and suggesting that "[t]he easiest solution would be to require companies to calculate compensation actually paid for 6 years, with the sixth year indexed to 100, similar to TSR in the stock performance graph").

TSR and peer group TSR for the pay-versus-performance disclosure could also lead to investor confusion.

We disagree with commenters who raised concerns that peer group TSR would be confusing to investors, expensive to calculate, and hard to understand. Peer group TSR is already included in other disclosures, meaning both investors and registrants are generally familiar with it. While peer group TSR is not specifically included in Section 14(i), we believe it is a useful measure for evaluating a registrant's performance, as noted by other commenters, and we are therefore using our discretionary authority to require this additional information to enhance the Dodd-Frank Act mandated disclosures. As we described above, peer group comparisons are often used by registrants' compensation committees,[289] and may help in determining whether a registrant's performance was driven by factors common to its peers, which may have been outside of the control of its executives.

As discussed below,[290] to address commenters' concerns with respect to the proposal to use TSR and peer group TSR as the sole measures of performance (such as causing companies to adjust their compensation programs to more heavily rely on TSR), we are also requiring registrants to include net income and a Company-Selected Measure as performance measures in the tabular disclosure, and also permitting companies to voluntarily include additional measures of their choosing in the table, as suggested by some commenters.[291] The inclusion of the Company-Selected Measure and the ability of registrants to voluntarily include additional measures may also address commenters' concerns with respect to incentivizing short-term performance at the expense of shareholders' long-term best interests. We believe these

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[289] *See supra* note 69 and accompanying text.

[290] *See infra* Sections II.D.2; II.D.4; and II.F.3.

[291] *See supra* note 249.

additional measures should help alleviate concerns expressed by some commenters that disclosing only TSR (for a registrant and its peer group) would put too much emphasis on that one measure.

2. Requirement to Disclose Net Income

i. Amendments Considered in the Reopening Release

In the Reopening Release, we requested comment on requiring registrants to disclose both income or loss before income tax expense and net income in their pay-versus-performance disclosure.[292] We stated we were considering these two measures because in reflecting a registrant's overall profits (net of costs and expenses), they could be additional important measures of company financial performance that may be relevant to investors in evaluating executive compensation, and could complement the market-based performance measures required in the Proposing Release (TSR and peer group TSR) by also providing accounting-based measures of financial performance. In addition, both net income and income or loss before income tax expense are measures that are familiar to registrants and investors, as both are generally required to be presented on the face of the Statement of Comprehensive Income by Regulation S-X. Net income is also a line item required by U.S. GAAP and International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board.

ii. Comments

Commenters were divided over the potential inclusion of income or loss before income tax expense and net income. A number of commenters generally supported the inclusion of the

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[292] As discussed above, in this release, to be consistent with the language in Regulation S-X, we are using the phrase "income or loss before income tax expense" in lieu of the phrase "pre-tax net income," which was used in the Reopening Release. *See supra* note 33.

measures as additional measures in the table;[293] noting that they will be useful to investors in assessing executive compensation;[294] will cause minimal compliance challenges, as they are already calculated by registrants;[295] and will increase comparability.[296] However, other commenters opposed requiring registrants to disclose the measures,[297] noting they are not relevant for or comparable across all companies[298] (particularly early stage companies and real estate investment trusts ("REITs")[299]); are not used by many companies in setting executive compensation;[300] would be incomplete or misleading without appropriate context;[301] and can vary period over period due to one-time adjustments and events such that the relationship with

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293 *See* letters from As You Sow, dated Mar. 4, 2022 ("As You Sow 2022"); Better Markets; Better Markets, Institute for Policy Studies, Global Economy Project, and Public Citizen, dated Mar. 4, 2022 ("Better Markets et al."); CalPERS 2022; CalSTRS; CII 2022; ICGN; Mark C, dated Feb. 21, 2022 ("Mark C"); PRI; Public Citizen, dated Mar. 4, 2022 ("Public Citizen 2022"); Teamsters; and Troop Inc., dated Feb. 17, 2022 ("Troop").

294 *See* letters from As You Sow 2022; Better Markets; Better Markets et al.; CalPERS 2022; CalSTRS; CII 2022; ICGN (noting that net income "could be useful for companies that have a highly complex tax structure"); PRI; Public Citizen 2022; Teamsters; and Troop.

295 *See* letter from Better Markets; Better Markets et al.; PRI; and Public Citizen 2022.

296 *See* letter from PRI.

297 *See* letters from AB; Aon HCS; ASA; Center on Executive Compensation, dated Mar. 4, 2022 ("CEC 2022"); Davis Polk 2022; Dimensional; FedEx Corp., dated Mar. 4, 2022; Georgiev; Infinite; Legal & General Investment, dated Mar. 3, 2022 ("LGIM"); McGuireWoods; Nareit, dated Mar. 4, 2022 ("Nareit"); NAM 2022; NIRI 2022; PG 2022; SCG; and TCA 2022.

298 *See* letters from AB; CEC 2022; Dimensional; Infinite; LGIM; Nareit; NIRI 2022; PG 2022; and SCG.

299 *See* letters from Dimensional (noting that changes to a company's business plan (such as closing business lines, selling certain assets, or investing in research and development) could result in low or negative net income, "even though the strategies may ultimately pay off for shareholders over the long term"); Infinite (noting that income or loss before income tax expense and net income "may not provide reliable insight into the results of management's efforts at developmental or transitional stage companies"); LGIM (noting that "different growth stages" of a company might necessitate it focusing on metrics other than income metrics); Nareit (stating that "[d]ue to certain features of the way REITs are organized and operated under [F]ederal tax law as well as certain features of U.S. GAAP," income or loss before income tax expense and net income are not typically used by investors or management when evaluating the alignment of pay with performance for REITs); and NIRI 2022 (stating that income measures are "completely impractical as measures of financial performance for smaller companies that are at a startup or early phase and not generating any net income under GAAP").

300 *See* letter from ASA; CEC 2022; and Davis Polk.

301 *See* letters from ICGN; Infinite; and PG 2022.

pay would be distorted.[302] Other commenters opposed the measures more generally, as non-company-specific measures, indicating their inclusion would "substantially lengthen" the pay-versus-performance disclosure, without providing specific insight into the registrant,[303] would not address the shortcomings of TSR because they have similar weaknesses (such as encouraging short-termism or "overemphasiz[ing] financial performance"),[304] or would stifle innovation by encouraging more uniform compensation structures given the standardized disclosure across registrants.[305]

iii. Final Amendments

We are adopting the final rules to require registrants to include net income in their tabular disclosure. As discussed above,[306] registrants would also be required to provide a clear description of the relationship of net income to executive compensation actually paid, in narrative or graphical form, or a combination of the two.

Although, as noted by some commenters, net income itself may not be frequently used by registrants directly in setting compensation, we believe that net income is closely related to other profitability measures that we believe, based on Commission staff experience, may be used by registrants in setting compensation, while also being widely understood and standardized, as a required disclosure item under Regulation S-X, U.S. GAAP, and IFRS. The inclusion of net income as an additional financial performance measure could complement the market-based performance measure of TSR, and, to the extent that TSR does not (in the view of

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302 *See* letter from Dimensional Infinite; and PG 2022.

303 Letter from Aon HCS.

304 *See* letters from Georgiev; and McGuireWoods.

305 *See* letter from SCG.

306 *See supra* Section II.A.2.iii.

management) fully reflect a company's performance, could help to provide investors more ready access to an additional key measure of the company's recent financial performance. As noted in the Reopening Release, to the extent that net income would otherwise be considered by investors when evaluating the alignment of pay with performance, its inclusion in the table may lower the burden of analysis for those investors.

We also believe that the standardized disclosure of net income could assist investors in generally understanding and analyzing the relationship between pay and performance. While, as noted by some commenters, net income may not be relevant for all registrants at all times,[307] including it may allow investors to have a standard baseline from which to analyze a registrant's pay-versus-performance disclosure. Moreover, by requiring a Company-Selected Measure and giving registrants the ability to disclose additional registrant-specific measures, we believe registrants can avoid concerns raised by commenters that financial performance would be overemphasized or disclosure overly standardized[308] by the required disclosure of net income.

The final rules do not require disclosure of income or loss before income tax expense, as considered in the Reopening Release. Net income and income or loss before income tax expense are highly correlated,[309] so we believe requiring both could lead to unnecessarily duplicative disclosure, which could have raised questions for investors trying to understand what, if any, meaningful differences there were between the measures. This potentially duplicative disclosure also would have required registrants to prepare additional relationship disclosure (about the relationship between income or loss before income tax and executive

[307] *See supra* notes 298–300 and accompanying text.

[308] *See supra* notes 304–305 and accompanying text.

[309] Based on staff analysis of data from Compustat, net income and income or loss before income tax expense are roughly 95 percent correlated.

compensation actually paid), which would have created an additional burden on registrants, and may have been less clear for investors. By requiring only one of the two net income measures, we also partially address the concern that adding both net income and income or loss before income tax expense could "substantially lengthen" the pay-versus-performance disclosure. In addition, we believe net income may, based on statistics provided by a commenter, be used by significantly more companies in linking pay to performance than income or loss before income tax expense.[310]

3. Tabular List of the Registrant's "Most Important" Performance Measures

i. Amendments Considered in the Reopening Release

In the Reopening Release, we requested comment on requiring registrants to provide a ranked tabular list of the five[311] most important measures that they use to link executive compensation actually paid during the fiscal year to company performance, over the time horizon of the disclosure. We requested comment on the inclusion of such a ranked list, in part, in response to commenters who stated that the proposal should be revised to require disclosure of the quantitative metrics or key performance targets companies actually use to set executive pay.[312] We noted that this disclosure, if required, would be supplemental to the existing CD&A disclosure, which requires registrants to disclose "all material elements of the compensation paid," including, for example, which "specific items of corporate performance are taken into account in setting compensation policies and making compensation decisions," but does not specifically mandate disclosure of the performance measures that determined the level of recent

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[310] *See* letter from CEC 2022.

[311] The Reopening Release provided that, if the registrant considers fewer than five performance measures when it links executive compensation actually paid during the fiscal year to company performance, the registrant would be required to disclose only the number of measures it actually considers.

[312] *See, e.g.*, letters from AFL-CIO 2015; CII 2015; Public Citizen 2015; and SBA-FL.

NEO compensation actually paid. We noted that, under the considered approach, registrants would be able to cross-reference to existing disclosures elsewhere in the applicable disclosure document that describe the various processes and calculations that go into determining NEO compensation as it relates to these performance measures, if they elected to do so.

ii. Comments

A number of commenters supported the inclusion of a ranked list.[313] Some of the commenters who supported the ranked list also suggested additional disclosures to supplement the list itself, including requiring "clear description of the relationship between the measures and executive compensation,"[314] the metrics and methodology used to calculate the measures,[315] and the "percentage of total compensation paid at the vesting date" with respect to each of the measures included in the list.[316] In addition, some commenters supported requiring or permitting environmental, social and governance ("ESG") metrics to be included in the ranked list.[317] One commenter also specifically supported using a tabular format for the list, stating that it would help make company-to-company comparisons.[318]

[313] *See* letters from As You Sow 2022; Better Markets; Better Markets et al.; CalSTRS; Ceres and Ceres Accelerator for Sustainable Capital Markets, dated Mar. 4, 2022 ("Ceres"); CII 2022; Dimensional; Infinite; ICGN; Mark C (stating that the list "would give investors greater transparency into [registrants'] policies as well as more tangible metrics by which to make their investment decisions"); PRI; Public Citizen 2022; and Responsible Asset Allocator Initiative at New America, and The Predistribution Initiative, dated Mar. 3, 2022 ("RAAI"); *see also* letter from AFREF (supporting the ranked list as an alternative to not disclosing 'all' performance measures).

[314] Letter from PRI.

[315] *See* letter from ICGN.

[316] Letter from Infinite.

[317] *See* letters from As You Sow 2022; Better Markets; Ceres; PRI; Public Citizen 2022; and RAAI.

[318] *See* letter from ICGN.

A number of other commenters opposed the ranked list,[319] with some indicating that its ranking requirement would be difficult to satisfy, as registrants do not rank their measures in the compensation setting process and measures can interact in determining pay in complex ways. Some commenters objected that the list oversimplifies the compensation setting process, particularly because there could be difficulty ranking multiple measures, which might be related or hold equal importance at any given time.[320] Others indicated the list and associated clarifications and explanations would increase the length and complexity of disclosure and associated burdens with little or no corresponding benefit.[321] In contrast, one commenter indicated that it was not aware of any additional costs to disclose the five most important performance measures, and that the disclosure of sensitive or competitive information should not be necessary to provide the list.[322] One commenter suggested that the ranked list was beyond the scope of the Dodd-Frank Act mandate,[323] and others noted that similar disclosure is already available in the CD&A.[324]

There were also a number of commenters who commented on the "most important" concept, which we considered applying both to the ranked list and the Company-Selected Measure (discussed below). Two commenters suggested that defining the "most important" measures would be burdensome for companies,[325] particularly given that many companies

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[319] *See* letters from Aon HCS; ASA; CEC 2022; Davis Polk 2022; IBC 2022; McGuireWoods; NAM 2022; NIRI 2022; PG 2022; SCG; and TCA 2022.

[320] *See* letters from Aon HCS; Davis Polk 2022; IBC 2022; LGIM; NAM 2022; and SCG.

[321] *See* letters from Aon HCS; CEC 2022; Davis Polk 2022; and IBC 2022.

[322] *See* letter from ICGN.

[323] *See* letter from SCG.

[324] *See* letters from CEC 2022; Davis Polk 2022; McGuireWoods; and SCG.

[325] *See* letters from Davis Polk 2022 and NAM 2022.

overlap and interrelate the measures they use to set compensation. One commenter, who opposed the requirement to include a Company-Selected Measure, stated that, if a "most important" concept is included in the final rules, the Commission should not define "most important" on behalf of registrants.[326] However, another commenter suggested that the Commission make explicit that the "most important" measures are those that drove the outcome of compensation payments, not those that were the most important in compensation decision-making.[327] Some commenters suggested that the Commission clarify whether certain market-linked measures could be considered the "most important" measures,[328] with one suggesting that companies should be able to select the measure they believe to be most important "regardless of whether that measure is one that it uses in a performance or market condition in the context of an incentive plan."[329] One commenter suggested that the "most important" concept would be improved, "if the definition includes the registrant's assessment that the measure will assist investors in better understanding how the registrant's pay programs contribute to the company's long-term shareholder return,"[330] while another suggested that the standard to evaluate "most important" should be "most useful" for the company.[331]

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[326] *See* letter from Davis Polk 2022.

[327] *See* letter from Infinite.

[328] *See* letters from Georgiev and Infinite.

[329] Letter from Davis Polk 2022 (opposing the requirement to include a Company-Selected Measure, but stating that, if it is required, the measure should be able to be one that is not linked to a performance or market condition). *See also Executive Compensation and Related Person Disclosure* Release No. 33-8732A (Aug. 29, 2006) [71 FR 53158] at n. 167 (discussing the use of performance conditions and market conditions in equity incentive plans).

[330] Letter from CII 2022.

[331] *See* letter from ICGN.

A number of commenters supported allowing the companies' "most important" measures to be non-financial measures.[332]

Two commenters specifically commented on the time period over which the "most important" measures should be measured: one supported using the measure that was the "most important" over the time horizon of the disclosure,[333] while the other suggested that the "most important" evaluation should be made annually.[334]

A few commenters were concerned that requiring companies to disclose a specific "most important" measure may lead companies to provide disclosure that highlights the measure that makes the company look the best.[335]

iii. Final Amendments

The final rules require registrants provide a list of their most important financial performance measures used by the registrant to link executive compensation actually paid during the fiscal year to company performance ("Tabular List"), and permit registrants to include non-financial performance measures in the Tabular List if such measures are among their most important performance measures.[336] However, in response to comments received on

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[332] *See* letters from AFREF; As You Sow 2022; Better Markets; CalSTRS; Ceres; CII 2022; Georgiev; PRI; and RAAI. *See also* letter from LWC (stating that companies should be required to discuss ESG metrics, and if ESG metrics are not used by the company, "the company should be required to explain why not").

[333] *See* letter from CII 2022.

[334] *See* letter from Davis Polk 2022.

[335] *See* letters from AFL-CIO 2022; AFREF; and Mark C.

[336] *See* 17 CFR 229.402(v)(6). We are clarifying that the measures required to be included in the registrant's list of its most important financial measures are "financial performance measures," given that the language in Section 14(i) specifically references financial performance. For purposes of Item 402(v) of Regulation S-K, as adopted,"financial performance measures" means measures that are determined and presented in accordance with the accounting principles used in preparing the issuer's financial statements, any measures that are derived wholly or in part from such measures, and stock price and total shareholder return. A financial performance measure need not be presented within the financial statements or otherwise included in a filing with the Commission to be included in the Tabular List or be the Company-Selected Measure. *See* 17 CFR 229.402(v)(2)(vi). "Non-financial performance measures" are performance measures other than those that fall within the definition of financial performance measures.

the Reopening Release, certain of the requirements for this list differ from the approach discussed in the Reopening Release.

First, in response to comments, we are not requiring the Tabular List to be ranked. As noted by a number of commenters, numerically ranking measures may be difficult for companies, given the frequent interplay between different measures within a company's compensation program. We believe an unranked list will provide investors with insights into companies' executive compensation programs by still presenting them with the "most important" measures, while avoiding potentially burdensome calculations and analysis that could be involved in specifically designating a first, second, third, *etc.* "most important" measure. We are not requiring registrants to provide the methodology used to calculate the measures included in the Tabular List. We believe such a requirement would be burdensome on registrants, particularly when the measures are already well understood by investors or otherwise disclosed. However, registrants should consider if such disclosure would be helpful to investors to understand the measures included in the Tabular List, or necessary to prevent the Tabular List disclosure from being confusing or misleading.

Second, under the final rules, the "most important" determination is made on the basis of looking only to the most recently completed fiscal year, as opposed to "the time horizon of the disclosure," as described in the Reopening Release. We believe this approach will alleviate commenters' concerns that identifying the "most important" measures would be difficult, particularly when companies have overlapping or interrelating measures, by narrowing the universe of measures to be considered when selecting the "most important" to those used in the prior year (instead of the prior five years). In addition, we believe focusing the disclosure on the registrant's "most recently completed fiscal year" will accommodate changes in compensation programs and in the compensation related to specific measures over time, and avoid situations where a registrant is disclosing measures that are no longer used in, or important to, its executive compensation program, but would still be "most important" based on the measure's usage in prior years disclosed in the table.

Finally, although the Reopening Release considered a list that would include the five most important measures, the final rules we are adopting require disclosure of at least three,[337] and up to seven financial performance measures,[338] and also permit registrants to include non-financial performance measures in that list. We believe that providing registrants with flexibility in the number of measures they can include in the list may also lessen the difficulty, noted by commenters, of identifying a registrant's "most important" measures. For example, a registrant with three, four, five, or six equally "most important" measures would not need to increase or decrease their "most important" measure disclosure to specifically disclose five measures. We acknowledge that, for certain issuers, this concern may still remain due to the minimum of three and limit of seven measures imposed by the final rules; however we are of the view that

337 If the registrant considers fewer than three financial performance measures when it links executive compensation actually paid during the fiscal year to company performance, under the final rules and as considered in the Reopening Release, the registrant will be required to disclose only the number of measures it actually considers. Registrants that do not use any financial performance measures to link executive compensation actually paid to company performance would not be required to present a Tabular List.

338 Based on staff experience, the majority of companies use fewer than seven metrics, in total, in their incentive plans. *See also, e.g.*, Meridian Compensation Partners, LLC, 2020 Trends and Developments in Executive Compensation (April 30, 2020), *available at* https://www.meridiancp.com/wp-content/uploads/Meridian-2020-Trends-and-Developments-Survey-Final.pdf ("Meridian 2020 Survey") (indicating that, while the measures used in long-term and annual incentive plans are often different, only 2% of 108 companies surveyed by Meridian used three or more performance measures in their long-term incentive plans or their annual incentive plans); and Aon plc, *The Latest Trends in Incentive Plan Design as Firms Adjust Plans Amid Uncertainty* (October 2020), *available at* https://humancapital.aon.com/insights/articles/2020/the-latest-trends-in-incentive-plan-design-as-firms-adjust-plans-amid-uncertainty ("Aon 2020 Study") (surveying the CEO short- and long-term incentive plans at a sample of the S&P 500, across all industries, and finding that for short-term incentive plans, "[a]ll industries, excluding energy, reveal most companies use one to two metrics" and that "[a]cross all sectors of the S&P 500, companies, on average, use two metrics for long-term incentives"). Given this, we believe a range of at least three and up to seven metrics should give almost all companies flexibility in listing their "most important" measures, even if they determine that all of their financial performance measures are the "most important."

providing an upper bound for the list will reduce the risk of lengthy, overly complicated lists, which would fail to advance the statutory objective of providing clear and simple comparisons of pay with performance. In addition, we believe allowing an unlimited number of measures could in some cases result in misleading or confusing disclosures by obscuring which performance measures are principally driving compensation actually paid.

As discussed in the Reopening Release, the final rules specify that measures required to be included in the Tabular List are financial performance measures that, in the registrant's assessment, represent the most important financial performance measures used by the registrant to link compensation actually paid during the fiscal year to company performance. As discussed in the Reopening Release, we believe that a list of the measures that the registrant assesses to be the "most important" may enable investors to more easily assess which performance measures actually have the most impact on compensation actually paid and make their own judgments as to whether that compensation appropriately incentivizes management. In addition, we believe this list will provide investors with helpful context for interpreting the pay-versus-performance disclosure, more generally, particularly when analyzing the other measures included in the table, by showing which (if any) of those measures are considered "important" by the registrant, in determining pay. While we recognize that some commenters supported permitting non-financial performance measures to be included in the list, the final rules specify that the only required disclosures in the Tabular List are "financial performance measures" given the "financial performance" language in Section 14(i). However, in response to commenters, the final rules provide that registrants have the option of including non-financial performance measures in the Tabular List. Registrants may do so only if such measures are included in their three to seven most important performance measures, and they have disclosed at least three (or fewer, if the registrant only uses fewer) most important financial performance measures. Regardless of whether registrants elect to disclose non-financial performance measures in their Tabular List, they still may only disclose a maximum of seven measures in the list.

Under the final rules, registrants may disclose the Tabular List in three different ways.[339] First, registrants may present one list with at least three, and up to seven, performance measures, which in the registrant's assessment represent the most important performance measures used by the registrant to link compensation actually paid to the registrant's NEOs, for the most recently completed fiscal year, to company performance, similar to the ranked list contemplated in the Reopening Release.

Second, registrants may break up the Tabular List disclosure into two separate lists: one for the PEO and one for the remaining NEOs. Third, registrants may break up the Tabular List disclosure into separate lists for the PEO and each NEO. If the registrant elects to provide the Tabular List disclosure in multiple lists (the second or third options, described above), each list must include at least three,[340] and up to seven, financial performance measures. As in situations where a registrant elects to provide one Tabular List, registrants electing to provide the Tabular List disclosure in multiple lists may include non-financial performance measures in such lists if such measures are among their most important performance measures. Requiring the Tabular List to include measures related to both PEO and NEO compensation is consistent with the approach taken throughout Item 402(v) of Regulation S-K and we believe this consistency in disclosure will make the disclosure more readily understandable to investors.

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339 *See* 17 CFR 229.402(v)(6)(i).

340 If the registrant considers fewer than three financial performance measures when it links compensation actually paid to the specific NEO (or group of NEOs) included in the list, during the fiscal year to company performance, the registrant will be required to disclose only the number of measures it actually considers.

As noted above, commenters suggested that such a list was beyond the scope of the Dodd-Frank Act mandate, and that similar disclosure is already available in the CD&A.[341] We believe the Tabular List would further the objectives of the Section 14(i) mandated disclosure, as it provides another avenue for investors to understand the relationship between executive compensation actually paid and the registrant's financial performance. It is within our authority to specify the form and content of this disclosure as well as to require additional information to enhance the Dodd-Frank Act mandated disclosures. While it is possible that some registrants provide similar disclosure in the CD&A, we note that the CD&A requires disclosure of performance measures that are "material elements of the registrant's compensation of named executive officers,"[342] not the "most important" measures used by the registrant to link executive compensation actually paid to company performance. There would be an overlap between those two disclosure requirements when the "most important" measures are also "material elements of the registrant's compensation of named executive officers"; however, they are not necessarily the same. Even in situations where the performance measures included in the Tabular List are already included in CD&A disclosure, we believe that the presentation of the measures in the Tabular List should allow investors to more readily understand what measures in the registrant's view are the "most important" to its compensation program, and thus better understand the relationship between registrant performance and executive compensation, as the statute provides.

Finally, as considered in the Proposing Release, under the final rules, registrants may cross-reference to other disclosures elsewhere in the applicable disclosure document that

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341 *See* letters from CEC 2022; Davis Polk 2022; McGuireWoods; and SCG.

342 Item 402(b) of Regulation S-K.

describe the registrant's processes and calculations that go into determining NEO compensation as it relates to these performance measures, if they elect to do so.

4. Requirement to Disclose a Company-Selected Measure

i. Amendments Considered in the Reopening Release

The Reopening Release requested comment on requiring registrants to disclose a Company-Selected Measure – a measure that in the registrant's assessment represents the most important performance measure (that is not already included in the table) used by the registrant to link executive compensation actually paid during the fiscal year to company performance, over the time horizon of the disclosure. We considered adding this requirement in order to both provide additional useful disclosure to investors regarding the measures the registrant actually used to set compensation, and to lessen the likelihood that the mandated measures in the tabular disclosure would misrepresent or provide an incomplete picture of how pay relates to performance. We believed that requiring disclosure of a Company-Selected Measure would not be overly burdensome on registrants, as, by definition, the Company-Selected Measure would be a measure already considered by registrants when making executive compensation determinations, and may already be discussed, in a different form, in the CD&A.

ii. Comments

A number of commenters provided feedback on potential disclosure of a Company-Selected Measure, as discussed in the Reopening Release. Some commenters supported mandatory disclosure of a Company-Selected Measure,[343] with one suggesting that the Company-Selected Measure (or Measures) should be the only mandated performance

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[343] *See* letters from As You Sow 2022; Better Markets; CalPERS 2022; CalSTRS; Dimensional; Georgiev; Infinite; ICGN; Nareit (specifically supporting the fact that it would provide REITs with flexibility to disclose a measure more relevant for them); PG 2022; PRI; RAAI; Teamsters; and Troop.

measure(s).[344] One commenter, who generally favored requiring registrants to disclose "all" measures used by registrants in linking executive compensation paid to performance, suggested that the Company-Selected Measure should be limited to financial measures, to provide an "alternative" to TSR, and suggested that companies should be permitted to omit the Company-Selected Measure if they do not have a single measure used to assess financial performance for compensation purposes.[345] Another commenter suggested requiring the disclosure of multiple Company-Selected Measures, such as three such measures, with corresponding peer group disclosure to prevent registrants from "cherry-pick[ing] measures."[346] Other commenters suggested that the Company-Selected Measure should be based on the compensation paid to the PEO, not all of the NEOs.[347]

Some commenters suggested that the Company-Selected Measures be disclosed alongside the methodology used to calculate it,[348] with two commenters specifically suggesting the Company-Selected Measure must be "auditable/assurable"[349] or accompanied by "an explanation of its calculation and a complete GAAP reconciliation, if possible."[350] Two commenters specifically said that, if ESG metrics are used as Company-Selected Measures, additional information about the metrics used should be disclosed.[351]

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344 *See* letter from NAM 2022.

345 *See* letter from Georgiev.

346 Letter from Dimensional; *see also* letter from Georgiev (suggesting registrants be permitted to include multiple Company-Selected Measures).

347 *See* letter from Davis Polk 2022 (opposing the mandatory disclosure of a Company-Selected Measure, but stating that, if it is required, it should be based on compensation paid to the PEO) and Infinite.

348 *See* letters from AFREF; CII 2022; and ICGN.

349 Letter from ICGN.

350 Letter from Teamsters.

351 *See* letters from Dimensional and PRI.

A number of commenters opposed the mandatory inclusion of a Company-Selected Measure,[352] stating that the idea that there is one "most important" measure "oversimplifies" the compensation setting process,[353] and that different measures cannot be considered in "isolation."[354]

As discussed above, a number of commenters supported allowing the companies' "most important" measures to be non-financial measures,[355] with some supportive of allowing non-financial measures to be a registrant's Company-Selected Measure.[356] Other commenters opposed either allowing non-financial measures to be included as Company-Selected Measures, indicating that doing so "would be at odds with both the language and intent of Section 953(a),"[357] or requiring or encouraging companies to incorporate ESG metrics in setting executive pay.[358]

Commenters were divided on whether Company-Selected Measures should be permitted to be changed from year to year, and if so, what disclosure should be required. One commenter was directly opposed to regular changes in the Company-Selected Measure, stating the measure should be required to remain the same for at least five years, in order to avoid companies

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352 *See* letters from Aon HCS; ASA; CEC 2022; Davis Polk 2022; IBC 2022; McGuireWoods; and TCA 2022 (stating that the Company-Selected Measure should be "allow[ed] for," while other prescribed measures should be eliminated).

353 Letter from IBC 2022.

354 Letter from CEC 2022.

355 *See supra* note 332. *See also* letter from Davis Polk 2022 (opposing the mandatory disclosure of a Company-Selected Measure, but stating that, if it is required, "it should be permitted to encompass factors other than measures that relate to financial performance").

356 *See* letters from AFREF; CII 2022; Ceres; and PRI.

357 *See* letter from Center for Capital Markets Competitiveness, dated Mar. 4, 2022.

358 *See* letter from Dimensional.

rationalizing the "best" measure each year.[359] Other commenters supported allowing annual changes to the Company-Selected Measure, so long as accompanying disclosure about the reason for the change or a period of disclosure of the 'old' and 'new' measures was provided.[360] One commenter alternatively suggested that the Company-Selected Measure should be the "most important" measure over a given period, and not the "most important measure" for all five years in the table.[361]

One commenter suggested that, if the "most important" measure is already included in the tabular disclosure, the next-most important measure should be included as the Company-Selected Measure,[362] while another commenter (who generally opposed the inclusion of the Company-Selected Measure) stated that, if it is a measure otherwise required to be disclosed in the table, the Company-Selected Measure should be able to be an already-included measure.[363]

iii. Final Amendments

The final rules require registrants to disclose a Company-Selected Measure in the table required under new 17 CFR 229.402(v)(1). The Company-Selected Measure must be a financial performance measure included in the Tabular List, which in the registrant's assessment represents the most important performance measure (that is not otherwise required to be disclosed in the pay-versus-performance table required under new Item 402(v) of Regulation S-K) used by the registrant to link compensation actually paid to the registrant's NEOs, for the

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[359] *See* letter from Better Markets et al.

[360] *See* letters from CalPERS 2022; CII 2022; Davis Polk 2022 (opposing the mandatory disclosure of a Company-Selected Measure, but stating that, if it is required, it should allow for variability over different years); ICGN; and Troop.

[361] *See* letter from PG 2022.

[362] *See* letter from PDI.

[363] *See* letter from Davis Polk 2022.

most recently completed fiscal year, to company performance. If the registrant's "most important" measure is already included in the tabular disclosure, the registrant would select its next-most important measure as its Company-Selected Measure. As discussed above,[364] registrants would also be required to provide a clear description of the relationship of the Company-Selected Measure to executive compensation actually paid, in narrative or graphical form, or a combination of the two.[365]

We believe that providing a quantified Company-Selected Measure, along with the Tabular List, will provide investors with useful context for understanding the measures actually used by registrants in their compensation programs. In order to allow investors to understand the measure that is most important, we are only requiring registrants to provide one Company-Selected Measure. However, we recognize some registrants may have additional performance measures (including non-financial measures) that they believe are "important" measures and that could warrant quantified disclosure. We note that, under the Plain English principles (discussed below[366]), registrants may provide additional performance measures as new columns in the table. However, such additional disclosures may not be misleading or obscure the required information, and the additional performance measures may not be presented with greater prominence than the required disclosure.[367] If a registrant elects to provide any

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[364] *See supra* Section II.A.2.iii.

[365] As with the Tabular List, we are also not requiring registrants to provide the methodology used to calculate the Company-Selected Measure. We believe such a requirement would be overly burdensome on registrants, particularly when the measure is already well understood by investors or otherwise disclosed. However, registrants should consider if such disclosure would be helpful to investors to understand the Company-Selected Measure, or necessary to prevent the Company-Selected Measure disclosure from being confusing or misleading.

[366] *See infra* Section II.F.3.

[367] Consistent with the Plain English principles, if a registrant elects to include multiple additional measures in the table, it should consider whether the addition of those measures modifies the disclosure in such a way that the disclosure becomes misleading, the required information in the table becomes obscured, or the additional

additional performance measures in the table, each additional measure must also be accompanied by a clear description of the relationship between executive compensation actually paid to the registrant's PEO, and, on average, to the other NEOs, and that measure.[368] We believe clarifying that registrants have the flexibility to include additional measures will, to some degree, alleviate concerns raised by some commenters in response to the Reopening Release that selecting one Company-Selected Measure was overly simplistic and did not reflect how companies actually approach their compensation programs, while also providing registrants the opportunity to provide context to the other mandatory measures disclosed in the table.

As the Company-Selected Measure must be a measure included in the Tabular List,[369] the determination of "most important" that registrants must use for selecting Company-Selected Measures is the same as the determination they must use for selecting required measures for the Tabular List (*i.e.*, the "most important" determination is made based on the most recently completed fiscal year and the measures required to be disclosed are financial measures of performance). We are limiting the measures required to be included in the Tabular List (and to be included as the Company-Selected Measure) to financial performance measures given the statutory language referencing "the relationship between executive compensation actually paid and the *financial performance* of the issuer."[370] We recognize that some registrants may

measures are presented with greater prominence than the required disclosure. In addition, in situations where registrants elect to describe multiple measures because they believe multiple measures are equally the "most important," they would still be required to select one Company-Selected Measure, but could provide explanatory disclosure, for example, about why additional measures are added and the reason that the Company-Selected Measure was selected.

368 *See* 17 CFR 229.402(v)(5).

369 *See* 17 CFR 229.402(v)(2)(vi).

370 15 U.S.C. 78n(i) (emphasis added).

consider one or more non-financial performance measures to be their most important measures for executive compensation purposes. In addition to the option under the final rules to include such measures in the Tabular list, under the Plain English principles, those registrants can supplement their mandatory pay-versus-performance disclosure with disclosure about those non-financial performance measures, as discussed below.[371]

The table will include the numerically quantifiable performance of the issuer under the Company-Selected Measure for each covered fiscal year. For example, if the Company-Selected Measure for the most recent fiscal year was total revenue, the company would disclose its quantified total revenue performance in each covered fiscal year. The Company-Selected Measure could change from one filing to the next, and we acknowledge that some commenters were concerned that registrants may change their Company-Selected Measure in order to present the relationship of pay to performance in a positive light.[372] However, we believe limiting the Company-Selected Measure to compensation linked to performance for the most recently completed fiscal year will provide investors with visibility into the registrant's current executive compensation program, and avoid situations in which the Company-Selected Measure is not a measure that is currently used by the registrant (*i.e.*, when a measure is only the "most important" measure based on historical usage). In addition, as is the case for the Tabular List, we believe limiting the Company-Selected Measure to the most recent fiscal year will allow registrants to more easily calculate and assess which measure is the "most important."

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371 *See infra* Section II.F.3.

372 *See* letters from Better Markets *et al.* (suggesting that the Company-Selected Measure should remain the same for five years to prevent firms from using a measure that best justifies compensation in a given year); *see also* letters from CalPERS 2022 (suggesting that if the Company-Selected Measure is changed, the prior and current Company-Selected Measures should both be reported for some period of time).

Similarly to the Tabular List, we do not believe it would be appropriate to limit the Company-Selected Measure to a measure relating only to the PEO's compensation, because our understanding is that Congress intended for the rules to provide disclosure about both PEOs and the remaining NEOs.

We are not mandating that the methodology used to calculate the Company-Selected Measure be included in the registrant's disclosure. However, as discussed above,[373] registrants will be required to provide a narrative, graphical, or combined narrative and graphical description of the relationships between executive compensation actually paid to the PEO, and, on average, the other NEOs, and the Company-Selected Measure, and may cross-reference to other disclosures elsewhere in the applicable disclosure document that describe the processes and calculations that go into determining NEO compensation as it relates to the Company-Selected Measure, if they elected to do so. In addition, registrants are permitted to supplement their Company-Selected Measure disclosure, so long as any additional disclosure is clearly identified as supplemental, not misleading and not presented with greater prominence than the required disclosure.

Further, we recognize that a registrant's Company-Selected Measure, or additional measures included in the table, may be non-GAAP financial measures. Under existing CD&A requirements, if a company discloses a target level that applies a non-GAAP financial measure in its CD&A, the disclosure will not be subject to the general rules regarding disclosure of non-GAAP financial measures, but the company must disclose how the number is calculated from

[373] *See supra* Section II.A.2.iii.

its audited financial statements.[374] Because the disclosure required by the final rules is intended, among other things, to supplement the CD&A, we believe it is appropriate to treat non-GAAP financial measures provided under Item 402(v) of Regulation S-K consistently with the existing CD&A provisions. As a result, the final rules specify that disclosure of a measure that is not a financial measure under generally accepted accounting principles will not be subject to Regulation G and Item 10(e) of Regulation S-K; however, disclosure must be provided as to how the number is calculated from the registrant's audited financial statements.

E. Time Period Covered

1. Proposed Amendments

We proposed requiring all registrants, other than SRCs, to provide the pay-versus-performance disclosure for the five most recently completed fiscal years, and requiring SRCs to provide disclosure for the three most recently completed fiscal years. We also proposed providing transition periods for registrants: SRCs would only be required to provide the Item 402(v) of Regulation S-K disclosure for the last two fiscal years in the first applicable filing after the rules became effective; and all other registrants would be required to provide the disclosure for three fiscal years, in the first applicable filing after the rules became effective, and to provide disclosure for an additional year in each of the two subsequent annual proxy filings where disclosure is required.

The Proposing Release also provided that the pay-versus-performance disclosure would only need to be provided for years in which a registrant was a reporting company pursuant to

[374] *See* Instruction 5 to Item 402(b) of Regulation S-K. The general non-GAAP financial measure provisions are specified in Regulation G [17 CFR 244.100 through 102] ("Regulation G") and Item 10(e) of Regulation S-K [17 CFR 229.10(e)] ("Item 10(e) of Regulation S-K").

Section 13(a) of the Exchange Act[375] or Section 15(d) of the Exchange Act[376] ("Section 15(d)"), consistent with the phase-in period for new reporting companies in their Summary Compensation Table disclosure.[377]

2. Comments

Several commenters supported the proposed disclosure periods,[378] while several others generally opposed them.[379] Some commenters who opposed the proposed disclosure periods stated that the periods were too short to measure management's performance;[380] while others argued the periods were too long, creating burdensome costs for registrants, and were inconsistent with other approaches taken in the proxy statement.[381]

Commenters suggested a number of different alternative time periods. Some commenters suggested permitting registrants to voluntarily disclose additional years in the tabular disclosure,[382] while others opposed permitting additional years of disclosure.[383] Some other commenters recommended the Commission use a three-year period,[384] with some of those commenters noting that three-year periods will have less NEO turnover, meaning registrants

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375 15 U.S.C. 78m(a).

376 15 U.S.C. 78o(d).

377 *See* Instruction 1 to 17 CFR 229.402(c) and Instruction 1 to 17 CFR 229.402(n).

378 *See* letters from CII 2015; CFA; Farient; LWC; OPERS; Quirin; SVA; and TIAA.

379 *See* letters from AON; BorgWarner; CEC 2015; Celanese; Hay; Hyster-Yale; McGuireWoods; NACCO; PNC; SCG; and WorldatWork.

380 *See* Letters from Hyster-Yale and NACCO.

381 *See* letters from BorgWarner; Celanese; Hay; and WorldatWork.

382 *See* letters from CFA; NACD 2015; Andrea Pawliczek, dated Mar. 4, 2022; and Simpson Thacher.

383 *See* letters from Barnard 2015 and Quirin.

384 *See* letters from AON; Celanese; FSR; Hay; Honeywell; McGuireWoods; SCG; and WorldatWork; *see also* letters from Davis Polk 2015 and Davis Polk 2022 (each recommending a one-year period, but suggesting a three-year period as an alternative to their suggestion).

will need to make less explanatory disclosure.[385] One commenter suggested we only require the disclosure for one year.[386] Another commenter suggested allowing registrants to set the time period covered, with a minimum requirement, such as three years.[387] Finally, one commenter did not propose a specific time period, but rather suggested the longer the period the better.[388]

Commenters were also divided on the suggested transition period. Some commenters supported the transition period,[389] while one commenter opposed it.[390] Others questioned whether there would be significant enough costs to justify applying a transition period.[391] One commenter specifically supported a transition period for newly public companies.[392]

Commenters offered a few alternatives to the proposed transition period, including a one-year transition period, not requiring reporting until the anniversary of the effective date of the rule,[393] and a longer transition period.[394]

3. Final Amendments

We are adopting the time periods as proposed. We believe that requiring registrants, other than SRCs, to provide pay-versus-performance disclosure for a five year period will provide a meaningful period over which a relationship between annual measures of pay and performance over time can be evaluated. Further, we are requiring that the disclosure be in order

385 *See* letters from AON and SCG.

386 *See* letters from Davis Polk 2015 and Davis Polk 2022.

387 *See* letter from Hall.

388 *See* letter from Hermes.

389 *See* letters from BRT; CFA; Hook; McGuireWoods; and TIAA.

390 *See* letter from Barnard 2015.

391 *See* letters from CII 2015 and Hermes.

392 *See* letter from Pearl.

393 *See* letters from BRT and NIRI 2015.

394 *See* letter from Pearl.

beginning with the most recent fiscal year. We believe that requiring a shorter time period, for all registrants, may not provide investors with enough data to evaluate the pay-versus-performance relationship, while requiring a longer period may be overly burdensome to registrants. We also believe that the scaled disclosure requirement under which SRCs may elect to provide three years of pay-versus-performance disclosure will provide investors with an appropriate time horizon over which to observe a relationship between pay and performance, while also remaining consistent with the scaled-disclosure approach generally applied to SRCs under our executive compensation rules. While SRCs generally are only required to provide two years of executive compensation disclosure in filings with the Commission, because the final rules include a transition period that permits an existing SRC to provide two years of disclosure, instead of three, in the first applicable filing after the rules become effective, and three years of disclosure in subsequent filings, we do not believe requiring three years of pay-versus-performance data will be unduly burdensome on SRCs.[395]

We are also adopting the transition periods and the requirement that a registrant provide pay-versus-performance disclosure only for years that it was a reporting company pursuant to Section 13(a) or Section 15(d) of the Exchange Act, as proposed. We believe both of these provisions will mitigate concerns expressed by some commenters regarding the costs of the potential disclosure, while also, over time, providing investors with a meaningful way to evaluate a registrant's period pay-versus-performance disclosure. In order to give companies adequate time to implement the new disclosures, we are providing that companies are required to comply with Item 402(v) of Regulation S-K in proxy and information statements that are

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[395] *See infra* Section II.G (discussing the required disclosures for SRCs).

required to include the Item 402 of Regulation S-K disclosure for fiscal years ending on or after December 16, 2022.

With respect to some commenters' suggestions that we should permit registrants to voluntarily provide additional years of disclosure, as noted below, under the Plain English principles, the final rules will permit registrants to provide additional years of disclosure, so long as doing so would not be misleading and would not obscure the required information.

F. Permitted Additional Pay-Versus-Performance Disclosure

1. Proposed Amendments

We proposed applying the Plain English principles in 17 CFR 240.13a-20 and 17 CFR 240.15d-20 to the pay-versus-performance disclosures. We noted that, under those principles, registrants would be permitted to provide additional information beyond what is specifically required by the rules so long as the information is not misleading and would not obscure the required information. As discussed in the Proposing Release, we note that the Plain English principles applicable to compensation disclosure would permit registrants to "include tables or other design elements, so long as the design is not misleading and the required information is clear, understandable, consistent with applicable disclosure requirements, consistent with any other included information, and not misleading."[396]

[396] *See Executive Compensation and Related Person Disclosure*, Release No. 33-8732A (Aug. 29, 2006) [71 FR 53158 (Sept. 8, 2006)], at Section II.C.6.

2. Comments

Some commenters supported applying the Plain English principles to the pay-versus-performance disclosure, noting that their application would be beneficial for both investors and the financial community.[397]

3. Final Amendments

The final amendments allow registrants to provide additional pay-versus-performance information beyond what is specifically required by Item 402(v) of Regulation S-K, so long as doing so would not be misleading and would not obscure the required information. For example, registrants that are already providing voluntary pay-versus-performance disclosures may generally continue to provide such disclosures in their present format, or could include disclosure of long-term performance metrics measured over periods longer than a single fiscal year.[398] Subject to these same principles, registrants will be permitted to include additional compensation and performance measures, or additional years of data, in the newly required table. Any supplemental measures of compensation or financial performance and other supplemental disclosures provided by registrants must be clearly identified as supplemental, not misleading, and not presented with greater prominence than the required disclosure. For example, depending on the facts and circumstances, a registrant could use a heading in the table indicating that the disclosure is supplemental, or include language in the text of its filing stating that the disclosure is supplemental. As noted above, to the extent additional performance

[397] *See* letters from McGuireWoods and PG 2015; *see also* letter from Hermes (supporting a "plain English" requirement for the pay-versus-performance disclosure, but questioning whether its application "can be mandated through regulation").

[398] As noted above, the placement and presentation of the information required by the final rules relative to existing disclosures may not obscure the required disclosures, place the required disclosures in a less prominent position, or otherwise mislead or confuse investors. In addition, a registrant should consider whether retaining its existing pay-versus-performance disclosure would be duplicative of the disclosures required by the final rules, and, if so, it may need to consider mitigating any such duplication.

measures are included in the table, these must also be accompanied by a clear description of their relationship to executive compensation actually paid to the PEO and to the average such compensation of the other NEOs. As discussed in the Proposing Release, and noted by commenters, we believe applying the Plain English principles to the pay-versus-performance disclosure will facilitate investors' understanding and decision-making with respect to the pay-versus-performance disclosure.

G. Required Disclosure for Smaller Reporting Companies

1. Proposed Amendments

The Proposing Release would have required SRCs to provide disclosure under Item 402(v) of Regulation S-K, but the disclosure would be scaled for those companies, consistent with SRCs' existing scaled executive compensation disclosure requirements. Specifically, as proposed, SRCs would:

- Only be required to present three, instead of five, fiscal years of disclosure under new Item 402(v) of Regulation S-K;
- Not be required to disclose amounts related to pensions for purposes of disclosing executive compensation actually paid;
- Not be required to present peer group TSR;
- Be permitted to provide two years of data, instead of three, in the first applicable filing after the rules became effective; and
- Be required to provide disclosure in the prescribed table in XBRL format beginning in the third filing in which it provides pay-versus-performance disclosure.

In the Reopening Release, the Commission indicated that it was considering requiring SRCs to disclose the income or loss before income tax expense and net income measures, but not the Company-Selected Measure or the list of their five most important measures.

2. Comments

Some commenters supported fully exempting SRCs from the pay-versus-performance disclosure requirements, stating that the disclosure requirements would be disproportionally burdensome to SRCs;[399] executive disclosure issues are less acute at SRCs;[400] and TSR is a more problematic measure for SRCs due to the relative illiquidity and volatility of SRCs' shares.[401] One commenter suggested that the Commission exempt SRCs from the disclosure requirements for five years, so that the Commission could first analyze the impact of the disclosure requirements on larger registrants.[402] Another commenter suggested that the pay-versus-performance disclosure be voluntary for SRCs.[403]

Other commenters stated that we should not exempt SRCs from the disclosure requirements.[404] One commenter opposed to exempting SRCs indicated that a lack of transparency could have negative market effects for SRCs.[405] In addition, one commenter specifically supported requiring SRCs to disclose income or loss before income tax expense, net income, the Company-Selected Measure, and the list of the five most important measures.[406]

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[399] *See* letters from CCMC 2015; Mercer; Pearl; TCA 2015; and TCA 2022.

[400] *See* letter from CCMC 2015.

[401] *See* letters from Mercer and Pearl.

[402] *See* letters from NIRI 2015 and NIRI 2022.

[403] *See* letter from ICGN.

[404] *See* letters from AB; Better Markets; CalPERS 2015; CalSTRS; CII 2015; Eileen Morrell, dated Mar. 6, 2022 ("Morrell"); SBA-FL; and Troop.

[405] *See* letter from CalPERS 2015.

[406] *See* letter from CII 2022.

With respect to the timing of the disclosure, one commenter, who supported SRCs being subject to the full pay-versus-performance disclosure requirement, suggested a one year "grace period."[407] Another commenter suggested that SRCs provide five years of data, but that we provide SRCs with a three year transition period requiring two years of data in the first applicable filing after the rules became effective, and increasing until the fourth applicable filing after the rules become effective, when all five years of data would be required.[408]

As discussed above, a number of commenters supported requiring all registrants to use Inline XBRL to tag their pay-versus-performance disclosure,[409] with one specifically stating that all filers are now familiar with Inline XBRL.[410] On the other hand, one commenter specifically suggested, in response to the Proposing Release, that we exempt SRCs from any XBRL tagging requirement.[411]

3. Final Amendments

We are adopting the scaled disclosure requirements for SRCs as described in the Proposing Release (and with respect to the net income measure, the Reopening Release). For the reasons noted above,[412] we believe requiring SRCs to provide three instead of five years is appropriate, and is aligned with SRCs' existing scaled executive compensation disclosure requirements. While the three-year period applicable for the disclosure is longer than what SRCs currently are required to disclose in the Summary Compensation Table, we believe the

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[407] *See* letter from AB.

[408] *See* letter from Hermes.

[409] *See* letters from CII 2022; Huddart; ICGN; and XBRL US.

[410] Letter from XBRL US.

[411] *See* letter from Hay.

[412] *See supra* Section II.E.3.

pay-versus-performance calculations, or the information required to make the calculations, for the additional year would generally be available in SRCs' disclosures from prior years.

We also believe that requiring SRCs to provide peer group TSR, a Company-Selected Measure, a Tabular List, or disclose amounts related to pensions would be unduly burdensome for SRCs, which, unlike larger registrants, are not otherwise required to present the TSR of a peer group or disclosure of how executive compensation relates to performance in a CD&A, and are subject to scaled compensation disclosure that does not include pension plans. Finally, we believe a transition period that would permit SRCs to provide two years of data, instead of three, in the first applicable filing after the rules become effective is appropriate, as is a phase-in period to allow SRCs to provide the required Inline XBRL data beginning in the third filing in which it provides pay-versus-performance disclosure, instead of the first.

III. OTHER MATTERS

If any of the provisions of these rules, or the application thereof to any person or circumstance, is held to be invalid, such invalidity shall not affect other provisions or application of such provisions to other persons or circumstances that can be given effect without the invalid provision or application.

Pursuant to the Congressional Review Act,[413] the Office of Information and Regulatory Affairs has designated these rules as not a "major rule," as defined by 5 U.S.C. 804(2).

IV. COMPLIANCE DATES

In order to give companies adequate time to implement these disclosures, we are requiring registrants to begin complying with Item 402(v) of Regulation S-K in proxy and

[413] 5 U.S.C. 801 *et seq.*

information statements that are required to include Item 402 disclosure for fiscal years ending on or after December 16, 2022.

V. ECONOMIC ANALYSIS

A. Background

We are adopting these final rules to satisfy the statutory mandate of Section 14(i). The Senate Report that accompanied the statute references shareholder interest in the relationship between executive pay and performance as well as the general benefits of transparency of executive pay practices.[414] As discussed above, we believe that the statute is intended to provide further disclosures concerning a registrant's executive compensation program for shareholders to consider when making related voting decisions, such as decisions with respect to the shareholder advisory vote on executive compensation, votes on other compensation matters, and director elections.

The final rules require the disclosure of information that is largely already reported under current disclosure rules, but that is currently not computed or presented in the way the final rules will require. This repackaging of some of the information from existing disclosures into the required pay-versus-performance disclosure is intended to allow investors to more quickly or easily process the information accurately.

The final rules require registrants to present the values of prescribed measures of executive compensation and financial performance for each of their five most recently completed fiscal years (three years for SRCs) in a standardized table in proxy or information

[414] The Senate Report includes the following with respect to Section 953(a) of the Dodd-Frank Act: "It has become apparent that a significant concern of shareholders is the relationship between executive pay and the company's financial performance of the issuers… The Committee believes that these disclosures will add to corporate responsibility as firms will have to more clearly disclose and explain executive pay." *See* Senate Report *supra* note 4.

statements in which executive compensation disclosure is required. Registrants will also be required to provide "clear descriptions" of the relationships between the compensation and performance measures in the table (and between TSR and peer group TSR), but will be allowed to choose the format used to present the relationships, such as graphical or narrative descriptions (or a combination of the two). The final rules will also allow registrants to supplement the required elements of the disclosure with additional measures or additional years of data, subject to certain restrictions. Registrants will be required to provide the disclosure in a structured data language using Inline XBRL.

The final rules reflect several modifications relative to the proposed rules in response to comments received. For example, one area of significant comment on the Proposing Release was the proposal's reliance on TSR (and, for registrants other than SRCs, peer group TSR) as the exclusive measure of financial performance used to present the relation of pay with performance.[415] The Reopening Release discussed, solicited comment on, and analyzed the economic effects of some possible additional measures of financial performance that the Commission was considering requiring. The final rules introduce two of these additional measures to the table: net income and, for registrants other than SRCs, a Company-Selected Measure. In addition, the final rules require registrants other than SRCs to provide a Tabular List of the most important financial performance measures used to link executive compensation actually paid, for the most recent fiscal year, to company performance. The additions will broaden the picture of registrant performance presented in the disclosure, providing additional detail and context that could enhance the usefulness of the disclosure by certain registrants or

415 *See supra* notes 229 and 230.

for certain investors. The additions will also entail some additional compliance costs and could make it more difficult for investors to quickly review the disclosure.

Many commenters to the Proposing Release also raised concerns that, under the proposed approach, the year to which company performance would be attributed and the year in which associated pay would be recognized would frequently be mismatched,[416] which could significantly limit the usefulness of the proposed disclosure. To address these comments, the final rules require equity awards to be revalued more frequently than had been proposed in order to better align pay and any related performance, at the expense of somewhat greater costs to registrants of computing the prescribed measure of pay.

We are mindful of the costs and benefits of the final rules. The discussion below addresses the economic effects of the final rules, including their anticipated costs and benefits, as well as the likely effects of the final rules on efficiency, competition, and capital formation.[417] The final rules reflect the statutory mandate in Section 14(i) as well as the discretion we exercise in implementing that mandate. For purposes of this economic analysis, we address the costs and benefits resulting from the statutory mandate and from our exercise of discretion together, recognizing that it is difficult to separate the costs and benefits arising from these two sources. We also analyze the potential costs and benefits of significant alternatives to the final rules.

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416 *See infra* note 631.

417 Section 3(f) of the Exchange Act [17 U.S.C. 78c(f)] requires the Commission, when engaging in rulemaking where it is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. Further, Section 23(a)(2) of the Exchange Act [17 U.S.C. 78w(a)(2)] requires the Commission, when making rules under the Exchange Act, to consider the impact that the rules would have on competition, and prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the Exchange Act.

B. Baseline

To assess the economic impact of the final rules, we are using as our baseline the current state of the market without a requirement for registrants to disclose the relationship between executive compensation actually paid and the financial performance of the registrant.

1. Affected Parties

We consider the impact of the final rules on investors and registrants (and their NEOs). The final rules will apply to all companies that are registered under Section 12 of the Exchange Act[418] ("Section 12") and are therefore subject to the Federal proxy rules, except EGCs. The final rules will also not apply to foreign private issuers or companies with reporting obligations only under Section 15(d) of the Exchange Act, which are not subject to the proxy rules. In addition, for some Section 12(g) of the Exchange Act[419] ("Section 12(g)") registrants, such as limited partnerships, the disclosure requirement might not apply in some or all years because these registrants might not file either proxy or information statements every year.[420]

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[418] 15 U.S.C. 78l.

[419] 15 U.S.C. 78l(g).

[420] Registrants subject to the final rules will be required to make pay-versus-performance disclosure under Item 402(v) of Regulation S-K when they file proxy statements or information statements in which executive compensation disclosure pursuant to Item 402 of Regulation S-K is required. Proxy statement disclosure obligations only arise under Section 14(a) of the Exchange Act [15 U.S.C. 78n(a)] when a registrant with a class of securities registered under Section 12 chooses to solicit proxies. Whether or not a registrant has to solicit proxies is dependent upon any requirement under its charter or bylaws, or otherwise imposed by law in the state of incorporation or stock-exchange (if listed), not the Federal securities laws. For example, NYSE, NYSE American, and Nasdaq require the solicitation of proxies for annual meetings of shareholders. A Section 12(b) of the Exchange Act [15 U.S.C. 78l(b)] ("Section 12(b)") registrant is listed on a national securities exchange, and therefore likely would solicit proxies and be compelled to provide the disclosure identified in Item 402(v) of Regulation S-K annually. Registrants with reporting obligations under Section 12(g), but not Section 12(b), would not be subject to any obligation to solicit proxies under the listing standards of an exchange, but may nevertheless solicit proxies as a result of an obligation under their charters, bylaws, or law of the jurisdiction in which they are incorporated. When Section 12 registrants that do not solicit proxies from any or all security holders are nevertheless authorized by security holders to take a corporate action at or in connection with an annual meeting or by written consent in lieu of such meeting, disclosure obligations also would arise under Item 402(v) of Regulation S-K due to the requirement to file and disseminate an information statement under Section 14(c).

We estimate that approximately 4,530 registrants will be subject to the final rules, including approximately 1,860 SRCs.[421] The proportion of SRCs among the affected registrants is expected to be similar to that which was reported at the time of the Proposing Release.[422] Among all registrants subject to the Federal proxy rules, we estimate that there are approximately 1,275 EGCs, of which approximately 1,065 are also SRCs, none of which will be subject to the final rules.[423]

2. Existing Disclosures and Analyses

The registrants that will be subject to the final rules must currently comply with Item 402 of Regulation S-K, which requires the disclosure of extensive information about the compensation of NEOs, and, except in the case of SRCs, with Item 201(e) of Regulation S-K, which requires graphical disclosure of registrant TSR and peer group TSR. They are also subject to financial statement and disclosure requirements under Regulation S-X. The underlying information necessary to provide the required pay-versus-performance disclosure is, with limited exceptions discussed below, already encompassed by these existing disclosure

[421] These estimates are based on a review of calendar year 2021 EDGAR filings. The final rules will apply to BDCs to the extent they are internally managed (*i.e.*, have named executive officers within the meaning of Item 402 of Regulation S-K) and are not EGCs. We estimate that there are approximately seven affected BDCs, which are included in the estimate of affected registrants.

[422] Based on 2021 filings, SRCs represent about 41% (1,860 out of 4,530) of the affected issuers, while the Proposing Release reported that, based on 2013 filings, about 2,430 out of 6,075, or 40%, of the affected issuers were expected to be SRCs. *See* Proposing Release at 30. The Commission amended the smaller reporting company definition effective September 2018, with the effect of expanding the number of registrants that qualified as SRCs. *See* Amendments to the Smaller Reporting Company Definition, Release No. 33-10513 (June 28, 2018) [83 FR 31992 (July 10, 2018)]. However, EGCs are not subject to the final rules, and the number of EGCs subject to the Federal proxy rules, including SRCs that are also EGCs, has grown more than three-fold since the time of the Proposing Release (from about 360, as reported in the Proposing Release, to about 1,275 based on our review of 2021 filings), offsetting any increase in the proportion of SRCs subject to the final rules.

[423] These estimates are based on a review of calendar year 2021 EDGAR filings.

requirements. However, the existing disclosures might not present the underlying information in a format that allows investors to readily assess the alignment of pay and performance.

Under the final rules, the definition of executive compensation actually paid for a fiscal year is, generally,[424] total compensation as reported in the Summary Compensation Table for that year (i) less the change in the actuarial present value of pension benefits,[425] (ii) less the grant-date fair value of any stock and option awards granted during that year, (iii) plus the pension service cost for the year and, in the case of any plan amendments (or initiations), the associated prior service cost (or less any associated credit), and (iv) plus the change in fair value of outstanding and unvested stock and option awards during that year (or as of the vesting date or the date the registrant determines the award will not vest, if within the year) as well as the fair value of new stock and option awards granted during that year as of the end of the year (or as of the vesting date or the date the registrant determines the award will not vest, if within the year). Adjustments (i) and (iii) with respect to pension plans will not apply to SRCs because they are not otherwise required to disclose executive compensation related to pension plans.

Under the baseline, investors generally should already have the required data to compute a reasonable estimate of executive compensation actually paid as defined in the final rules, even though registrants are not required to compute or disclose this measure. Specifically, under existing requirements of Item 402 of Regulation S-K, registrants must report, in the Summary Compensation Table, the value of total compensation and each of its components,[426] including

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[424] The required deductions and additions in computing executive compensation actually paid are provided in greater detail in Section II.C above.

[425] If the change in actuarial value of pension plans is not positive, it is not currently included in total compensation and therefore need not be deducted for the purpose of this adjustment.

[426] For registrants that are not SRCs, total compensation consists of the dollar value of the executive's base salary and bonus, plus the fair market value at the grant date of any new stock and option awards, the dollar value of any non-equity incentive plan award earnings, the change (if positive) in actuarial value of the accumulated

the aggregate grant-date fair value of equity awards and, for registrants other than SRCs, the total change (if positive) in actuarial present value of pension benefits, for each NEO. The total compensation and amounts required to be subtracted from this total in the computation of executive compensation actually paid for each NEO, or adjustments (i) and (ii) referenced above, are thus already available in the Summary Compensation Table.[427]

The amounts that must be added back in this computation, or adjustments (iii) and (iv) referenced above, are not required to be directly reported under existing disclosure requirements, but can be estimated based on existing disclosures. In particular, Item 402 of Regulation S-K requires further disclosure about equity awards and pension plans, such as, for non-SRCs, the Grant of Plan-Based Awards Table and the Pension Benefits Table and the associated narrative and footnotes, which include the detailed terms of these components of compensation and certain valuation assumptions. Using these existing disclosures and other public data, it is possible for investors to make reasonable (though perhaps not identical) estimates of the annual and vesting-date fair values of outstanding stock and option grants. In fact, various third parties, such as proxy advisory service providers and compensation consultants, currently make similar computations using existing disclosures in order to construct alternative pay measures as part of the services they provide to certain investors and/or

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benefit under all defined benefit and pension plans, any above-market interest or preferential earnings on deferred compensation and all other compensation. The all other compensation component includes, among other things, the value of perquisites and other personal benefits (unless less than $10,000 in aggregate) and registrant contributions to defined contribution plans.

[427] While the time period applicable for existing Item 402 of Regulation S-K disclosures (two years for SRCs and three years for other affected registrants) is shorter than will be required for the pay-versus-performance disclosure (three years for SRCs and five years for other affected registrants), the information required to make these computations for the additional years would be available in disclosures from previous years. New registrants would not be required to report data for years in which they were not reporting companies.

registrants.[428] Market participants other than those providing actuarial services may have less experience with the computations required with respect to pension plans. However, it is still possible to compute an estimate of pension service cost for the year (plus the prior service cost, or credit, associated with any plan amendments or initiations) by using existing disclosures and public data to construct the required actuarial assumptions and computations.[429]

That said, these computations can be complex and investors would bear costs to make such computations or obtain them from third parties. Further, if investors or third parties were to estimate executive compensation actually paid based on existing disclosures, these estimates may differ from each other and from similar estimates made by registrants themselves. For example, because registrants are not currently required to disclose the equity valuation assumptions that they would apply at any time after the grant date (which may differ from the grant-date assumptions), investors may not know how the registrant would apply its discretion in choosing from a range of reasonable assumptions to compute fair values at these other

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428 *See, e.g.,* Institutional Shareholder Services, *ISS United States Compensation Policies: Frequently Asked Questions* (updated Dec. 17, 2021), *available at* https://www.issgovernance.com/file/policy/active/americas/US-Compensation-Policies-FAQ.pdf ("ISS FAQ") (describing their computation of "realizable pay" as "all non-incentive compensation paid [and] the value of equity or cash incentive awards earned or, if the award remains on-going, revalued at target level as of the end of the measurement period"); Glass Lewis, *Pay-for-Performance Methodology & FAQ* (Oct. 2020)*, available at* https://www.glasslewis.com/wp-content/uploads/2020/10/2020-NA-Compensation-Overview-FAQs.pdf ("Glass Lewis Methodology") (describing compensation computations in which the company "performs its own stock and option valuations and excludes any cash severance or changes in pension value"); Equilar, *Pay for Performance* [Brochure] (Nov. 2020), *available at* https://www.equilar.com/pay-for-performance (providing screenshots of the their pay for performance profile, which presents compensation computed in numerous different ways, including under multiple definitions of "realizable pay" that would require the revaluation of equity awards after the grant date).

429 While service costs associated with defined benefit plans are currently disclosed in financial statement footnotes, these costs are currently not disaggregated by individual. Pension plan benefit formulas and certain pension-related assumptions (such as discount rates) are currently disclosed in proxy statements or financial statement footnotes. Additional assumptions required to compute service costs, such as expectations with respect to retirement age, mortality, and future compensation growth, may not be reported or may differ for this purpose from assumptions presented in, or implied by, existing disclosures. While an outsider may not be as well positioned to estimate some of these required inputs as management, deriving reasonable assumptions should be possible based on broader population statistics and trends.

dates.[430] Estimates constructed by or on behalf of investors may also differ from registrant estimates if simplifications are made in order to more easily produce estimates for a large number of registrants.[431]

Information about registrant financial performance is readily available to investors under the baseline. The final rules require the disclosure of historical TSR, peer group TSR, and net income for up to five years. Disclosure of historical TSR and TSR of a particular peer group is already required under Item 201(e) of Regulation S-K: specifically, this item requires the disclosure of the TSR for the registrant as well as a peer group (a published industry or line-of-business index, peer issuers selected by the registrant, or issuers with similar market capitalizations), for the past five years, in annual reports.[432] The final rules allow registrants to choose to use either the peer group required under Item 201(e) of Regulation S-K or, if the registrant uses a peer group in benchmarking its compensation, the peer group disclosed in its CD&A in its pay versus performance disclosure. In the latter case, however, the components of such a peer group would be disclosed in the CD&A and the shareholder returns of these companies would be publicly available from many sources, if not already reported in the CD&A. Similarly, while SRCs are not required to comply with Item 201(e) of Regulation S-K

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430 For SRCs, which are not required to provide the Grant of Plan-Based Awards Table and accompanying narrative and footnotes, investors may also not know all of the detailed terms of each equity award, which could affect the accuracy of fair value estimates constructed by, or on behalf of, investors.

431 *See, e.g.*, Charlie Pontrelli (Equilar), *Proxy Advisors and Pay Calculations* (Sept. 29, 2019), Harv. L. F. on Corp. Governance Blog, *available at* https://corpgov.law.harvard.edu/2019/09/29/proxy-advisors-and-pay-calculations (noting that "it is important to carefully consider the details of the [alternative pay] calculation in order to avoid misleading conclusions," and citing the example of a situation in which an alternative pay measure was constructed using a different option valuation model than that used by a company in its disclosures).

432 Item 201(e) of Regulation S-K disclosure is only required in an annual report that precedes or accompanies a registrant's proxy or information statement relating to an annual meeting of security holders at which directors are to be elected (or special meeting or written consents in lieu of such meeting). As discussed above, an annual meeting could theoretically not include an election of directors, such that Item 201(e) of Regulation S-K disclosure would not be required, although pay-versus-performance disclosure would still be required in such years if action is to be taken with regard to executive compensation.

or CD&A disclosure requirements and yet would still have to report their own TSR under the final rules, data about their returns is publicly available. The final rules do not require SRCs to present the TSR of a peer group. Finally, all of the affected registrants are currently required to disclose net income as part of their financial reports filed in Form 10-K, including three years of data for registrants other than SRCs, and two years of data for SRCs, with additional history generally available in previous filings.

We expect that the quantitative disclosure of Company-Selected Measures called for in the new disclosures is also generally encompassed by existing financial statement disclosure requirements or voluntarily disclosed in existing proxy statements. However, if registrants do not already disclose historical quantitative data for these measures over the past five years, the required disclosure may provide new information relative to the baseline to the extent that any computations required to derive the value of these measures from reported financial data may not always be straightforward for investors to replicate. The disclosure of a Company-Selected Measure may also provide investors with new information in the form of any insight gained based on the registrant's choice of which of the measures reported in the CD&A in this or previous years was deemed to be the most important with respect to the most recent fiscal year.

While the bulk of the information about compensation and registrant performance to be included in the new disclosure is currently available to investors elsewhere, not all of this information is accessible for large-scale analysis under the baseline. Currently, every affected registrant is, or will soon be, subject to Inline XBRL tagging requirements for a subset of its other Commission disclosures, including the financial statements and financial statement footnotes.[433] Thus, information that is already available from these sources—such as net income, some Company-Selected Measures or statistics used to compute these measures, and information in footnotes regarding inputs and assumptions used to compute pension liabilities and stock-based compensation expense—is already tagged and thus readily machine-readable. However, other information that will be reflected in the required pay-versus-performance disclosure, such as the compensation measures, as well as most of the information required to compute these measures, is not currently tagged,[434] and could therefore become more readily available for analysis as a result of the final rules.

For the affected registrants other than SRCs, Item 402 of Regulation S-K requires a description in the CD&A of how the registrant's compensation policy relates pay to performance, if material to the registrant's compensation policies and decisions. This description must include information about any performance targets that are a material element of a company's executive compensation policies or decisions.[435] While the final rules will newly require registrants other than SRCs to name the top three to seven most important performance measures used by the registrant to link NEO pay to performance in the most recent fiscal year, these registrants likely already disclose these measures in the CD&A under existing requirements. However, as in the case of the Company-Selected Measure, the Tabular List may

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433 *See* 17 CFR 229.601(b)(101) and 17 CFR 232.405 (for requirements related to tagging operating company and BDC financial statements (including footnotes and schedules), audit reports, and BDC prospectus disclosures, in Inline XBRL); 17 CFR 229.601(b)(104) and 17 CFR 232.406 (for requirements related to tagging cover page disclosures in Inline XBRL); and 17 CFR 229.601(b)(107) and 17 CFR 232.408 (for requirements related to tagging filing fee exhibit disclosures in Inline XBRL).

434 Information currently provided in response to Item 201(e) of Regulation S-K, Item 402 of Regulation S-K, or voluntarily in proxy statements is not currently required to be tagged.

435 A registrant may omit target levels with respect to specific quantitative or qualitative performance-related factors involving confidential trade secrets or confidential commercial or financial information from the CD&A only if the disclosure of these target levels would result in competitive harm. See Instruction 4 to Item 402(b) of Regulation S-K.

provide new information relative to the baseline in the form of any insight gained based on the registrant's choice of which of the measures reported in the CD&A were deemed to be the most important with respect to the last completed fiscal year.

Registrants are not currently required to disclose, in a side-by-side fashion, or report the actual historical relationship between, any measures of executive compensation and registrant financial performance. As discussed in the Proposing Release, some registrants voluntarily provide such disclosures, which are generally limited to analyses of the compensation of the PEO and which vary with regard to the compensation and performance measures used.[436] Such voluntary disclosures remain a minority practice, with the rate of such disclosures declining somewhat since the time of the Proposing Release,[437] and they remain highly varied.[438] Whether or not they directly disclose the relationship of pay with performance, some registrants disclose alternative measures of pay to demonstrate the variation in the value of pay after it is granted, but, again, this is a minority practice and the measures used vary.[439] Thus, even when voluntary disclosures are provided, their comparability is limited, which can make them difficult for

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[436] *See* Proposing Release at 32. *See also, e.g.,* letters from CAP; CEC 2015; Hall; and PG 2015.

[437] In 2013, a compensation consulting firm found that, of 250 large public companies examined, 27% provided tabular or graphical information on the relationship between pay and performance in their CD&A; in 2021, the same firm found that 24% of the 200 large public companies examined included disclosures comparing pay and performance. *See* Proposing Release at n. 120 and Meridian Compensation Partners, *2021 Corporate Governance & Incentive Design Survey* (Fall 2021), *available at* https://www.meridiancp.com/wp-content/uploads/2021/09/Meridian-2021-Governance-and-Design-Survey-2.pdf ("Meridian 2021 Report"). A different compensation consulting firm found in 2021 that 14.1% of the 100 large public companies examined included a pay for performance graph in their most recent proxy statements, down from 21.6% five years earlier. *See* Equilar, *Preparing for Proxy Season 2022* (Nov. 2021), *available at* https://info.equilar.com/preparing-for-proxy-season-2022-report-request.

[438] *See, e.g.,* Meridian 2021 Report at 22.

[439] *See, e.g.,* Meridian 2021 Report at 23 (stating that 24% of the 200 large registrants reviewed included "realized" or "realizable pay" disclosure, with 58% of these using "realizable pay").

investors to use.[440] Commenters and other observers have also raised concerns that registrants choose to present measures that make the alignment of pay and performance appear more favorable.[441]

Certain investors also have access to analyses of historical pay-versus-performance data produced by third parties, such as proxy advisory firms and compensation consultants. These analyses are based on compensation and performance information disclosed by registrants. Compared to voluntary disclosures by registrants, these third-party analyses are available for a larger number of registrants, and apply more consistent methodologies across registrants. However, this consistency has led to criticism that the analyses are not appropriately tailored to the circumstances of different kinds of registrants.[442] Further, these analyses are only available to investors who pay for these services, and the computations and analytical approaches used vary across the third-party information providers.[443] Some other investors generate their own

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[440] *See, e.g.,* Kosmas Papadopoulos & John Roe (ISS Analytics), *Realizable Pay: Insights into Performance Alignment* (Apr. 29, 2019), Harv. L. Sch. F. on Corp. Governance Blog, *available at* https://corpgov.law.harvard.edu/2019/04/29/realizable-pay-insights-into-performance-alignment/ ("ISS Realizable Pay Article") (stating that "[d]ifferent companies and different compensation consultants arrived at different ways of calculating and presenting these alternative [pay] measures, making it very difficult for investors to systematically use these disclosures in the analysis of pay and performance—much to the frustration of investors and companies alike"). *See also, e.g.,* letters from As You Sow 2015; CAP; and Public Citizen 2015.

[441] *See, e.g.,* letters from AFREF (stating that "companies have chosen misleading metrics to justify excessive executive compensation in the past") and As You Sow 2015 (stating that "every company cherry-picks data that makes it appear in the best possible light"); and Dave Michaels, *Misleading CEO Pay-for-Performance Numbers Target of SEC,* BLOOMBERG (Dec. 17, 2013), *available at* http://www.bloomberg.com/news/articles/2013-12-17/misleading-ceo-pay-for-performance-numbers-target-of-sec.

[442] *See, e.g.,* Compensia, *The New ISS Pay-for-Performance Methodology – A Closer Look at the Gathering Storm* (Jun. 12, 2017), *available at* https://compensia.com/the-new-iss-pay-for-performance-methodology-a-closer-look-at-the-gathering-storm/.

[443] *See, e.g.,* Glass Lewis Methodology and Institutional Shareholder Services, *Pay-for-Performance Mechanics* (Dec. 2021), available at https://www.issgovernance.com/file/policy/active/americas/Pay-for-Performance-Mechanics.pdf ("ISS Methodology"), for the quantitative methodologies for evaluating pay and performance alignment used by two major proxy advisory firms.

pay-versus-performance analyses for the registrants in their portfolios, using a variety of approaches.[444] Given the resources required, smaller investors, particularly retail investors, are the least likely, under the baseline, to subscribe to third party services or to do their own detailed pay-versus-performance computations for each of their holdings.

As was the case at the time of the Proposing Release, there continues to be no consensus around the best approach to analyzing the alignment of pay and performance, and we do not have complete information about the approaches used by all investors. However, the varied statistics and analyses that we can observe[445] investors using may still shed some light on the type of information that they find to be useful for this purpose, particularly as many of the third-party analyses have evolved over time based on shareholder demand. For example, while many third party and shareholder analyses use a measure of pay based on grant date valuations of stock and options,[446] potentially because this has historically been the most readily available measure,[447] most of the recent analyses that we have observed also include a "realizable pay"

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444 *See, e.g.,* disclosures about the evaluation of executive compensation by the California Public Employees Retirement System ("CalPERS"), *available at* https://www.calpers.ca.gov/docs/executive-compensation-analysis-framework.pdf ("CalPERS Methodology") (describing an analysis involving CEO realizable pay and TSR, in each case for the company as well as its peers); as compared to the corresponding disclosures by Northern Trust Asset Management, *available at* https://www.northerntrust.com/content/dam/northerntrust/pws/nt/documents/investment-management/scorecard-methodology.pdf ("Northern Trust Methodology") (describing an analysis involving the grant date value of CEO pay and nine unique fundamental performance indicators in addition to TSR, in all cases for the company as well as its peers). *See also* letter from BlackRock (providing detail on its say-on-pay analysis framework).

445 We note that the analyses that are disclosed in detail, and which we are therefore able to observe, are likely among the more sophisticated that are currently in use.

446 *See, e.g.,* ISS FAQ; Northern Trust Methodology; and Glass Lewis, *Understanding Glass Lewis' Approach to Say on Pay Analysis*, *available at* https://www.glasslewis.com/say-on-pay/, (last accessed Jun. 29, 2022) ("Glass Lewis Overview").

447 *See, e.g.,* Mercer, *The Role of Realized and Realizable Pay in Disclosure and Beyond* (2014), *available at* Mercer LLC's website (last accessed Aug. 9, 2022) ("Mercer Realizable Pay Article") (stating that many investors "favor [the use of realized and realizable pay] as an appropriate way to measure and analyze executive pay" but that "[w]hen shareholders assess their companies' executive pay levels, they do so using the information most readily available, which includes the … summary compensation table and past performance").

measure.[448] While there are various approaches to defining and computing "realizable pay," it is generally intended to capture both pay that has been realized by an executive in the period as well as an updated value, to reflect actual company performance, of outstanding equity awards that could potentially be realized in the future.[449] A recent survey by one proxy advisory firm found that 84 percent of investors support the use of an outcomes-based pay measure such as realizable pay in a quantitative pay-for-performance evaluation,[450] further demonstrating investor demand for such computations.

With respect to performance measures, the analyses by or on behalf of investors that we observe all use TSR as a primary measure of performance.[451] However, most also supplement TSR with other measures of financial performance.[452] For example, some of the performance measures presented by third parties as part of pay-for-performance analyses in recent years include operating cash flow growth; earnings per share growth; growth in earnings before interest, taxes, depreciation and amortization ("EBITDA"); return on equity; return on invested

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448 *See, e.g.,* letter from BlackRock; CalPERS Methodology; ISS FAQ; and Glass Lewis Overview. Beginning in 2020, Glass Lewis changed its compensation analytics partner, and may no longer be reporting realizable pay in its proxy research reports for the US market, though it does report a measure of realized pay; it is unclear to us whether this shift is temporary or permanent. *See, e.g.*, Glass Lewis Sample Proxy Research Reports *available at* https://www.glasslewis.com/sample-proxy-papers (last accessed May 15, 2022) (including some samples for the US market that include realizable pay data and others that do not). *See also* Northern Trust Asset Management, *Executive Compensation Guide for Proxy Voting and Engagements* (Nov. 2018), available at https://cdn.northerntrust.com/pws/nt/documents/investment-management/exec-compensation-guide-digital.pdf (stating that companies should "showcase realized versus realizable pay, preferably over five annualized performance periods" in their disclosures, even though, per note 444 above, this shareholder focuses on grant date pay in its analysis of pay-for-performance alignment).

449 Definitions vary as to whether, for example, options are valued at fair value or intrinsic value and pay is realized when awards are vested or exercised. *See, e.g.,* Mercer Realizable Pay Article and ISS Realizable Pay Article.

450 *See* Institutional Shareholder Services, *2017-2018 Policy Application Survey: Summary of Results* (Oct. 19, 2017), *available at* https://www.issgovernance.com/file/policy/2017-2018-Policy-Application-Survey-Results-Summary.pdf.

451 *See, e.g.,* letter from BlackRock; CalPERS Methodology; Glass Lewis Methodology; ISS FAQ; and Northern Trust Methodology.

452 *See, e.g.,* letter from Blackrock; Glass Lewis Methodology; ISS FAQ; and Northern Trust Methodology.

capital; return on assets; and various ratios and growth rates using "economic value added."[453] The inclusion of these measures may demonstrate investors' interest in additional measures of performance, particularly with respect to profitability, when considering compensation. Shareholder demand for such information is further supported by a recent survey by one proxy advisory firm, in which 84 percent of investors surveyed supported the continued reporting of some of the profitability measures listed above as part of the proxy advisory firm's proxy research in the area of pay-for-performance.[454]

Overall, we have observed, and commenters have identified, an increasing sophistication in how investors are evaluating executive compensation disclosures[455] as well as an increasing refinement in how registrants are crafting these disclosures,[456] particularly after about a decade of experience with "say-on-pay" votes. However, despite the significant amount of information about executive compensation disclosed by registrants under the baseline, investors have expressed some discontent with current disclosures. For example, commenters have indicated that existing disclosures can be challenging to review, in that investors find it difficult to collect

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[453] *See, e.g.,* Glass Lewis Methodology (listing the following performance measures besides TSR: change in operating cash flow, earnings per share growth, return on equity, and return on assets, with "change in operating cash flow" replaced with "tangible book value per share growth" for companies in the Banks, Diversified Financials and Insurance sectors, and with "growth in funds from operations" for certain REITs); and ISS Methodology (listing the following performance measures besides TSR: EVA Margin, EVA Spread, EVA Momentum vs. Sales, EVA Momentum vs. Capital, return on equity, return on assets, return on invested capital, and EBITDA growth, with EBITDA growth replaced by cash flow growth in certain industries). "Economic value added" (or "EVA," which is a registered trademark of Stern Value Management, Ltd) is equal to net operating profit after taxes, less a cost of capital charge.

[454] *See* Institutional Shareholder Services, *2019 Global Policy Survey: Summary of Results* (Sept. 11, 2019), available at https://www.issgovernance.com/file/policy/2019-2020-iss-policy-survey-results-report.pdf.

[455] *See, e.g.,* letters from AFL-CIO 2022; IBC 2022; and PG 2022 (stating that "the SEC's proposal, in contrast, appears to be out of step with these more sophisticated approaches of relating pay and performance").

[456] *See, e.g.,* letters from Blackrock; NIRI; Pearl; and SCG.

or interpret the information in which they are interested.[457] Commenters also highlighted shareholder concerns about the length and complexity of existing compensation disclosures.[458] These disclosures have generally increased in length since the time of the Proposing Release.[459]

3. Executive Compensation Practices

The structure of executive compensation, and how it varies across the affected registrants, will influence the effects of the final rules and how those effects will vary across registrants. For example, because the final rules require that equity awards and compensation related to pension plans be reflected differently than in the Summary Compensation Table, the prevalence and variation in usage and design of these items in executive compensation packages may affect the benefits of the disclosures as well as the burden involved in making the required calculations to provide the disclosures. Similarly, variation in the number and nature of performance metrics in executive compensation plans may also affect the variation in costs and benefits of the final rules across registrants.

The final rules require that executive compensation actually paid include the annual change in fair value, through year-end or the vesting date, if earlier, of any outstanding stock and option awards. A majority of CEO direct compensation is delivered in the form of such

[457] *See*, *e.g.*, letters from AFL-CIO 2022; Better Markets *et al.*; Dimensional; Barbara S. Mortenson, dated May 30, 2015; Public Citizen; SVA; and Teamsters. *See also* Council of Institutional Investors, *CII Roundtable Report: Real Talk on Executive Compensation* (March 27, 2018), *available at* https://www.cii.org/special_reports, at 10 (discussing concerns with the transparency of executive compensation).

[458] *See*, *e.g.*, letters from Allison; CCMC; and Ross. *See also* Stanford University, RR Donnelley & Equilar, *2015 Investor Survey: Deconstructing Proxy Statements – What Matters to Investors* (Feb. 2015), *available at* http://www.sec.gov/comments/4-681/4681-3.pdf ("Stanford 2015 Investor Survey").

[459] *See*, *e.g.*, Equilar, *Preparing for Proxy Season 2020* (November 2019), *available at* https://info.equilar.com/2019-0201-Proxy-Report-2020 (stating that the average CD&A length among the 100 large companies reviewed grew by almost 500 words from 2014 to 2017). Part of the increase in length of existing disclosures may be due to other regulatory mandates that have been adopted in the interim. *See, e.g.*, *Pay Ratio Disclosure*, Release No. 33-9877 (Aug. 5, 2015) [80 FR 50103]; and *Disclosure of Hedging by Employees, Officers and Directors*, Release No. 33-10593 (Dec. 20, 2018) [84 FR 2402].

equity awards, and their contribution to the total value of such compensation at the grant date has grown in recent years.[460] The use of stock grants,[461] and the frequency of such grants to the CEO, by some of the potentially affected registrants is reported in the table below.[462]

[460] *See, e.g.,* Gallagher, *CEO and Executive Compensation Practices Report: 2021 Edition* (Oct. 2021), available at https://www.ajg.com/us/executive-compensation-report-2021/ ("Gallagher 2021 Study") (stating that the portion of total direct compensation represented by equity awards grew to 71% in 2020 from 65% in 2016 for CEOs of registrants in the Russell 3000 index).

[461] Throughout this release, the term "stock grant" or "stock award" is used to refer to the award of instruments such as common stock, restricted stock, restricted stock units, phantom stock, phantom stock units, common stock equivalent units or any other similar instruments that do not have option-like features.

[462] These statistics are based on staff analyses of compensation data from the Standard & Poor's Execucomp database, which in turn is sourced from company proxy statements. Execucomp covers firms in the S&P Composite 1500 Index (which includes the S&P 500, S&P MidCap 400, and S&P SmallCap 600) as well as some firms that were previously removed from the index but are still trading and some requested by Execucomp clients. Years mentioned refer to fiscal years, under the convention that companies with fiscal closings after May 31 in a given year are assigned to that fiscal year while companies with fiscal closings on or before May 31 in a given year are assigned to the previous fiscal year. Use of the term "CEO" is based on the use of this term in the Execucomp database, and is believed to be equivalent to the term "PEO" used in this release and in the final rules.

Table 1. Use of executive stock grants by registrants covered by Execucomp

	All Firms in Database	Firms in S&P 500	Firms in S&P MidCap 400	Firms in S&P SmallCap 600
Firms in Sample	1,694	497	393	580
Stock Grants to 2020 CEO:				
% of CEOs Granted Stock in 2020	81.0%	87.5%	85.0%	82.2%
Among subset of firms for which 2020 CEO was also CEO in 2019 and 2018:				
% of CEOs Granted Stock 0 out of Past 3 Years (2018-2020)	11.2%	8.7%	8.3%	11.7%
% of CEOs Granted Stock 1 out of Past 3 Years (2018-2020)	5.9%	4.6%	6.3%	5.5%
% of CEOs Granted Stock 2 out of Past 3 Years (2018-2020)	16.6%	14.2%	19.1%	16.3%
% of CEOs Granted Stock 3 out of Past 3 Years (2018-2020)	66.3%	72.5%	66.3%	66.5%
Stock Grants to Other 2020 NEOs:				
% of Firms that Granted Stock to Any NEO other than CEO in 2020	86.8%	92.6%	90.3%	88.4%
Among Firms that Made Such Grants, Average Number of Other NEOs Granted Stock in 2020	4.2	4.0	3.9	3.9

Per the first row of each panel of Table 1, roughly 80 to 90 percent of registrants, both large and small, make use of stock grants to CEOs and other NEOs in a given year. The last row of the first panel of Table 1 indicates that about two-thirds of registrants, and slightly more among the largest registrants, make such grants to the CEO every year. The prevalence and frequency of stock grants have not changed markedly since the time of the Proposing Release.[463]

[463] *See* Proposing Release at Table 1.

The use of option grants,[464] and the frequency of such grants to the CEO, by some of the potentially affected registrants is reported in the table below. [465]

Table 2. Use of executive stock option grants by registrants covered by Execucomp

	All Firms in Database	Firms in S&P 500	Firms in S&P MidCap 400	Firms in S&P SmallCap 600
Firms in Sample	1,694	497	393	580
Option Grants to 2020 CEO				
% of CEOs Granted Options in 2020	22.4%	31.2%	20.9%	20.9%
Among subset of firms for which 2020 CEO was also CEO in 2019 and 2018:				
% of CEOs Granted Options 0 out of Past 3 Years (2018-2020)	61.5%	50.4%	59.8%	67.7%
% of CEOs Granted Options 1 out of Past 3 Years (2018-2020)	13.0%	12.3%	15.8%	12.4%
% of CEOs Granted Options 2 out of Past 3 Years (2018-2020)	14.7%	20.7%	14.5%	10.6%
% of CEOs Granted Options 3 out of Past 3 Years (2018-2020)	10.8%	16.6%	9.9%	9.3%
Option Grants to Other 2020 NEOs:				
% of Firms that Granted Options to Any NEO other than CEO in 2020	31.2%	42.1%	28.5%	29.1%
Among Firms that Made Such Grants, Average Number of Other NEOs Granted Options in 2020	3.1	3.3	3.1	2.8

Per the first row of the first panel of Table 2, roughly 30 percent of the largest registrants, and about 20 percent of smaller registrants, grant options to their CEOs in a given year. This represents a significant drop, of greater than half, in the use of options to incentivize

464 Throughout this release, the term “option” is used to refer to instruments such as stock options, stock appreciation rights and similar instruments with option-like features.

465 *See supra* note 462.

CEOs across all categories since the time of the Proposing Release.[466] The decline in option grants to CEOs has largely been offset by an increase in the number and size of performance-contingent stock grants,[467] marking the continuation of a trend also discussed in the Proposing Release.[468] Per the first row of the second panel of Table 2, the granting of options to any other NEO is a bit more prevalent, with roughly 40 percent of the largest and about 30 percent of smaller registrants using such grants in a given year, but these rates have also dropped significantly since the time of the Proposing Release.[469] In contrast to stock grants, option grants are also less frequent; per the last row of the first panel of Table 2, about 10 to 15 percent of registrants grant options to the CEO every year.

Because the final rules require the valuation of equity awards annually until the time of vesting, we have also considered the variation in vesting schedules. Equity awards may be subject to time-based or performance-based vesting, or a combination of the two. Awards with time-based vesting may vest in full at the end of their vesting period ("cliff vesting") or in increments over the period of vesting ("graded vesting").

Market practices regarding vesting schedules have remained relatively consistent since the time of the Proposing Release.[470] We estimate that about 45 percent of stock grants are

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[466] *See* Proposing Release at Table 2, reporting that 64.1%, 49.0%, and 43.1% of S&P 500, S&P MidCap 400, and S&P SmallCap 600 constituents respectively granted options to their CEO in 2012.

[467] *See, e.g.,* Pay Governance, *S&P 500 CEO Compensation Increase Trends* (Jan. 13, 2021), *available at* https://www.paygovernance.com/viewpoints/s-p-500-ceo-compensation-increase-trends-4; and Gallagher, *CEO and Executive Compensation Practices Report: 2020 Edition* (February 2021), available at https://www.ajg.com/us/news-and-insights/2021/feb/ceo-executive-compensation-practices-report-2020/.

[468] *See* Proposing Release at n. 133 and the accompanying text (discussing the increased prevalence of performance-contingent equity grants).

[469] *See* Proposing Release at Table 2.

[470] *See* Proposing Release at 35 for additional estimates with respect to vesting structures at and prior to the time of the Proposing Release based on third-party studies. We were unable to obtain updated third-party studies,

subject to time-based vesting, though this has declined slightly (by about three percentage points) since the time of the Proposing Release with the growth in reliance on performance-contingent stock.[471] Of the time-vesting stock awards, roughly one-third have cliff-vesting schedules while the vast majority of the remaining have graded vesting in annual increments.[472] For the stock awards that vest based on achieving performance conditions (approximately 55 percent of stock awards), the vast majority have cliff-vesting schedules.[473] Approximately ten percent of awards with performance-based vesting also have an additional time-based vesting period at the end of the performance period.[474] For option awards, the vast majority have time-based, graded vesting in annual increments.[475] Given the decline in option awards (which tend to have graded vesting schedules) and the increasing prevalence of performance-contingent stock (which tends to cliff-vest) discussed above, there has been a corresponding increase in cliff-vesting overall.[476]

For affected registrants other than SRCs, compensation related to pension plans is also measured differently in executive compensation actually paid, as reported under the final rules,

but have instead provided statistics based on staff analysis of available data. These statistics are largely consistent with the estimates presented in the Proposing Release.

471 This estimate is based on staff analysis of data about equity grants by 1,100 large registrants from 2018 to 2020 (or, for estimates around the time of the Proposing Release, from 2012 to 2015) from the ISS IncentiveLab Database.

472 *Id*. About 95% of the awards with graded vesting vest in annual increments. Results are similar if we compute such an estimate around the time of the Proposing Release.

473 *See supra* note 471. About 85% (about 80% around the time of the Proposing Release) of the awards with performance-based vesting cliff-vest.

474 *See supra* note 471. Results are similar if we compute such an estimate around the time of the Proposing Release.

475 *See supra* note 471. About 95% of the option grants have time-based vesting, of which about 85% have graded vesting, of which about 95% vest in annual increments. Results are similar if we compute such estimates around the time of the Proposing Release.

476 *See supra* note 471. At the time of the Proposing Release, roughly 45% of new equity awards cliff-vested; this rate has now increased to about 55%.

than it is in the Summary Compensation Table. The use of pension plans and the years of credited service at some of the potentially affected registrants are reported in the table below.[477]

Table 3. Use of pension plans by registrants covered by Execucomp

	All Firms in Database	Firms in S&P 500	Firms in S&P MidCap 400	Firms in S&P SmallCap 600
Firms in Sample	1,694	497	393	580
2020 Pension Plans				
% of CEOs with Pension Plans	22.5%	36.4%	24.4%	14.3%
Among Firms with CEO Plans, Median Years of Credited Service in Pension Plan	19.3	21.5	17.6	16.9
% Firms with Pension Plans for any NEO other than CEO	29.0%	45.7%	29.5%	19.1%
Among Firms with Other NEO Plans, Average Number of Other NEOs with Pension Plans	2.8	2.9	2.7	2.5

There has been a decrease of about ten percentage points in the prevalence of pension plans for CEOs or other NEOs since the time of the Proposing Release.[478] Per Table 3, such pension plans, and, for those with pension plans, a higher number of years of creditable service, remain more common among larger registrants. For the affected registrants other than SRCs, the final rules require that executive compensation actually paid include only the service cost for the year (and any prior service cost, or credit, associated with plan amendments or initiations), a value which is not currently required to be reported at this disaggregated level and which will usually differ from the total change in actuarial value of pension benefits included in total compensation reported in the Summary Compensation Table. In particular, the value currently included in total compensation reflects the change in actuarial pension value related to changes

[477] *See supra* note 462.

[478] *See* Proposing Release at Table 3.

in the value of benefits accrued in prior years as well as the value of benefits earned during the applicable fiscal year. As such, the value currently included with respect to pensions in total compensation reported in the Summary Compensation Table will generally be more volatile (because of changes in interest rates and other actuarial assumptions) than the value to be included with respect to pensions in the executive compensation actually paid measure. The degree of difference between these two computations will generally increase with an executive's total number of years of credited service (and thus the extent of benefits already accumulated) under the pension plan.

Besides the decreased prevalence of option awards and pension plans, and the increased reliance on performance contingent-stock awards, there have also been changes since the time of the Proposing Release in the performance metrics used by registrants in their incentive plans. For example, as noted in the Reopening Release, there appears to have been a decline in the use of TSR as the sole metric used in long-term incentive plans, in those cases where the awards' vesting or quantities are contingent on one or more performance metrics.[479] Among large companies, most use one to three financial metrics in their CEO's long-term incentive plan, with two metrics being the most common number.[480] The most commonly used metric among

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479 *See, e.g.,* Meridian 2020 Survey (summarizing responses to a survey from 108 companies, and discussing, among other developments, a decline in the use of TSR as the sole performance metric in long-term incentive plans, from 47% in 2016 to 30% in 2020, and the recent use by some companies of TSR as a modifier to results initially determined by one or more other financial metrics). However, as a result of the difficulty in setting absolute or accounting performance targets given recent uncertainty due to, *e.g.*, the COVID-19 pandemic, some market participants predict at least a temporary increase in the reliance on relative TSR as a performance metric. *See, e.g.*, Aon 2020 Study.

480 *See, e.g.,* Meridian Compensation Partners, LLC, *2021 Trends and Developments in Executive Compensation* (April 30, 2020), *available at* https://www.meridiancp.com/insights/2021-meridian-trends-and-developments-survey/ ("Meridian 2021 Survey") (summarizing responses to a survey from 309 large companies, and indicating that 35%, 51%, and 12% of the respondents used one, two, and three metrics respectively in long-term incentive plans); and Aon 2020 Study (presenting, in Figure 8, the number of metrics used in the CEO's long-term incentive plan among S&P 500 companies, broken down by industry, with an average of two metrics used in every industry).

these companies is still TSR, followed by profitability measures (particularly measures of operating income), and then scaled profitability measures (such as return on equity or return on invested capital).[481] Commenters pointed out that the metrics used are often non-GAAP financial measures.[482]

Some commenters indicated that another recent change in compensation practices has been an increased linkage of pay to ESG performance.[483] Our research confirms that this appears to be a growing practice, but that consideration of ESG metrics does not often seem to be tied to specific quantitative goals and that ESG metrics are generally used in short-term incentive plans.[484] These plans, such as annual bonus programs, generally make up a significantly smaller portion of total executive pay as compared to long-term incentive plans.[485] As in the case of metrics for long-term incentive plans, among large companies, most use one to three financial metrics in their CEO's short-term incentive plan, with two financial metrics

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481 *See, e.g.,* Meridian 2021 Survey (summarizing responses to a survey from 309 large companies, and indicating that TSR is the most commonly used long-term incentive performance metric, with use reported by 60% of the respondents); and Aon 2020 Study (indicating, in Figure 9, that TSR is the most commonly used metric in the CEO's long-term incentive plan among S&P 500 companies in most industries, where the use of TSR ranges from 22% to 61% of companies depending on the industry). Even when TSR is not used as an explicit performance metric, we note that these incentives are usually delivered in the form of stock awards, whose value will vary with the stock price.

482 *See, e.g.,* letters from As You Sow 2022; CII 2022; IBC 2022; Nareit; Pawliczek; and Teamsters. *See also* Nicholas Guest, S.P. Kothari, and Robert Pozen, *Why Do Large Positive Non-GAAP Earnings Adjustments Predict Abnormally High CEO Pay?* ACCT. REV. (forthcoming 2022), *available at* https://doi.org/10.2308/TAR-2019-0003.

483 *See, e.g.,* letters from Aon HCS; CII 2022; Georgiev; and Infinite.

484 *See, e.g.,* Meridian Compensation Partners, LLC, *2021 Study on Environmental, Social and Governance Metrics in Incentive Plans* (Oct. 7, 2021), *available at* https://www.meridiancp.com/wp-content/uploads/2021/10/Meridian-2021-ESG-Survey.pdf (reporting the results of a review of the proxy statements of 315 large U.S. companies for the use of ESG metrics in incentive plans).

485 *See, e.g.,* Gallagher 2021 Study (reporting, in Figure 1.4, that for Russell 3000 companies in the year 2020, long term incentives represented 71% of the value of total direct compensation to CEOs, compared to 17% of such value being attributed to annual bonuses).

being the most common.[486] The most commonly used metric among these companies is profitability (particularly measures of operating income), followed by revenues, and then measures of cash flow.[487] It is also common to include business unit performance goals and non-financial metrics, such as measures of individual performance, strategic goals, or ESG metrics.[488] There may be overlap in the measures used in executive's short-term incentive plans and those used in their long-term incentive plans, but more often than not these metrics are different.[489]

There is no consensus in the market on the number of metrics that should be used in designing executive compensation, with some advocating for the use of more metrics[490] and others advocating for fewer.[491]

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486 *See, e.g.,* Meridian 2021 Survey (summarizing responses to a survey from 309 large companies, and indicating that 37%, 46%, and 11% of the respondents used one, two, and three financial metrics respectively in short-term incentive plans); and Aon 2020 Study (presenting, in Figure 1, the number of financial metrics used in the CEO's short-term incentive plan among S&P 500 companies, broken down by industry, with an average of two metrics used in every industry except Energy, with an average of three metrics, and Real Estate, with an average of one metric).

487 *See, e.g.,* Meridian 2021 Survey and Aon 2020 Study.

488 *Id*.

489 *See, e.g.,* Pearl Meyer & Partners, LLC, *Overlap of Executive Incentive Plan Performance Measures: Is the Concern Warranted?* (December 2019), *available at* https://www.pearlmeyer.com/overlap-executive-incentive-plan-performance-measures-concern-warranted.pdf.

490 *See, e.g.,* letter from Better Markets 2022 (stating that any issuer using less than five performance metrics is "likely focusing NEO performance on too small a group of metrics"); and Radhakrishnan Gopalan, John Horn, and Todd Milbourn, *Comp Targets That Work*, HARVARD BUS. REV., Sept. 2017, at 102, *available at* https://hbr.org/2017/09/comp-targets-that-work (indicating that using too few metrics can "create opportunities to manage to the targets" and suggesting that companies use multiple metrics that are not too closely correlated).

491 *See, e.g.,* Norges Bank Investment Management, *CEO Remuneration Position Paper* (Apr. 7, 2017), *available at* https://www.nbim.no/en/the-fund/responsible-investment/our-voting-records/position-papers/ceo-remuneration (stating that shares awarded to a CEO should not be subject to any performance conditions, which "are often ineffective and may result in unbalanced outcomes"); and Council of Institutional Investors, *Policies on Executive Compensation* (Sept. 17, 2019), *available at* https://www.cii.org/files/ciicorporategovernancepolicies/20190918NewExecCompPolicies.pdf ("CII 2019 Policies") (criticizing the "numerous and wide-ranging" metrics that contribute to the complexity of performance-based pay).

Overall, it is clear that the structure of executive compensation continues to evolve, as noted by commenters,[492] and further changes may be on the horizon. For example, recent tax law changes[493] and concerns about the complexity and effectiveness of performance-contingent stock awards[494] could encourage registrants to reduce their reliance on such awards. Uncertainty in the wake of the COVID-19 pandemic[495] and lower say-on-pay approval[496] at large companies in recent years, as compared to previous years, could also drive changes in compensation structure, though it remains difficult to predict whether these factors will have lasting effects and what such effects are likely to be.

C. Discussion of Economic Effects

The final rules require registrants to present, in one location, information that for the most part is disclosed in various other locations (and using different computations) under existing rules, and to tag the new disclosure using a machine-readable data language (Inline XBRL). The anticipated benefits and costs of the final rules are therefore driven by the impact that this additional format for presenting information may have on investors and registrants,

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492 *See, e.g.,* letters from CEC 2022; Davis Polk; and SCG.

493 *See* IRS Notice 2018-68, 2018-36 I.R.B. 418 (regarding, among other things, the revision to Section 162(m) that removed the exception for qualified performance-based compensation in determining the amount of remuneration for any covered employee that would not be deductible by a registrant for tax purposes). *See also* Kevin Murphy & Michael Jensen, *The Politics of Pay: The Unintended Consequences of Regulating Executive Compensation*, 3 J. L. FIN. & ACCT. 189 (2018) (stating that amendments to Section 162(m) passed in 2017 would reduce or eliminate negative consequences of this rule, such as the "recent (and ill-advised) escalation of performance-share plans"). However, recent studies have generally not found evidence of significant changes in compensation structure in reaction to this change in tax law. *See infra* note 596.

494 *See, e.g.,* Marc Hodak, *Are Performance Shares Shareholder Friendly?* 31 J. APP. CORP. FIN., No. 3, 126 (Summer 2019); and CII 2019 Policies.

495 *See, e.g.,* Pay Governance, *The COVID-19 Pandemic's Fleeting and Lasting Impact on Executive Compensation* (Apr. 2022), *available at* https://www.paygovernance.com/viewpoints/the-covid-19-pandemics-fleeting-and-lasting-impact-on-executive-compensation.

496 *See, e.g.,* Semler Brossy, *2022 Say on Pay & Proxy Results* (May 26, 2022), *available at* https://semlerbrossy.com/insights/2022-say-on-pay-report/ (documenting a decline in say-on-pay voting support at S&P 500 companies in 2021 and 2022 relative to previous years).

rather than by the disclosure of new underlying informational content that investors could not already access or that would require registrants to collect significant new data. The economic benefits and costs of the final rules, including impacts on efficiency, competition and capital formation, are discussed below. We also discuss the relative benefits and costs of significant, reasonable alternatives to the implementation choices reflected in the final rules.

1. Introduction

As discussed in the Proposing Release, compensating executive officers with pay that varies with registrant performance may encourage executive officers, through financial incentives, to exert effort and make decisions that create shareholder value. However, there are also potential negative consequences of such compensation plans. For example, some such plans may cause executives to focus overly on short-term performance to the detriment of long-term performance, or may make some executives less likely to take on risky but (from a typical shareholder's perspective) valuable projects if they are unwilling to take the chance that the project could fail and result in lower compensation than would result from less risky projects.

An optimal compensation policy is generally considered to be one that maximizes shareholder[497] value in the long term by balancing the need to provide executives with the incentive to perform well against the monetary costs and potential detrimental effects of the compensation policy. What constitutes an optimal compensation policy, including which performance metrics should be considered and how much compensation should vary with these metrics, is difficult to ascertain and will vary with a registrant's individual circumstances.

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497 Some argue that optimal compensation would maximize broader stakeholder value, not just the value of shareholders, while others respond that long-term shareholder value incorporates effects on other stakeholders. *See, e.g.*, letter from TCA 2022.

Academic research remains mixed as to whether prevailing compensation structures are optimal, are too closely linked to company performance, or should be more sensitive to company performance.[498] Thus, it is unclear whether changes that would more closely link executive pay with registrant performance than current compensation structures would have a positive, a negative, or no impact on shareholder value creation.

In addition to uncertainties about the optimality of pay-versus-performance alignment, there are challenges in measuring such alignment. For example, the available performance statistics may not adequately measure a given executive's contribution to a registrant's performance, such as when registrant performance is strongly related to market moves, sector opportunities, commodity prices, or other factors unrelated to managerial effort or skill.[499] Even if the performance measure were not subject to such concerns, it could be difficult to match registrant performance with the associated executive actions and, perhaps, related compensation because of timing differences. For example, an executive may be rewarded with extra compensation for an accomplishment in the year it is made, even though a registrant's expected profits related to this executive performance (such as an investment or restructuring decision)

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498 *See, e.g.,* Alex Edmans, Xavier Gabaix & Dirk Jenter, *Executive Compensation: A Survey of Theory and Evidence*, in Benjamin Hermalin & Michael Weisbach (eds.), HANDBOOK ECON. CORP. GOV. (2017), at 383-539 ("Edmans *et al*. 2017 Survey Paper") (summarizing theoretical and empirical research on executive compensation, including on its sensitivity to performance, and noting that the results are mixed, and that "[e]ven seemingly fundamental questions, such as the causal effect of pay on firm outcomes, … remain largely unanswered"). For seminal studies presenting differing views, *see, e.g.,* Alex Edmans & Xavier Gabaix, *Is CEO Pay Really Inefficient? A Survey of New Optimal Contracting Theories*. 15 EUR. FIN. MGMT (2009), at 486-496; Michael Jensen & Kevin Murphy, *Performance Pay and Top-Management Incentives*. 98 J. POL. ECON 225 (1990); and Lucian Bebchuk & Jesse Fried, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION, Harvard University Press (Oct. 2006).

499 *See, e.g.,* Marianne Bertrand & Sendhil Mullainathan, *Are CEOS Rewarded for Luck? The Ones Without Principals Are*, 116 Q. J. OF ECON. 901 (2001). Other situations in which registrant performance statistics may differ from an executive's performance include cases in which the statistics measure managerial effort but not of the particular manager in question (which may be particularly likely in the case of NEOs other than the PEO) and situations in which other factors such as registrant size affect the translation of a given level of managerial effort into the measured statistics.

might not follow until several years later. Similarly, a registrant's stock price may rise at the announcement of a new PEO who is expected to add significant value to the registrant, even though he or she may not commence employment and begin receiving compensation until the following year. The alignment of an executive's financial incentives with registrant performance can also be difficult to evaluate without also considering holdings of vested equity which link an executive's wealth accumulation to the performance of the company whether or not they were obtained as compensation.[500] Such issues may lead to concerns with any standardized approach to presenting the relationship between pay and performance.

Despite the uncertainty and challenges involved in evaluating the relation of pay with performance, pay-versus-performance alignment is likely important to investors. In fact, academic research concludes that the incentives created for executives through the linkage of their pay with registrant performance outcomes may be the most value-relevant feature of current executive compensation plans, beyond even the level of executive pay.[501] Accordingly, investors may consider the optimality of pay-versus-performance alignment as part of their evaluation of executive compensation packages when making voting decisions relating to the compensation of the NEOs and the election of directors, as well as when making investment decisions.[502]

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500 *See, e.g.,* Kevin J. Murphy, *Executive Compensation: Where We Are, and How We Got There*, HANDBOOK ECON. FIN., Volume 2 (George Constantinides, Milton Harris & René Stulz eds., 2013), at 211-356 ("Murphy 2013 Study") (stating that incentive compensation is negatively correlated with manager's vested equity interests, reflecting the redundancy of granting further equity awards to executives whose wealth is already substantially tied to the company's equity).

501 *See, e.g.,* Edmans *et al.* 2017 Survey Paper (stating that "[the] level of pay receives the most criticism, but usually amounts to only a small fraction of firm value. Badly structured incentives, on the other hand, can easily cause value losses that are orders of magnitudes larger.").

502 *See, e.g.,* Stanford 2015 Investor Survey (stating that 64% of institutional investors surveyed indicated that their firms used pay-for-performance alignment information from proxy statements to make voting decisions; 34% of those surveyed indicated that this information was used to make investment decisions).

2. Benefits

For the most part, the final rules require a different presentation of certain existing information rather than the disclosure of new underlying informational content. The primary benefits of the final rules relative to the baseline will therefore depend on the extent to which the computations provided or the format used for the required disclosure makes it easier or less costly for investors to evaluate how executive compensation relates to registrant performance.

As discussed above, investors currently have access to detailed information disclosed by registrants with respect to executive compensation and registrant financial performance, but some investors have expressed dissatisfaction with existing disclosures. Data from the currently required, standardized tables and accompanying information may require further computation and analysis before investors can evaluate actual historical pay-versus-performance alignment under the baseline. Also, voluntary disclosures that provide more direct measures of the historical pay-versus-performance relationship are provided by a minority of registrants and lack standardization and comparability, as discussed in the Baseline section above. The more standardized quantitative analyses of pay-versus-performance alignment provided by the major proxy advisory firms to their clients, as well as the analyses undertaken by certain large institutional investors on their own, demonstrate shareholder demand for additional computations regarding this relationship, beyond existing disclosures.[503]

Investors may therefore benefit from the final rules to the extent that the new presentation of data required by these final rules lowers their burden of analysis in evaluating the executive compensation policies of the affected registrants. If the repackaging of some of the information from existing disclosures into the required pay-versus-performance disclosure,

[503] *See, e.g., supra* notes 443 and 444.

and the Inline XBRL tagging of this disclosure, allows investors to more quickly or easily process the information accurately, the final rules may generate productive efficiencies by preventing duplicative analytical effort by investors. If the disclosure helps investors process and understand compensation data faster, this information may also be more quickly incorporated in market prices, marginally increasing the informational efficiency of markets.

The final rules should make it much easier for an investor reviewing a proxy statement to relate registrant performance with concurrent changes in the value of compensation, because the amount disclosed as executive compensation actually paid will more closely track these changes than currently required compensation disclosure. Further, for a number of reasons, the disclosure required under the final rules is expected to be significantly more comparable across registrants and across time than existing required disclosures in the CD&A regarding how pay relates to performance as well as current voluntary pay-versus-performance disclosures. This enhanced comparability will likely enable more efficient processing of the information. For example, the consistent tabular format will likely make the information easier to find, and standardization of the measures of pay, TSR, and net income will allow investors to understand what these measures represent without having to examine varying definitions used by different registrants. In addition, prescribing particular measures of pay and performance reduces the ability of registrants to only include measures that lead to more favorable pay-versus-performance disclosures, which, in turn, would reduce their utility and comparability. The specific definition of executive compensation actually paid under the final rules also enhances the comparability of the disclosures, as discussed in more detail below, as it treats similar economic situations relatively consistently, allowing investors to more easily evaluate the disclosure in the context of the disclosure of other registrants.

Some commenters agreed that such disclosures may reduce the time, effort, and/or cost required to review proxy statements,[504] with several noting that the proposed disclosure could be used by investors to more easily review disclosures to identify which registrants' compensation arrangements they should investigate in greater detail.[505] Also, many commenters supported the importance of the consistency and comparability of the disclosures.[506]

On the other hand, a number of commenters indicated that meaningful comparability of pay-versus-performance disclosure is not feasible or not desirable given, for example, the degree of variation in the circumstances of registrants and the vast, differing array of considerations that go into their compensation programs.[507] We acknowledge that perfect comparability may be impossible to achieve, and that some registrants may choose to supplement the required disclosures to better communicate their specific situation. However, compensation and performance, and their alignment, also cannot be properly evaluated in a vacuum. Broader economic conditions and the labor market for executive talent have significant effects on the appropriate level and performance-sensitivity of pay.[508] Pay-versus-performance disclosures that can be compared across registrants should facilitate investors' consideration of these factors. Registrants already have substantial flexibility to provide tailored disclosures in proxy statements with respect to the relation of pay with performance. However, as discussed above, many investors are obtaining standardized third-party analyses of

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[504] *See, e.g.,* letters from Farient; Hermes; LGIM; OPERS; SVA; and TIAA.

[505] *See, e.g.,* letters from Hermes and OPERS.

[506] *See, e.g.,* letters from American Tower; As You Sow 2015; Barnard 2015; Barnard 2022; CalSTRS; CAP; CFA; CII 2015; Farient; Hermes; Hook; KPMG; OPERS; PDI; PRI; Quirin; Teamsters; and TIAA.

[507] *See, e.g.,* letters from BorgWarner; Celanese; Exxon; FSR; NAM 2015; NIRI 2015; SCG; SCSGP; and Simpson Thacher.

[508] *See, e.g.,* Edmans *et al.* 2017 Survey Paper.

pay-versus-performance across different registrants, or constructing their own, which demonstrates demand for more consistent, comparable disclosure.

Some commenters indicated that, whether or not comparability is desirable, the proposed amendments would not actually provide disclosures that could be compared across registrants.[509] These commenters stated that the proposed disclosure would not be comparable because, for example, equity granting and vesting practices vary across registrants,[510] valuation assumptions may vary across registrants,[511] and there is no single way to uniformly measure performance across different registrants.[512] We expect that the revised definition of executive compensation actually paid will increase the comparability of this measure across registrants with different compensation structures. In particular, for outstanding equity awards between their grant and vesting date, the change in value reported as part of this measure for a particular year is equal to the change in fair value during that particular year, and therefore may be associated with performance during the same year. This is true regardless of the grant and vesting patterns, such that similar economic exposure for executives across different registrants should be reflected more similarly than under the proposed amendments, even when the formal structure differs.

With respect to the concern about the lack of comparability of performance measures, several commenters agreed with our view that, despite certain concerns discussed below, TSR is the most comparable financial performance measure available.[513] Given that TSR is nonetheless

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[509] *See, e.g.,* letters from Celanese; Hodak; Honeywell; IBC 2015; SCSGP; and Simpson Thacher.

[510] *See, e.g.,* letters from Celanese; Hodak; SCSGP; and Simpson Thacher.

[511] *See, e.g.,* letters from IBC 2015 and Simpson Thacher.

[512] *See, e.g.,* letters from Celanese and Honeywell.

[513] *See, e.g.,* letters from Davis Polk 2022; Hodak; and TIAA.

an imperfect measure, the inclusion of peer group TSR, net income, and at least one Company-Selected Measure may provide useful context for investors when comparing the disclosed performance across registrants. Finally, with respect to the concern about varying valuation assumptions, the disclosure of equity award valuation assumptions when they differ materially from the disclosures of assumptions as of the grant date may help investors to identify if a particular registrant's approach to these assumptions appears to be an outlier. Overall, as noted above, perfect comparability is difficult to achieve. However, the final rules are intended to provide some basic standardized elements that can be more easily reviewed and compared across registrants. At the same time, they also include more tailored elements that may better reflect registrants' individual circumstances, such as additional registrant-specific context, significant latitude in how registrants describe the relationships between the measures in the prescribed table, and the option of supplemental disclosures in case, in the registrant's view, additional detail or clarifications would be helpful.

The overall size of the potential benefit to investors depends on the extent to which the required disclosure approximates or contributes to any of the calculations and analyses that investors would choose to perform in order to process the existing disclosures. That is, the benefits of consistency and comparability will apply only to the extent that investors find the prescribed measures to be useful. While the specific extent of benefits is difficult to ascertain, commenters as well as our observations of current analyses by or on behalf of investors provide support that the disclosures are likely to be useful to investors.

For example, the new measure of executive compensation actually paid will reflect new required computations (based on information in existing disclosures) that may be particularly relevant in the context of evaluating the relationship of pay with performance. These computations may make information of interest to investors more readily available than it is under the baseline. Commenters indicating that investors would find the proposed measure of executive compensation actually paid to be useful generally cited potential benefits discussed in the Proposing Release, such as the fact that this measure would reflect the change in value of equity awards based on performance outcomes after they are granted,[514] that it would focus on economic exposure due to compensation committee intent and not executives' personal investment decisions,[515] that it would reflect all elements of compensation for completeness and comparability,[516] and that it would eliminate noise caused by the revaluation of pension benefits earned in prior periods.[517] The revised definition of executive compensation actually paid preserves all of these features, while also mitigating concerns raised by a large number of commenters about a likely timing mismatch between the proposed measure of pay and the associated performance.[518] By requiring the revaluation of equity awards every year, the revised measure significantly improves the degree of matching between the period to which a change in pay is ascribed and the period of the associated performance, which should make the measure substantially more useful for investors.[519]

The revised measure is also very similar to the concept of realizable pay, discussed above. A number of commenters indicated that a realizable pay measure would be particularly

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514 *See, e.g.,* letters from CII 2015; LGIM; Pawliczek; and TIAA.

515 *See, e.g.,* letters from AFL-CIO 2015; CII 2015; Hall; OPERS; and Public Citizen.

516 *See, e.g.,* letters from AFL-CIO 2015; Barnard 2015; Barnard 2022; and OPERS.

517 *See, e.g.,* letters from Hall and TIAA.

518 *See* Section IV.C.4.iii below for more detail on these concerns.

519 *See, e.g.,* letter from TIAA (noting that addressing the alignment issue "would greatly improve the clarity and value of the disclosure for investors").

appropriate for evaluating the alignment of pay and performance.[520] While definitions of realizable pay vary,[521] they reflect, like executive compensation actually paid, an attempt to measure the change in value of an executive's pay package—including outstanding awards that have not yet been realized—after the grant date, as performance outcomes are experienced. We believe that the increasing consideration of realizable pay (as computed by third parties) by investors when evaluating pay and performance alignment[522] is evidence that a measure with similar features,[523] such as the adopted measure of executive compensation actually paid, is likely to be useful to investors in this context.[524]

Although investors could estimate executive compensation actually paid using existing disclosures, and may already be making similar estimates on their own or relying on third party estimates of related measures, they may benefit from these computations becoming readily available in the prescribed compensation measure. The newly disclosed computations could reduce duplicative analytical effort by replacing or validating related investor or third party estimates. In addition, some investors or third parties hired by investors may be interested in

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520 *See, e.g.,* letters from CEC 2015; Pearl; PG 2015; PG 2022; and SCSGP (citing the conclusions of a broader working group led by the Conference Board). Others recommended the adopted approach or other variations similar to realizable pay. *See* letters from CAP; Farient; Hodak; Infinite; TCA 2015; and TCA 2022.

521 Realizable pay generally reflects the end-of-period value of outstanding equity awards as well as the value of any cash and equity awards realized during the period, with a focus on equity awards that were granted within a particular horizon. Differences across definitions include whether outstanding options are valued at fair value or intrinsic ("in-the-money") value, and whether the value of performance- or time-based awards is recognized when earned, when vested, or at the end of the period. *See, e.g.,* ISS Realizable Pay Article.

522 See *supra* note 454.

523 Differences between realizable pay measures and the adopted definition of executive compensation actually paid and associated costs and benefits for this purpose are discussed in more detail in Section IV.C.4.iii below.

524 To the extent that some investors may be interested in considering the relationship of performance with a measure of pay that reflects the grant date value of equity awards, they would be able to refer to the Summary Compensation Table measure of total compensation required alongside executive compensation actually paid in the tabular disclosure. As discussed above, some of the existing pay-for-performance analyses by, or on behalf of, investors use such a measure, though most of the analyses that we observe also supplement this with a realizable pay measure. See *supra* notes 446 and 448.

leveraging the disclosures to more easily compute slightly different pay measures, whether these are the measures they currently use under the baseline or refined versions of these measures that are more feasible to construct due to the availability of the new disclosures, or in using parts of the required computations for other purposes.[525] In such cases they are likely to benefit from the required footnote disclosure of the adjustments made to compute executive compensation actually paid and the disclosure of equity valuation assumptions, if materially different from the grant date assumptions. Also, requiring that the disclosure be provided in a structured data language may benefit investors interested in extracting and analyzing some or all of the data in the disclosure across a large number of filings.

With respect to the performance information required in the new disclosures, as discussed above, there are challenges associated with measuring an executive's contribution to registrant performance that may lead to concerns with any performance measure. Commenters expressed a number of concerns with the use of TSR in particular in evaluating executive performance, such as its sensitivity to external factors outside of the control of executives,[526] a possible emphasis on short-term performance,[527] and the possibility of strategies that could artificially inflate TSR.[528] However, we are not aware of, and commenters did not identify, any standard, singular measure that would be a uniformly better alternative, and some commenters

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[525] *See, e.g.,* letters from CII 2015 (stating that "[s]ophisticated investors will make different adjustments to the compensation information… they are given"); and As You Sow 2015 (expressing interest in a cumulative measure of executive compensation actually paid, which we note could be constructed from the annual measures that will be disclosed).

[526] *See, e.g.,* letters from AFL-CIO 2015; Aspen; CalPERS 2015; CEC 2015; Celanese; Dimensional; FSR; Hay; IBC 2015; IBC 2022; McGuireWoods; Mercer; NACCO; NIRI 2015; NIRI 2022; PDI; Pearl; Samuelson; and SBA-FL.

[527] *See, e.g.,* letters from AFREF; ASA; Blackrock; BRT 2015; CCMC 2015; CEC 2015; Coalition; FedEx 2015; FSR; Hall; IBC 2015; IBC 2022; Mercer; NACCO; NACD 2015; NAM 2015; NIRI 2015; Samuelson; SCG; Simpson Thacher; and WorldatWork.

[528] *See, e.g.,* letters from Better Markets; Hodak; IBC 2022; McGuireWoods; NACCO; Pearl; and PDI.

noted that TSR would be a useful measure. In particular, commenters that indicated that investors would find TSR to be useful noted that it is the ultimate measure of corporate success and shareholder value creation[529] and it is widely comparable across registrants.[530] We agree with these commenters that, despite its limitations, TSR is likely to be a useful measure in this context, particularly because it incorporates information about a variety of facets of registrant performance, including market expectations of the future impact of current executive actions, and it is responsible for a significant amount of the variation in compensation outcomes experienced by executives. Specifically, academic studies indicate that changes in the value of equity awards after the grant date, with the movement of stock prices, are the primary channel though which pay is linked to registrant performance.[531] TSR is mechanically a significant determinant of executive pay outcomes, as it is the most commonly used metric in long-term incentive plans, and, more importantly, a majority of CEO compensation is awarded in the form of equity awards, whose value is closely tied to stock prices even when TSR is not explicitly used as a performance metric.[532] Current market practices provide further evidence that TSR is likely to be useful to investors in this context: every investor and third-party analysis of

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529 *See, e.g.,* letters from AFL-CIO 2015; CII 2015; Farient; Hermes; Hodak; and OPERS.

530 *See, e.g.,* letters from Barnard 2015; Barnard 2022; CII 2015; Davis Polk 2022; Hodak; and TIAA.

531 *See, e.g.,* Edmans *et al.* 2017 Survey Paper (presenting evidence that "the vast majority of executive incentives stem from revaluations of stock and option holdings, rather than changes in annual pay"); and Murphy 2013 Study (stating that studies show that virtually all of the sensitivity of pay to corporate performance for the typical CEO is attributable to the direct link between stock price performance and the CEO's portfolio of stock and options). *See also* letter from Hodak (stating that, for the average company, "upwards of 80 percent of the real variation in the value of pay would derive from unvested equity").

532 *See* Section IV.B.3 above. One commenter stated that the Proposing Release did not provide "any compelling evidence that [TSR] is a metric commonly used by companies to measure performance or in setting compensation." *See* letter from CCMC 2015. Section IV.B.3 above provides more detail on the significant use of TSR as a performance metric as well as the heavy reliance on equity awards, whose value is closely tied to TSR, in compensating executives. However, as discussed in this section, there is also other evidence that TSR may be an appropriate measure for this purpose.

pay-for-performance that we have observed incorporates TSR as a primary performance measure.[533]

However, even if TSR, despite the limitations noted above, is a particularly useful measure for the purpose of evaluating the relation of pay with registrant performance, it may not provide a complete picture of registrant performance. Further, relying solely on TSR to evaluate registrant and executive performance may even be misleading in certain situations, such as when expected outperformance is already reflected in the starting stock price,[534] when a stock is thinly traded,[535] or when market dynamics cause stock returns to become particularly disconnected from fundamental performance.[536] The required disclosure of additional financial performance measures may help to address these concerns by broadening the picture of registrant performance presented in the disclosure, providing additional detail and context that could enhance the usefulness of the disclosure by certain registrants or for certain investors.

For example, several investors commented that the inclusion of TSR of a peer group would enhance the comparability of TSR,[537] perhaps by providing a benchmark for some of the market- or industry-wide factors that may affect performance at each registrant. Some commenters indicated that the required inclusion of a Company-Selected Measure and net income would provide a more complete picture of registrant performance.[538] More specifically,

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533 *See supra* note 451.

534 *See, e.g.,* letters from Aspen and SCSGP.

535 *See, e.g.,* letters from Hyster-Yale and NACCO.

536 *See, e.g.,* letters from McGuireWoods and SCG (citing the recent “meme stocks” phenomenon as an example of massive fluctuations in stock price which have little to do with fundamental performance).

537 *See, e.g.,* letters from OPERS and TIAA.

538 *See, e.g.,* with respect to the Company-Selected Measure, letters from Better Markets; CII 2022; and Dimensional; and with respect to net income, letters from CII 2022 and Teamsters.

commenters stated that a Company-Selected Measure would provide insight into the registrant's perspective[539] and a facet of performance that is directly relevant for understanding compensation,[540] and that net income would provide a more objective accounting benchmark that is not affected by items like non-GAAP adjustments[541] and stock buybacks.[542] Similarly, some commenters indicated that including a list of the most important performance measures used by the registrant to link compensation actually paid to company performance would provide useful context or a more complete view of pay-for-performance programs,[543] and may therefore help address concerns that the pay-versus-performance disclosure could otherwise "mislead" investors.[544] Finally, to the extent registrants include additional supplemental measures of performance, commenters indicated they generally expect investors to benefit from an even more complete picture of performance.[545]

As discussed in the Baseline section above, all of the required performance information is generally already available in existing disclosures in annual reports or the CD&A of proxy statements. However, including this performance information in the pay-versus-performance disclosure may be useful to investors to the extent it limits the time they need to spend referring to other disclosures[546] in order to interpret the pay-versus-performance disclosure, or prevents

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539 *See, e.g.,* letter from AFL-CIO 2022.

540 *See, e.g.,* letters from CalPERS 2022; CalSTRS; and Infinite.

541 *See, e.g.,* letters from As You Sow 2022 and Teamsters.

542 *See, e.g.,* letters from Better Markets and CalSTRS.

543 *See, e.g.,* letters from AFREF; Better Markets; and CII 2022.

544 *See, e.g.,* letters from AFREF and CII 2022.

545 *See, e.g.,* letters from AFL-CIO 2022; CalPERS 2015; CFA; CII 2022; and Hay.

546 *See, e.g.,* letters from AFL-CIO 2022 (stating that shareholders must currently "comb through the narrative disclosure provided in the Compensation Discussion and Analysis and then separately match up the company's actual performance from financial statements"); and As You Sow 2015 (stating that they focus primarily on proxy statements from March to May, and would therefore support moving the Item 201(e) of Regulation S-K graph, which includes TSR and the TSR of a peer group, to the proxy statement from the annual report).

some investors from overlooking important context about the broader performance or pay-for-performance programs of a registrant. The required description, in graphical or narrative form, of the relationship between pay and the performance measures in the prescribed table is not anticipated to provide significant additional information beyond the contents of the table, but if it presents this information effectively, it may help investors to more easily interpret the disclosure.

If the required disclosure is useful to investors, the benefits are likely to vary across investors of different types. For example, it may be particularly beneficial to those investors who do not have access to third-party analyses, have fewer analytical resources, or are less adept at interpreting current disclosures on their own.[547] That said, some such investors may limit their proxy statement review to items like a voluntarily-provided proxy summary section regardless of the existence of the new disclosure, in which case they are unlikely to benefit.[548] Among investors with more resources or sophistication, some may benefit by being able to more quickly review proxy statements to determine which to investigate in more detail,[549] and some may reduce their analytical burdens by relying on information from the new disclosure to replace, to validate, or to more easily construct the inputs for their existing analyses. To the extent third parties are able to similarly leverage information provided in the new disclosures in constructing their own quantitative analyses, they may pass on some of these benefits in the form of a lower cost or a more useful analysis to subscribing investors. On the other hand, some

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547 *See, e.g.,* letters from OPERS and Teamsters.

548 *See, e.g.,* letters from Axcelis and NIRI. *See* also Abt SRBI, *Mandatory Disclosure Documents Telephone Survey*, Commissioned by SEC's Office of Investor Education and Advocacy (July 30, 2008), *available at* https://www.sec.gov/pdf/disclosuredocs.pdf, at 38 (presenting survey evidence that, among individual investors that read proxy statements, 43% reported spending less than 10 minutes reading proxy statements).

549 *See supra* note 505.

investors or the third parties they subscribe to may continue to independently construct their own analyses without using any elements of the new disclosure; these investors are unlikely to benefit from the disclosure.[550] For all of the investors that would benefit from the disclosures, they are likely to benefit the most in the case of (i) registrants with particularly complex compensation plans, and where the alignment of pay and performance may therefore be difficult to assess, and (ii) registrants that do not already provide useful pay-versus-performance disclosure on a voluntary basis.

Overall, the direct benefits of the final rules hinge on the new disclosures being relatively easy to review and including the information investors are most interested in when evaluating the relation of pay with performance. Therefore, if the included measures are significantly different from those investors would collect or construct on their own in order to evaluate executive compensation, or if the disclosure is too long or complicated to review quickly, benefits to investors could be limited. Some commenters expressed such concerns, indicating that the proposed disclosures would be of minimal or no benefit to investors.[551] However, as discussed above, there is evidence that the revised measure of executive compensation actually paid and TSR are similar to measures currently used by many investors in quantitative analyses of pay and performance alignment, which suggests that these elements of the new disclosure are likely to be at least somewhat useful to investors. It is less clear to what extent the overall effect of the additional required performance measures will be to enhance the utility of the new disclosures to investors, recognizing that the usefulness of these components may be reduced by their contribution to the overall length and complexity of the

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550 *See, e.g.,* letters from Axcelis; IBC 2015; and SCG.

551 *See, e.g.,* letters from BRT 2015; CAP; Celanese; FedEx 2015; NAM 2015; and Pearl.

disclosures,[552] which may make it difficult to quickly interpret the basic elements of the disclosures. Any supplemental explanations registrants include may further increase the length and complexity of the new disclosures.[553] That said, the tabular disclosure of the underlying data will provide a degree of consistency and comparability, which can aid investors in quickly processing the information.

The final rules could also have indirect benefits if the required disclosures lead to more optimal compensation policies, perhaps as a result of increased attention on the level or structure of NEO compensation and/or registrant performance. Specifically, if, by virtue of the disclosure, NEOs become less likely to demand, or boards become less likely to approve, a compensation level or structure that is not optimal (in that, as discussed above, it does not maximize long-term shareholder value),[554] then benefits will arise to investors and registrants. The resulting pay packages may represent either a benefit or a cost to the NEOs depending on whether or not the more optimal compensation structure, including the level of compensation as well as the risk exposure, is preferred by the executives. The final rules could also indirectly benefit investors and registrants in the form of more optimal board composition, if, by virtue of the disclosure, shareholders make more informed voting decisions.

The likelihood of such indirect effects is difficult to estimate because the ideal pay-versus-performance analysis, as well as the optimal pay structure, is uncertain and may vary by company, and because reactions to the repackaging of information are difficult to

[552] *See, e.g.,* letters from CEC 2015; McGuireWoods; Meridian; and TCA 2022.

[553] *See, e.g.,* letters from Aon HCS; Aspen; CEC 2022; Celanese; Coalition; Exxon; Hyster-Yale; IBC 2022; NACCO; NAM 2015; NIRI 2015; NIRI 2022; and PNC.

[554] It is important to note that, as mentioned above, a closer link between executive pay and stock performance than the current status of compensation could be either beneficial or detrimental to shareholder value creation.

predict. As discussed above, the disclosure is intended to facilitate investors' consideration of the alignment between pay and performance when making related voting decisions. Several commenters indicated that they anticipated that the proposed amendments would therefore result in improvements in compensation and/or corporate governance.[555] However, because the final rules do not require the disclosure of significant new underlying informational content, and given the high level of existing attention to pay practices—including increased engagement on these matters with institutional investors, and the sophisticated methods and processes that many investors and third parties have developed for evaluating pay—we believe that it is unlikely that the final rules will play a significant role in encouraging more optimal pay packages or corporate governance. We therefore believe that the final rules are likely to have no material beneficial effects on competition or capital formation.

Lastly, we note that the required pay-versus-performance disclosure will provide some incremental information relative to the underlying informational content already available to the public in other formats, but that the extent of this information is limited. For example, the valuation of equity awards such as options and performance-contingent stock involve certain assumptions and expectations, and registrants are not currently required to disclose valuation assumptions for most[556] such awards on dates other than the grant date. Vesting-date values currently are provided for stock awards in the Stock Vested and Options Exercised Table, but the applicable fair values at times before these dates, other than the grant date, and for options at all dates other than the grant date, are not separately presented by registrants. That said, for

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555 *See, e.g.,* letters from Better Markets and Sacred Heart.

556 A minority of option-like awards may be classified as liability awards under FASB ASC Topic 718, because of, *e.g.*, certain cash settlement features or conditions or other features that are indexed to conditions other than a market, performance, or service condition. In such cases, the entity is required to revalue the award at fair value each period and to adjust its cumulative cost in the financial statements, and the associated valuation assumptions would generally be available in financial statement footnote disclosures.

some awards, additional assumptions are not required to compute their fair values at these other dates. Specifically, for stock awards, such as restricted stock, that only have service-based conditions, the fair value would generally simply equal the stock price at the time. For stock with performance-based conditions other than market conditions, determining the fair value would involve a reassessment of the probable outcome with respect to the performance metrics involved, but registrants are also required to reassess these probable outcomes each period for the purpose of financial statement reporting, and associated footnotes should provide insight into the registrant's evaluation to the extent the changes in estimates are material.

Computing the fair value of other awards, such as options and stock with market-based conditions, after the grant date would likely require new assumptions. Using existing disclosures, investors can themselves make estimates of the fair values of options and stock with market-based conditions at dates beyond the grant date based on the disclosed terms of these awards, and by using publicly available data to make reasonable valuation assumptions.[557] In contrast, a fair value estimate provided directly by the registrant would reflect its discretion in choosing a valuation methodology and estimating the inputs required, such as the expected option life and the expected volatility of the stock.[558] The grant-date valuations provided by registrants already demonstrate, to some extent, how the registrants choose to apply their discretion in the valuation process.[559] It is unclear to what extent investors would find

557 Such data might include financial statement footnote disclosures relating to significant assumptions made by the registrant in arriving at disclosed grant-date valuations and information regarding the past exercise behavior at the registrant or a broader group of firms, as well as market information on bond and dividend yields and stock price volatilities.

558 While FASB ASC Topic 718 requires that the assumptions used shall not represent the biases of a particular party, there will generally be a range of assumptions that could be considered to be reasonable, and so the choice of particular assumptions will reflect registrant discretion.

559 An academic study of executive compensation among firms in the S&P 1500 from 1996 to 2001 found that the grant-date valuations of option awards by these registrants were, on average, understated. However, because

information about what valuation assumptions registrants would apply at later dates, which would similarly reflect registrant discretion, to represent meaningful new information beyond what is available in existing disclosures (though investors may find the computations useful regardless of whether they reflect meaningful new information).

With respect to pensions, while aggregate service costs are reported in financial statement disclosures, and pension plan terms and assumptions are disclosed in detail, registrants are not currently required to separately report the service cost, or prior service cost due to any plan amendments or initiations, that is associated with each individual NEO, so the disclosure of these costs may reveal marginal new information about actuarial assumptions specific to the estimation of service costs for these individuals, such as any embedded assumptions about future compensation levels.

Additional potential sources of new information for investors include the Company-Selected Measure and the Tabular List. As discussed above, if registrants do not already disclose the historical outcomes for their Company-Selected Measure over the past five years, the disclosure may provide new information to the extent that any required adjustments or computations required to derive the value of these measures from reported financial data may not always be straightforward for investors to replicate. Finally, both the Company-Selected Measure and the Tabular List may provide new information in the form of any insight gained based on the registrant's choice of which of the measures reported in the CD&A were deemed to be the most important with respect to the last completed fiscal year.

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this paper uses data from 1996 to 2001, it might not accurately reflect current practices. *See* David Aboody, Mary E. Barth & Ron Kasznik, *Do Firms Understate Stock-Based Compensation Expense Disclosed under SFAS 123?* 11 REV. ACC. STUD., No. 4, 429 (2006). Notably, when evaluating executive compensation, two major proxy advisory firms use their own, standardized set of methodologies and assumptions to value option grants rather than relying on each registrant's estimate of grant-date value. *See* Glass Lewis Methodology and ISS Methodology.

Overall, the extent of new underlying informational content that could be made available in the disclosures is limited, and, while some investors may find the incremental information to be useful, it is unclear to what extent it would be meaningful to investors more broadly. We therefore believe that the potential benefits of the final rules derive primarily from the manner in which the information is presented rather than the disclosure of any significant new underlying informational content. The benefits of some specific implementation choices are discussed in more detail in the Implementation Alternatives section below.

3. Costs

The primary costs of complying with the final rules reside largely with registrants and include the time and expense to make the required computations; to select the tailored components of the required disclosure; to design a format for the required descriptions and create these elements of the disclosure; to draft the footnotes and any supplementary disclosures that are deemed necessary; to apply Inline XBRL data tagging; and to ensure appropriate review, such as by management, in-house counsel, outside counsel and members of the board of directors. The costs will be mitigated by phasing in the time periods for the disclosure for both new and existing registrants, thereby limiting the computations required when first producing the disclosure, and providing scaled requirements and a phased-in tagging requirement for SRCs.

In the Proposing Release, we indicated that we believed that the costs to registrants of complying with the proposed amendments likely would be relatively low, given that the required disclosures would not require the collection of any significant new information relative to the baseline and the required additional computations would be straightforward. Some commenters agreed that the compliance costs would be relatively low and/or that the required computations would not be difficult.[560] However, some other commenters indicated that the Proposing Release may not have fully accounted for the costs of the proposed disclosures,[561] particularly with respect to the expense of producing new option valuations[562] and supplemental disclosures that would be required to prevent confusion.[563] Also, we acknowledge that the compliance costs associated with the final rules will generally be higher than those that would have been associated with the approach set forth in the Proposing Release, given the revised definition of executive compensation actually paid and the disclosures with respect to additional performance measures that were not included in the proposal. We have, accordingly, revised our burden estimates for purposes of the Paperwork Reduction Act of 1995[564] ("PRA"), as discussed below and in Section VI of this release. However, we believe that, given that the disclosures require the collection of minimal new information, the overall compliance costs of the final rules should be modest.

In particular, while some of the computations involved are more complex than simple arithmetic, existing models and established methodologies should aid in making the required calculations. For example, commenters indicated that the determination of pension service cost, disaggregated by executive, would require minimal effort by the actuaries who are already making the required computations to produce aggregate pension service cost for the financial

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560 *See, e.g.,* letters from Aon HCS; Better Markets; Hodak; and Infinite.

561 *See, e.g.,* letters from NAM 2015; Pearl; and TCA 2015. Some other commenters raised general concerns about the costs of the proposal. *See, e.g.,* letters from CEC 2022; NIRI; and WorldatWork.

562 *See, e.g.,* letter from Pearl.

563 *See, e.g.,* letter from TCA 2015.

564 44 U.S.C. 3501 *et seq.*

statements.[565] While there may be an incremental charge to obtain these estimates,[566] or to make the required additional computations in the case of any plan amendments, we expect it to be low. The annual revaluation of restricted stock and performance-contingent stock should only require consideration of the prevailing stock price and any updates with respect to the probable outcome of performance conditions, which are already reassessed as of the end of each fiscal year for financial reporting purposes.[567] Finally, the annual revaluation of options (as well as any stock with market-based conditions) can generally be accomplished by reevaluating the appropriate inputs and entering these into the existing valuation models used to calculate currently disclosed values. Several commenters indicated that this process would be tedious and generate administrative burdens,[568] and that the appropriate models as well as inputs may need to be reconsidered when revaluing option awards beyond the grant date.[569]

We acknowledge that the revaluation of options, which will be required more frequently under the final rules than under the proposal, will likely be the most computationally-intensive requirement of the final rules. However, a minority of registrants utilizes option awards in compensating NEOs, and we agree with several commenters who indicated that annual computations of fair value of outstanding equity awards would not be overly burdensome.[570] Option valuation is a well-established discipline, and existing models and software,[571] as well as reliance on third-party experts when necessary, should aid the registrants that grant options to

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565 *See, e.g.,* letters from Mercer and Towers.

566 *See, e.g.,* letters from AON and NACCO.

567 *See* FASB ASC Topic 718-10-30. *See also* letter from CAP.

568 *See, e.g.,* letters from Cook; KPMG; Pearl; and WorldatWork.

569 *See, e.g.,* letters from CAP; TCA 2015; and TCA 2022.

570 *See, e.g.,* letters from Hodak; Infinite; TCA 2015; and TCA 2022.

571 *See, e.g.,* letters from Hodak and ICGN.

their NEOs in making the required calculations. Further, on an ongoing basis, the value of executive compensation actually paid will only need to be computed for a single fiscal year at a time (and, given the phase-in of requirements, for three fiscal years at inception, or two fiscal years in the case of SRCs), limiting the total computations required in order to update the disclosure each year. Also, as discussed above, some investors, or third parties on behalf of investors, are currently making similar computations. While the required computations may represent a burden for registrants, they may reduce such duplicative efforts and place responsibility for the calculations in the hands of registrants, who are best positioned to produce them.

Several commenters raised concerns about the extent of supplemental disclosure that would be required to clear up "misconceptions" that could result from the required elements of the proposed disclosure.[572] While we expect that some registrants may choose to provide supplemental disclosure, such as to clarify the required disclosure, and that producing such disclosure will be associated with further compliance costs, we believe that the revised definition of executive compensation actually paid should reduce the need for clarifying disclosures because, relative to the proposed measure of pay, it is less likely to require the reporting of pay in a different period than the associated performance.[573]

Commenters to the Reopening Release also raised concerns about the cost to include the additional information with respect to performance measures contemplated in that release. The final rules include modifications that should limit these costs. For example, some commenters

572 *See, e.g.,* letters from CCMC 2022; CEC 2015; and FSR. *See also* letters from BlackRock; Celanese; Cook; Exxon; NAM 2015; NAM 2022; NIRI 2015; TCA 2015; and TCA 2022.

573 *See, e.g.,* letter from Cook (providing sample language that may have been required to address such a mismatch).

indicated that the inclusion of net income and income or loss before income tax expense would increase the length and/or cost of disclosure.[574] The final rules require the inclusion of net income, but not income or loss before income tax expense, which should limit the size and costs of the associated disclosure. Similarly, some commenters indicated that the selection of a single Company-Selected Measure would be difficult[575] and result in substantial additional cost[576] to registrants, in part because of the prominence of this single measure and the resulting scrutiny required from board members and senior management, with input from outside advisors. The final rules require the inclusion of a Company-Selected Measure, but registrants will be permitted to include additional supplemental measures in the table, which may mitigate burdens in cases where it is difficult to isolate a single most important measure.

Finally, some commenters indicated that the list of the top five most important performance measures contemplated in the Reopening Release would be difficult to produce,[577] particularly because of the difficulty in ranking such measures, and that it would increase the length and complexity of disclosure[578] due to the additional explanations registrants might consider necessary for clarification. The final rules do not include a ranking requirement and allow a variable number (from three to seven) of the most important measures, which may make it easier for registrants to find a more natural break-point in isolating a group of the measures they consider to be most important. This additional flexibility may thereby also limit the amount of additional explanatory disclosure that registrants choose to provide.

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574 *See, e.g.,* letters from FedEx 2022; McGuireWoods; NAM; and TCA 2022.

575 *See, e.g.,* letters from Aon HCS; CEC 2022; Davis Polk 2022; LGIM; and NAM.

576 *See, e.g.,* letter from Davis Polk 2022.

577 *See, e.g.,* letters from ASA; Davis Polk 2022; LGIM; McGuireWoods; NAM 2022; and SCG.

578 *See, e.g.,* letters from Aon HCS; CEC 2022; Davis Polk 2022; and IBC 2022.

We also note that the number of relationships that the final rules will require registrants to describe in narrative or graphical form has increased to seven, for registrants other than SRCs, from the three that would have been required per the Proposing Release. For SRCs the number has increased from two to four. In particular, a registrant must describe the relationship of each required performance measure (TSR, net income, and, for non-SRCs, the Company-Selected Measure) with the PEO's compensation actually paid as well as with the average such pay of the other NEOs, and (for non-SRCs) they must also describe the relationship of TSR to peer group TSR. We acknowledge that these additional requirements will increase compliance costs, but we expect that the descriptions can be scaled depending on their relevance to a particular registrant. For example, if TSR or net income have little correlation, or only a spurious correlation,[579] with pay at a particular registrant, and is not a metric used in their compensation plans, a simple statement to this effect may suffice.

Overall, the expansion of the disclosures with respect to performance measures will increase the compliance costs of the final rules relative to the requirements reflected in the Proposing Release, but, as discussed above, these disclosures may provide helpful context to investors.

As discussed above, registrants will be required to file the pay-versus-performance disclosure in certain proxy or information statements. While much of the disclosure will be based on information that is otherwise disclosed, the new computations and new presentation of this underlying information, as well as the inclusion of existing measures—TSR and peer group TSR—that are otherwise "furnished" but not "filed," may create an incremental risk of litigation

[579] A spurious correlation, in the context of statistics and related fields, is an apparent association between two variables that occurs, *e.g.*, by coincidence, and not because of a causal relationship.

under Section 18 of the Exchange Act ("Section 18").[580] Several commenters indicated that this may increase the cost to registrants of the disclosures,[581] because of the need for additional assurance and because of litigation risks. However, we note that Section 18 does not provide for strict liability with respect to "filed" information.[582]

Compliance costs associated with the final rules are likely to vary among registrants depending on the complexity of their compensation structures. For example, the computation of executive compensation actually paid from total compensation reported in the Summary Compensation Table involves adjustments to the treatment of equity awards and pension benefits. Registrants that include these elements in their executive compensation plans are therefore expected to require more computations to produce the disclosure.[583] This is particularly the case for registrants that use options, both because the required computations are more involved, as discussed above, and also because options tend to vest ratably over time,[584] so registrants may need to track and value many different tranches of options in a given year. As shown in Tables 2 and 3 in the Baseline section above, the use of both options and pensions has declined since the time of the Proposing Release, but each still has a prevalence of roughly 20 percent among S&P 1500 CEOs (and 30 percent among their other NEOs). Overall, though, the registrants for whom the computations will be more burdensome—those with more complex

[580] 15 U.S.C. 78r.

[581] *See, e.g.,* letters from Hodak; NAM 2015; and SCSGP.

[582] *See* Section 18. A plaintiff asserting a claim under Section 18 would need to meet the elements of the statute to establish a claim, including purchasing or selling a security in reliance on the misstatement, and damages caused by that reliance.

[583] *See, e.g.,* letter from Cook (discussing the preparation of five sample disclosures based on the proposed requirements, and finding that there was "considerably more time and effort required for companies that grant stock options and/or have pension plans").

[584] *See* Section IV.B.3 above.

compensation packages—are also generally those for which investors are expected to benefit most from the disclosure: in the absence of the disclosure, it is more difficult for investors to assess the alignment of pay and performance when compensation is more complex.

Large companies are more likely than smaller ones to have pension plans and grant stock and option awards to executives.[585] However, a significant fraction of mid-sized and smaller companies feature these components in their compensation plans as well.[586] Thus, while the compliance costs are likely to be relatively low, these costs may be slightly more burdensome for those affected registrants that have complex compensation packages and yet are small enough that the costs of the disclosure are relatively more consequential in comparison to their size. That said, SRCs will be subject to scaled requirements consistent with their existing disclosure requirements, including fewer years of disclosure; no requirement to report peer group performance, a Company-Selected Measure, or a list of the most important performance measures; and the exclusion of items related to pension plans in computing executive compensation actually paid. SRCs are not currently required to comply with Item 201(e) of Regulation S-K, so they may face a small incremental burden of computing their own TSR for the purpose of this disclosure as compared to other affected registrants.

Based on analysis for purposes of the PRA, as discussed in Section VI of this release, we estimate that the total incremental burden on all registrants of the final rules will be, annually, approximately 95,800 hours for internal company time, and about $12.8 million for the services of outside professionals. These estimates represent an increase in estimated burden hours per

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585 *Id*.

586 *Id*.

affected registrant of about 87 percent[587] (from 15 to 28 hours) for non-SRCs, and about 13 percent[588] (from 15 to 17 hours) for SRCs, relative to the estimates in the Proposing Release. As discussed above, these costs are expected to vary across registrants depending on the complexity of their compensation structures. Also, certain registrants – such as those whose executive compensation is not tied closely to TSR or net income – may be more likely to voluntarily supplement the disclosure with additional measures, explanations, or analyses in order to explain the patterns in the required disclosure, and may thus face higher overall costs. However, we do not believe that any of the variation in the compliance burden will be large enough to have a material detrimental effect on competition or capital formation.

While the new disclosure requirements are intended to make it easier for investors to assess the alignment of pay and performance, investors may instead bear increased information processing costs as a consequence of the final rules if they increase the length and complexity of existing disclosures without significantly adding to the ease of interpretation. Some commenters raised concerns that the proposed disclosures would result in such information overload.[589] The likelihood and extent of such costs resulting from the final rules may be a function of the degree of supplementary disclosures registrants choose to provide, as well as the complexity of and variation in presentation formats. The risk of information overload may also be exacerbated by the required disclosures with respect to additional performance measures,[590] which could provide helpful context for investors, or could end up complicating or obscuring the elements of

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[587] The incremental burden hours per filing estimated for PRA purposes is 28 hours for non-SRCs, compared to an estimate of 15 hours in the Proposing Release, representing an increase of (28/15 – 1) or about 87%.

[588] The incremental burden hours per filing estimated for PRA purposes is 17 hours for SRCs, compared to an estimate of 15 hours in the Proposing Release, representing an increase of (17/15 – 1) or about 13%.

[589] *See, e.g.,* letters from BlackRock; BRT 2015; CCMC 2015; CEC 2015; Meridian; and TCA 2015.

[590] *See supra* notes 574 and 578. *See also* letters from BRT 2022 and IBC 2022.

the disclosure that would be most useful to investors. If the required disclosures complicate rather than facilitate the task of understanding executive pay policies, they may marginally decrease the informational efficiency of markets.

The final rules could confuse investors about the optimality of pay practices if they bring attention to a particular relationship that might not be relevant, given the facts and circumstances of a particular registrant, in evaluating the alignment of pay and performance at that particular registrant.[591] As discussed above, there are challenges in measuring pay-versus-performance alignment which are likely to impact any standardized approach to presenting this relationship. However, the required inclusion of additional context in the disclosure may help to mitigate potential confusion. For example, the inclusion of net income, a Company-Selected Measure, and a Tabular List could be helpful in limiting confusion stemming from differences in the timing of an executive's accomplishments and when they may be reflected in TSR, to the extent that other performance measures may better align with executive performance in such cases. Further, including peer group TSR in the disclosure may help investors to identify when registrant TSR could be driven by market moves, sector opportunities, commodity prices, or other factors unrelated to managerial effort or skill. That said, the required disclosure may be less meaningful at a particular registrant if TSR, even relative to peers, is very different from the contribution of the given NEO to performance, or if the disclosed relationship between compensation and TSR does not (*e.g.*, because of vested equity holdings that are not reflected in executive compensation actually paid) fully capture the economic relationship between the company's performance and the financial rewards to the

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[591] *See, e.g.,* letters from BlackRock; BorgWarner; CEC 2015; CCMC 2015; FSR; Honeywell; Hyster-Yale; NACCO; and Ross.

NEO. Similarly, the required net income disclosure may be less meaningful at registrants at which net income is not particularly relevant to understanding executive performance.[592]

As discussed in the Proposing Release, the potential for confusion is especially concerning given that the new disclosure may be of particular interest to less sophisticated investors, who may be less likely to have access to third-party pay-versus-performance analyses or may be less adept at conducting their own such analyses. The possibility of confusion is mitigated by allowing registrants to provide supplemental measures of pay and performance, as well as the ability of registrants to provide further explanatory disclosures. Some commenters agreed that this flexibility to supplement the disclosure would improve investors' understanding or mitigate potential confusion.[593] However, such clarifying disclosures may be more likely to be provided when the disclosure is perceived by the registrant to incorrectly indicate the misalignment of pay and performance than when the disclosure is perceived to incorrectly indicate strong alignment. Further, as noted by other commenters, less sophisticated investors may be unlikely to consider these supplemental disclosures.[594] While some commenters were not convinced that a Company-Selected Measure or list of most important performance measures would help in such cases,[595] it is possible that these additional required elements of the disclosure may help mitigate confusion by providing a mandatory, prominent indicator of the broader performance landscape in the specific context of a given registrant.

[592] *See, e.g.,* letters from Aon HCS; ASA; CEC 2022; Davis Polk 2022; Dimensional; FedEx 2022; IBC 2022; Nareit; NAM; NIRI 2022; PG 2022; and TCA 2022.

[593] *See, e.g.,* letters from CalPERS 2015; CAP; CFA; CII 2015; Farient; OPERS; and TIAA.

[594] *See, e.g.,* letters from Aspen; CEC 2015; Celanese; FSR; and NACCO.

[595] *See, e.g.,* letters from CCMC 2022; NAM 2022; and TCA 2022.

The final rules could also lead to indirect costs if the required disclosures lead to changes in compensation packages that are not beneficial.[596] Registrants may make changes to avoid disclosure that they perceive indicates the misalignment of pay and performance, whether that indication is valid or merely due to limitations of the standardized approach. For example, by virtue of the disclosure, boards may become more likely to approve compensation structures that more strongly link pay to stock price performance,[597] even in situations in which this would not be optimal.[598] The inclusion of net income in the disclosure could mitigate this risk, or could instead encourage the use of net income as a performance metric in incentive programs, even when this is not beneficial.[599] Commenters raised concerns that such pressures on compensation design could lead to compensation that incentivizes short-termism and/or the inappropriate homogenization of compensation plans.[600] If such changes are indirectly encouraged by the final rules, they may entail costs to registrants and their shareholders. As in the case of any shifts towards more optimal compensation structures, discussed in the Benefits section above, the resulting pay packages may represent either a benefit or a cost to the NEOs themselves

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[596] *See, e.g.,* letter from Brian Cadman, dated Feb. 18, 2022 (discussing the potential unintended consequences of regulation of executive compensation disclosures). We note, however, that the research cited in this letter focuses on changes in a prior period, before registrants were regularly holding say on pay votes and engaging as heavily with investors on compensation. In contrast, more recent regulatory changes have not always been as impactful as expected, perhaps because of the offsetting effect of this heightened investor engagement on pay structure. *See, e.g.*, Lisa De Simone, Charles McClure & Bridget Stomberg, *Examining the Effects of the TCJA on Executive Compensation* (Apr. 15, 2022). Kelley School of Business Research Paper No. 19-28, *available at* https://ssrn.com/abstract=3400877 (finding no evidence that the repeal of a long-standing exception under Section 162(m) of the tax code that allowed companies to deduct executives' qualified performance-based compensation in excess of $1 million reversed a related shift in executive compensation away from cash compensation and towards performance pay).

[597] *See, e.g.,* letters from CEC 2015; CCMC 2015; Hall; Hay; Hermes; Hodak; FSR; Georgiev; McGuireWoods; Mercer; Pearl; PNC; SCSGP; Simpson Thacher; and WorldatWork.

[598] *See supra* notes 498 and 499 regarding academic studies that find that a stronger link between pay and stock price performance may not be optimal. *See also* letter from Aspen (highlighting research indicating that financial incentives in general may be problematic "when complex or creative mental tasks are required").

[599] *See, e.g.,* letters from NAM and SCG.

[600] *See, e.g.,* letters from CEC 2022; Georgiev; Hay; NAM; and SCG.

depending on whether or not the less optimal compensation structure, including the level of compensation as well as the risk exposure, is preferred by the executives.

As in the case of the potential benefits outlined above, many of these costs are difficult to quantify because the ideal pay-versus-performance analysis for investors, as well as the optimal pay structure, is uncertain and may vary by company and because reactions to the repackaging of information are difficult to predict. Still, because the final rules do not require the disclosure of significant new information, and given the high level of existing attention to pay practices—including the increased engagement on these matters with institutional investors, and the sophisticated methods and processes that many investors and third parties have developed for evaluating pay—we believe that it is unlikely that the final rules will play a significant role in encouraging sub-optimal pay practices.[601] We therefore believe that the final rules likely will have no material detrimental effects on competition or capital formation.

The costs of some specific implementation choices are discussed in more detail in the Implementation Alternatives section below.

4. Implementation Alternatives

In this section, we present significant implementation alternatives and a discussion of their benefits and costs relative to the implementation choices in the final rules.

i. Registrants and Filings Subject to the Disclosure Requirement

An alternative to the final rules would be to fully exempt SRCs from the disclosure requirement. Exempting SRCs generally would be consistent with the overall scaled disclosure requirements that apply to SRCs. While the final rules subject SRCs to scaled requirements in order to limit the incremental burdens such companies may face relative to other registrants,

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[601] *See supra* note 596.

some such burdens remain. For example, SRCs are currently not required to disclose their TSR in annual reports, so they would face a higher burden than other registrants to calculate and include this measure in the pay-versus-performance disclosure. SRC pay-versus-performance disclosure, under the final rules, may also benefit investors to a lesser degree than that for other registrants, because the scaled requirements reduce the content and comparability of the disclosures. Also, in the absence of CD&A disclosure, investors will have less information with which to interpret pay-versus-performance disclosures from these registrants. As discussed above, some commenters agreed that SRC pay-versus-performance disclosure would generate greater burdens and/or lesser benefits than that for other registrants.[602]

On the other hand, it is possible that investors may particularly benefit from the required pay-versus-performance disclosure for SRCs, precisely because these registrants currently provide less extensive disclosure about compensation. For example, some investors may believe that the long-term performance of younger, high-growth companies may be highly sensitive to the design of executive compensation. Such investors may be particularly interested in compensation structures at SRCs but may find it difficult to assess these structures in the absence of CD&A disclosure for SRCs. These investors may benefit from SRC pay-versus-performance disclosures, even if these disclosures are not directly comparable with the disclosures of other affected registrants. Further, the data that SRCs do currently disclose is less likely to be available in aggregate form from data vendors that collect such data from the proxy statements of larger companies. Investors that are interested in comparing executive compensation across SRCs may particularly benefit from the data in the pay-versus-performance disclosure being tagged in Inline XBRL, to the extent this makes the

[602] *See supra* notes 405 to 407 and accompanying text.

data more accessible or increases the likelihood that more commercial databases expand their coverage to such registrants.[603] Some commenters agreed that there may be particular governance concerns at SRCs[604] and that investors would benefit from pay-versus-performance disclosures by these registrants.[605]

The final rules permit SRCs to present fewer years of information in the disclosure; to not include peer group performance, a Company-Selected Measure, or a Tabular List; and to exclude items related to pension plans in computing executive compensation actually paid. While these scaled requirements may reduce the benefits of the disclosure, these accommodations should substantially limit the incremental burdens faced by SRCs in providing pay-versus-performance disclosure, while preserving some benefits to investors interested in executive compensation at such registrants.

Another alternative with respect to the applicability of the final rules would be to expand the filings requiring pay-versus-performance disclosure, such as requiring that such disclosure accompany any Item 402 of Regulation S-K disclosure, including in Form 10-K or Form S-1. Such an approach would make pay-versus-performance disclosures more consistently available for Section 12(g) registrants subject to the final rules and broaden the disclosure requirement to include Section 15(d) registrants other than EGCs. However, the required disclosure may be most useful to shareholders when they are deciding whether to approve the compensation of the NEOs through the say-on-pay vote, voting on the election of directors or acting on a

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603 *See* Y. Cong, H. Du & M.A. Vasarhelyi, Are XBRL Files Being Accessed? *Evidence from the SEC EDGAR Log File Dataset*, 32 J. INFO. SYS. 3 (concluding that "small company investors not only access XBRL files but also prefer them to the non-XBRL files when both are available to download for a filing").

604 *See, e.g.,* letters from Morrell and Troop.

605 *See, e.g.,* letters from Better Markets; CalPERS 2015; and CalSTRS.

compensation plan. The adopted approach requires pay-versus-performance disclosure in proxy statements in each of these cases. As discussed above, one commenter agreed that this approach would provide "relevant information" when it is "most useful." [606] Nonetheless, shareholders making voting decisions at a particular registrant may benefit from broader and more consistent availability of pay-versus-performance disclosures on an annual basis at other registrants. Specifically, these disclosures may allow shareholders to more easily compare pay practices across registrants when deciding how to vote at a particular registrant, particularly, for example, in the case of smaller companies whose peers may be more likely to be Section 12(g) or Section 15(d) registrants. Such disclosures may also be of use to some investors in making investment decisions, irrespective of any matters that are up for a vote.

However, registrants with reporting obligations only under Section 12(g) or Section 15(d) do not have securities that are registered on national securities exchanges, so the markets for their shares are likely to be comparatively less liquid. Estimates of share values and therefore of TSR for such registrants may be less precise and less readily available, potentially making pay-versus-performance comparisons based on this measure less meaningful across such registrants. Also, as in the case of SRCs, Section 15(d) registrants are not subject to Item 201(e) of Regulation S-K requirements for stock price performance disclosure. Similarly, Section 12(g) registrants may not be required to disclose Item 201(e) of Regulation S-K information in some or all years, so Section 15(d) registrants and some Section 12(g) registrants would bear an additional burden of calculating their own TSR and, except in the case of SRCs, the TSR of a peer group for this purpose. One commenter supported requiring the new pay-versus-performance disclosure in all filings that discuss compensation, but this commenter

606 *See* letter from OPERS.

also acknowledged that shareholders would most likely only read those materials assembled for an annual meeting,[607] which would include the new disclosure under the final rules.

ii. General Disclosure Requirements

We have considered several reasonable alternatives to the general disclosure requirements of the final rules.

Many commenters recommended a more principles-based approach that would permit registrants to determine which measures of pay and performance to disclose or how to disclose the relationship between these measures based on what they deem to be appropriate for their individual situations.[608] Such an approach could have the potential to allow investors to more directly observe how management views the alignment of pay and performance at a given registrant, and might reduce reporting costs because registrants need only report what they believe to be appropriate given their unique circumstances. To the extent that the prescribed measures may be less meaningful at particular registrants, a principles-based approach could reduce shareholder confusion in understanding the relationship between pay and performance at a particular registrant. A principles-based approach would also reduce the risk that the disclosure requirements could lead registrants to change their compensation structures in ways that are less than optimal for the sake of achieving what they perceive to be more favorable pay-versus-performance disclosure.

On the other hand, a principles-based approach may reduce comparability of the disclosure and could increase shareholder confusion because the choice of pay and performance

[607] *See* letter from Quirin.

[608] *See, e.g.,* letters from AB; ASA; Aspen; BlackRock; BorgWarner; BRT 2015; CCMC 2015; CCMC 2022; CEC 2015; CEC 2022; Celanese; Coalition; Exxon; FSR; Hall; Honeywell; Hyster-Yale; NACCO; Nareit; NAM 2022; NIRI 2015; NIRI 2022; PG 2015; Pearl; PNC; SCG; SCSGP; TCA 2015; TCA 2022; and WorldatWork.

measures, and the disclosure time horizon, may vary significantly across registrants. Also, a principles-based approach may allow registrants to selectively choose the measures or time horizon that result in the most favorable disclosure. Several commenters indicated that scrutiny by sophisticated investors and proxy advisory firms, as well as the incentive effect of say-on-pay votes, would motivate registrants to produce effective disclosures within the flexibility of a principles-based regime.[609] However, we note that investors continue to express discontent with existing disclosures despite these factors.[610] The adopted approach of specifying some uniform requirements for the disclosure, requiring certain elements that will vary across registrants (the Company-Selected Measure and Tabular List), allowing registrants to choose the format for describing the relationship between different measures, and permitting the inclusion of additional measures, additional years of data, or other supplemental disclosure should promote comparability while preserving flexibility to tailor the disclosure to a registrant's individual situation. Registrants will also continue to have significant latitude in presenting additional compensation analyses, which provides further opportunity for registrants to clarify their unique circumstances and considerations in designing compensation.

Conversely, we also considered prescribing a uniform format or some minimum requirements for the descriptions of the relationships between different measures. Under the final rules, registrants may apply a wide range of formats when presenting these relationships. For example, some registrants may discuss percentage changes in the measures in narrative form while others may present the levels of the measures in graphical form. Investors' ability to easily interpret and compare the disclosure across registrants could be increased by requiring a

[609] *See, e.g.,* letters from BorgWarner and Honeywell.

[610] *See* Section IV.B.2 above.

uniform format for presenting the relationship, such as a standardized graphical presentation, or some minimum standards for the presentation format, such as a requirement that the disclosure be in the form of a graph. The cost of these more prescriptive approaches would be the restrictions on the ability of registrants to tailor the format of the required disclosures to best reflect their individual circumstances, which may vary significantly. For example, with a prescribed format, registrants might not be able to scale a required description to reflect the relevance of a particular measure at that particular registrant, which could result in lengthy disclosure about relationships that are not meaningful. Under the final rules, the tabular disclosure of the annual values of the required compensation and performance measures should facilitate comparisons of the underlying content of the disclosures across registrants regardless of the format for the required descriptions. It is also possible that these descriptions could become more comparable as registrants gain experience with the requirements; as one commenter predicted, "[o]ver time best practices will emerge, and investors will encourage companies to follow those best practices."[611]

We also considered alternatives with respect to the extent of the required descriptions. As discussed above, the final rules require, for non-SRCs, the description of seven different relationships (and four in the case of SRCs) in graphical or narrative format. An alternative would be to not require the description of some of these relationships, such as that between net income and executive compensation actually paid of the PEO or the other NEOs. Such an approach could help to mitigate commenter concerns about the costs and length of the required disclosure,[612] given that the description of a specific relationship might require the application

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[611] *See* letter from CFA.

[612] *See* Section IV.C.3 above.

of significant discretion and involve more space in the proxy statement than a particular column in the required table. Reducing the number of mandated descriptions may reduce the extent of disclosure in cases where the measures in question may not be relevant in the context of a particular registrant. A more focused set of required descriptions could reduce compliance costs and make it easier for investors to more quickly review the disclosures. The underlying measures would still be available in tabular form for investors to consider; for example, investors might refer to net income as a benchmark to gauge the adjustments in a non-GAAP profitability measure presented as a Company-Selected Measure. However, investors may benefit from understanding the registrant's perspective on each performance measure, and, as discussed above, we expect that the descriptions can be scaled depending on their relevance to a particular registrant.

We also considered alternative approaches to presenting the pay and performance data. For example, several commenters suggested that, instead of requiring the presentation of year-by-year data, we could require registrants to aggregate pay over a three to five year horizon and compute the cumulative TSR over a similar horizon, and then either present a single pair of statistics or a set of rolling values of these multi-year statistics.[613] As noted by these commenters, such an approach could help to smooth any lumpiness in pay (such as when certain awards or payments are not made every year) or short-term volatility in the performance measure. However, it would also make it harder to discern how pay has been associated with year-by-year changes in performance. Further, for investors preferring this approach, a form of aggregate analysis should be relatively straightforward to construct from the disclosure required under the final rules, by adding the values of executive compensation actually paid over

[613] *See, e.g.,* letters from Farient; Pearl; and Ross.

multiple years and comparing this to the cumulative TSR over that horizon. In contrast, presenting aggregate statistics would not reduce compliance costs over time because new computations for the latest fiscal year would still be required each year that the disclosure is produced.

Other commenters suggested that we require registrants to isolate pay granted in a particular year and provide an updated valuation of that pay, for each grant year in the time horizon of the disclosure, at the end of the latest fiscal year (or possibly at vesting), and relate those updated values to cumulative performance.[614] Such a focus on the pay granted in a particular year, and how its value has changed, may provide insight specific to the compensation decisions by the board in each year. However, given that grants have overlapping performance periods, it may be difficult under this approach to judge the overall association of pay with performance, and the relationship between the performance in a particular period and all of the associated pay.

We also considered alternatives with respect to the required structuring of the disclosures. Alternatives to the adopted approach include not requiring that the underlying data disclosed in tabular form be provided using a structured data language (*i.e.*, tagged in Inline XBRL), requiring more or less of the information to be tagged, or requiring a different structured data language. Not requiring that the disclosure be provided in a structured data language would reduce the costs of compliance. Some commenters indicated that the tagging requirements would increase the costs and time to produce the disclosure or delay the filing process.[615] The affected registrants are familiar with Inline XBRL because they are required to

[614] *See, e.g.,* letters from CAP and PG 2015.

[615] *See, e.g.,* letters from CCMC 2015; Celanese; FedEx 2015; Hay; IBC 2015; and NACCO.

provide information in other filings in this data language, but the exact specifications differ and, with limited exception, they are not required to provide any structured data in proxy or information statements.[616] The Inline XBRL requirements would impose additional burdens on registrants, beyond what they currently spend on producing structured data for other purposes, because their contracts with outside data tagging vendors and/or the responsibilities of their in-house staff that works on data tagging would have to be expanded to include the new tagging requirement. In addition, a few commenters anticipated some difficulties because staff preparing proxy statements would be unfamiliar with Inline XBRL.[617] One commenter stated the cost of XBRL tagging can be up to tens of thousands of dollars.[618] A few commenters remarked that the costs of XBRL tagging outweigh the benefit to investors,[619] and questioned whether there was sufficient evidence that such structured data was being used by, or would benefit, investors.[620]

Since the time of the Proposing Release, the market has had significantly more experience with structured data languages, including XBRL. We expect that this experience, along with the adoption of Inline XBRL, will reduce the costs of implementing the requirements

616 BDCs were not previously required to provide their financial statements and financial statement footnotes in XBRL or Inline XBRL, and may thus be less familiar with data tagging than other registrants. However, all BDCs will be required to provide their financial statements and financial statement footnotes, as well as certain prospectus disclosures, in Inline XBRL from, at latest, February 1, 2023. Some BDCs may choose to incorporate prospectus disclosures by reference to their proxy or information statements, in which case those proxy or information statements would include Inline XBRL tagging. See *Securities Offering Reform for Closed-End Investment Companies*, Release No. IC–33836 (Apr. 8, 2020) [85 FR 28853 (May 5, 2020)]. We estimate that there are approximately seven BDCs that would be required to produce the pay-versus-performance disclosure.

617 *See, e.g.,* letters from NACCO; Hyster-Yale; and XBRL US.

618 *See* letter from CCMC 2015.

619 *See, e.g.,* letters from CCMC 2015; Celanese; and NIRI 2015.

620 *See, e.g.,* letters from CCMC 2015 and NIRI 2015.

and enhance the quality of the data made available.[621] While costs will remain, the Inline XBRL requirements should facilitate the extraction of the tagged data across large numbers of filings. These requirements may therefore benefit investors interested in analyzing and comparing the information in the disclosure across large numbers of registrants or, eventually, a large number of years.[622] The tagging of compensation information under the final rules may be particularly beneficial to investors, in that several widely-used commercial databases collect compensation data only for large companies.[623] Some commenters agreed that tagging the disclosures would enhance the benefits to investors, by increasing the efficiency with which large amounts of data could be filtered and analyzed,[624] by enhancing the ability of investors to compare the data across companies or over time,[625] and by allowing investors to obtain this data efficiently or at lower cost.[626] There is also increased evidence that structured data is used by investors and generates benefits. For example, one study found that XBRL has helped to reduce the

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621 *See, e.g.,* Michael Cohn, *AICPA Sees 45% Drop in XBRL Costs for Small Companies*, ACCOUNTING TODAY (Aug. 15, 2018), *available at* https://www.accountingtoday.com/news/aicpa-sees-45-drop-in-xbrl-costs-for-small-reporting-companies (retrieved from Factiva database) (observing a 45% decline in average cost and a 69% decline in median cost of annual XBRL requirements for SRCs from 2014 to 2017); *see also* Ariel Markelevich, *The Quality and Usability of XBRL Filings in the US, 5 Int'l. J. Acct. Tax 2 (2017)* (with findings suggesting that, "starting in 2012, there has been a steady improvement in the quality and usability of the XBRL filings in most aspects… consistent with the notion of companies moving along a learning curve and improving the quality and usability of the XBRL data as they gain more experience tagging").

622 Some investors that are interested in analyzing compensation data across a large number of filings may also wish to analyze the substantial amount of other information regarding compensation in the proxy statement. Because this other data is not currently provided in a structured data language, such investors would have to continue to purchase such data from a data vendor that aggregates this data or to electronically parse or hand-collect such data from filings. The incremental benefit of the structured data requirement is likely to be lower for such investors than for those primarily interested in the data to be tagged.

623 For example, the Standard & Poor's Execucomp database covers the S&P 1500 and some additional registrants, and the ISS IncentiveLab database covers about 1,100 registrants, with coverage in both of these cases representing well under half of the affected registrants.

624 *See, e.g.,* letters from CalPERS 2015 and XBRL US.

625 *See*, *e.g.*, letters from AFL-CIO 2015; CII 2015; Public Citizen; SBA-FL; and XBRL US.

626 *See*, *e.g.*, letters from CalPERS 2015 and XBRL US.

informational advantage of large institutions over small ones, in that small institutions' trading responsiveness to Form 10-K information and stock-picking skills improved relative to large institutions after the adoption of XBRL.[627] Other studies provide evidence consistent with XBRL tagging of financial statement disclosures leading to an increase in stock price informativeness (*i.e.*, the extent to which market prices reflect company-specific information).[628]

We considered not requiring some or all of the block tagging that the final rules will require, such as: the graphical or narrative disclosure that would follow the tabular disclosure; the disclosure of deductions and additions used to determine executive compensation actually paid; and the disclosure regarding vesting date valuation assumptions. While the nature and potential variation in format of these disclosures may make them less suitable for large-scale analysis than the numerical data in the main table, the incremental costs of tagging these disclosures as block-text should be low and such tagging could benefit investors interested in extracting these parts of the disclosure from a large number of filings We also considered, as proposed, not requiring that each numerical item in the deductions and additions used to determine executive compensation actually paid and the vesting date valuation assumptions be tagged separately. While such tagging will require incremental compliance costs, it may benefit investors interested in using this data, such as for constructing alternate pay measures.

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627 *See* Nilabhra Bhattacharya, Young Jun Cho & Jae B. Kim, *Leveling the Playing Field Between Large and Small Institutions: Evidence from the SEC's XBRL Mandate,* ACCT. REV., Sept. 2018, at 51.

628 *See, e.g.*, Y. Huang, Y.G. Shan & J.W Yang, *Information Processing Costs and Stock Price Informativeness: Evidence from the XBRL Mandate*, 46 AUS. J. MGMT. 1 (2021) (finding XBRL adoption "leads to more informative stock price through two channels, the firm-specific information incorporation, and increased disclosures"); *see also* Y. Dong, O.Z. Li, Y. Lin & C. Ni, *Does Information Processing Cost Affect Firm-Specific Information Acquisition? Evidence from XBRL Adoption*, 51 J. FIN. QUANT. ANALYS. 2 (2016) (finding "evidence consistent with the SEC's statement that XBRL adoption helps market participants translate more firm-specific information into stock prices").

We also considered requiring registrants to provide the data an XML-based data language specific to the pay-versus-performance disclosures ("custom XML") rather than Inline XBRL.[629] As discussed in the Proposing Release, a custom XML requirement could increase the ease of implementation of the structured formatting requirement for the main table, and could thus reduce costs of structuring, particularly for smaller registrants. However, the Commission's custom XML data languages are generally unsuitable for tagging large blocks of information or implementing detail tags within such blocks, and are therefore not as appropriate for implementing the requirements of the final rules.

iii. Compensation Measures

We have considered several alternative approaches to the compensation measures to be included in the disclosure, particularly with respect to the definition of executive compensation actually paid. The final rules define this compensation measure generally in line with the approach described as "incremental compensation earned" in the discussion of implementation alternatives in the Proposing Release. We also considered adopting definitions that would treat equity awards and pensions differently, such as in the proposed definition, or that would include different elements of compensation.

With respect to equity awards, the proposed approach would have required registrants to include the fair value of stock and option awards in executive compensation actually paid at the time of vesting. As discussed in more detail above,[630] some commenters agreed with arguments in the Proposing Release that certain features of this approach, such as the fact that it would

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[629] This would be consistent with the approach used for other XML-based structured data languages created by the Commission for certain forms, including the data languages used for reports on each of Form 13F, Form D and the Section 16 beneficial ownership reports (Forms 3, 4 and 5).

[630] *See* Section IV.C.2 above.

reflect the change in value of equity awards based on performance outcomes after they are granted, would be beneficial for this purpose. However, many commenters raised concerns that the proposed definition would generate a mismatch between the period in which pay was reported and the period of the associated performance,[631] and that this would significantly reduce the potential usefulness of the disclosure.[632]

Specifically, as discussed in the Proposing Release, under the proposed definition of executive compensation actually paid, the measure may be subject to volatility based not on performance but on the vesting pattern of equity awards, because it includes, in the year of vesting, the original grant-date value and all gains (or losses) related to returns in all years since the grant was made. A number of commenters highlighted concerns of this nature.[633] Similar issues that commenters noted include an exacerbation of the misalignment when the size of an award is intended to recognize performance in the year of grant (or prior);[634] when awards formally vest in a different year than the end of the performance period,[635] or when the vesting date of an award is distant from the end of the year.[636] Commenters also noted that the timing mismatch would not apply equally to different types of compensation or across different vesting

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[631] *See, e.g.,* letters from Allison; CAP; CCMC 2015; CEC 2015; Celanese; Coalition; Cook; Davis Polk 2022; Farient; Faulkner; FSR; Georgiev; Hodak; Huddart; Hyster-Yale; Infinite; NACCO; NACD 2015; NAM 2015; NAM 2022; PG 2015; PG 2022; Pearl; Ross; SBA-FL; SVA; TCA 2015; TCA 2022; Teamsters; TIAA; and WorldatWork.

[632] *See, e.g.,* letters from CEC 2015; Celanese; Cook; NACCO; NAM 2022; Pearl; PG 2015; Ross; TIAA; TCA 2022; and WorldatWork.

[633] *See, e.g.,* letters from CEC 2015; Celanese; Cook; Faulkner; Hodak; Hyster-Yale; Infinite; NACCO; SVA; and TCA 2022.

[634] *See, e.g.,* CCMC 2015; McGuireWoods; and NAM 2022.

[635] *See, e.g.,* letters from Hall; PG 2015; PG 2022; and Towers.

[636] *See, e.g.,* letters from Celanese; Hyster-Yale; and NACCO.

patterns, leading to difficulties in comparisons across registrants or executives.[637] Consider, for example, a fiscal year in which one PEO receives a $1 million cash bonus and another instead receives a $1 million restricted stock award that vests after one year. Under the definition that was proposed, executive compensation actually paid would have been $1 million and zero, respectively, for the two PEOs in that fiscal year.[638]

As discussed above,[639] the treatment of equity awards in the adopted measure of executive compensation actually paid is expected to preserve the benefits noted by commenters of the proposed approach while substantially reducing the risk of a timing mismatch.[640] Under the adopted approach, the total value reflected in executive compensation actually paid for a given award, when summed across years, will be equivalent by the time of vesting to that which would have been included at vesting under the proposed approach. However, by attributing the change in an equity award's fair value in a given year—which would reflect performance in that same year— to that individual year, rather than ascribing the full value to the vesting date, the revised measure should better align pay with the associated performance.

This improved alignment will limit the volatility associated with vesting patterns, by distributing pay over the full vesting period, as it is earned. It will also reduce the sensitivity to small differences in formal vesting dates, by associating amounts of pay with particular years

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[637] *See, e.g.,* letters from Hodak; Honeywell; Hyster-Yale; and NACCO.

[638] The Proposing Release also provides an example of comparability issues in the case of executives with asynchronous vesting dates.

[639] *See* Section IV.C.2 above.

[640] Some timing mismatches may remain, even under the adopted approach. For example, in the case of compensation contingent on a performance condition (*e.g.*, based on achieving a particular level of net income), that is later recovered (*i.e.*, clawed back) because of a restatement, the market stock price correction associated with the restatement may happen in a more recent period, while the historical accounting performance and compensation measure would be corrected retroactively. In this case, even after recovery of the erroneously awarded compensation, the effect on executive compensation actually paid is not likely to appear in the same period as the associated market reaction in TSR.

based on the changes in value attributable to those years rather than solely based on where the vesting date happens to fall. Attributing some of the value of equity awards to the grant year addresses the possibility that the size of awards may be designed to reward grant year performance.[641] The revised approach also improves comparability; for example, the two PEOs discussed above, who receive a $1 million cash bonus and a $1 million restricted stock award, will both be considered to receive $1 million of compensation actually paid in that year, while any change in the value of the second executive's stock until vesting would also be reflected in future years. Overall, the enhanced alignment resulting from the revised definition is expected to make it easier for investors to understand the relationship between pay and performance,[642] though this comes at the cost of increased compliance costs for registrants.

In valuing option awards in executive compensation actually paid, a number of commenters recommended that we use intrinsic values (*i.e.*, the "in-the-moneyness," or the amount that would be gained upon immediate exercise) instead of fair values. Those commenters indicated that intrinsic values would be easier and less burdensome to calculate[643] or would more appropriately reflect compensation rather than the effect of an executive's investment decisions.[644] We acknowledge that fair values are more burdensome to compute than

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641 To the extent that registrants may use infrequent awards or so-called mega-grants in some years to award performance over multiple years (*see, e.g.*, letters from Cook and PG 2015), the revised definition of executive compensation may increase sharply in grant years regardless of performance. The inclusion of Summary Compensation Table total compensation (which reports the aggregate grant date fair value of all equity awards granted to the NEO during the fiscal year, and would therefore also reflect any differences in annual grant sizes) alongside executive compensation actually paid in the tabular disclosure may assist investors in filtering these effects out from the patterns in pay that are more likely to be driven by performance after the grant date.

642 The revised definition may also reduce the unintended, indirect encouragement of shorter or more graduated vesting schedules in order to smooth executive compensation actually paid under the proposed definition. *See, e.g.,* letter from Pearl.

643 *See, e.g.,* letters from CAP; Corning; Davis Polk 2015; Honeywell; Pearl; and WorldatWork.

644 *See, e.g.,* letters from CEC 2015; CEC 2022; Honeywell; and Pearl.

intrinsic values. However, intrinsic values can severely understate the values of options.[645] The fair value of an option provides a more accurate picture of the total value of the asset being transferred, which includes both the current intrinsic value and the ongoing time value of the option: the ability to potentially capture additional upside while not taking the commensurate downside risk. By granting an option with significant remaining time to maturity after vesting, boards are consciously awarding executives with value beyond the vesting-date intrinsic value. As such, this transfer of value may reasonably be considered to be compensation. While an executive might not wait until maturity to exercise an option, the fair value calculation should generally incorporate an assumption regarding typical exercise behavior. Whether the executive chooses to exercise earlier or later than is typical (and therefore expected by the board) can reasonably be considered an investment decision.

Some commenters also suggested that we consider valuing equity awards as of alternate dates, such as the grant date[646] or, for options, the exercise date.[647] Valuations as of these alternative dates may be less burdensome to calculate, as grant date fair values are already included in the Summary Compensation Table and the amount realized on exercise of options is already included in the Stock Vested and Options Exercised Table. However, grant date valuations would not reflect the performance sensitivity of unvested equity awards. As discussed above, because the empirical relationship between pay and performance is driven by changes in the value of executive stock and option holdings, considering only grant-date values may ignore one of the primary channels for relating pay and performance. Exercise date

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645 *See, e.g.,* Zvi Bodie, Robert S. Kaplan & Robert C. Merton, *For the Last Time, Stock Options are an Expense,* HARV. BUS. REV. (Mar. 2003), available at https://hbr.org/2003/03/for-the-last-time-stock-options-are-an-expense.

646 *See, e.g.,* letters from CAP and NAM 2022.

647 *See, e.g.,* letters from CEC 2015; Corning; Coalition; and FSR.

valuations, in turn, reflect the effect of performance after the grant date, but also reflect the executive's decision of when to exercise awards, which may reasonably be considered an investment decision rather than a compensation decision. For example, as one commenter noted, "executives who hold their options to the full term before exercise may be unjustifiably seen as being overpaid compared to executives who exercise their options quickly."[648]

With respect to pensions, the final rules require that executive compensation actually paid include the pension service cost for the year as well as the prior service cost (or credit) due to any plan amendments or initiations in the year, rather than just the pension service cost, as proposed. Some commenters alternatively suggested that we include the present value of pension benefits that were earned in the last fiscal year, or, similarly, the change in present value of accumulated pension benefits while holding the beginning and ending valuation assumptions constant.[649] All of these approaches—including what is being adopted, what was proposed, and the commenters' suggestions—should reduce the volatility in reported pay caused solely by changes in assumptions relative to the pension component of the Summary Compensation Table, because the latter includes the change in value of all previously accumulated benefits with changes in interest rates and other actuarial assumptions. Thus, any of these approaches should make it easier for investors to evaluate the relationship of pay with performance. We considered, as an alternative to the adopted approach, including only pension service cost (as proposed) or the present value of pension benefits that were earned in the last fiscal year (as suggested by, or similar to what was suggested by, various commenters).

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648 *See* letter from Honeywell.

649 *See* letters from AON; Barnard; Exxon; Mercer; Towers; and WorldatWork.

Pension benefits may be a function of compensation levels, as in the case of pay-related, final-pay, final-average-pay, or career-average-pay plans. They are also a function of the terms of the plan. Service costs are based on estimates of future benefits that assume plan terms remain fixed and that may already incorporate projections about future compensation levels. Service costs are also smoothed over time relative to how the future benefits are actually earned or change over time. As a result, the effect of plan amendments and actual changes in current compensation levels on the value included for pensions under the proposed approach may be dampened. For example, if a plan were amended, current and future service costs would be adjusted upwards, but there would be no corresponding adjustment for service costs reported for previous years. The adopted approach would more fully reflect the effect of any plan amendments by including a catch-up adjustment for the impact on service costs reported in previous years.

The adopted approach does not fully account for changes in actual compensation levels from the estimated compensation levels used to estimate service cost. Because actual changes in current compensation may be related to performance, and these changes in compensation may be magnified by pension benefits that are a function of compensation levels, the alternative approach of including the present value of pension benefits earned in a given year may be more useful in evaluating the relationship between pay and performance. This alternative approach would fully reflect plan amendments as well as unexpected increases in pay,[650] whose impact on pension benefits may reflect an important source of increased compensation.[651] Under this alternative, registrants may be able to make the required computations based on the information

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650 *See, e.g.,* letter from Mercer.

651 *See, e.g.,* Irina Stefanescu, Yupeng Wang, Kangzhen Xie & Jun Yang, *Pay Me Now (and Later): Pension Benefit Manipulation Before Plan Freezes and Executive Retirement,* 127 J. FIN. ECON. 152 (2018).

already available to them, rather than through their actuarial services provider, which could marginally reduce compliance costs. Such an approach may also further increase the comparability between compensation provided through defined benefit and defined contribution plans, because registrant contributions to defined benefit plans may also be directly related to current compensation levels or other such metrics with respect to the last fiscal year. However, the amount included with respect to pensions under this alternative would not have as direct of a relationship with the values included in the audited GAAP financial statements as the service cost (and prior service cost or credit) included under the adopted approach.

Some commenters suggested excluding components of pay that may be considered unrelated to performance—such as perquisites and values related to retirement benefits—from the definition of executive compensation actually paid.[652] As discussed in the Proposing Release, restricting the definition of executive compensation actually paid in such a way would not provide investors with a complete picture of compensation and how it relates to financial performance. While compensation committees may rely mainly on particular components of compensation in order to provide performance incentives, the other components of compensation may still vary with company performance and, even if they do not vary with performance, may be important to consider in order to understand how sensitive the totality of compensation is to performance.[653] Restricting the types of compensation included in executive compensation actually paid may also reduce the comparability of disclosures across registrants that rely more heavily on types of compensation that would be excluded from the prescribed measure versus those that rely more heavily on compensation types that would be included.

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[652] *See, e.g.,* letters from AON; CEC 2015; Coalition; Corning; Honeywell; and PG 2015.

[653] *See, e.g.,* Lucian Bebchuk & Jesse Fried, *Stealth Compensation via Retirement Benefits,* 1 BERKELEY BUS. L. J., 291 (2004).

We also considered adjusting the definition of executive compensation actually paid to account for executives' continued exposure to registrant performance after an equity award vests, due to restrictions on the transfer or monetization of such equity,[654] by continuing to reflect such awards in executive compensation actually paid until these other restrictions lapse. In some cases, the relationship of executives' wealth accumulation to registrant performance may be driven by their vested holdings of equity. When such holdings are mandated, the resulting exposure to registrant performance after vesting may reflect a compensation decision rather than an active investment decision by the executives, and could be helpful to consider in order to better understand the total required sensitivity of an executive's income and financial assets to the registrant's performance.

However, different sets of restrictions on the transfer or monetization of equity can have different effects on the degree of continued required exposure. For example, some non-transferable holdings could be monetized by executives through contractual agreements with a broker-dealer, if the registrant's hedging policies permit such transactions. There is therefore uncertainty as to how best to reflect such restrictions for the purpose of the new disclosure. While the adopted definition of executive compensation actually paid does not include adjustments for restrictions on the transfer or monetization of equity awards, registrants can choose to provide supplemental measures of pay if they believe that those measures better demonstrate the effects of these features.

The final rules require registrants to include the Summary Compensation Table measure of total compensation together with executive compensation actually paid in the tabular

[654] Such restrictions include delayed option exercisability as well as equity anti-hedging, holding, and mandatory deferral requirements. *See, e.g.,* letters from CEC 2015; CEC 2022; Davis Polk 2015; Hyster-Yale; and NACCO (describing awards to their executives consisting of "immediately vested and taxable restricted stock" that is "non-transferrable and generally may not be hedged, pledged or transferred for a period of 10 years").

disclosure of pay and performance measures. We considered excluding this measure. Some commenters indicated that it would be extraneous or confusing in the pay-versus-performance disclosure.[655] However, as discussed above, some current pay-for-performance analyses used by investors use grant-date measures of pay, similar to total compensation from the Summary Compensation Table.[656] To the extent that some investors may be interested in considering the relationship of performance with a measure of pay that excludes changes in the value of equity awards, they would be able to refer to the Summary Compensation Table measure of total compensation in the tabular disclosure. Further, as discussed above, this existing total compensation measure may be a useful benchmark for understanding executive compensation actually paid, such as in the case where infrequent grants designed to provide multi-year incentives may cause sharp increases in the latter measure in the years when such grants are made.[657]

We considered also requiring the disclosure of a measure of realizable pay, a type of measure that a number of commenters indicated may be useful in this context.[658] The adopted measure of executive compensation actually paid is quite similar conceptually to realizable pay measures, with a few key differences. For example, realizable pay is typically computed based on equity awards granted over a fixed period. This approach may make it easier to evaluate the compensation decisions made by a board over such fixed period. However, equity awards can have long vesting periods and typically have overlapping performance periods, so considering all unvested awards, regardless of when they were granted, may provide a more complete

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655 *See, e.g.,* letters from CEC 2015; Exxon; Hall; McGuireWoods; Meridian; PG 2015; TCA 2015; and TCA 2022.

656 *See* Section IV.B.2 above.

657 *See supra* note 641.

658 *See supra* note 520.

picture of pay for the purpose of evaluating its alignment with performance. Realizable pay is also typically computed over a multi-year period, with outstanding equity awards valued as of the end of the period (or sometimes at vesting or exercise, if earlier). As discussed above, such aggregated, multi-year pay measures can smooth certain outliers but can also obscure the year-to-year relationship of pay and performance. Registrants may voluntarily include measures of realized or realizable pay in the disclosure if they deem them to be helpful to explaining the relationship of their pay with performance.

Lastly, we considered also requiring the disclosure of peer group compensation. While TSR for a peer group is required to be included under the final rules, also incorporating pay information for a peer group in order to produce relative pay-versus-performance disclosures may be useful to investors as it would provide further context in which to evaluate the pay-versus-performance alignment of a registrant.[659] However, requiring further comparisons to a peer group may reduce the comparability of disclosures because of registrant discretion in selecting the peer group or variation in the availability of a closely comparable peer group. There are also practical implementation considerations, as peer compensation for the last fiscal year is not likely to be available at the time a registrant is compiling the disclosure. Further, even if these practical considerations could be mitigated (*e.g.*, by permitting peer information to be excluded when unavailable), requiring relative pay-versus-performance disclosures would most likely impose higher compliance costs. Under the final rules, investors can construct relative pay-versus-performance analyses on their own by comparing the separate pay-versus-performance disclosures of each of a registrant's peers, based on the peer group

[659] *See, e.g.,* letter from Cook.

reported by a registrant under Item 201(e) of Regulation S-K or in the CD&A, if such peers have filed their disclosures as of the time of comparison.

iv. Performance Measures

We have considered several reasonable alternatives with respect to the performance measures to be included in the disclosures. For example, commenters raised, and we have considered, many different approaches to computing and presenting TSR. As discussed above, common suggestions included, among others, presenting a rolling average of TSR (*i.e.*, for each year, registrants would report the cumulative TSR for the previous five years) or an annualized TSR (*i.e.*, for each year, registrants would report TSR for that single year).[660] While a rolling average could present a broader view of performance to those taking a longer-term perspective, it could also obscure the performance specific to a given year. A five-year rolling average TSR could change from year to year because of performance in the current year being newly included in the rolling average or because of the performance six years ago being newly excluded from the rolling average. An annualized TSR would provide greater clarity and align with the revised definition of executive compensation actually paid, which will reflect, in a given year, changes in the value of outstanding equity awards over that specific year. Also, according to one commenter, "most investors and proxy advisors generally look to an annualized approach when they assess a company's TSR."[661]

However, the adopted approach of computing cumulative TSR, and presenting it as the changing value of an initial fixed dollar investment, will be familiar to both investors and registrants because it aligns with the Item 201(e) of Regulation S-K performance graph

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[660] *See supra* notes 254 to 257 and accompanying text.

[661] *See* letter from Towers.

requirement. We also expect this approach will make the trend in performance easier to understand for less sophisticated investors, given concerns about financial literacy among investors[662] and, particularly, a common difficulty in appropriately combining percentage changes[663] (*e.g.*, recognizing that a negative 50 percent return followed by a positive 50 percent return represents a negative 25 percent return on a cumulative basis). A cumulative return, scaled to a fixed investment, will still make the return attributable to a given year apparent, and sophisticated investors can easily use this return to compute other variations of TSR that they may prefer.

We also considered not requiring any registrants, including non-SRCs, to include peer group TSR in the disclosure. As discussed above, a number of commenters had concerns about the peer group TSR requirement,[664] including that it would be costly and yet the benefits could be limited because variation in peer group selection, and in the degree of relevance of peer group performance, could reduce comparability and mislead investors. We acknowledge that peer group TSR will not provide an equally relevant benchmark across all registrants. However, it may nonetheless provide helpful context for assessing registrant TSR by providing some indication of broader market or industry conditions, and may help to address the concerns of commenters that registrant TSR could reflect a number of factors outside of the control of the executives of the registrant.[665] We continue to expect the costs of including peer group TSR to

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[662] *See, e.g., SEC Staff Study Regarding Financial Literacy Among Investors*, as required by Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (August 2012), *available at* https://www.sec.gov/files/917-financial-literacy-study-part1.pdf; and Annamaria Lusardi & Olivia Mitchell, *The Economic Importance of Financial Literacy: Theory and Evidence*, 52 J. ECON. LIT., No. 1, 5 (2014).

[663] *See, e.g.,* Haipeng Chen & Akshay Rao, *When Two Plus Two is Not Equal to Four: Errors in Processing Multiple Percentage Changes*, 34 J. CONSUMER RSCH. 327 (Oct. 2007).

[664] *See supra* notes 261 to 269 and accompanying text.

[665] *See supra* note 526.

be limited, even if a registrant does not use the same peer group as in the Item 201(e) of Regulation S-K peer group TSR disclosure, because the required data is readily available and the required computations are relatively straightforward.

Another alternative to the final rules would be, as in the proposed rules, to not require any other prescriptive performance measures, beyond TSR and peer group TSR, to be included in the disclosure. As some commenters noted, it is not clear that any single measure other than TSR would be relevant across most registrants.[666] Declining to prescribe additional measures would reduce costs and limit the risk that registrants would have to include and discuss a measure that could be misleading or which investors may not find to be useful. This approach could thereby increase the likelihood that investors could process the disclosures quickly, while not decreasing the total amount of underlying information available from public disclosures. At the same time, if the addition of another performance measure would better explain the pattern in executive compensation actually paid, registrants would be able to voluntarily provide such measures, and would likely be motivated to do so.[667]

However, as discussed in the Benefits section above, the inclusion of net income as an additional measure may provide investors with useful context for interpreting the disclosure. Even if required to include a Company-Selected Measure, registrants might not always provide a measure of profitability, in which case net income may help to provide a more complete picture of registrant performance. Further, as discussed above, measures of profitability are commonly used as performance metrics in executive compensation contracts.[668] Yet, if registrants provide measures of profitability in the disclosure, they may be non-GAAP or

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[666] *See, e.g.,* letters from AB; BlackRock; Davis Polk 2022; and TIAA.

[667] *See, e.g.,* letters from CFA; CII 2015; Davis Polk 2022; and SCG.

[668] *See* Section IV.B.3 above.

adjusted measures, and investors may benefit from having net income beside these measures as a benchmark to better understand the effects of such adjustments. Finally, limiting the additional prescribed measures to a single, readily available measure should help to contain the costs and risks of expanding the required measures that are noted above.

We also considered other financial measures as alternatives to net income. As discussed in the Baseline section above, the measures presented by third parties as part of pay-for-performance analyses in recent years—which may reflect investor interest in or demand for the measures—include operating cash flow growth, earnings per share growth, EBITDA growth, return on equity, return on invested capital, return on assets, and various ratios and growth rates using "economic value added." [669] Measures that commenters suggested we consider include EBITDA,[670] free cash flow,[671] revenue or profit growth,[672] return on investment,[673] shareholder value added,[674] or the ratio of enterprise value to either EBITDA or earnings before interest and taxes ("EBIT").[675] Overall, these suggestions and the measures presented in third party analyses differ from net income in that many involve some form of scaling—that is, some are ratios, which can help to account for the capital or assets used to generate profits, while others are growth rates—and many include adjustments to focus on operating items or cash flows. It is possible that investors may benefit more from a prescribed measure with these characteristics, rather than net income. However, it is not obvious that there

[669] *See supra* note 453.

[670] *See* letter from Dimensional.

[671] *See* letters from Dimensional and Quirin.

[672] *See* letter from Grier.

[673] *See* letter from Quirin.

[674] *See* letter from Quirin.

[675] *See* letter from PDI.

is a single preferred measure, and net income has the benefit of being a clearly-defined, widely-understood measure. Registrants may supplement the disclosure with other measures if they feel they would be useful or if their investors demand them.

Another alternative to the final rules would be, as in the proposed rules, to give registrants the option to include additional performance measures but not to require a Company-Selected Measure of any registrant. As discussed above, if the addition of another performance measure would better explain the pattern in executive compensation actually paid, registrants would likely be motivated to include such a measure on a voluntary basis. Not requiring a Company-Selected Measure would also eliminate any costs or difficulties associated with isolating a single most important measure and give registrants more flexibility to include only the measures that they expect may be most useful to investors. For example, investors may benefit if registrants are able to present a different measure than the Company-Selected Measure in cases where the measure that drove compensation in the last fiscal year may not be the most important for explaining the pattern in executive compensation actually paid over the full five-year horizon of the disclosure. On the other hand, requiring a Company-Selected Measure may elicit additional helpful context in cases where registrants would not otherwise supplement the required performance measures.

As an alternative to the Tabular List, we also considered other approaches to providing context about the measures that were critical in linking pay to performance at a given registrant. For example, we could have required registrants to disclose all of the measures actually used to link pay to performance, with or without quantitative disclosure of the outcomes of the quantifiable measures, any applicable thresholds and targets, and the associated payouts. Such disclosure may provide a more complete view of how pay is linked to performance at a given registrant, and the potential quantitative element may allow investors to more readily assess the sensitivity of pay to particular measures and the rigor of performance goals. Some investors commented that they would benefit from this information being more readily available.[676] However, depending on the specific requirements, such disclosure could be more costly to produce than the Tabular List and may take more time for investors to review, rather than providing simple context and framing for an investor's review of the main table and associated descriptions. There may also be implications of increased transparency of quantitative targets and thresholds, such as pressuring registrants to limit discretion in their pay programs, which may or may not be beneficial. Finally, we note that several commenters mentioned that some registrants are already providing such disclosures,[677] with one indicating that the market does not seem to have coalesced around a consistent format for such disclosures.[678] We expect that market practices in this area may continue to develop.

VI. PAPERWORK REDUCTION ACT

A. Background

Certain provisions of our regulations and schedules that would be affected by the final rules contain a "collection of information" within the meaning of the PRA. The Commission is submitting the final rules to the Office of Management and Budget ("OMB") for review in accordance with the PRA.[679] The Commission published a notice requesting comment on changes to these collection of information requirements in the Proposing Release and submitted

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[676] *See, e.g.,* letters from AFL-CIO 2015; AFL-CIO 2022; CalPERS 2022; CII 2015; CII 2022; and SBA-FL.

[677] *See, e.g.,* letters from PG 2022 and SBA-FL.

[678] *See* letter from PG 2022.

[679] 44 U.S.C. 3507(d) and 5 CFR 1320.11.

these requirements to the OMB for review in accordance with the PRA.[680] The hours and costs associated with preparing, filing, and distributing the schedules constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to comply with, a collection of information unless it displays a currently valid OMB control number. Compliance with the final rules is mandatory. Responses to the information collections will not be kept confidential and there is no mandatory retention period for the information disclosed.

The titles for the collections of information are:

"Regulation 14A and Schedule 14A" (OMB Control No. 3235-0059); and

"Regulation 14C and Schedule 14C" (OMB Control No. 3235-0065).

We adopted the above-referenced regulations and schedules pursuant to the Securities Act or the Exchange Act. The regulations and schedules set forth the disclosure requirements for proxy and information statements filed by registrants to help investors make informed investment and voting decisions. The final rules are intended to satisfy the requirements of Section 14(i).

A description of the final amendments, including the need for the information and its use, as well as a description of the likely respondents, can be found in Section II above, and a discussion of the expected economic effects of the final amendments can be found in Section V above.

B. Summary of Comment Letters and Revisions to PRA Estimates

In the Proposing Release, the Commission requested comment on the PRA burden hour and cost estimates and the analysis used to derive such estimates. While several commenters

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680 *Id.*

provided comments on the potential costs of the proposed rules and of the potential requirements discussed and analyzed in the Reopening Release, only one commenter specifically addressed our PRA estimates, stating that the Commission's estimates of the man hour and cost burden of the rule on companies were "grossly underestimated."[681] As discussed, above, we have made some changes to the proposed amendments as a result of comments received in response to the Proposing Release and the Reopening Release. We have revised our estimates from the Proposing Release accordingly, taking into account the changes and the comments received.

C. Summary of Collection of Information Requirements

We are adding new Item 402(v) to Regulation S-K. This item requires registrants to provide a table containing the Summary Compensation Table measure of total compensation and the values of the prescribed measure of executive compensation actually paid for the PEO and as an average for the other NEOs, TSR both for the registrant and its peer group, the registrant's net income, and a Company-Selected Measure. Item 402(v) of Regulation S-K also requires a registrant to provide a clear description of (i) the relationships between executive compensation actually paid to its PEOs and, on average, to its other NEOs and the registrant's TSR, (ii) the relationship between executive compensation actually paid to the registrant's PEOs and, on average, its other NEOs, and the net income of the registrant, (iii) the relationships between executive compensation actually paid to the registrant's PEOs and, on average, its other NEOs and the registrant's Company-Selected Measure, and (iv) the relationship between the registrant's TSR and its peer group TSR, in each case over the

[681] *See* letter from NAM 2015. Another commenter contended that the Reopening Release should have included an updated PRA analysis. *See* letter from Toomey/Shelby. That letter is discussed in footnote 8, *supra*.

registrant's five most recently completed fiscal years. A registrant will also be required to disclose an unranked Tabular List of its most important financial performance measures used by it to link executive compensation actually paid to its PEOs and other NEOs during the fiscal year to registrant performance. The final rules require registrants to separately tag the values disclosed in the table in Inline XBRL, block-text tag the footnote and relationship disclosure and the Tabular List in Inline XBRL, and tag specific data points (such as quantitative amounts) within the footnote disclosures in Inline XBRL.

The disclosure is required in proxy statements on Schedule 14A and information statements on Schedule 14C in which executive compensation disclosure pursuant to Item 402 of Regulation S-K is required. EGCs, registered investment companies, and foreign private issuers are not required to provide the disclosure. SRCs are subject to scaled disclosure requirements, under which they will not be required to provide a peer group TSR or a Company-Selected Measure (or any related relationship disclosures), nor will they be required to provide a Tabular List or disclose amounts related to pensions; and will only be required to provide three (two in the first applicable filing after the rules become effective) years of disclosure. SRCs must provide the Inline XBRL data beginning in the third filing in which they provide the required pay-versus-performance disclosure.

Much of the information required to produce the pay-versus-performance disclosure is based on items that are already required elsewhere in the executive compensation disclosure and financial statements provided by registrants. In particular, we believe that using as a starting point the total compensation that registrants already are required to report in the Summary Compensation Table and making adjustments to those figures will help reduce the burden on registrants in preparing the disclosure required by new Item 402(v) of Regulation S-K. As discussed above, the final rules are not expected to require registrants to collect significant new data, relative to current disclosure requirements.[682] All of the individual components needed to calculate executive compensation actually paid already must be reported under existing disclosure requirements, with the exception of the values to be included with respect to equity awards and the values to be included with respect to pension benefits for registrants other than SRCs, which are not required to include such pension amounts in their calculation of executive compensation actually paid. Information about net income for all registrants is already required to be disclosed in the registrant's financial statements. Further, information about TSR and peer group TSR is already required to be disclosed in a registrant's annual report to shareholders under Item 201(e) of Regulation S-K, and the measures that make up the Tabular List and the Company-Selected Measure are already considered by registrants when making executive compensation determinations, and may already be discussed, in a different form, in the CD&A. SRCs are not required to provide disclosure under Item 201(e) of Regulation S-K or a CD&A, but also are not required under the final rules to provide disclosure of peer group TSR, the Tabular List, or the Company-Selected Measure. However, SRCs, which currently are not required to disclose their TSR in annual reports, will need to calculate this measure under the final rules.

We arrived at the estimates discussed below by reviewing our burden estimates for similar disclosure and considering our experience with other tagged data initiatives. In addition, the estimates discussed below reflect our belief that much of the information required to prepare the pay-versus-performance disclosure will be readily available to registrants because the information is required to be gathered, determined, or prepared in order to satisfy the other

[682] *See supra* Section V.C.

disclosure requirements of our rules, including Item 402 of Regulation S-K. We believe that the amendments regarding pay-versus-performance disclosure will enhance the already required compensation disclosure.

The following PRA Table 1 summarizes the estimated effects of the final amendments on the paperwork burdens associated with the affected collections of information listed in Section VI.A.

PRA Table 1. Estimated Paperwork Burden Effects of the Final Amendments

Final Amendments and Effects	**Estimated Burden Effect***
Pay-versus-Performance Table: • *Registrants other than SRCs*: Requiring a table containing the Summary Compensation Table measure of total compensation and the values of the prescribed measure of executive compensation actually paid for the PEO and as an average for the other NEOs, TSR for both the registrant and its peer group, the registrant's net income, and a Company-Selected Measure. The calculation of executive compensation actually paid includes adjustments from the Summary Compensation Table amounts with respect to equity awards and pension benefits. Related footnote disclosure of the amounts that were deducted from, and added to, the Summary Compensation Table total and of valuation assumptions also required. Registrants required to separately tag the values disclosed in the table, block-text tag the footnote disclosure, and tag specific data points (such as quantitative amounts) within the footnote	• 28 hour increase in compliance burden per schedule for registrants other than SRCs • 17 hour increase in compliance burden per schedule for SRCs

disclosures, all in Inline XBRL. *Estimated burden increase: 20 hours per schedule*. • *SRCs*: Requiring a table containing the Summary Compensation Table measure of total compensation and the values of the prescribed measures of executive compensation actually paid for the PEO and as an average for the other NEOs, TSR for the registrant, and the registrant's net income. The calculation of executive compensation actually paid includes adjustments from the Summary Compensation Table amounts with respect to equity awards. Related footnote disclosure of the amounts that were deducted from, and added to, the Summary Compensation Table total and of valuation assumptions also required. Registrants required to separately tag the values disclosed in the table, block-text tag the footnote disclosure, and tag specific data points (such as quantitative amounts) within the footnote disclosures, all in Inline XBRL. *Estimated burden increase: 15 hours per schedule*. Relationship Disclosure: • *Registrants other than SRCs*: Requiring a clear description of (i) the relationships between executive compensation actually paid to its PEOs and, on average, its other NEOs and the registrant's TSR, (ii) the relationships between executive compensation actually paid to the registrant's PEOs and, on average, its other NEOs and	

the net income of the registrant, (iii) the relationships between executive compensation actually paid to the registrant's PEOs and, on average, its other NEOs and the registrant's Company-Selected Measure, and (iv) the relationships between the registrant's TSR and its peer group TSR, in each case over the registrant's five most recently completed fiscal years. Registrants required to block-text tag the relationship disclosure in Inline XBRL. *Estimated burden increase: 4 hours per schedule*. • *SRCs*: Requiring a clear description of (i) the relationships between executive compensation actually paid to its PEOs and, on average, its other NEOs and the registrant's TSR and (ii) the relationships between executive compensation actually paid to the registrant's PEOs and, on average, its other NEOs and the net income of the registrant, in each case over the registrant's three most recently completed fiscal years. Registrants required to block-text tag the relationship disclosure in Inline XBRL. *Estimated burden increase: 2 hours per schedule.* Tabular List: • Requiring a registrant that is not an SRC to disclose an unranked Tabular List of the most important financial performance measures used by it to link executive compensation actually paid to its PEOs and NEOs during	

the fiscal year to company performance. Registrants required to block-text tag the Tabular List in Inline XBRL. *Estimated burden increase: 4 hours per schedule.*	

*Estimated effect expressed as an increase of burden hours on average and derived from Commission staff review of samples of relevant sections of the affected forms and schedules.

The estimated burden increase associated with the final rules for both SRCs and non-SRCs reflects an increase from the estimated average burden increase of 15 hours for all registrants that was included in the Proposing Release.[683] The increase reflects adjustments made due to comments received and accounts for several modifications relative to the proposed rules, including with respect to the calculation of executive compensation actually paid, the addition of net income and the Company-Selected Measure as performance measures to be included in the table, and related relationship disclosures with respect to those performance measures, and the requirement to provide the Tabular List. Because these estimates are averages of the burdens for all such companies in each respective category, the burden could be more or less for any particular company, and may vary depending on a variety of factors, such as the complexity of companies' compensation plans or the degree to which companies use the services of outside professionals, or internal staff and resources, to tag the data in Inline XBRL. This burden, as discussed in more detail below, will be added to the current burdens for Schedule 14A and Schedule 14C.

D. Incremental and Aggregate Burden and Cost Estimates for the Final Amendments

We anticipate that new disclosure requirements will increase the burdens and costs for the affected registrants. We derived our new burden hour and cost estimates by estimating the

[683] *See* Section V.C of the Proposing Release.

total amount of time it would take a registrant to prepare and review the disclosure requirements contained in the final rules, as well as the average hourly rate for outside professionals who assist with such preparation. The burden estimates were calculated by multiplying the estimated number of responses by the estimated average amount of time it would take a registrant to prepare and review disclosure required under the final amendments. For purposes of the PRA, the burden is to be allocated between internal burden hours and outside professional costs. For the proxy and information statements on Schedule 14A and Schedule 14C, we estimate that 75% of the burden of preparation is carried by the company internally and that 25% of the burden of preparation is carried by outside professionals retained by the company at an average cost of $400 per hour.[684] The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the company internally is reflected in hours.

We estimate that about 1,275 EGCs are required to file proxy statements on Schedule 14A or information statements on Schedule 14C, in which executive compensation disclosure pursuant to Item 402 of Regulation S-K is required. We have adjusted the estimates to deduct the filings attributed to these companies from our estimate because EGCs are not subject to the final rules.[685] The table below sets forth our estimates of the number of current filings on the schedules that will be affected by the final rules. We used this data to extrapolate the effect of these changes on the paperwork burden for the listed collections of information.

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[684] We recognize that the costs of retaining outside professionals may vary depending on the nature of the professional services, but for purposes of this PRA analysis, we estimate that such costs would be an average of $400 per hour. This estimate is based on consultations with several issuers, law firms, and other persons who regularly assist issuers in preparing and filing reports with the Commission.

[685] *See supra* note 23. Although EGCs would not have been subject to the proposed amendments, the estimates included in the Proposing Release were not adjusted to deduct the number of EGCs because at the time the precise number of these filers was difficult to determine.

PRA Table 2: Estimated Number of Affected Filings

Form	Current Annual Responses in PRA Inventory*	Estimated Number of Affected Filings**
Schedule 14A	6,369	4,968
Schedule 14C	569	444

* The number of responses reflected in the table equals the three-year average of the number of schedules filed with the Commission and currently reported by the Commission to OMB.

** Based on the approximately 1,275 EGCs that we estimate are required to file proxy statements on Schedule 14A or information statements on Schedule 14C relative to the estimated total number of approximately 4,530 registrants subject to the final rules, we estimate that approximately 22% of the registrants filing Schedules 14A or 14C are EGCs, which are not subject to the final rules. In estimating the hours and service costs, we have removed those filers from the Current Annual Responses totals for Schedule 14A and Schedule 14C. As a result, we expect the final rules to affect approximately 4,968 Schedule 14A filings [6,369 x 0.22 = 1,401; 6,369 – 1,401 = 4,968] and approximately 444 Schedule 14C filings [569 x 0.22 = 125; 569 – 125 = 444].

In deriving our estimates, we recognize that the burdens will likely vary among individual registrants based on a number of factors, including the size and complexity of their executive compensation arrangements. We believe that some registrants will experience costs in excess of this average (particularly in the first year of compliance with the final rules) and some registrants may experience less than the average costs. PRA Table 3 below illustrates the incremental change to the total annual compliance burden of affected collections of information, in hours and in costs, as a result of the final amendments.

PRA Table 3: Calculation of the Incremental Change in Burden Estimates of Current Responses Resulting from the Final Amendments

Collection of Information	Filed By*	Estimated Number of Affected Responses (A)	Burden Hour Increase per Affected Response (B)	Increase in Burden Hours for Current Affected Responses (C) =(A) x (B)	Increase in Company Hours for Current Affected Responses (D) =(C) x 0.75	Increase in Professional Hours for Current Affected Responses (E) =(C) x 0.25	Increase in Professional Costs for Current Affected Responses (F) = (E) x $400
Schedule 14A	Non-SRC	2,981	28	83,468			

Schedule 14A	SRC	1,987	17	33,779			
Schedule 14A (Total)		4,968		117,247	87,935	29,312	$11,724,800
Schedule 14C	Non-SRC	266	28	7,448			
Schedule 14C	SRC	178	17	3,026			
Schedule 14C (Total)		444		10,474	7,856	2,619	$1,047,600

* Based on 2021 filings, SRCs represent about 41 percent (1,860 out of 4,530) of the affected registrants. We assume for purposes of our PRA estimates that 60 percent of each affected collection of information was filed by non-SRCs and 40 percent by SRCs.

The following PRA Table 4 summarizes the requested paperwork burden, including the estimated total reporting burdens and costs, under the final amendments.

PRA Table 4. Requested Paperwork Burden under the Final Amendments

	Current Burden			Program Change			Revised Burden		
Collection of Information	Current Annual Responses (A)	Current Burden Hours (B)	Current Cost Burden (C)	Number of Affected Responses (D)	Increase in Company Hours (E)†	Increase in Professional Costs (F)‡	Annual Responses (G) = (A)	Burden Hours (H) = (B) + (E)	Cost Burden (I) = (C) + (F)
Schedule 14A	6,369	778,802	$103,805,312	4,968	87,935	$11,724,800	6,369	866,737	$115,530,112
Schedule 14C	569	56,356	$7,514,944	444	7,856	$1,047,600	569	64,212	$8,562,544

† From Column (D) in PRA Table 3.
‡From Column (F) in PRA Table 3.

VII. FINAL REGULATORY FLEXIBILITY ANALYSIS

The Regulatory Flexibility Act ("RFA")[686] requires the Commission, in promulgating rules under Section 553 of the Administrative Procedure Act,[687] to consider the impact of those rules on small entities. We have prepared this Final Regulatory Flexibility Analysis ("FRFA")

686 5 U.S.C. 601 *et seq.*

687 5 U.S.C. 553.

in accordance with Section 604 of the RFA.[688] An Initial Regulatory Flexibility Analysis ("IRFA") was prepared in accordance with the RFA and was included in the Proposing Release. This FRFA relates to the amendments to Item 402 of Regulation S-K, Item 405 of Regulation S-T, Schedule 14A, and Schedule 14C.

A. Need For, and Objectives of, the Final Rules

The final rules are designed to implement the requirements of Section 14(i), which was added by Section 953(a) of the Dodd-Frank Act. Section 14(i) mandates that the Commission adopt rules addressing specified disclosure requirements. Specifically, as described in detail in Section II above, the final rules will require registrants (other than EGCs, registered investment companies, and foreign private issuers) to disclose in any proxy or information statement for which disclosure under Item 402 of Regulation S-K is required, the relationship between executive compensation actually paid to the registrant's PEO and, on average, its other NEOs and the financial performance of the registrant for the three most recently completed fiscal years in the case of a registrant that qualifies as an SRC (or the five most recently completed fiscal years in the case of a non-SRC), taking into account any change in the value of the shares of stock and dividends of the registrant and any distributions.

The final rules require registrants to present pay-versus-performance disclosure that can be readily compared across registrants, while also providing investors with disclosure reflecting the specific situation of the registrant. We believe that the final rules will, among other things, allow investors to assess a registrant's executive compensation actually paid relative to its financial performance more easily and at a lower cost to investors. The need for, and objectives of, the final rules are described in greater detail in Sections I and II.

[688] 5 U.S.C. 604.

B. Significant Issues Raised by Public Comments

In the Proposing Release, we requested comment on all aspects of the IRFA, including the nature of any impact on small entities and empirical data to support the extent of the impact. In addition, the Reopening Release included a discussion of the potential impact on SRCs of requiring disclosure of the additional performance measures discussed in that release and also requested comment on a number of matters with respect to SRCs in relation to the proposed rules and the additional requirements considered in that release. We did not receive any comments specifically addressing the IRFA.[689] However, we received a number of comments on the proposed rules generally,[690] and have considered these comments in developing the FRFA. In addition, as discussed in detail above in Section II.G.2, we received a variety of comments on whether SRCs should be subject to the proposed rules.[691] Some commenters supported fully exempting SRCs from the pay-versus-performance disclosure requirements,[692] while another suggested that the pay-versus-performance disclosure be voluntary for SRCs.[693] Other commenters stated that we should not exempt SRCs from the disclosure requirements,[694] some noting that a lack of transparency could have negative market effects for SRCs.[695] Commenters also made a variety of suggestions with respect to the timing of the disclosure for SRCs, including that SRCs be subject to the full pay-versus-performance disclosure requirement

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689 As discussed in footnote 8, *supra*, one comment letter noted that the Commission did not update the RFA analysis in the Reopening Release, and "urge[d]" the Commission to "re-propose" with an updated RFA analysis. *See* letter from Toomey/Shelby.

690 *See supra* Section II.

691 *See supra* notes 399–406 and accompanying text.

692 *See* letters from CCMC 2015; Mercer; Pearl; TCA 2015; and TCA 2022.

693 *See* letter from ICGN.

694 *See* letters from AB; Better Markets; CalPERS 2015; CalSTRS; CII 2015; Morrell; SBA-FL; and Troop.

695 *See* letter from CalPERS 2015.

but with a one year "grace period,"[696] or that SRCs provide five years of data, but with a three year transition period.[697] One commenter also suggested that the Commission exempt SRCs from the disclosure requirements for five years so that the Commission could first analyze the impact of the disclosure requirements on larger registrants.[698]

C. Small Entities Subject to the Final Amendments

The final rules will affect some companies that are small entities. For purposes of the RFA, under our rules, an issuer, other than an investment company,[699] is a "small business" or "small organization" if it had total assets of $5 million or less on the last day of its most recent fiscal year.[700] The final rules will affect issuers that have a class of securities that are registered under Section 12 of the Exchange Act but are not foreign private issuers, registered investment companies, or EGCs. We estimate that there are approximately 450 issuers that may be considered small entities and are potentially subject to the final amendments. An investment company, including a BDC, is considered to be a "small business" if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[701] We believe that the final rules will affect some small entities that are BDCs that have a class of securities registered under Section

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[696] *See* letter from AB.

[697] *See* letter from Hermes.

[698] *See* letters from NIRI 2015 and NIRI 2022.

[699] For purposes of the RFA, an investment company is a "small business" or "small organization" that, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year. [17 CFR 270.0-10].

[700] See Exchange Act Rule 0-10(a) [17 CFR 240.0-10(a)].

[701] 17 CFR 270.0-10(a).

12 of the Exchange Act. We estimate that one affected BDC may be considered a small entity.[702]

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

We expect the final rules to have an incremental effect on existing reporting, recordkeeping and other compliance burdens for all issuers, including small entities. Under the final rules, SRCs are permitted to provide disclosure in accordance with Item 402(v) of Regulation S-K that is scaled for small companies, consistent with SRCs' existing scaled executive compensation disclosure requirements. Specifically, SRCs are not required to provide a peer group TSR, a Company-Selected Measure, a Tabular List, or to disclose amounts related to pensions. Because SRCs are not required to provide a peer group TSR or Company-Selected Measure, they are similarly not required to provide relationship disclosure with respect to those performance measures. In addition, because the existing scaled definition of NEO in Item 402 of Regulation S-K applicable to SRCs applies for purposes of the new Item 402(v) disclosure, SRCs are required to provide disclosure about fewer NEOs than non-SRC registrants. SRCs also will only be required to provide three years of disclosure (two in the first applicable filing after the rules become effective). Both SRCs and non-SRC registrants are required to separately tag the values disclosed in the table in Inline XBRL, block-text tag the footnote and relationship disclosure and the Tabular List in Inline XBRL, and tag specific data points (such as quantitative amounts) within the footnote disclosures in Inline XBRL, but SRCs are required to provide the required Inline XBRL data beginning in the third filing in which they provide pay-versus-performance disclosure.

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[702] Of the seven BDCs that will be subject to the final amendments, one may be considered a small entity for purposes of the RFA.

Much of the information required in the pay-versus-performance disclosure is based on items that are already required elsewhere in the executive compensation disclosure and financial statements provided by registrants, and the final rules are not expected to require registrants to collect significant new data, relative to current disclosure requirements.[703] Compliance with certain provisions affected by the amendments will require the use of professional skills, including accounting, legal, and technical skills. The final amendments are discussed in detail in Sections I and II above. We discuss the economic impact, including the estimated compliance costs and burdens of the final rules on all registrants, including small entities, in Sections V and VI above.

E. Agency Action to Minimize Effect on Small Entities

The RFA directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. In connection with the final rules, we considered the following alternatives:

- Establishing different compliance or reporting requirements or timetables that take into account the resources available to small entities;
- Clarifying, consolidating or simplifying compliance and reporting requirements under the rules for small entities;
- Using performance rather than design standards; and
- Exempting small entities from all or part of the final rules.

As noted above, the final rules will require clear disclosure of prescribed measures of executive compensation actually paid and the company's financial performance and the relationship between these measures. All of the individual components needed for SRCs to

[703] *See supra* Section V.C.

calculate executive compensation actually paid already must be reported by SRCs under current disclosure rules, with the exception of the values to be included with respect to equity awards. In addition, net income is required under existing financial disclosure. As discussed above, we do not believe that it is necessary to exempt small entities from the final rules entirely, as we believe the benefit to investors of small entities providing pay-versus-performance disclosure outweighs the costs to them of preparing the scaled disclosure.[704] We have provided some different and simplified compliance requirements for small entities, taking into account their resources. In particular, we have scaled the disclosure requirements for SRCs in an attempt to limit the compliance burden to which such companies will be subject. Accordingly, registrants that are SRCs will be subject to the final rules, but will be permitted to provide only three years of disclosure, instead of five years as required for all other registrants. Also, the final rules will require SRCs to disclose their company TSR and their net income, but they will not be required to disclose peer group TSR, a Company-Selected Measure, or a Tabular List. In addition, because the scaled compensation disclosure that applies to SRCs under existing Item 402 of Regulation S-K does not include pension plans, the pension plan adjustment otherwise required under the final rules will not apply to SRCs. To the extent that a small entity is a registrant, we believe that there are few, if any, small entities that do not qualify as SRCs because it is unlikely that an entity with total assets of $5 million or less would have a public float of $75 million or more. Under the final rules, a small entity, therefore, will likely be subject to the scaled disclosure requirements described above that will apply to SRCs.[705] We believe this will

[704] The alternative of exempting SRCs in their entirety from the final rules is discussed above in Section V.C.4.i.

[705] *See supra* Section II.G.3.

minimize any adverse impact on small entities of providing new disclosures which they generally do not currently provide.

With respect to compliance timetables, the final rules also provide SRCs with transitional relief under which they may provide two years of disclosure, instead of three, in the first applicable filing after the rules become effective, and three years of disclosure in subsequent proxy and information statement filings. The final rules also provide SRCs with a phase-in of the requirement to provide the disclosure in Inline XBRL, under which SRCs need not comply with the Inline XBRL requirement until the third filing in which they provide pay-versus-performance disclosure.

Although the final rules will require disclosure of prescribed measures of executive compensation actually paid and registrant financial performance, they will permit issuers significant flexibility in presenting the relationship between these measures. For example, issuers, including small entities, can describe the relationships in narrative form or by means of a graph or chart, or a combination of both forms. In this respect, the final rules make use of both design and performance standards as a means of balancing the investors' need for uniform disclosure across registrants while also providing registrants, including small entities, with flexibility to describe their pay-versus-performance relationship in a format that is best suited to their particular circumstances.

STATUTORY AUTHORITY AND TEXT OF AMENDMENTS

The final amendments contained in this release are being adopted under the authority set forth in Section 953(a) of the Dodd-Frank Act and Sections 3(b), 14, 23(a) and 36 of the Exchange Act.

List of Subjects in 17 CFR Parts 229, 232, and 240

Reporting and Recordkeeping requirements; Securities.

For the reasons set out in the preamble, we are amending title 17, chapter II, of the Code of Federal Regulations as follows:

PART 229 – STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975 – REGULATION S-K

1. The authority citation for part 229 continues to read as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77n, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78j-3, 78*l*, 78m, 78n, 78n-1, 78o, 78u-5, 78w, 78*ll*, 78mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11, and 7201 *et seq.*; 18 U.S.C. 1350; sec. 953(a), Pub. L. 111-203, 124 Stat. 1904 (2010); sec. 953(b), Pub. L. 111-203, 124 Stat. 1904 (2010); and sec. 102(c), Pub. L. 112-106, 126 Stat. 310 (2012).

2. Amend § 229.402 by adding paragraph (v) to read as follows:

§ 229.402 (Item 402) Executive compensation.

*   *   *   *   *

(v) *Pay versus performance*. In connection with any proxy or information statement for which the rules of the Commission require executive compensation disclosure pursuant to this section (excluding any proxy or information statement of an "emerging growth company," as defined in § 230.405 of this chapter or § 240.12b-2 of this chapter):

(1) Provide the information specified in paragraph (v)(2) of this section for each of the registrant's last five completed fiscal years in the following tabular format:

Pay Versus Performance

Year (a)	Summary Compensation Table Total for PEO (b)	Compensation Actually Paid to PEO (c)	Average Summary Compensation Table Total for Non-PEO Named Executive Officers (d)	Average Compensation Actually Paid to Non-PEO Named Executive Officers (e)	Value of Initial Fixed $100 Investment Based On:		Net Income (h)	[Company-Selected Measure] (i)
					Total Shareholder Return (f)	Peer Group Total Shareholder Return (g)		

(2) The table required by paragraph (v)(1) of this section must include:

(i) The fiscal year covered (column (a)).

(ii) The PEO's (as defined in paragraph (a)(3) of this section) total compensation for the covered fiscal year as reported in the Summary Compensation Table pursuant to paragraph (c)(2)(x) of this section, or paragraph (n)(2)(x) of this section for smaller reporting companies (column (b)), and the average total compensation reported for the remaining named executive officers collectively reported pursuant to such applicable paragraph (column (d)). If more than one person served as the registrant's PEO during the covered fiscal year, provide the total compensation, as reported in accordance with the immediately preceding sentence, for each person who served as the PEO during that period separately in an additional column (b) for each such person.

(iii) The executive compensation actually paid to the PEO (column (c)) and the average executive compensation actually paid to the remaining named executive officers collectively (column (e)). If more than one person served as the registrant's PEO during the covered fiscal year, provide the compensation actually paid to each person who served as PEO during that period separately in an additional column (c) for each such person. For purposes of columns (c) and (e) of the table required by paragraph (v)(1) of this section, executive compensation actually paid must be the total compensation for the covered fiscal year for each named executive officer as provided in paragraph (c)(2)(x) of this section, or paragraph (n)(2)(x) of this section for smaller reporting companies, adjusted to:

(A) Deduct the aggregate change in the actuarial present value of the named executive officer's accumulated benefit under all defined benefit and actuarial pension plans reported in the Summary Compensation Table in accordance with paragraph (c)(2)(viii)(A) of this section;

(B)(*1*) Add, for all defined benefit and actuarial pension plans reported in the Summary Compensation Table in accordance with paragraph (c)(2)(viii)(A) of this section, the aggregate of:

(*i*) Service cost, calculated as the actuarial present value of each named executive officer's benefit under all such plans attributable to services rendered during the covered fiscal year; and

(*ii*) Prior service cost, calculated as the entire cost of benefits granted (or credit for benefits reduced) in a plan amendment (or initiation) during the covered fiscal year that are attributed by the benefit formula to services rendered in periods prior to the amendment.

(*2*) “Service cost” and “prior service cost” must be calculated using the same methodology as used for the registrant’s financial statements under generally accepted accounting principles.

(C)(*1*) Deduct the amounts reported in the Summary Compensation Table pursuant to paragraphs (c)(2)(v) and (vi) of this section and then include an amount calculated as follows for all stock awards, and all option awards, with or without tandem SARs (as defined in paragraph (a)(6)(i) of this section) (including awards that subsequently have been transferred):

(*i*) Add the fair value as of the end of the covered fiscal year of all awards granted during the covered fiscal year that are outstanding and unvested as of the end of the covered fiscal year;

(*ii*) Add the amount equal to the change as of the end of the covered fiscal year (from the end of the prior fiscal year) in fair value (whether positive or negative) of any awards granted in any prior fiscal year that are outstanding and unvested as of the end of the covered fiscal year;

(*iii*) Add, for awards that are granted and vest in the same year, the fair value as of the vesting date;

(*iv*) Add the amount equal to the change as of the vesting date (from the end of the prior fiscal year) in fair value (whether positive or negative) of any awards granted in any prior fiscal year for which all applicable vesting conditions were satisfied at the end of or during the covered fiscal year;

(*v*) Subtract, for any awards granted in any prior fiscal year that fail to meet the applicable vesting conditions during the covered fiscal year, the amount equal to the fair value at the end of the prior fiscal year; and (*vi*) Add the dollar value of any dividends or other earnings paid on stock or option awards in the covered fiscal year prior to the vesting date that are not otherwise included in the total compensation for the covered fiscal year.

(*2*) If at any time during the last completed fiscal year, the registrant has adjusted or amended the exercise price of options or SARs held by a named executive officer, whether through amendment, cancellation or replacement grants, or any other means, or otherwise has materially modified such awards, the changes in fair value included pursuant to this paragraph (v)(2)(iii)(C) must take into account the excess fair value, if any, of any such modified award over the fair value of the original award as of the date of such modification.

(*3*) Fair value amounts must be computed in a manner consistent with the fair value methodology used to account for share-based payments in the registrant's financial statements under generally accepted accounting principles. For any awards that are subject to performance conditions, calculate the change in fair value as of the end of the covered fiscal year based upon the probable outcome of such conditions as of the last day of the fiscal year.

(iv) For purposes of columns (f) and (g) of the table required by paragraph (v)(1) of this section, for each fiscal year disclose the cumulative total shareholder return of the registrant (column (f)) and peer group cumulative total shareholder return (column (g)) calculated, except as set forth below, in the same manner as under § 229.201(e) of this chapter (Item 201(e) of Regulation S-K). For purposes of calculating the cumulative total shareholder return of the registrant and peer group cumulative total shareholder return, the term "measurement period" must be the period beginning at the "measurement point" established by the market close on the last trading day before the registrant's earliest fiscal year in the table, through and including the end of the fiscal year for which cumulative total shareholder return of the registrant or peer group cumulative total shareholder return is being calculated. The closing price at the measurement point must be converted into a fixed investment of one hundred dollars, stated in dollars, in the registrant's stock (or in the stocks represented by the peer group). For each fiscal year, the amount included in the table must be the value of such fixed investment based on the cumulative total shareholder return as of the end of that year. The same methodology must be used in calculating both the registrant's total shareholder return and that of the peer group. For purposes of determining the total shareholder return of the registrant's peer group, the registrant must use the same index or issuers used by it for purposes of § 229.201(e)(1)(ii) of this chapter or, if applicable, the companies it uses as a peer group for purposes of its disclosures under paragraph (b) of this section. If the peer group is not a published industry or line-of-business index, the identity of the issuers composing the group must be disclosed in a footnote. The returns of each component issuer of the group must be weighted according to the respective issuers' stock market capitalization at the beginning of each period for which a return is indicated. If the registrant selects or otherwise uses a different peer group from the peer group used by it for the immediately preceding fiscal year, explain, in a footnote, the reason(s) for this change and compare the registrant's cumulative total return with that of both the newly selected peer group and the peer group used in the immediately preceding fiscal year.

(v) The registrant's net income for each fiscal year (column (h)).

(vi) An amount for each fiscal year attributable to an additional financial performance measure included in the Tabular List provided pursuant to paragraph (v)(6) of this section, designated as the Company-Selected Measure, which in the registrant's assessment represents the most important financial performance measure (that is not otherwise required to be disclosed in the table) used by the registrant to link compensation actually paid to the registrant’s named executive officers, for the most recently completed fiscal year, to company performance (column (i)). For purposes of this paragraph (v) of this section, “financial performance measures” means measures that are determined and presented in accordance with the accounting principles used in preparing the issuer’s financial statements, any measures that are derived wholly or in part from such measures, and stock price and total shareholder return. A financial performance measure need not be presented within the registrant’s financial statements or otherwise included in a filing with the Commission to be a Company-Selected Measure. Disclosure of any Company-Selected Measure, or any additional measure that the registrant elects to provide, that is not a financial measure under generally accepted accounting principles will not be subject to §§ 244.100 through 102 of this chapter (Regulation G) and § 229.10(e) of this chapter (Item 10(e)); however, disclosure must be provided as to how the number is calculated from the registrant’s audited financial statements.

(3) For each amount disclosed in columns (c) and (e) of the table required by paragraph (v)(1) of this section, disclose in footnotes to the table each of the amounts deducted and added pursuant to paragraph (v)(2)(iii) of this section, the name of each named executive officer included as a PEO or in the calculation of the average remaining named executive officer compensation, and the fiscal years in which such persons are included. For disclosure of the executive compensation actually paid to named executive officers other than the PEO, provide the amounts required under this paragraph as averages.

(4) For the value of equity awards added pursuant to paragraph (v)(2)(iii)(C) of this section, disclose in a footnote to the table required by paragraph (v)(1) of this section any assumption made in the valuation that differs materially from those disclosed as of the grant date of such equity awards.

(5) In proxy or information statements in which disclosure is required pursuant to this Item, use the information provided in the table required by paragraph (v)(1) of this section to provide a clear description (graphically, narratively, or a combination of the two) of the relationships:

(i) Between:

(A) The executive compensation actually paid by the registrant to the PEO (column (c)) and the average of the executive compensation actually paid to the named executive officers other than the PEO (column (e)) included in the Summary Compensation Table; and

(B) The cumulative total shareholder return of the registrant (column (f)), across the registrant's last five completed fiscal years;

(ii) Between:

(A) The executive compensation actually paid by the registrant to the PEO (column (c)) and the average of the executive compensation actually paid to the named executive officers other than the PEO (column (e)) included in the Summary Compensation Table; and

(B) Net income of the registrant (column (h)), across the registrant's last five completed fiscal years; and

(iii) Between:

(A) The executive compensation actually paid by the registrant to the PEO (column (c)) and the average of the executive compensation actually paid to the named executive officers other than the PEO (column (e)) included in the Summary Compensation Table; and

(B) The Company-Selected Measure (column (i)), across the registrant's last five completed fiscal years.

(iv) The description provided in response to paragraph (v)(5)(i) of this section must also include a comparison of the cumulative total shareholder return of the registrant (column (f)) and cumulative total shareholder return of the registrant's peer group (column (g)) over the same period. If a registrant elects to provide any additional measures in the table, each additional measure must be accompanied by a clear description of the relationship between:

(A) The executive compensation actually paid by the registrant to the PEO (column (c)) and the average of the executive compensation actually paid to the named executive officers other than the PEO (column (e)) included in the Summary Compensation Table; and

(B) That additional measure, across the registrant's last five completed fiscal years.

(6) Subject to paragraph (v)(6)(iii) of this section, provide a tabular list of at least three, and up to seven, financial performance measures, which in the registrant's assessment represent the most important financial performance measures used by the registrant to link compensation actually paid to the registrant's named executive officers, for the most recently completed fiscal year, to company performance ("Tabular List").

(i) The registrant may provide the Tabular List disclosure either as one tabular list, as two separate tabular lists (one for the PEO, and one for all named executive officers other than the PEO), or as separate tabular lists for the PEO and each named executive officer other than the PEO. If the registrant elects to provide multiple tabular lists in accordance with the immediately preceding sentence, each tabular list must include at least three, and up to seven, financial performance measures, which in the registrant's assessment represent the most important financial performance measures used by the registrant to link compensation actually paid to that, or those, particular named executive officer, or officers, for the most recently completed fiscal year, to company performance.

(ii) If fewer than three financial performance measures were used by the registrant to link compensation actually paid to the registrant's named executive officers, for the most recently completed fiscal year, to company performance, the Tabular List must include all such measures that were used, if any.

(iii) A registrant may include non-financial performance measures (*i.e.*, performance measures other than those that fall within the definition of financial performance measures) used by the registrant to link compensation actually paid to the registrant's named executive officers, for the most recently completed fiscal year, to company performance in the Tabular List, if it determines that such measures are among its three to seven most important performance measures, and it has disclosed its most important three (or fewer, if the registrant only uses fewer) financial performance measures, in accordance with this paragraph (v)(6).

(iv) The Tabular List may include a maximum of seven performance measures, regardless of whether the registrant elects to include non-financial performance measures in the Tabular List.

(7) The disclosure provided pursuant to this paragraph (v), including, but not limited to, any disclosure provided pursuant to paragraphs (v)(3) and (6) of this section, must appear with, and in the same format as, the rest of the disclosure required to be provided pursuant to this section and, in addition, must be provided in an Interactive Data File in accordance with § 232.405 of this chapter and the EDGAR Filer Manual (referenced in § 232.301 of this chapter).

(8) A registrant that qualifies as a "smaller reporting company," as defined by §229.10(f)(1) of this chapter, may provide the information required by this paragraph (v) for three years, instead of five years. A smaller reporting company may provide the disclosure

required by this paragraph (v) for only two fiscal years in the first filing in which it provides this disclosure, and is not required to provide the disclosure required by paragraph (v)(2)(iv) or (v)(5) of this section with respect to the total shareholder return of any peer group, or the Company-Selected Measure disclosure required by paragraph (v)(2)(vi) of this section, or the Tabular List provided pursuant to paragraph (v)(6) of this section. For purposes of paragraph (v)(2)(iii) of this section with respect to smaller reporting companies, executive compensation actually paid must be the total compensation for the covered fiscal year for each named executive officer as provided in paragraph (n)(2)(x) of this section, adjusted to deduct the amounts reported in the Summary Compensation Table pursuant to paragraphs (n)(2)(v) and (vi) of this section, and to add in their place the fair value of the amounts added in paragraph (v)(2)(iii)(C) of this section. Disclose in a footnote to the table required pursuant to paragraph (v)(1) of this section for the PEO and average remaining named executive officer compensation the amounts deducted from, and added to, the Summary Compensation Table pursuant to this instruction, the name of each named executive officer included as a PEO or in the calculation of the average remaining named executive officer compensation, and the fiscal years in which they are included. A smaller reporting company is required to comply with paragraph (v)(7) of this section in the third filing in which it provides the disclosure required by this paragraph (v).

Instructions to paragraph (v).

1. *Transitional relief.* A registrant may provide the disclosure required by this paragraph (v) for three years, instead of five years, in the first filing in which it provides this disclosure, and may provide disclosure for an additional year in each of the two subsequent annual filings in which this disclosure is required.

2. *New registrants*. Information for fiscal years prior to the last completed fiscal year will not be required if the registrant was not required to report pursuant to Section 13(a) or 15(d) of the Exchange Act (15 U.S.C. 78m(a) or 78o(d)) at any time during that year.

3. *Incorporation by reference*. The information required by paragraph (v) of this section will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

PART 232 — REGULATION S-T — GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

3. The general authority citation for part 232 continues to read as follows:

Authority: 15 U.S.C. 77c, 77f, 77g, 77h, 77j, 77s(a), 77z-3, 77sss(a), 78c(b), 78*l*, 78m, 78n, 78o(d), 78w(a), 78*ll*, 80a-6(c), 80a-8, 80a-29, 80a-30, 80a-37, 80b-4, 80b-10, 80b-11, 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

*   *   *   *   *

4. Amend § 232.405 by:

a. Revising the introductory text and paragraphs (a)(2) and (4).

b. In paragraph (b)(1)(i), removing the word "and" from the end of the sentence;

c. In paragraph (b)(1)(ii), removing the period from the end of the sentence, and adding "; and" in its place;

d. Adding paragraph (b)(1)(iii);

e. In paragraph (b)(3)(i)(A), removing the word "and" from the end of the sentence;

f. In paragraph (b)(3)(i)(B), adding "and" at the end;

g. Adding paragraphs (b)(3)(i)(C) and (b)(4); and

h. Revising Note 1 to § 232.405.

The additions and revisions read as follows:

§ 232.405 Interactive Data File submissions.

This section applies to electronic filers that submit Interactive Data Files. Section 229.601(b)(101) of this chapter (Item 601(b)(101) of Regulation S-K), General Instruction F of Form 11-K (§ 249.311), paragraph (101) of Part II—Information Not Required to be Delivered to Offerees or Purchasers of Form F-10 (§ 239.40 of this chapter), paragraph 101 of the Instructions as to Exhibits of Form 20-F (§ 249.220f of this chapter), paragraph B.(15) of the General Instructions to Form 40-F (§ 249.240f of this chapter), paragraph C.(6) of the General Instructions to Form 6-K (§ 249.306 of this chapter), Note D.5 of Rule 14a-101 under the Exchange Act (§ 240.14a-101 of this chapter), Item 1 of Rule 14c-101 under the Exchange Act (§ 240.14c-101 of this chapter), General Instruction C.3.(g) of Form N-1A (§§ 239.15A and 274.11A of this chapter), General Instruction I of Form N-2 (§§ 239.14 and 274.11a-1 of this chapter), General Instruction C.3.(h) of Form N-3 (§§ 239.17a and 274.11b of this chapter), General Instruction C.3.(h) of Form N-4 (§§ 239.17b and 274.11c of this chapter), General Instruction C.3.(h) of Form N-6 (§§ 239.17c and 274.11d of this chapter), and General Instruction C.4 of Form N-CSR (§§ 249.331 and 274.128 of this chapter) specify when electronic filers are required or permitted to submit an Interactive Data File (§ 232.11), as further described in note 1 to this section. This section imposes content, format and submission requirements for an Interactive Data File, but does not change the substantive content requirements for the financial and other disclosures in the Related Official Filing (§ 232.11).

(a) * * *

(2) Be submitted only by an electronic filer either required or permitted to submit an Interactive Data File as specified by § 229.601(b)(101) of this chapter (Item 601(b)(101) of Regulation S-K), General Instruction F of Form 11-K (§ 249.311), paragraph (101) of Part II—Information Not Required to be Delivered to Offerees or Purchasers of Form F-10 (§ 239.40 of this chapter), paragraph 101 of the Instructions as to Exhibits of Form 20-F (§ 249.220f of this chapter), paragraph B.(15) of the General Instructions to Form 40-F (§ 249.240f of this chapter), paragraph C.(6) of the General Instructions to Form 6-K (§ 249.306 of this chapter), Note D.5 of Rule 14a-101 under the Exchange Act (§ 240.14a-101 of this chapter), Item 1 of Rule 14c-101 under the Exchange Act (§ 240.14c-101 of this chapter), General Instruction C.3.(g) of Form N-1A (§§ 239.15A and 274.11A of this chapter), General Instruction I of Form N-2 (§§ 239.14 and 274.11a-1 of this chapter), General Instruction C.3.(h) of Form N-3 (§§ 239.17a and 274.11b of this chapter), General Instruction C.3.(h) of Form N-4 (§§ 239.17b and 274.11c of this chapter), General Instruction C.3.(h) of Form N-6 (§§ 239.17c and 274.11d of this chapter), or General Instruction C.4 of Form N-CSR (§§ 249.331 and 274.128 of this chapter), as applicable;

* * *

(4) Be submitted in accordance with the EDGAR Filer Manual and, as applicable, Item 601(b)(101) of Regulation S-K (§ 229.601(b)(101) of this chapter), General Instruction F of Form 11-K (§ 249.311 of this chapter), paragraph (101) of Part II—Information Not Required to be Delivered to Offerees or Purchasers of Form F-10 (§ 239.40 of this chapter), paragraph 101 of the Instructions as to Exhibits of Form 20-F (§ 249.220f of this chapter), paragraph B.(15) of the General Instructions to Form 40-F (§ 249.240f of this chapter), paragraph C.(6) of the General Instructions to Form 6-K (§ 249.306 of this chapter), Note D.5 of Rule 14a-101 under the Exchange Act (§ 240.14a-101 of this chapter), Item 1 of Rule 14c-101 under the Exchange

Act (§ 240.14c-101 of this chapter), General Instruction C.3.(g) of Form N-1A (§§ 239.15A and 274.11A of this chapter), General Instruction I of Form N-2 (§§ 239.14 and 274.11a-1 of this chapter), General Instruction C.3.(h) of Form N-3 (§§ 239.17a and 274.11b of this chapter), General Instruction C.3.(h) of Form N-4 (§§ 239.17b and 274.11c of this chapter), General Instruction C.3.(h) of Form N-6 (§§ 239.17c and 274.11d of this chapter); or General Instruction C.4 of Form N-CSR (§§ 249.331 and 274.128 of this chapter).

(b) * * *

(1) * * *

(iii) The disclosure set forth in paragraph (b)(4) of this section.

* * * * *

(3) * * *

(i) * * *

(C) The disclosure set forth in paragraph (b)(4) of this section.

* * * * *

(4) The disclosure provided under 17 CFR part 229 (Regulation S-K) and related provisions that is required to be tagged, including, as applicable:

(i) The information provided pursuant to § 229.402(v) of this chapter (Item 402(v) of Regulation S-K).

(ii) [Reserved].

* * * * *

Note 1 to § 232.405: Section 229.601(b)(101) of this chapter (Item 601(b)(101) of Regulation S-K) specifies the circumstances under which an Interactive Data File must be submitted and the circumstances under which it is permitted to be submitted, with respect to

§ 239.11 of this chapter (Form S-1), § 239.13 of this chapter (Form S-3), § 239.25 of this chapter (Form S-4), § 239.18 of this chapter (Form S-11), § 239.31 of this chapter (Form F-1), § 239.33 of this chapter (Form F-3), § 239.34 of this chapter (Form F-4), § 249.310 of this chapter (Form 10-K), § 249.308a of this chapter (Form 10-Q), and § 249.308 of this chapter (Form 8-K). General Instruction F of § 249.311 of this chapter (Form 11-K) specifies the circumstances under which an Interactive Data File must be submitted, and the circumstances under which it is permitted to be submitted, with respect to Form 11-K. Paragraph (101) of Part II—Information not Required to be Delivered to Offerees or Purchasers of § 239.40 of this chapter (Form F-10) specifies the circumstances under which an Interactive Data File must be submitted and the circumstances under which it is permitted to be submitted, with respect to Form F-10. Paragraph 101 of the Instructions as to Exhibits of § 249.220f of this chapter (Form 20-F) specifies the circumstances under which an Interactive Data File must be submitted and the circumstances under which it is permitted to be submitted, with respect to Form 20-F. Paragraph B.(15) of the General Instructions to § 249.240f of this chapter (Form 40-F) and Paragraph C.(6) of the General Instructions to § 249.306 of this chapter (Form 6-K) specify the circumstances under which an Interactive Data File must be submitted and the circumstances under which it is permitted to be submitted, with respect to § 249.240f of this chapter (Form 40-F) and § 249.306 of this chapter (Form 6-K). Note D.5 of § 240.14a-101 of this chapter (Schedule 14A) and Item 1 of § 240.14c-101 of this chapter (Schedule 14C) specify the circumstances under which an Interactive Data File must be submitted with respect to Schedules 14A and 14C. Section 229.601(b)(101) (Item 601(b)(101) of Regulation S-K), paragraph (101) of Part II—Information not Required to be Delivered to Offerees or Purchasers of Form F-10, paragraph 101 of the Instructions as to Exhibits of Form 20-F, paragraph B.(15) of the General

Instructions to Form 40-F, and paragraph C.(6) of the General Instructions to Form 6-K all prohibit submission of an Interactive Data File by an issuer that prepares its financial statements in accordance with 17 CFR 210.6-01 through 210.6-10 (Article 6 of Regulation S-X). For an issuer that is a management investment company or separate account registered under the Investment Company Act of 1940 (15 U.S.C. 80a *et seq.*) or a business development company as defined in Section 2(a)(48) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(48)), General Instruction C.3.(g) of Form N-1A (§§ 239.15A and 274.11A of this chapter), General Instruction I of Form N-2 (§§ 239.14 and 274.11a-1 of this chapter), General Instruction C.3.(h) of Form N-3 (§§ 239.17a and 274.11b of this chapter), General Instruction C.3.(h) of Form N-4 (§§ 239.17b and 274.11c of this chapter), General Instruction C.3.(h) of Form N-6 (§§ 239.17c and 274.11d of this chapter), and General Instruction C.4 of Form N-CSR (§§ 249.331 and 274.128 of this chapter), as applicable, specifies the circumstances under which an Interactive Data File must be submitted.

PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

5. The general authority citation for part 240 continues to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78*l*, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78dd, 78*ll*, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7210 *et seq.*, and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5521(e)(3); 18 U.S.C. 1350; and Pub. L. 111-203, 939A, 124 Stat. 1376, (2010); and Pub. L. 112-106, sec. 503 and 602, 126 Stat. 326 (2012), unless otherwise noted.

* * * * *

6. Amend § 240.14a-101 by adding paragraph D.5 to the Notes to read as follows:

§240.14a-101 Schedule 14A. Information required in proxy statement.

Schedule 14A Information

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Notes

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D. * * *

5. *Interactive Data File*. An Interactive Data File must be included in accordance with § 232.405 of this chapter and the EDGAR Filer Manual where applicable pursuant to § 232.405(b) of this chapter.

* * * * *

7. Amend § 240.14c-101 by revising Item 1 to read as follows:

§240.14c-101 Schedule 14C. Information required in information statement.

Schedule 14C Information

* * * * *

Item 1. Information required by Items of Schedule 14A (17 CFR 240.14a-101). Furnish the information called for by all of the items of Schedule 14A of Regulation 14A (17 CFR 240.14a-101) (other than Items 1(c), 2, 4 and 5 thereof) which would be applicable to any matter to be acted upon at the meeting if proxies were to be solicited in connection with the meeting. Notes

A, C, D, and E to Schedule 14A (including the requirement in Note D.5 to provide an Interactive Data File in accordance with § 232.405 of this chapter and the EDGAR Filer Manual where applicable pursuant to § 232.405(b) of this chapter) are also applicable to Schedule 14C.

* * * * *

By the Commission.

Dated: August 25, 2022.

Vanessa A. Countryman,

Secretary.

Press Release

SEC Proposes Cybersecurity Risk Management Rules and Amendments for Registered Investment Advisers and Funds

FOR IMMEDIATE RELEASE
2022-20

Washington D.C., Feb. 9, 2022 — The Securities and Exchange Commission today voted to propose rules related to cybersecurity risk management for registered investment advisers, and registered investment companies and business development companies (funds), as well as amendments to certain rules that govern investment adviser and fund disclosures.

"Cyber risk relates to each part of the SEC's three-part mission, and in particular to our goals of protecting investors and maintaining orderly markets," said SEC Chair Gary Gensler. "The proposed rules and amendments are designed to enhance cybersecurity preparedness and could improve investor confidence in the resiliency of advisers and funds against cybersecurity threats and attacks."

The proposed rules would require advisers and funds to adopt and implement written cybersecurity policies and procedures designed to address cybersecurity risks that could harm advisory clients and fund investors. The proposed rules also would require advisers to report significant cybersecurity incidents affecting the adviser or its fund or private fund clients to the Commission on a new confidential form.

To further help protect investors in connection with cybersecurity incidents, the proposal would require advisers and funds to publicly disclose cybersecurity risks and significant cybersecurity incidents that occurred in the last two fiscal years in their brochures and registration statements.

Additionally, the proposal would set forth new recordkeeping requirements for advisers and funds that are designed to improve the availability of cybersecurity-related information and help facilitate the Commission's inspection and enforcement capabilities.

The proposal will be published on SEC.gov and in the Federal Register. The public comment period will remain open for 60 days following the publication of the proposing release on the SEC's website or 30 days following the publication of the proposing release in the Federal Register, whichever period is longer.

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Related Materials

- Proposed Rule
- Fact Sheet

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 229, 232, 239, 240, and 249

[Release Nos. 33–11038; 34–94382; IC–34529; File No. S7–09–22]

RIN 3235–AM89

Cybersecurity Risk Management, Strategy, Governance, and Incident Disclosure

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission (''Commission'') is proposing rules to enhance and standardize disclosures regarding cybersecurity risk management, strategy, governance, and cybersecurity incident reporting by public companies that are subject to the reporting requirements of the Securities Exchange Act of 1934. Specifically, we are proposing amendments to require current reporting about material cybersecurity incidents. We are also proposing to require periodic disclosures about a registrant's policies and procedures to identify and manage cybersecurity risks, management's role in implementing cybersecurity policies and procedures, and the board of directors' cybersecurity expertise, if any, and its oversight of cybersecurity risk. Additionally, the proposed rules would require registrants to provide updates about previously reported cybersecurity incidents in their periodic reports. Further, the proposed rules would require the cybersecurity disclosures to be presented in Inline eXtensible Business Reporting Language (''Inline XBRL''). The proposed amendments are intended to better inform investors about a registrant's risk management, strategy, and governance and to provide timely notification of material cybersecurity incidents.

DATES: Comments should be received on or before May 9, 2022.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's internet comment form (*https://www.sec.gov/rules/submitcomments.htm*).
- Send an email to *rule-comment@sec.gov.* Please include File Number S7–09–22 on the subject line; or

Paper Comments

- Send paper comments to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number S7–09–22. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method of submission. The Commission will post all comments on the Commission's website (*https://www.sec.gov/rules/proposed.shtml*). Comments also are available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Operating conditions may limit access to the Commission's public reference room. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on our website. To ensure direct electronic receipt of such notifications, sign up through the ''Stay Connected'' option at *www.sec.gov* to receive notifications by email.

FOR FURTHER INFORMATION CONTACT: Ian Greber-Raines, Special Counsel, Office of Rulemaking, at (202) 551–3460, Division of Corporation Finance; and, with respect to the application of the proposal to business development companies, David Joire, Senior Special Counsel, at (202) 551–6825 or *IMOCC@sec.gov,* Chief Counsel's Office, Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: We are proposing to amend or add the following rules and forms:

Commission reference		CFR citation (17 CFR)
Regulation S–K		17 CFR 229.10 through 229.1305.
	Items 106 and 407	§ 229.106 and § 229.407.
Regulation S–T		17 CFR 232.10 through 232.903.
	Rule 405	§ 232.405.
Securities Act of 1933 (''Securities Act'') [1]	Form S–3	§ 239.13.
	Form SF–3	§ 239.45.
Securities Exchange Act of 1934 (''Exchange Act'') [2]	Rule 13a–11	§ 240.13a–11.
	Rule 15d–11	§ 240.15d–11.
	Schedule 14A	§ 240.14a–101.
	Schedule 14C	§ 240.14c–101.
	Form 20–F	§ 249.220f.
	Form 6–K	§ 249.306.
	Form 8–K	§ 249.308.
	Form 10–Q	§ 249.308A.
	Form 10–K	§ 249.310.

Table of Contents

[1] 15 U.S.C. 77a *et seq.*

[2] 15 U.S.C. 78a *et seq.*

I. Background

Public company investors and other participants in the capital markets depend on companies' use of secure and reliable information systems to conduct their businesses. A significant and increasing amount of the world's economic activities occurs through digital technology and electronic communications.[3] In today's digitally connected world, cybersecurity threats and incidents pose an ongoing and escalating risk to public companies, investors, and market participants.[4] Cybersecurity risks have increased for a variety of reasons, including the digitalization of registrants' operations;[5] the prevalence of remote work, which has become even more widespread because of the COVID–19 pandemic;[6] the ability of cyber-criminals to monetize cybersecurity incidents, such as through ransomware, black markets for stolen data, and the use of crypto-assets for such transactions;[7] the growth of digital payments;[8] and increasing company reliance on third party service providers for information technology services, including cloud computing technology.[9] In particular, cybersecurity

[3] Bhaskar Chakravorti, Ajay Bhalla, & Ravi Shankar Chaturvedi, *Which Economies Showed the Most Digital Progress in 2020?,* Harv. Bus. Rev. (Dec. 18, 2020), *available at https://hbr.org/2020/12/which-economies-showed-the-most-digital-progress-in-2020. See Percentage of Business Conducted Online,* IBISWORLD, *https://www.ibisworld.com/us/bed/percentage-of-business-conducted-online/88090/* (last updated Jan. 13, 2022). *See also U.S. Department of Commerce, Bureau of Economic Analysis, Updated Digital Economy Estimates—June 2021, available at https://www.bea.gov/system/files/2021-06/DE%20June%202021%20update%20for%20web%20v3.pdf* (''The digital economy accounted for 9.6 percent ($2,051.6 billion) of current-dollar gross domestic product ($21,433.2 billion) in 2019, according to new estimates from BEA. When compared with traditional U.S. industries or sectors, the digital economy ranked just below the manufacturing sector[.]'').

[4] *See* Steve Morgan, *Cybercrime to Cost The World $10.5 Trillion Annually By 2025,* Cybercrime Magazine, (Nov. 13, 2020), *available at https://cybersecurityventures.com/cybercrime-damage-costs-10-trillion-by-2025/*; Matt Powell, *11 Eye Opening Cyber Security Statistics for 2019,* CPO Magazine (June 25, 2019) *available at https://www.cpomagazine.com/tech/11-eye-opening-cyber-security-statistics-for-2019/* (The largest cybersecurity incidents involving public companies took place in the last ten years.); *see* Michael Hill and Dan Swinhoe, cso, The 15 biggest data breaches of the 21st century, *available at https://www.csoonline.com/article/2130877/the-biggest-data-breaches-of-the-21st-century.html; see e.g.,* Commission Statement and Guidance on Public Company Cybersecurity Disclosures (''2018 Interpretive Release''), Release No. 33–10459 (Feb. 26, 2018) No. 33–10459 (Feb. 21, 2018) [83 FR 8166 Feb. 26, 2018], *available at https://www.sec.gov/rules/interp/2018/33-10459.pdf* (''Companies today rely on digital technology to conduct their business operations and engage with their customers, business partners, and other constituencies. In a digitally connected world, cybersecurity presents ongoing risks and threats to our capital markets and to companies operating in all industries, including public companies regulated by the Commission.'').

[5] *See The US Digital Trust Insights Snapshot,* PwC Research (June 2021), *available at https://www.pwc.com/us/en/services/consulting/cybersecurity-risk-regulatory/library/2021-digital-trust-insights/cyber-threat-landscape.html.*

[6] *See* Stephen Klemash and Jamie Smith, *What companies are disclosing about cybersecurity risk and oversight,* EY (Aug. 10, 2020), *available at https://www.ey.com/en_us/board-matters/what-companies-are-disclosing-about-cybersecurity-risk-and-oversight* (noting ''[w]ith the COVID–19-driven accelerated shift to digital business and massive, potentially permanent shifts to remote working, including virtual board and executive management meetings, cybersecurity risks are exponentially greater.''). *See Navigating Cyber 2021,* FS–ISAC, *available at https://www.fsisac.com/navigatingcyber2021-report. See also* Vikki Davis, *Combating the cybersecurity risks of working home,* Cyber Magazine (Dec. 2, 2021), *available at https://cybermagazine.com/cyber-security/combating-cybersecurity-risks-working-home. See also* Dave Burg, Mike Maddison, & Richard Watson, *Cybersecurity: How do you rise above the waves of a perfect storm?,* The EY Glob. Info. Sec. Survey (July 22, 2021), *available at https://www.ey.com/en_us/cybersecurity/cybersecurity-how-do-you-rise-above-the-waves-of-a-perfect-storm.* (in a survey of 1,000 senior cybersecurity leaders, the results indicated that 81% of those surveyed said that COVID–19 forced organizations to bypass cybersecurity processes.).

[7] *See Combating Ransomware: A Comprehensive Framework For Action: Key Recommendations from the Ransomware Task Force,* Inst. for Sec. & Tech. (Apr. 2021), *available at https://securityandtechnology.org/ransomwaretaskforce/report*; (''The explosion of ransomware as a lucrative criminal enterprise has been closely tied to the rise of Bitcoin and other cryptocurrencies, which use distributed ledgers, such as blockchain, to track transactions.''); *see* James Lewis, *Economic Impact of Cybercrime—No Slowing Down,* P. 4, CSIS (Feb. 2018) (''Monetization of stolen data, which has always been a problem for cybercriminals, seems to have become less difficult because of improvements in cybercrime black markets and the use of digital currencies.''). *But see* Avivah Litan, *Gartner Predicts Criminal Cryptocurrency Transactions Will Drop by 30% by 2024,* gartner (Jan. 14, 2022) *available at https://www.gartner.com/en/articles/gartner-predicts-criminal-cryptocurrency-transactions-will-drop-by-30-by-2024* (predicting that successful ransomware payments will drop in the near future because of a number of developments including the transparency behind the blockchain platforms that crypto tokens use). *See also* Jeff Benson, *Biden Administration Seeks to Expand Crypto Tracking to Fight Ransomware,* decrypt, *available at https://decrypt.co/72582/biden-administration-seeks-expand-crypto-tracking-fight-ransomware* (noting that law enforcement agencies are putting additional resources into crypto-asset tracking as ''the overwhelming majority of ransomware attackers demand Bitcoin.'').

[8] Sumathi Bala, *Rise in online payments spurs questions over cybersecurity and privacy,* CNBC (July 1, 2021), *available at https://www.cnbc.com/2021/07/01/new-digital-payments-spur-questions-over-consumer-privacy-security-.html* (''Threats over cyber security have become a growing concern as more people turn to online payments.''). *See also* Vaibhav Goel, Deepa Mahajan, Marie-Claude Nadeau, Owen Sperling, & Stephanie Yeh, *New trends in US consumer digital payments,* McKinsey & Company (Oct. 2021), *available at https://www.mckinsey.com/industries/financial-services/our-insights/banking-matters/new-trends-in-us-consumer-digital-payments.*

[9] *See The Cost of Third-Party Cybersecurity Risk Management,* Ponemon Institute LLC (Mar. 2019), *available at* https://info.cybergrx.com/ponemon-report (''Third-party breaches remain a dominant

Continued

incidents involving third party service provider vulnerabilities are becoming more frequent.[10] Additionally, cyber criminals are using increasingly sophisticated methods to execute their attacks.[11]

With an increase in the prevalence of cybersecurity incidents, there is an increased risk of the effect of cybersecurity incidents on the economy and registrants. Large scale cybersecurity attacks can have systemic effects on the economy as a whole, including serious effects on critical infrastructure and national security.[12] Public companies of all sizes and operating in all industries are susceptible to cybersecurity incidents that can stem from intentional or unintentional acts.[13] Additionally, senior management and boards of directors of public companies have become increasingly concerned about cybersecurity threats.[14] In a 2019 survey, chief executive officers of the largest 200 global companies rated "'national and corporate cybersecurity' as the number one threat to business growth and the international economy in the next 5 or 10 years." [15]

The cost to companies and their investors of cybersecurity incidents is rising and doing so at an increasing rate.[16] The types of costs and adverse consequences that companies may incur or experience as a result of a cybersecurity incident include the following:[17]

- Costs due to business interruption, decreases in production, and delays in product launches;
- Payments to meet ransom and other extortion demands;
- Remediation costs, such as liability for stolen assets or information, repairs of system damage, and incentives to customers or business partners in an effort to maintain relationships after an attack;
- Increased cybersecurity protection costs, which may include increased insurance premiums and the costs of making organizational changes, deploying additional personnel and protection technologies, training employees, and engaging third-party experts and consultants;
- Lost revenues resulting from intellectual property theft and the unauthorized use of proprietary information or the failure to retain or attract customers following an attack;
- Litigation and legal risks, including regulatory actions by state and federal governmental authorities and non-U.S. authorities;
- Harm to employees and customers, violation of privacy laws, and reputational damage that adversely affects customer or investor confidence; and
- Damage to the company's competitiveness, stock price, and long-term shareholder value.

As indicated by the examples enumerated above, the potential costs and damage that can stem from a material cybersecurity incident are extensive. Many smaller companies have been targets of cybersecurity attacks so severe that the companies have gone out of business as a result.[18] These direct and indirect financial costs can negatively impact stock prices,[19] as well as short-term and long-term shareholder value. To mitigate the potential costs and damage that can result from a material cybersecurity incident, management and boards of directors may establish and maintain effective risk management strategies to address cybersecurity risks.[20]

Recent research suggests that cybersecurity is among the most critical governance-related issues for investors, especially U.S. investors.[21] Some

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security challenge for organizations, with over 63% of breaches linked to a third party."); *see Digital Transformation & Cyber Risk: What You Need to Know Stay Safe,* Ponemon Sullivan Privacy Report (June 2020), *available at https://ponemonsullivanreport.com/2020/07/digital-transformation-cyber-risk-what-you-need-to-know-to-stay-safe/* (although companies are increasingly reliant on third parties, "63% of respondents say their organizations have difficulty ensuring there is a secure cloud environment."). *See, e.g., Cost of Data Breach Report 2021,* IBM (July 2021), *available at https://www.ibm.com/security/data-breach* (finding 15% of the initial cybersecurity attack vectors were caused by cloud misconfiguration).

[10] *See Data Risk in the Third-Party Ecosystem: Second Annual Study,* Ponemon Institute LLC (Sept. 2017) *available at https://insidecybersecurity.com/sites/insidecybersecurity.com/files/documents/sep2017/cs2017_0340.pdf* (noting that "Data breaches caused by third parties are on the rise."). *See e.g., The Cost of Third Party Cybersecurity Risk Management,* Ponemon Institute LLC (Mar. 2019), *available at https://www.cybergrx.com/resources/research-and-insights/ebooks-and-reports/the-cost-of-third-party-cybersecurity-risk-management* ("Over 53% of respondents have experienced a third-party data breach in the past 2 years at an average cost of $7.5 million.").

[11] *See Cybersecurity: How do you rise above the waves of a perfect storm?, supra* note 6.

[12] *See* Cyber-Risk Oversight 2020, Key Principles and Practical Guidance for Corporate Boards (2020), nacd, *available at http://isalliance.org/wp-content/uploads/2020/02/RD-3-2020_NACD_Cyber_Handbook__WEB_022020.pdf* ("According to the Global Risks Report 2019, business leaders in advanced economies rank cyberattacks among their top concerns. A serious attack can destroy not only a company's financial health but also have systemic effects causing harm to the economy as a whole and even national security."). *See also The Cost of Malicious Cyber Activity to the U.S. Economy* (Feb. 16, 2018), White H. Council of Econ. Advisers, *available at https://trumpwhitehouse.archives.gov/wp-content/uploads/2018/02/The-Cost-of-Malicious-Cyber-Activity-to-the-U.S.-Economy.pdf* ("An attack have significant spillover effects to corporate partners, customers, and suppliers.") and Testimony of Robert Kolasky, Director, National Risk Management Center, Cybersecurity and Infrastructure Security Agency (CISA), *Securing U.S. Surface Transportation from Cyber Attacks,* U.S. House of Representatives, Committee on Homeland Security (Feb. 26, 2019), *available at https://www.congress.gov/116/meeting/house/108931/witnesses/HHRG-116-HM07-Wstate-KolaskyB-20190226.pdf. See also Exec. Order No. 14028, Improving the Nation's Cybersecurity,* (May 12, 2021), 86 FR 26633, *available at https://www.whitehouse.gov/briefing-room/presidential-actions/2021/05/12/executive-order-on-improving-the-nations-cybersecurity/.*

[13] *See Economic Report of the President: Together with The Annual Report of the Council of Economic Advisers,* (Mar. 2019), *available at https://www.govinfo.gov/content/pkg/ERP-2019/pdf/ERP-2019.pdf* ("Drawing on new data, we document that cyber vulnerabilities are quite prevalent—even in Fortune 500 companies with significant resources at their disposal.").

[14] NACD, *Cyber-Risk Oversight2020, Key Principles and Practical Guidance for Corporate Boards, supra* note 12.

[15] *See EY CEO Imperative Study 2019,* July 2019, *available at https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/growth/ey-ceo-imperative-exec-summ-single-spread-final.pdf.*

[16] *See Cost of Data Breach Report 2021,* IBM Security (July 2021), *available at https://www.ibm.com/security/data-breach* ("The average total cost of a data breach increased by nearly 10% year over year, the largest single year cost increase in the last seven years.").

[17] *See e.g., 2018 Interpretive Release*; and Shinichi Kamiya, Jun-Koo Kang, Jungmin Kim, Andreas Milidonis, & Rene M. Stulz, *Risk management, firm reputation, and the impact of successful cyberattacks on target firms,* 139 J. of Fin. Econ. at 747, 749 (2021).

[18] *See* Testimony of Dr. Jane LeClair, Chief Operating Officer, National Cybersecurity Institute at Excelsior College, before the U.S. House of Representatives Committee on Small Business (Apr. 22, 2015), *available at http://docs.house.gov/meetings/SM/SM00/20150422/103276/HHRG-114-SM00-20150422-SD003-U4.pdf* ("Fifty percent of [small businesses] SMB's have been the victims of cyber attack and over 60 percent of those attacked go out of business. Often SMB's do not even know they have been attacked until it is too late.").

[19] *See infra* note 101, section III.A.

[20] *See* NACD, *Cyber-Risk Oversight2020, Key Principles and Practical Guidance for Corporate Boards, supra* note 12.

[21] *2019 Responsible Investing Survey Key Findings,* RBC Glob. Asset Mgmt. (2019), *available at https://global.rbcgam.com/sitefiles/live/documents/pdf/rbc-gam-responsible-investing-survey-key-findings-2019.pdf.* This was a study developed by RBC Global Asset Management and BlueBay Asset Management LLP and distributed to a range of constituencies including institutional asset owners, consultants, clients, P&I Research Advisory Panel members, and members of the Pensions & Investment database. Study participants included individuals in Canada, Europe, Asia, and the United States. Two thirds of all respondents identified cybersecurity as an issue they were concerned about. The percentages were higher for the U.S., where out of all the environmental, social, and governance ("ESG")-issues, the highest percentage of respondents ranked cybersecurity as the most concerning issue. *See also* J.P. Morgan Global Research, *Why is Cybersecurity Important to ESG Frameworks?*, J.P. Morgan Glob. Rsch. (Aug. 19, 2021), *available at https://www.jpmorgan.com/insights/research/why-is-cybersecurity-important-to-esg. See also Cyber security: Don't report on ESG without it* (2021), kpmg, *available at https://advisory.kpmg.us/articles/2021/cyber-security-report-on-esg.html.*

investors have been seeking information regarding registrants' cybersecurity risk management, strategy, and governance practices,[22] and there is evidence that the disclosure of cybersecurity incidents can affect both a registrant's reputation and its share price.[23] There may also be a positive correlation between a registrant's stock price and investments in certain cybersecurity technology.[24] Thus, whether and how a registrant is managing cybersecurity risks could impact an investor's return on investment and would be decision-useful information in an investor's investment or considerations.

We believe investors would benefit from more timely and consistent disclosure about material cybersecurity incidents, because of the potential impact that such incidents can have on the financial performance or position of a registrant. We also believe that investors would benefit from greater availability and comparability of disclosure by public companies across industries regarding their cybersecurity risk management, strategy, and governance practices in order to better assess whether and how companies are managing cybersecurity risks. The proposal reflects these policy goals.

Specifically, in this release, we are proposing to amend Form 8–K to require current disclosure of material cybersecurity incidents. We are also proposing to add new Item 106 of Regulation S–K that would require a registrant to: (1) Provide updated disclosure in periodic reports about previously reported cybersecurity incidents; (2) describe its policies and procedures, if any, for the identification and management of risks from cybersecurity threats, including whether the registrant considers cybersecurity risks as part of its business strategy, financial planning, and capital allocation; and (3) require disclosure about the board's oversight of cybersecurity risk, management's role in assessing and managing such risk, management's cybersecurity expertise, and management's role in implementing the registrant's cybersecurity policies, procedures, and strategies. We also are proposing to amend Item 407 of Regulation S–K to require disclosure of whether any member of the registrant's board has expertise in cybersecurity, and if so, the nature of such expertise.[25]

A. Existing Regulatory Framework and Interpretive Guidance Regarding Cybersecurity Disclosure

Although there are no disclosure requirements in Regulation S–K or S–X that explicitly refer to cybersecurity risks or incidents, in light of the increasing significance of cybersecurity incidents, over the past decade the Commission and staff have issued interpretive guidance concerning the application of existing disclosure and other requirements under the federal securities laws to cybersecurity risks and incidents. In 2011, the Division of Corporation Finance issued interpretive guidance (''2011 Staff Guidance''), providing the Division's views concerning operating companies' disclosure obligations relating to cybersecurity risks and incidents.[26]

In 2018, recognizing the ''the frequency, magnitude and cost of cybersecurity incidents,'' and the need for investors to be informed about material cybersecurity risks and incidents in a timely manner, the Commission issued interpretive guidance (''2018 Interpretive Release'') to assist operating companies in determining when they may be required to disclose information regarding cybersecurity risks and incidents under existing disclosure rules.[27] The 2018 Interpretive Release reinforced and expanded upon the 2011 Staff Guidance and also addressed the importance of cybersecurity policies and procedures, as well as the application of insider trading prohibitions in the context of cybersecurity.

Specifically, the 2018 Interpretive Release stated that companies should consider the materiality of cybersecurity risks and incidents when preparing the disclosure required in registration statements under the Securities Act and Exchange Act, as well as in periodic and current reports under the Exchange Act. The 2018 Interpretive Release identified the following existing provisions in Regulations S–K and S–X that may require disclosure about cybersecurity risks, governance, and incidents: [28]

- Item 105 of Regulation S–K (Risk Factors) [29]—the 2018 Interpretive Release sets forth issues for companies to consider in evaluating the need for cybersecurity risk factor disclosure, including risks arising in connection with acquisitions.
- Item 303 of Regulation S–K (Management's Discussion and Analysis of Financial Condition and Results of Operations) [30]—the 2018 Interpretive Release discusses how the costs of ongoing cybersecurity efforts, the costs and other consequences of cybersecurity incidents, and the risks of potential cybersecurity incidents, among other matters, can inform a company's management's discussion and analysis. The 2018 Interpretive Release describes a wide array of potential costs that may be associated with cybersecurity issues and incidents such as loss of intellectual property and reputational harm.
- Item 101 of Regulation S–K (Description of Business) [31]—the 2018 Interpretive Release notes that if cybersecurity incidents or risks materially affect a company's products,

[22] *See* Harvard Law School Forum on Corporate Governance Blog, posted by Steve W. Klemash, Jamie C. Smith, and Chuck Seets, *What Companies are Disclosing About Cybersecurity Risk and Oversight,* (posted Aug. 25, 2020) *available at https://corpgov.law.harvard.edu/2020/08/25/what-companies-are-disclosing-about-cybersecurity-risk-and-oversight* (''Because the threat of a breach cannot be eliminated, some investors stressed that they are particularly interested in resiliency, including how (and how quickly) companies are detecting and mitigating cybersecurity incidents. Some are asking their portfolio companies about specific cybersecurity practices, such as whether the company has had an independent assessment of its cybersecurity program, and some are increasingly focusing on data privacy and whether companies are adequately identifying and addressing related consumer concerns and expanding regulatory requirements.'').

[23] *See* Shinichi Kamiya, Jun-Koo Kang, Jungmin Kim, Andreas Milidonis, & Rene M. Stulz, *Risk management, firm reputation, and the impact of successful cyberattacks on target firms,* 139 J. of Fin. Econ. at 747, 749 (2021); Georgios Spanos, and Lefteris Angelis, *The Impact of Information Security Events to the Stock Market: A Systematic Literature Review,* 58 Comput. & Sec. at 216, 226 (2016) (''Respectively, negative information security events, as the security breaches, have a negative impact to the stock price of the breached firms in the majority of the studies.'').

[24] *Id.*

[25] Proposed Item 407(j) of Regulation S–K.

[26] *See* CF Disclosure Guidance: Topic No. 2—Cybersecurity (Oct. 13, 2011), *available at https://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic2.htm.*

[27] *See* Commission Statement and Guidance on Public Company Cybersecurity Disclosures, Release No. 33–10459 (Feb. 26, 2018) No. 33–10459 (Feb. 21, 2018) [83 FR 8166], *available at https://www.sec.gov/rules/interp/2018/33-10459.pdf.* In 2018, the Commission also issued a Report of Investigation pursuant to Section 21(a) of the Exchange Act regarding certain cyber-related frauds perpetrated against public companies and related internal accounting controls requirements. The report cautioned that public companies subject to the internal accounting controls requirements of Exchange Act Section 13(b)(2)(B) should consider cyber threats when implementing their internal accounting controls. The report is based on SEC Enforcement Division investigations that focused on business email compromises in which perpetrators posed as company executives or vendors and used emails to dupe company personnel into sending large sums to bank accounts controlled by the perpetrators. *See Report of Investigation Pursuant to 21(a) of the Securities Exchange Act of 1934 Regarding Certain Cyber-Related Frauds Perpetrated Against Public Companies and Related Internal Accounting Controls Requirements,* SEC Release No. 34–84429 (Oct. 16, 2018).

[28] There are corresponding provisions in Form 20–F for foreign private issuers.

[29] *See also* Item 3.D of Form 20–F. Please note that Risk Factors was designated as Regulation S–K Item 503 at the time the 2018 Interpretive Release was issued.

[30] *See also* Item 5 of Form 20–F.

[31] *See also* Item 4.B of Form 20–F.

services, relationships with customers or suppliers, or competitive conditions, the company must provide appropriate disclosure.

- Item 103 of Regulation S–K (Legal Proceedings)—the 2018 Interpretive Release explains that this item may require disclosure about material pending legal proceedings that relate to cybersecurity issues.
- Item 407 of Regulation S–K (Corporate Governance) [32]—the 2018 Interpretive Release clarifies that a company must describe how the board administers its risk oversight function to the extent that cybersecurity risks are material to a company's business, including a description of the nature of the board's role in overseeing the management of such risks.
- Regulation S–X Financial Disclosures—the 2018 Interpretive Release notes the Commission's expectation that a company would design its financial reporting and control systems to provide reasonable assurance that information about the range and magnitude of the financial impacts of a cybersecurity incident would be incorporated into its financial statements on a timely basis as that information becomes available.

The 2018 Interpretive Release also addresses the importance of a company's adoption of disclosure controls and procedures that cause the company to appropriately record, process, summarize, and report to investors material information related to cybersecurity risks and incidents.[33] In addition, the 2018 Interpretive Release reminds companies, their directors, officers, and other corporate insiders of the need to comply with insider trading laws in connection with information about cybersecurity risks and incidents, including vulnerabilities and breaches. The 2018 Interpretive Release further discusses disclosure obligations that companies may have under 17 CFR 243 (''Regulation FD'') in connection with cybersecurity matters. The guidance set forth in both the 2011 Staff Guidance and the 2018 Interpretive Release would remain in place if the Commission adopts the proposed rule amendments described in this release.

B. Current Disclosure Practices

The majority of registrants reporting material cybersecurity incidents do so in a Form 8–K, press release, or periodic report. Although we are unable to determine the number of material cybersecurity incidents that either are not being disclosed or not being disclosed in a timely manner, the staff has observed certain cybersecurity incidents that were reported in the media but that were not disclosed in a registrant's filings. Further, the staff in the Division of Corporation Finance's review of Form 8–K filings, as well as Form 10–K and Form 20–F filings, has shown that the nature of the cybersecurity incident disclosure varies widely. In these filings, companies provide different levels of specificity regarding the cause, scope, impact, and materiality of cybersecurity incidents. For example, some companies provide a materiality analysis, disclose the estimated costs of an incident, discuss their engagement of cybersecurity professionals, and/or explain the remedial steps they have taken or are taking in response to a cybersecurity incident, while others do not provide such disclosure or provide much less detail in their disclosure on these topics.

The staff has also observed that, while the majority of registrants that are disclosing cybersecurity risks appear to be providing such disclosures in the risk factor section of their annual reports on Form 10–K, the disclosures are sometimes blended with other unrelated disclosures, which makes it more difficult for investors to locate, interpret, and analyze the information provided. Further, the staff has observed a divergence in these disclosures by industry and that, smaller reporting companies generally provide less cybersecurity disclosure as compared to larger registrants. One report noted a disconnect in which the industries experiencing the most high profile cybersecurity incidents provided disclosure with the ''least amount of information.'' [34] While cybersecurity risks and attacks may disproportionately affect certain industries at different times and in different ways, cybersecurity risks and threats may be dynamic; it is foreseeable and perhaps even predictable that malicious actors will adapt their strategies and target companies in any industry where there are perceived vulnerabilities.

Registrants' disclosures of both material cybersecurity incidents and cybersecurity risk management and governance have improved since the issuance of the 2011 Staff Guidance and the 2018 Interpretive Release.[35] Yet, current reporting may contain insufficient detail [36] and the staff has observed that such reporting is inconsistent, may not be timely, and can be difficult to locate. We believe that investors would benefit from enhanced disclosure about registrants' cybersecurity incidents and cybersecurity risk management and governance practices, including if the registrant's board of directors has expertise in cybersecurity matters, and we are proposing rule amendments to enhance disclosure in those areas.

We welcome feedback and encourage interested parties to submit comments on any or all aspects of the proposed rule amendments. When commenting, it would be most helpful if you include the reasoning behind your position or recommendation.

II. Proposed Amendments

A. Overview

Cybersecurity risks and incidents can impact the financial performance or position of a company. Consistent, comparable, and decision-useful disclosures regarding a registrant's cybersecurity risk management, strategy, and governance practices, as well as a registrant's response to material cybersecurity incidents, would allow investors to understand such risks and incidents, evaluate a registrant's risk management and governance practices regarding those risks, and better inform their investment and voting decisions.

The proposed rules would require current and periodic reporting of

[32] This disclosure also is required by Item 7 of Schedule 14A.

[33] *See supra* note 4, 2018 Interpretive Release at 8167 (''Crucial to a public company's ability to make any required disclosure of cybersecurity risks and incidents in the appropriate timeframe are disclosure controls and procedures that provide an appropriate method of discerning the impact that such matters may have on the company and its business, financial condition, and results of operations, as well as a protocol to determine the potential materiality of such risks and incidents.'').

[34] Moody's Investors Service, Research Announcement, ''Cybersecurity disclosures vary greatly in high-risk industries,'' (Oct. 3, 2019), *available at https://www.moodys.com/research/Moodys-Cybersecurity-disclosures-vary-greatly-in-high-risk-industries--PBC_1196854.*

[35] Stephen Klemash and Jamie Smith, *What companies are disclosing about cybersecurity risk and oversight,* EY, supra note 6 (EY researchers looked at cybersecurity-related disclosures in the proxy statements and Form 10–K filings for the 76 ''Fortune 100'' companies that filed those documents from 2018 through May 31, 2020. Their finding indicated that, ''[m]any companies are enhancing their cybersecurity disclosures, with modest increases across most of the disclosures tracked.'').

[36] One report notes ''the average public company's cyber disclosure contains insufficient detail for investors looking to evaluate its risk profile and to understand which remediation strategies, if any, it has implemented to control for the identified risks.'' NACD et al., *The State of Cyber-Risk Disclosures of Public Companies* at 3 (Mar. 2021) *available at https://www.nacdonline.org/insights/publications.cfm?ItemNumber=71711.* This same report contends (and cites other sources that argue) that the 2018 Interpretive Release alone has not resulted in adequate disclosures to investors. *Id.* at 4.

material cybersecurity incidents. Additionally, we are proposing amendments that would require periodic disclosures about a registrant's policies and procedures to identify and manage cybersecurity risk, including the impact of cybersecurity risks on the registrant's business strategy; management's role and expertise in implementing the registrant's cybersecurity policies, procedures, and strategies; and the board of directors' oversight role, and cybersecurity expertise, if any.

Specifically, we are proposing to:

- Amend Form 8–K to add Item 1.05 to require registrants to disclose information about a cybersecurity incident within four business days after the registrant determines that it has experienced a material cybersecurity incident; [37]
- Amend Forms 10–Q and 10–K to require registrants to provide updated disclosure relating to previously disclosed cybersecurity incidents, as specified in proposed Item 106(d) of Regulation S–K. We also propose to amend these forms to require disclosure, to the extent known to management, when a series of previously undisclosed individually immaterial cybersecurity incidents has become material in the aggregate.[38]
- Amend Form 10–K to require disclosure specified in proposed Item 106 regarding:
  - ○ A registrant's policies and procedures, if any, for identifying and managing cybersecurity risks; [39]
  - ○ A registrant's cybersecurity governance, including the board of directors' oversight role regarding cybersecurity risks; [40] and
  - ○ Management's role, and relevant expertise, in assessing and managing cybersecurity related risks and implementing related policies, procedures, and strategies.[41]
- Amend Item 407 of Regulation S–K to require disclosure about if any member of the registrant's board of directors has cybersecurity expertise.[42]
- Amend Form 20–F to require foreign private issuers (''FPIs'') [43] to provide cybersecurity disclosures in their annual reports filed on that form that are consistent with the disclosure that we propose to require in the domestic forms;
- Amend Form 6–K to add ''cybersecurity incidents'' as a reporting topic; and
- Require that the proposed disclosures be provided in Inline XBRL.[44]

B. Reporting of Cybersecurity Incidents on Form 8–K

1. Overview of Proposed Item 1.05 of Form 8–K

There is growing concern that material cybersecurity incidents [45] are underreported [46] and that existing reporting may not be sufficiently timely.[47] We are proposing to address these concerns by requiring registrants to disclose material cybersecurity incidents in a current report on Form 8–K within four business days after the registrant determines that it has experienced a material cybersecurity incident.[48]

Specifically, we propose to amend Form 8–K by adding new Item 1.05 that would require a registrant to disclose the following information about a material cybersecurity incident, to the extent the information is known at the time of the Form 8–K filing:

- When the incident was discovered and whether it is ongoing;
- A brief description of the nature and scope of the incident;
- Whether any data was stolen, altered, accessed, or used for any other unauthorized purpose;
- The effect of the incident on the registrant's operations; and
- Whether the registrant has remediated or is currently remediating the incident.

We believe that this information would provide timely and relevant disclosure to investors and other market participants (such as financial analysts, investment advisers, and portfolio managers) and enable them to assess the possible effects of a material cybersecurity incident on the registrant, including any long-term and short-term financial effects or operational effects. While registrants should provide disclosure responsive to the enumerated items to the extent known at the time of filing of the Form 8–K, we would not expect a registrant to publicly disclose specific, technical information about its planned response to the incident or its cybersecurity systems, related networks and devices, or potential system vulnerabilities in such detail as would impede the registrant's response or remediation of the incident.[49]

We believe that the proposed requirement to file an Item 1.05 Form 8–K within four business days after the registrant determines that it has experienced a material cybersecurity incident would significantly improve the timeliness of cybersecurity incident disclosures, as well as provide investors with more standardized and comparable disclosures.[50]

We are proposing that the trigger for an Item 1.05 Form 8–K is the date on which a registrant determines that a cybersecurity incident it has experienced is material, rather than the date of discovery of the incident, so as to focus the Form 8–K disclosure on

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[37] Proposed Item 1.05.

[38] Proposed Item 106(d) of Regulation S–K.

[39] Proposed Item 106(b) of Regulation S–K.

[40] Proposed Item 106(c)(1) of Regulation S–K.

[41] Proposed Item 106(c)(2) of Regulation S–K.

[42] Proposed Item 407(j).

[43] An FPI is any foreign issuer other than a foreign government, except for an issuer that (1) has more than 50% of its outstanding voting securities held of record by U.S. residents; and (2) any of the following: (i) A majority of its officers or directors are citizens or residents of the U.S.; (ii) more than 50% of its assets are located in the U.S.; or (iii) its business is principally administered in the U.S. *See* 17 CFR 230.405. *See also* 17 CFR 240.3b–4(c).

[44] Proposed Rule 405 of Regulation S–T.

[45] *See infra* Section II.D.3 for a discussion on the proposed definition of ''cybersecurity incident.''

[46] *See New Study Reveals Cybercrime May Be Widely Underreported—Even When Laws Mandate Disclosure,* ISACA Press Release (June 3, 2019), *available at https://www.isaca.org/why-isaca/about-us/newsroom/press-releases/2019/new-study-reveals-cybercrime-may-be-widely-underreported-even-when-laws-mandate-disclosure. See also* Gerrit De Vynck, *Many ransomware attacks go unreported. The FBI and Congress want to change that.* Wash. Post (July 27, 2021), *available at https://www.washingtonpost.com/technology/2021/07/27/fbi-congress-ransomware-laws/* (quoting Eric Goldstein, executive assistant director at Cybersecurity & Infrastructure Security Agency (CISA), a federal agency created in 2018 to protect the U.S. from cyberattacks, as stating, ''[w]e believe that only about a quarter of ransomware intrusions are actually reported[.]'').

[47] *See also infra* section III.C(1)(a).

[48] As will be discussed in Section II.D, we propose to define the term ''cybersecurity incident'' as an unauthorized occurrence on or conducted through a registrant's information systems that jeopardizes the confidentiality, integrity, or availability of a registrant's information systems or any information residing therein. We also propose to define the term ''information systems'' as ''information resources, owned or used by the registrant, including physical or virtual infrastructure controlled by such information resources, or components thereof, organized for the collection, processing, maintenance, use, sharing, dissemination, or disposition of a registrant's information to maintain or support the registrant's operations.'' The definitions of ''cybersecurity incident'' and ''information systems'' as proposed in Item 106 of Regulation S–K would also apply to such terms as used in proposed Item 1.05 of Form 8–K.

[49] *See also* 2018 Interpretive Release at Section II.A.1. Any material information not known or disclosable at the time of the Form 8–K filing would need to be updated in future periodic reports in response to proposed Item 106(d) of Regulation S–K. *See* discussion *infra* at Section II.C.1.

[50] If a triggering determination occurs within four business days before a registrant's filing of a Form 10–Q or Form 10–K, the Commission staff generally has not objected to the registrant satisfying its Form 8–K reporting obligation by including the disclosure in Item 5 (Other Information) of Part II of its Form 10–Q or Item 9B (Other Information) of its Form 10–K. *See* SEC Division of Corporation Finance, Exchange Act *Form 8-K Compliance and Disclosure Interpretations* (updated Dec. 22, 2017), Question 1, *available at https://www.sec.gov/divisions/corpfin/form8kfaq.htm.*

incidents that are material to investors. In some cases, the date of the registrant's materiality determination may coincide with the date of discovery of an incident, but in other cases the materiality determination will come after the discovery date. If we adopt the date of the materiality determination as the Form 8–K reporting trigger, as proposed, we expect registrants to be diligent in making a materiality determination in as prompt a manner as feasible. To address any concern that some registrants may delay making such a determination to avoid a disclosure obligation, Instruction 1 to proposed Item 1.05 states: ''a registrant shall make a materiality determination regarding a cybersecurity incident as soon as reasonably practicable after discovery of the incident.''

What constitutes ''materiality'' for purposes of the proposed cybersecurity incidents disclosure would be consistent with that set out in the numerous cases addressing materiality in the securities laws, including: *TSC Industries, Inc.* v. *Northway, Inc.*,[51] *Basic, Inc.* v. *Levinson*,[52] and *Matrixx Initiatives, Inc.* v. *Siracusano*.[53] Information is material if ''there is a substantial likelihood that a reasonable shareholder would consider it important'' [54] in making an investment decision, or if it would have ''significantly altered the 'total mix' of information made available.'' [55] In articulating this materiality standard, the Supreme Court recognized that ''[d]oubts as to the critical nature'' of the relevant information ''will be commonplace.'' But ''particularly in view of the prophylactic purpose'' of the securities laws, and ''the fact that the content'' of the disclosure ''is within management's control, it is appropriate that these doubts be resolved in favor of those the statute is designed to protect,'' namely investors.[56]

A materiality analysis is not a mechanical exercise, nor should it be based solely on a quantitative analysis of a cybersecurity incident. Rather, registrants would need to thoroughly and objectively evaluate the total mix of information, taking into consideration all relevant facts and circumstances surrounding the cybersecurity incident, including both quantitative and qualitative factors, to determine whether the incident is material. Even if the probability of an adverse consequence is relatively low, if the magnitude of the loss or liability is high, the incident may still be material; materiality ''depends on the significance the reasonable investor would place on'' the information.[57] Thus, under the proposed rules, when a cybersecurity incident occurs, registrants would need to carefully assess whether the incident is material in light of the specific circumstances presented by applying a well-reasoned, objective approach from a reasonable investor's perspective based on the total mix of information.

2. Examples of Cybersecurity Incidents That May Require Disclosure Pursuant to Proposed Item 1.05 of Form 8–K

The following is a non-exclusive list of examples of cybersecurity incidents [58] that may, if determined by the registrant to be material, trigger the proposed Item 1.05 disclosure requirement:

- An unauthorized incident that has compromised the confidentiality, integrity, or availability of an information asset (data, system, or network); or violated the registrant's security policies or procedures. Incidents may stem from the accidental exposure of data or from a deliberate attack to steal or alter data;
- An unauthorized incident that caused degradation, interruption, loss of control, damage to, or loss of operational technology systems;
- An incident in which an unauthorized party accessed, or a party exceeded authorized access, and altered, or has stolen sensitive business information, personally identifiable information, intellectual property, or information that has resulted, or may result, in a loss or liability for the registrant;
- An incident in which a malicious actor has offered to sell or has threatened to publicly disclose sensitive company data; or
- An incident in which a malicious actor has demanded payment to restore company data that was stolen or altered.

3. Ongoing Investigations Regarding Cybersecurity Incidents

Proposed Item 1.05 would not provide for a reporting delay when there is an ongoing internal or external investigation related to the cybersecurity incident. As the Commission stated in the 2018 Interpretive Release, while an ongoing investigation might affect the specifics in the registrant's disclosure, ''an ongoing internal or external investigation—which often can be lengthy—would not on its own provide a basis for avoiding disclosures of a material cybersecurity incident.'' [59] Additionally, any such delay provision could undermine the purpose of proposed Item 1.05 of providing timely and consistent disclosure of cybersecurity incidents given that investigations and resolutions of cybersecurity incidents may occur over an extended period of time and may vary widely in timing and scope. At the same time, we recognize that a delay in reporting may facilitate law enforcement investigations aimed at apprehending the perpetrators of the cybersecurity incident and preventing future cybersecurity incidents. On balance, it is our current view that the importance of timely disclosure of cybersecurity incidents for investors would justify not providing for a reporting delay.

Many states have laws that allow companies to delay providing public notice about a data breach incident or notifying certain constituencies of such an incident if law enforcement determines that notification will impede a civil or criminal investigation. A registrant may have obligations to report incidents at the state or federal level (to customers, consumer credit reporting entities, state or federal regulators and law enforcement agencies, etc.); those obligations are distinct from its obligations to disclose material information to its shareholders under the federal securities laws. To the extent that proposed Item 1.05 of Form 8–K would require disclosure in a situation in which a state law delay provision

[51] *TSC Indus.* v. *Northway,* 426 U.S. 438, 449 (1976).

[52] *Basic Inc.* v. *Levinson,* 485 U.S. 224, 232 (1988).

[53] 563 U.S. 27 (2011).

[54] *TSC Indus.* v. *Northway,* 426 U.S. at 449.

[55] *Id. See also* the definition of ''material'' in Securities Act Rule 405, 17 CFR 230.405; Exchange Act Rule 12b–2, 17 CFR 240.12b–2.

[56] *TSC Indus.* v. *Northway,* 426 U.S. at 448.

[57] *Basic Inc.* v. *Levinson,* 485 U.S. at 240.

[58] As discussed *infra* in Section II.D, we propose to define cybersecurity incident as ''an unauthorized occurrence on or conducted through a registrant's information systems that jeopardizes the confidentiality, integrity, or availability of a registrant's information systems or any information residing therein.'' We believe this term is sufficiently understood and broad enough to encompass incidents that could adversely affect a registrant's information systems or information residing therein, such as gaining access without authorization or by exceeding authorized access to such systems and information that could lead, for example, to the modification or destruction of systems and information. We also propose to define information systems as ''information resources, owned or used by the registrant, including physical or virtual infrastructure controlled by such information resources, or components thereof, organized for the collection, processing, maintenance, use, sharing, dissemination, or disposition of a registrant's information to maintain or support the registrant's operations.'' The definitions of ''cybersecurity incident'' and ''information systems'' as proposed in Item 106 of Regulation S–K would also apply to such terms as used in proposed Item 1.05 of Form 8–K. *See infra* note 80.

[59] *See supra* note 33, 2018 Interpretive Release.

would excuse notification, there is a possibility a registrant would be required to disclose the incident on Form 8–K even though it could delay incident reporting under a particular state law. The proposed Form 8–K requirement would advance the objective of timely reporting of material cybersecurity incidents without the uncertainties of delay. It is critical to investor protection and well-functioning, orderly, and efficient markets that investors promptly receive information regarding material cybersecurity incidents.

4. Proposed Amendment to Form 6–K

FPIs are not required to file current reports on Form 8–K.[60] Instead, they are required to furnish on Form 6–K[61] copies of all information that the FPI: (i) Makes or is required to make public under the laws of its jurisdiction of incorporation, (ii) files, or is required to file under the rules of any stock exchange, or (iii) otherwise distributes to its security holders. We are proposing to amend General Instruction B of Form 6–K to reference material cybersecurity incidents among the items that may trigger a current report on Form 6–K. As with proposed Item 1.05 of Form 8–K, the proposed change to Form 6–K is intended to provide timely cybersecurity incident disclosure in a manner that is consistent with the general purpose and use of Form 6–K.

5. Proposed Amendments to the Eligibility Provisions of Form S–3 and Form SF–3 and Safe Harbor Provision in Exchange Act Rules 13a–11 and 15d–11

We are proposing to amend General Instruction I.A.3.(b) of Form S–3 and General Instruction I.A.2 of Form SF–3 to provide that an untimely filing on Form 8–K regarding new Item 1.05 would not result in loss of Form S–3 or Form SF–3 eligibility. Under our existing rules, the untimely filing on Form 8–K of certain specified items does not result in loss of Form S–3 or Form SF–3 eligibility, so long as Form 8–K reporting is current at the time the Form S–3 or SF–3 is filed. In the past, when we have adopted new disclosure requirements that differed from the traditional periodic reporting obligations of companies, we have acknowledged concerns about the potentially harsh consequences of the loss of Form S–3 or Form SF–3 eligibility, and addressed such concerns by specifying that untimely filing of Forms 8–K relating to certain topics would not result in the loss of Form S–3 or Form SF–3 eligibility.[62] For the same reason, we believe that it is appropriate to add proposed Item 1.05 to the list of Form 8–K items in General Instruction I.A.3.(b) of Form S–3 and General Instruction I.A.2 of Form SF–3.[63]

We are also proposing to amend Rules 13a–11(c) and 15d–11(c) under the Exchange Act to include new Item 1.05 in the list of Form 8–K items eligible for a limited safe harbor from liability under Section 10(b) or Rule 10b–5 under the Exchange Act.[64] In 2004, when the Commission adopted the limited safe harbor, the Commission noted its view that the safe harbor is appropriate if the triggering event for the Form 8–K requires management to make a rapid materiality determination.[65] While the registrant would need to file an Item 1.05 Form 8–K within four business days after the registrant determines that it has experienced a material cybersecurity incident, rather than within four business days after its discovery of the incident, we expect management to make a materiality determination about the incident as soon as reasonably practicable after its discovery of the incident.[66] In some cases, we expect that management would make a materiality determination coincident with discovering a cybersecurity incident and therefore file a Form 8–K very soon after the registrant experiences or discovers a cybersecurity incident. Therefore, we believe that it is appropriate to extend the safe harbor to this proposed new item.

Request for Comment

1. Would investors benefit from current reporting about material cybersecurity incidents on Form 8–K? Does the proposed Form 8–K disclosure requirement appropriately balance the informational needs of investors and the reporting burdens on registrants?

2. Would proposed Item 1.05 require an appropriate level of disclosure about a material cybersecurity incident? Would the proposed disclosures allow investors to understand the nature of the incident and its potential impact on the registrant, and make an informed investment decision? Should we modify or eliminate any of the specified disclosure items in proposed Item 1.05? Is there any additional information about a material cybersecurity incident that Item 1.05 should require?

3. Could any of the proposed Item 1.05 disclosures or the proposed timing of the disclosures have the unintentional effect of putting registrants at additional risk of future cybersecurity incidents? If so, how could we modify the proposal to avoid this effect? For example, should registrants instead provide some of the disclosures in proposed Item 1.05 in the registrant's next periodic report? If so, which disclosures?

4. We are proposing to require registrants to file an Item 1.05 Form 8–K within four business days after the registrant determines that it has experienced a material cybersecurity incident. Would the proposed four-business day filing deadline provide sufficient time for registrants to prepare the disclosures that would be required under proposed Item 1.05? Should we modify the timeframe in which a registrant must file a Form 8–K under proposed Item 1.05? If so, what timeframe would be more appropriate for making these disclosures?

5. Should there be a different triggering event for the Item 1.05 disclosure, such as the registrant's discovery that it has experienced a cybersecurity incident, even if the registrant has not yet been able to determine the materiality of the incident? If so, which information should be disclosed in Form 8–K based on a revised triggering event? Should we instead require disclosure only if the expected costs arising from a cybersecurity incident exceed a certain quantifiable threshold, *e.g.,* a percentage of the company's assets, equity, revenues or net income or alternatively a precise number? If so, what would be an appropriate threshold?

6. To what extent, if any, would the proposed Form 8–K incident reporting obligation create conflicts for a registrant with respect to other obligations of the registrant under federal or state law? How would any such conflicting obligations arise, and what mechanisms could the Commission use to ensure that registrants can comply with other laws and regulations while providing these

[60] *See* Exchange Act Rules 13a–11 and 15d–11 [17 CFR 240.13a–11 and 15d–11].

[61] 17 CFR 249.306.

[62] *See* Selective Disclosure and Insider Trading, Release No. 33–7881 (Aug. 15, 2000) [65 FR 51715 (Aug. 24, 2000)]; *see also* Additional Form 8–K Disclosure Requirements and Acceleration of Filing Date, Release No. 33–8400 (Mar. 16, 2004) [69 FR 15593 (Mar. 25, 2004)] (the ''Additional Form 8–K Disclosure Release'').

[63] *See* Selective Disclosure and Insider Trading, Release No. 33–7881 (Aug. 15, 2000) [65 FR 51715]; Additional Form 8–K Disclosure Release.

[64] Rules 13a–11(c) and 15d–11(c) each provides that ''[n]o failure to file a report on Form 8–K that is required solely pursuant to Item 1.01, 1.02, 2.03, 2.04, 2.05, 2.06, 4.02(a), 5.02(e), or 6.03 of Form 8–K shall be deemed a violation of'' Section 10(b) of the Exchange Act or Rule 10b–5 thereunder.

[65] Additional Form 8–K Disclosure Release at 69 FR 15607.

[66] Instruction 1 to proposed Item 1.05 of Form 8–K.

timely disclosures to investors? What costs would registrants face in determining the extent of a potential conflict?

7. Should any rule provide that the Commission shall allow registrants to delay reporting of a cybersecurity incident where the Attorney General requests such a delay from the Commission based on the Attorney General's written determination that the delay is in the interest of national security?

8. We are proposing to include an instruction that ''a registrant shall make a materiality determination regarding a cybersecurity incident as soon as reasonably practicable after discovery of the incident.'' Is this instruction sufficient to mitigate the risk of a registrant delaying a materiality determination? Should we consider further guidance regarding the timing of a materiality determination? Should we, for example, suggest examples of timeframes that would (or would not), in most circumstances, be considered prompt?

9. Should certain registrants that would be within the scope of the proposed requirements, but that are subject to other cybersecurity-related regulations, or that would be included in the scope of the Commission's recently-proposed cybersecurity rules [67] for advisers and funds, if adopted, be excluded from the proposed requirements? For example, should the proposed Form 8–K reporting requirements or the other disclosure requirements described in this release, as applicable, exclude business development companies (''BDCs''),[68] or the publicly traded parent of an adviser?

10. As described further below, we are proposing to define cybersecurity incident to include an unauthorized occurrence on or through a registrant's ''information systems,'' which is proposed to include ''information resources owned or used by the registrant.'' Would registrants be reasonably able to obtain information to make a materiality determination about cybersecurity incidents affecting information resources that are used but not owned by them? Would a safe harbor for information about cybersecurity incidents affecting information resources that are used but not owned by a registrant be appropriate? If so, why, and what would be the appropriate scope of a safe harbor? What alternative disclosure requirements would provide investors with information about cybersecurity incidents and risks that affect registrants via information systems owned by third parties?

11. We are proposing that registrants be required to file rather than permitted to furnish an Item 1.05 Form 8–K. Should we instead permit registrants to furnish an Item 1.05 Form 8–K, such that the Form 8–K would not be subject to liability under Section 18 of the Exchange Act unless the registrant specifically states that the information is to be considered ''filed'' or incorporates it by reference into a filing under the Securities Act or Exchange Act?

12. We note above a non-exclusive list of examples that would merit disclosure under Item 1.05 of Form 8–K covers some, but not all, types of material cybersecurity incidents. Are there additional examples we should address? Should we include a non-exclusive list of examples in Item 1.05 of Form 8–K?

13. Should we include Item 1.05 in the Exchange Act Rules 13a-11 and 15d-11 safe harbors from public and private claims under Exchange Act Section 10(b) and Rule 10b-5 for failure to timely file a Form 8–K, as proposed?

14. Should we include Item 1.05, as proposed, in the list of Form 8–K items where failure to timely file a Form 8–K will not result in the loss of a registrant's eligibility to file a registration statement on Form S–3 and Form SF–3?

C. Disclosure About Cybersecurity Incidents in Periodic Reports

1. Updates to Previously Filed Form 8–K Disclosure

Proposed Item 106(d)(1) of Regulation S–K would require registrants to disclose any material changes, additions, or updates to information required to be disclosed pursuant to Item 1.05 of Form 8–K in the registrant's quarterly report filed with the Commission on Form 10–Q or annual report filed with the Commission on Form 10–K for the period (the registrant's fourth fiscal quarter in the case of an annual report) in which the material change, addition, or update occurred.

We are proposing this requirement to balance the need for prompt and timely disclosure regarding material cybersecurity incidents with the fact that a registrant may not have complete information about a material cybersecurity incident at the time it determines the incident to be material. Proposed Item 106(d)(1) provides a means for investors to receive regular updates regarding the previously reported incident when and for so long as there are material changes, additions, or updates during a given reporting period. For example, after filing the initial Form 8–K disclosure, the registrant may become aware of additional material information about the scope of the incident and whether any data was stolen or altered; the proposed Item 106(d)(1) disclosure requirements would allow investors to stay informed of such developments.

The registrant also may be able to provide information about the effect of the previously reported cybersecurity incident on its operations as well as a description of remedial steps it has taken, or plans to take, in response to the incident that was not available at the time of the initial Form 8–K filing.[69] In order to assist registrants in developing updated incident disclosure in its periodic reports, proposed Item 106(d)(1) provides the following non-exclusive examples of the type of disclosure that should be provided, if applicable:

- Any material impact of the incident on the registrant's operations and financial condition;
- Any potential material future impacts on the registrant's operations and financial condition;
- Whether the registrant has remediated or is currently remediating the incident; and
- Any changes in the registrant's policies and procedures as a result of the cybersecurity incident, and how the incident may have informed such changes.

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[67] *See* Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies, Release No. 34–94197 (Feb. 9, 2022) [87 FR 13524 (Mar. 9, 2022)] (''Investment Management Cybersecurity Proposing Release''). In this release, the Commission proposed new rules and rule amendments that would require: (i) Registered investment advisers (''advisers'') and investment companies (''funds'') to adopt and implement written cybersecurity policies and procedures reasonably designed to address cybersecurity risks; (ii) advisers to report significant cybersecurity incidents affecting the adviser, or its fund or private fund clients, to the Commission; (iii) advisers and funds to provide cyber-related disclosures to clients and investors; and (iv) advisers and funds to maintain certain records related to the proposed cybersecurity risk management obligations and the occurrence of cybersecurity incidents.

[68] For purposes of this release, the terms ''public companies,'' ''companies,'' and ''registrants,'' include issuers that are business development companies as defined in section 2(a)(48) of the Investment Company Act of 1940 (''Investment Company Act''), but not those investment companies registered under that Act.

[69] Notwithstanding proposed Item 106(d)(1), there may be situations where a registrant would need to file an amended Form 8–K to correct disclosure from the initial Item 1.05 Form 8–K, such as where that disclosure becomes inaccurate or materially misleading as a result of subsequent developments regarding the incident. For example, if the impact of the incident is determined after the initial Item 1.05 Form 8–K filing to be significantly more severe than previously disclosed, an amended Form 8–K may be required.

2. Disclosure of Cybersecurity Incidents That Have Become Material in the Aggregate

Proposed Item 106(d)(2) would require disclosure when a series of previously undisclosed individually immaterial cybersecurity incidents become material in the aggregate. Thus, registrants would need to analyze related cybersecurity incidents for materiality, both individually and in the aggregate. If such incidents become material in the aggregate, registrants would need to disclose: When the incidents were discovered and whether they are ongoing; a brief description of the nature and scope of such incidents; whether any data was stolen or altered; the impact of such incidents on the registrant's operations and the registrant's actions; and whether the registrant has remediated or is currently remediating the incidents.

While such incidents conceptually could take a variety of forms, an example would be where one malicious actor engages in a number of smaller but continuous cyber-attacks related in time and form against the same company and collectively, they are either quantitatively or qualitatively material, or both. Such incidents would need to be disclosed in the periodic report for the period in which a registrant has made a determination that they are material in the aggregate.

Request for Comment

15. Should we require registrants to disclose any material changes or updates to information that would be disclosed pursuant to proposed Item 1.05 of Form 8–K in the registrant's quarterly or annual report, as proposed? Are there instances, other than to correct inaccurate or materially misleading prior disclosures, when a registrant should be required to update its report on Form 8–K or file another Form 8–K instead of providing disclosure of material changes, additions, or updates in a subsequent Form 10–Q or Form 10–K?

16. Should we require a registrant to provide disclosure on Form 10–Q or Form 10–K when a series of previously undisclosed and individually immaterial cybersecurity incidents becomes material in the aggregate, as proposed? Alternatively, should we require a registrant to provide disclosure in Form 8–K, rather than in a periodic report, as proposed, when a series of previously undisclosed and individually immaterial cybersecurity incidents becomes material in the aggregate?

D. Disclosure of a Registrant's Risk Management, Strategy and Governance Regarding Cybersecurity Risks

1. Risk Management and Strategy

Companies typically address significant risks to their businesses by developing risk management systems, which may include policies and procedures for identifying, assessing, and managing the risks. These policies and procedures may then be subject to oversight by a company's management and board.[70] Policies and procedures reasonably designed to provide oversight, risk assessments, and incident responses may be adopted to help prevent or mitigate cyber-attacks and potentially prevent future attacks. Staff in the Division of Corporation Finance has observed that most of the registrants that disclosed a cybersecurity incident in 2021 did not describe their cybersecurity risk oversight and related policies and procedures. Some of these registrants provided only general disclosures, such as a reference to cybersecurity as one of the risks overseen by the board or a board committee.

We are proposing Item 106(b) of Regulation S–K to require registrants to provide more consistent and informative disclosure regarding their cybersecurity risk management and strategy. We believe that disclosure of the relevant policies and procedures, to the extent a registrant has established any, would benefit investors by providing greater transparency as to the registrant's strategies and actions to manage cybersecurity risks. For example, proposed disclosure about whether the registrant has a cybersecurity risk assessment program and undertakes activities designed to prevent, detect, and minimize effects of cybersecurity incidents can improve an investor's understanding of the registrant's cybersecurity risk profile. Given that a significant number of cybersecurity incidents pertain to third party service providers, the proposed rules would require disclosure concerning a registrant's selection and oversight of third-party entities as well.[71]

[70] *See* Martin Lipton, Wachtell, Lipton, Rosen & Katz, *Spotlight on Boards 2018,* Harv. L. Sch. F. on Corp. Governance (May 31, 2018), *available at https://corpgov.law.harvard.edu/2018/05/31/spotlight-on-boards-2018* (one of the board's responsibilities is to, ''[o]versee and understand the corporation's risk management and compliance efforts and how risk is taken into account in the corporation's business decision-making; respond to red flags if and when they arise.'').

[71] *See* Stephen Klemash and Jamie Smith, *What companies are disclosing about cybersecurity risk and oversight,* EY, supra note 6 (''Around a third of the disclosed data breaches related to cyber attacks of third-party service providers.'').

Additionally, cybersecurity risks may have an impact on a registrant's business strategy, financial outlook, or financial planning. Across industries, companies increasingly rely on information technology, collection of data, and use of digital payments as critical components of their business model and strategy. Their exposure to cybersecurity risks and previous cybersecurity incidents may affect these critical components, informing changes in their business model, financial condition, financial planning, and allocation of capital. For example, a company with a business model that relies highly on collecting and safeguarding sensitive and personally identifiable information from its customers may consider raising additional capital to invest in enhanced cybersecurity protection, improvements in its information security infrastructure, or employee cybersecurity training. Another company may examine the risks and decide that its business model should be adapted to minimize its collection of sensitive and personally identifiable information in order to reduce its risk exposure. These strategic decisions have implications for the company's financial planning and future financial performance. Disclosure about the impact of cybersecurity risks on business strategy would enable investors to assess whether companies will become more resilient or conversely, more vulnerable to cybersecurity risks in the future.

We also propose requiring disclosure of whether cybersecurity related risk and previous incidents have affected or are reasonably likely to affect the registrant's results of operations or financial condition. Investors would likely want to understand the financial impacts of cybersecurity risks and previous cybersecurity incidents in order to understand how these risks and incidents affect the company's financial performance or position, and thus the return on their investment. For example, a company that has previously experienced a cybersecurity incident may plan to provide compensation to consumers or it may anticipate regulatory fines or legal judgments as a result of the incident. These financial impacts would help investors understand the degree to which cybersecurity risks and incidents could affect the company's financial performance or position.

Proposed Item 106(b) would therefore require registrants to disclose its policies and procedures, if it has any, to identify and manage cybersecurity risks and threats, including: Operational risk; intellectual property theft; fraud; extortion; harm to employees or customers; violation of privacy laws and other litigation and legal risk; and reputational risk. Specifically, proposed Item 106(b) of Regulation S–K would require disclosure, as applicable, of whether: [72]

• The registrant has a cybersecurity risk assessment program and if so, provide a description of such program;

• The registrant engages assessors, consultants, auditors, or other third parties in connection with any cybersecurity risk assessment program;

• The registrant has policies and procedures to oversee and identify the cybersecurity risks associated with its use of any third-party service provider (including, but not limited to, those providers that have access to the registrant's customer and employee data), including whether and how cybersecurity considerations affect the selection and oversight of these providers and contractual and other mechanisms the company uses to mitigate cybersecurity risks related to these providers;

• The registrant undertakes activities to prevent, detect, and minimize effects of cybersecurity incidents;

• The registrant has business continuity, contingency, and recovery plans in the event of a cybersecurity incident;

• Previous cybersecurity incidents have informed changes in the registrant's governance, policies and procedures, or technologies;

• Cybersecurity related risk and incidents have affected or are reasonably likely to affect the registrant's results of operations or financial condition and if so, how; and

• Cybersecurity risks are considered as part of the registrant's business strategy, financial planning, and capital allocation and if so, how.

2. Governance

Disclosure regarding board oversight of a registrant's cybersecurity risk and the inclusion or exclusion of management from the oversight of cybersecurity risks and the implementation of related policies, procedures, and strategies impacts an investor's ability to understand how a registrant prepares for, prevents, or responds to cybersecurity incidents.[73] Accordingly, proposed Item 106(c) would require disclosure of a registrant's cybersecurity governance, including the board's oversight of cybersecurity risk and a description of management's role in assessing and managing cybersecurity risks, the relevant expertise of such management, and its role in implementing the registrant's cybersecurity policies, procedures, and strategies.[74]

Specifically, as it pertains to the board's oversight of cybersecurity risk, disclosure required by proposed Item 106(c)(1) would include a discussion, as applicable, of the following: [75]

• Whether the entire board, specific board members or a board committee is responsible for the oversight of cybersecurity risks;

• The processes by which the board is informed about cybersecurity risks, and the frequency of its discussions on this topic; and

• Whether and how the board or board committee considers cybersecurity risks as part of its business strategy, risk management, and financial oversight.

This proposed disclosure about the board's oversight would inform investors about the role of the board in cybersecurity risk management, which may help inform their investment and voting decisions. Proposed Item 106(c)(1) would also reinforce the 2018 Interpretive Release, which states that the board's role in overseeing cybersecurity risks should be disclosed if ''cybersecurity risks are material to a company's business'' and that such disclosures should address how a board ''engages with management on cybersecurity issues'' and ''discharg[es] its [cybersecurity] risk oversight responsibility.'' [76]

Proposed Item 106(c)(2) would require a description of management's role in assessing and managing cybersecurity-related risks and in implementing the registrant's cybersecurity policies, procedures, and strategies. This description would include, but not be limited to, the following information: [77]

• Whether certain management positions or committees are responsible for measuring and managing cybersecurity risk, specifically the prevention, mitigation, detection, and remediation of cybersecurity incidents, and the relevant expertise of such persons or members;

• Whether the registrant has a designated chief information security officer,[78] or someone in a comparable position, and if so, to whom that individual reports within the registrant's organizational chart, and the relevant expertise [79] of any such persons;

• The processes by which such persons or committees are informed about and monitor the prevention, mitigation, detection, and remediation of cybersecurity incidents; and

• Whether and how frequently such persons or committees report to the board of directors or a committee of the board of directors on cybersecurity risk.

This proposed disclosure of how a registrant's management assesses and implements policies, procedures, and strategies to mitigate cybersecurity risks would be of importance to investors both as they understand how registrants are planning for cybersecurity risks and as they make decisions as to how best to allocate their capital.

3. Definitions

Proposed Item 106(a) defines the terms ''cybersecurity incident,'' ''cybersecurity threat,'' and ''information systems,'' as used in proposed Item 106 and proposed Form 8–K Item 1.05 as follows: [80]

[72] *See* proposed Item 106(b).

[73] *See* John F. Saverese et al., *Cybersecurity Oversight and Defense—A Board and Management Imperative,* Harv. L.Sch. F. on Corp. Governance (May 14, 2021), *available at https://corpgov.law.harvard.edu/2021/05/14/cybersecurity-oversight-and-defense-a-board-and-management-imperative/.*

[74] Proposed amendments to Form 10–K clarify that an asset-backed issuer (as defined in Item 1101 of Regulation AB) that does not have any executive officers or directors may omit the information required by 17 CFR 229.106(c) (Item 106(c) of Regulation S–K).

[75] *See* proposed Item 106(c)(1). In the case of a FPI with a two-tier board of directors, proposed Instruction 1 to Item 106(c) clarifies that the term ''board of directors'' means the supervisory or non-management board. In the case of a FPI meeting the requirements of 17 CFR 240.10A–3(c)(3), for purposes of proposed Item 106(c), the term, ''board of directors'' means the registrant's board of auditors (or similar body) or statutory auditors, as applicable.

[76] *See* 2018 Interpretive Release.

[77] *See* proposed Item 106(c)(2).

[78] The chief information security officer may be responsible for identifying and monitoring cybersecurity risks, communicating with senior management and the registrant's business units about acceptable risk levels, developing risk mitigation strategies, and implementing a security framework that protects the registrant's digital assets. *The Role of the CISO and the Digital Security Landscape,* isaca j. vol. 2, at 22, 23–29 (2019) *available at https://www.isaca.org/resources/isaca-journal/issues/2019/volume-2/the-role-of-the-ciso-and-the-digital-security-landscape.*

[79] Proposed Instruction 2 to Item 106(c) provides guidance that ''expertise'' in Item 106(c)(2)(i) and (ii) may include, for example: Prior work experience in cybersecurity; any relevant degrees or certifications; any knowledge, skills, or other background in cybersecurity.

[80] *See* proposed Item 106(a). These three terms are derived from a number of established sources. *See* Presidential Policy Directive—United States Cyber Incident Coordination (July 26, 2016) (''PPD–41''); 6 U.S.C. 1501 (2021); 44 U.S.C. 3502 (2021); 44 U.S.C. 3552 (2021); *see also* National Institute of Standards and Technology (NIST), Computer Security Resource Center Glossary (last visited Feb.

- *Cybersecurity incident* means an unauthorized occurrence on or conducted through a registrant's information systems that jeopardizes the confidentiality, integrity, or availability of a registrant's information systems or any information residing therein.
- *Cybersecurity threat* means any potential occurrence that may result in, an unauthorized effort to adversely affect the confidentiality, integrity or availability of a registrant's information systems or any information residing therein.
- *Information systems* means information resources, owned or used by the registrant, including physical or virtual infrastructure controlled by such information resources, or components thereof, organized for the collection, processing, maintenance, use, sharing, dissemination, or disposition of the registrant's information to maintain or support the registrant's operations.

What constitutes a ''cybersecurity incident'' for purposes of our proposal should be construed broadly and may result from any one or more of the following: An accidental exposure of data, a deliberate action or activity to gain unauthorized access to systems or to steal or alter data, or other system compromises or data breaches.[81]

Request for Comment

17. Should we adopt Item 106(b) and (c) as proposed? Are there other aspects of a registrant's cybersecurity policies and procedures or governance that should be required to be disclosed under Item 106, to the extent that a registrant has any policies and procedures or governance? Conversely, should we exclude any of the proposed Item 106 disclosure requirements?

18. Are the proposed definitions of the terms ''cybersecurity incident,'' ''cybersecurity threat,'' and ''information systems,'' in Item 106(a) appropriate or should they be revised? Are there other terms used in the proposed amendments that we should define?

19. The proposed rule does not define ''cybersecurity.'' We could define the term to mean, for example: ''any action, step, or measure to detect, prevent, deter, mitigate, or address any cybersecurity threat or any potential cybersecurity threat.'' Would defining ''cybersecurity'' in proposed Item 106(a) be helpful? Why or why not? If defining this term would be helpful, is the definition provided above appropriate, or is there another definition that would better define ''cybersecurity''?

20. Should we require the registrant to specify whether any cybersecurity assessor, consultant, auditor, or other service that it relies on is through an internal function or through an external third-party service provider? Would such a disclosure be useful for investors?

21. As proposed, a registrant that has not established any cybersecurity policies or procedures would not have to explicitly state that this is the case. If applicable, should a registrant have to explicitly state that it has not established any cybersecurity policies and procedures?

22. Are there concerns that certain disclosures required under Item 106 would have the potential effect of undermining a registrant's cybersecurity defense efforts or have other potentially adverse effects by highlighting a registrant's lack of policies and procedures related to cybersecurity? If so, how should we address these concerns while balancing investor need for a sufficient description of a registrant's policies and procedures for purposes of their investment decisions?

23. Should we exempt certain categories of registrants from proposed Item 106, such as smaller reporting companies, emerging growth companies, or FPIs? If so, which ones and why? How would any exemption impact investor assessments and comparisons of the cybersecurity risks of registrants? Alternatively, should we provide for scaled disclosure requirements by any of these categories of registrants, and if so, how?

24. Should we provide for delayed compliance or other transition provisions for proposed Item 106 for certain categories of registrants, such as smaller reporting companies, emerging growth companies, FPIs, or asset-backed securities issuers? Proposed Item 106(b), which would require companies to provide disclosures regarding existing policies and procedures for the identification and management of cybersecurity incidents, would be required in annual reports. Should the proposed Item 106(b) disclosures also be required in registration statements under the Securities Act and the Exchange Act?

25. To what extent would disclosure under proposed Item 106 overlap with disclosure required under Item 407(h) of Regulation S–K (''Board leadership structure and role in oversight'') with respect to board oversight of cybersecurity risks? To the extent there is significant overlap, should we expressly provide for the use of hyperlinks or cross-references in Item 106? Are there other approaches that would effectively decrease duplicative disclosure without being cumbersome for investors?

E. Disclosure Regarding the Board of Directors' Cybersecurity Expertise

Cybersecurity is already among the top priorities of many boards of directors[82] and cybersecurity incidents and other risks are considered one of the largest threats to companies.[83] Accordingly, investors may find disclosure of whether any board members have cybersecurity expertise to be important as they consider their investment in the registrant as well as their votes on the election of directors of the registrant.

We propose to amend Item 407 of Regulation S–K by adding paragraph (j) to require disclosure about the cybersecurity expertise of members of the board of directors of the registrant, if any. If any member of the board has cybersecurity expertise, the registrant would have to disclose the name(s) of any such director(s), and provide such detail as necessary to fully describe the nature of the expertise.[84]

The proposed requirements would build upon the existing disclosure requirements in Item 401(e) of Regulation S–K (business experience of directors) and Item 407(h) of Regulation

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6, 2022), *available at https://csrc.nist.gov/glossary* (''NIST Glossary''). The proposed definitions also are consistent with proposed definitions in the Investment Management Cybersecurity Proposing Release. *See* Investment Management Cybersecurity Proposing Release at notes 27, 28, and 30. We believe the proposed terms are sufficiently precise for registrants to understand and use in connection with the proposed rules. Use of common terms is intended to facilitate compliance and reduce regulatory burdens. Using common terms and similar definitions with the Investment Management Cybersecurity Proposing Release along with other federal cybersecurity rulemakings is intended to facilitate compliance and reduce regulatory burdens.

[81] *See supra* Section II.B.2, for examples of cybersecurity incidents that may require disclosure pursuant to proposed Item 1.05 of Form 8–K.

[82] NACD, *2019–2020 NACD Public Company Governance Survey, available at https://corpgov.law.harvard.edu/wp-content/uploads/2020/01/2019-2020-Public-Company-Survey.pdf.*

[83] *See id.*

[84] Consistent with proposed Instruction 1 to Item 106(c), we are proposing an instruction to Item 407(j) to clarify that in the case of a FPI with a two-tier board of directors the term ''board of directors'' means the supervisory or non-management board. In the case of a FPI meeting the requirements of 17 CFR 240.10A–3(c)(3), for purposes of 407(j), the term, ''board of directors'' means the registrant's board of auditors (or similar body) or statutory auditors, as applicable. *See* proposed Instruction 2 to Item 407(j). Likewise, proposed General Instruction J to Form 10–K permits an asset-backed issuer that does not have any executive officers or directors to omit the Item 407 disclosure required by Form 10–K as these entities are generally passive pools of assets and are subject to substantially different reporting requirements than operating companies. Similarly, such entities would be permitted to omit the proposed Item 407(j) disclosure from Form 10–K under General Instruction J for the same reason.

S–K (board risk oversight). The proposed Item 407(j) disclosure would be required in a registrant's proxy or information statement when action is to be taken with respect to the election of directors, and in its Form 10–K.

Proposed Item 407(j) would not define what constitutes ''cybersecurity expertise,'' given that such expertise may cover different experiences, skills, and tasks. Proposed Item 407(j)(1)(ii) does, however, include the following non-exclusive list of criteria that a registrant should consider in reaching a determination on whether a director has expertise in cybersecurity:

- Whether the director has prior work experience in cybersecurity, including, for example, prior experience as an information security officer, security policy analyst, security auditor, security architect or engineer, security operations or incident response manager, or business continuity planner;
- Whether the director has obtained a certification or degree in cybersecurity; and
- Whether the director has knowledge, skills, or other background in cybersecurity, including, for example, in the areas of security policy and governance, risk management, security assessment, control evaluation, security architecture and engineering, security operations, incident handling, or business continuity planning.

Proposed Item 407(j)(2) would state that a person who is determined to have expertise in cybersecurity will not be deemed an expert for any purpose, including, without limitation, for purposes of Section 11 of the Securities Act (15 U.S.C. 77k),[85] as a result of being designated or identified as a director with expertise in cybersecurity pursuant to proposed Item 407(j).[86] This proposed safe harbor is intended to clarify that Item 407(j) would not impose on such person any duties, obligations, or liability that are greater than the duties, obligations, and liability imposed on such person as a member of the board of directors in the absence of such designation or identification.[87] This provision should alleviate such concerns for cybersecurity experts considering board service. Conversely, we do not intend for the identification of a cybersecurity expert on the board to decrease the duties and obligations or liability of other board members.[88]

Request for Comment

26. Would proposed Item 407(j) disclosure provide information that investors would find useful? Should it be modified in any way?

27. Should we require disclosure of the names of persons with cybersecurity expertise on the board of directors, as currently proposed in Item 407(j)(1)? Would a requirement to name such persons have the unintended effect of deterring persons with this expertise from serving on a board of directors?

28. When a registrant does not have a person with cybersecurity expertise on its board of directors, should the registrant be required to state expressly that this is the case under proposed Item 407(j)(1)? As proposed, we would not require a registrant to make such an explicit statement.

29. Proposed Item 407(j) would require registrants to describe fully the nature of a board member's expertise in cybersecurity without mandating specific disclosures. Is there particular information that we should instead require a registrant to disclose with respect to a board member's expertise in cybersecurity?

30. As proposed, Item 407(j)(1) includes a non-exclusive list of criteria that a company should consider in determining whether a director has expertise in cybersecurity. Are these factors for registrants to consider useful in determining cybersecurity expertise? Should the list be revised, eliminated, or supplemented?

31. Would the Item 407(j) disclosure requirements have the unintended effect of undermining a registrant's cybersecurity defense efforts or otherwise impose undue burdens on registrants? If so, how?

32. Should 407(j) disclosure of board expertise be required in an annual report and proxy or information statement, as proposed?

33. To what extent would disclosure under proposed Item 407(j) overlap with disclosure required under Item 401(e) of Regulation S–K with respect to the business experience of directors? Are there alternative approaches that would avoid duplicative disclosure without being cumbersome for investors?

34. As proposed, Item 407(j) does not include a definition of the term ''expertise'' in the context of cybersecurity? Should Item 407(j) define the term ''expertise''? If so, how should we define the term?

35. Should certain categories of registrants, such as smaller reporting companies, emerging growth companies, or FPIs, be excluded from the proposed Item 407(j) disclosure requirement? How would any exclusion affect the ability of investors to assess the cybersecurity risk of a registrant or compare such risk among registrants?

36. Should we adopt the proposed Item 407(j)(2) safe harbor to clarify that a director identified as having expertise in cybersecurity would not have any increased level of liability under the federal securities laws as a result of such identification? Are there alternatives we should consider?

37. As proposed, disclosure under Item 407(j) would be required in a proxy or information statement. Should we require the disclosure under Item 407(j) to appear in a registrant's proxy or information statement regardless of whether the registrant is relying on General Instruction G(3)? Is this information relevant to a security holder's decision to vote for a particular director?

F. Periodic Disclosure by Foreign Private Issuers

We propose to amend Form 20–F to add Item 16J that would require an FPI to include in its annual report on Form 20–F the same type of disclosure that we propose in Items 106 and 407(j) of Regulation S–K and that would be required in periodic reports filed by domestic registrants. One difference is that while domestic registrants would be required to include the proposed Item 407(j) disclosure about board expertise in both their annual reports and proxy or information statements, FPIs are not subject to Commission rules for proxy or information statement filings and thus, would only be required to include this disclosure in their annual reports.[89]

With respect to incident disclosure, where an FPI has previously reported an incident on Form 6–K, the proposed amendments would require an update regarding such incidents, consistent with proposed Item 106(d)(1) of Regulation S–K.[90] We are also proposing to amend Form 20–F to require FPIs to disclose on an annual basis information regarding any previously undisclosed material cybersecurity incidents that have occurred during the reporting period, including a series of previously undisclosed individually immaterial cybersecurity incidents that has become material in the aggregate.[91]

The Commission created Form 40–F in connection with its establishment of a multijurisdictional disclosure system (''MJDS''). This system generally

[85] 15 U.S.C. 77k.

[86] *See* proposed Item 407(j)(3)(i).

[87] *See* proposed Item 407(j)(3)(ii).

[88] *See* proposed Item 407(j)(3)(iii).

[89] Exchange Act Rule 3a12–3(b) [17 CFR 240.3a12–3(b)].

[90] *See* proposed Item 16J(d)(1).

[91] *See* proposed Item 16J(d)(2).

permits eligible Canadian FPIs to use Canadian disclosure standards and documents to satisfy the Commission's registration and disclosure requirements. Accordingly, we are not proposing prescriptive cybersecurity disclosure requirements for Form 40–F filers.

Request for Comment

38. Should we amend Form 20–F, as proposed to require disclosure regarding cybersecurity risk management and strategy, governance, and incidents? Additionally, should we amend Form 6–K, as proposed, to add ''cybersecurity incidents'' as a reporting topic? Are there unique considerations with respect to FPIs in these contexts?

39. We are not proposing any changes to Form 40–F. Should we instead require an MJDS issuer filing an annual report on Form 40–F to comply with the Commission's specific proposed cybersecurity-related disclosure requirements in the same manner as Form 10–K or Form 20–F filers?

G. Structured Data Requirements

We are proposing to require registrants to tag the information specified by Item 1.05 of Form 8–K and Items 106 and 407(j) of Regulation S–K in Inline XBRL in accordance with Rule 405 of Regulation S–T (17 CFR 232.405) and the EDGAR Filer Manual.[92] The proposed requirements would include block text tagging of narrative disclosures, as well as detail tagging of quantitative amounts disclosed within the narrative disclosures. Inline XBRL is both machine-readable and human-readable, which improves the quality and usability of XBRL data for investors.[93]

Requiring Inline XBRL tagging of the disclosures provided pursuant to these disclosure items would benefit investors by making the disclosures more readily available and easily accessible to investors, market participants, and others for aggregation, comparison, filtering, and other analysis, as compared to requiring a non-machine readable data language such as ASCII or HTML. This Inline XBRL tagging would enable automated extraction and analysis of the granular data required by the proposed rules, allowing investors and other market participants to more efficiently perform large-scale analysis and comparison of this information across registrants and time periods. For narrative disclosures, an Inline XBRL requirement would allow investors to extract and search for disclosures about cybersecurity incidents reported on Form 8–K, updated information about cybersecurity incidents reported in a registrant's periodic reports, a registrant's cybersecurity policies and procedures, management's role in assessing and managing cybersecurity risks, and the board of directors' oversight of cybersecurity risk and cybersecurity expertise rather than having to manually run searches for these disclosures through entire documents. The Inline XBRL requirement would also enable automatic comparison of these disclosures against prior periods, and targeted artificial intelligence/machine learning assessments of specific narrative disclosures rather than the entire unstructured document. At the same time, we do not expect the incremental compliance burden associated with tagging the proposed additional information to be unduly burdensome because registrants subject to the proposed tagging requirements are for the most part subject to similar Inline XBRL requirements in other Commission filings.

Request for Comment

40. Should we require registrants to tag the disclosures required by proposed Item 1.05 of Form 8–K and Items 106 and 407(j) of Regulation S–K in Inline XBRL, as proposed? Are there any changes we should make to ensure accurate and consistent tagging? If so, what changes should we make? Should we require registrants to use a different structured data language to tag these disclosures? If so, what structured data language should we require? Are there any registrants, such as smaller reporting companies, emerging growth companies, or FPIs that we should exempt from the tagging requirement?

General Request for Comment

We request and encourage any interested person to submit comments regarding the proposed rule amendments, specific issues discussed in this release, and other matters that may have an effect on the proposed rule amendments. With regard to any comments, we note that such comments are of particular assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments.

III. Economic Analysis

A. Introduction

Cybersecurity threats and incidents continue to increase in prevalence and seriousness, posing an ongoing and escalating risk to public companies, investors, and other market participants.[94] The number of reported breaches disclosed by public companies has increased over the last decade, from 28 in 2011 to 144 in 2019 and 117 in 2020.[95] Although estimating the total cost of cybersecurity incidents is difficult, as many events may be unreported, some estimates put the total costs in the trillions of dollars per year in the U.S. alone.[96] The Council of Economic Advisers estimated that in 2016 the total cost of cybersecurity incidents was between $57 billion and $109 billion, or between 0.31 and 0.58 percent of U.S. GDP in that year.[97]

As described earlier, while cybersecurity incident disclosure has become more frequent since the issuance of the 2011 Staff Guidance and 2018 Interpretive Release, there is concern that material cybersecurity incidents are underreported.[98] For instance, the staff has observed that certain cybersecurity incidents were reported in the media but not disclosed in a registrant's filings.[99] Even when

[92] This tagging requirement would be implemented by including a cross-reference to Rule 405 of Regulation S–T in proposed Item 1.05 of Form 8–K and Items 106 and 407(j) of Regulation S–K, and by revising Rule 405(b) of Regulation S–T [17 CFR 232.405(b)] to include the listed disclosure Items. In conjunction with the EDGAR Filer Manual, Regulation S–T governs the electronic submission of documents filed with the Commission. Rule 405 of Regulation S–T specifically governs the scope and manner of disclosure tagging requirements for operating companies and investment companies, including the requirement in Rule 405(a)(3) to use Inline XBRL as the specific structured data language to use for tagging the disclosures.

[93] *See* Inline XBRL Filing of Tagged Data, Securities Act Release No. 10514 (June 28, 2018) [83 FR 40846 (Aug. 16, 2018)]. Inline XBRL allows filers to embed XBRL data directly into an HTML document, eliminating the need to tag a copy of the information in a separate XBRL exhibit. Inline XBRL is both human-readable and machine-readable for purposes of validation, aggregation, and analysis. *Id.* at 40851.

[94] Unless otherwise noted, when we discuss the economic effects of the proposed amendments on ''other market participants,'' we mean those market participants that typically provide services for investors and who rely on the information in registrant's filings (such as financial analysts, investment advisers, and portfolio managers).

[95] Audit Analytics, *Trends in Cybersecurity Breaches* (Mar. 2021) (stating that: ''[c]ybersecurity breaches can result in a litany of costs, such as investigations, legal fees, and remediation. There is also the risk of economic costs that directly impact financial performance, such as a reduction in revenue due to lost sales.'').

[96] *See* Cybersecurity and Infrastructure Security Agency, *Cost of a Cyber Incident: Systemic Review and Cross-Validation* (Oct. 26, 2020), *available at https://www.cisa.gov/sites/default/files/publications/CISA-OCE_Cost_of_Cyber_Incidents_Study-FINAL_508.pdf.*

[97] *See supra* note 12, The Council of Economic Advisers, *The Cost of Malicious Cyber Activity to the U.S. Economy* (Feb. 2018).

[98] *See supra* section II.B and note 46. *See also infra* note 146, Amir et al. (2018) (providing evidence that companies underreport cyber-attacks).

[99] *See supra* section I.B.

disclosures about cybersecurity breaches are made, they may not be timely. According to Audit Analytics data, in 2020, it took on average 44 days for companies to discover breaches, and then in addition, it took an average of 53 days and a median of 37 days for companies to disclose a breach after its discovery.[100] Additionally, incident disclosure practices currently vary widely across registrants—some registrants disclose incidents through Form 8–K and some may disclose on a company website or in a press release. Because cybersecurity incidents can significantly impact companies' stock prices, delayed reporting results in mispricing of registrants' securities, harming investors.[101] Therefore, more timely and informative disclosure of a cybersecurity incident is needed for investors to assess an incident's impact and a registrant's ability to respond to the incident and to make more informed decisions.

Investors also need to better understand the growing cybersecurity risks registrants are facing and their ability to manage such risks in order to better value their securities. Executives, boards of directors, and investors are focused on this emerging risk. A 2019 survey of CEOs, boards of directors, and institutional investors found that they identified cybersecurity as the top global challenge for CEOs.[102] In 2021, a survey of audit committee members identified cybersecurity as the second highest risk that their audit committee would focus on in 2022, second only to financial reporting and internal controls.[103]

Disclosures about cybersecurity risk management, strategy, and governance are increasing, although they are not currently provided by all registrants. An analysis of disclosures by Fortune 100 companies found that disclosures of cybersecurity risk in proxy statements were found in 89 percent of filings in 2020, up from 79 percent in 2018, and disclosures of efforts to mitigate cybersecurity risk were found in 92 percent of proxy statements or 10–K Forms, up from 83 percent in 2018.[104]

As with incident reporting, there is a lack of uniformity in current reporting practice for cybersecurity risk management, strategy, and governance disclosure.[105] The relevant disclosures currently are made in varying sections of a registrant's periodic and current reports, such as in risk factors, in management's discussion and analysis, in a description of business and legal proceedings, or in financial statement disclosures, and are sometimes blended with other unrelated disclosures. The varied disclosure about both cybersecurity incidents and cybersecurity risk management, strategy, and governance makes it difficult for investors and other market participants to understand the cybersecurity risks that companies face and their preparedness for an attack, and to make comparisons across registrants.

To provide investors and other market participants with more timely, informative, and consistent disclosure about cybersecurity incidents, and cybersecurity risk management, strategy, and governance, we are proposing the following amendments.[106] Regarding incident reporting, we propose to: (1) Amend Form 8–K to add Item 1.05 to require registrants to disclose information about a cybersecurity incident within four business days following the registrant's determination that such an incident is material to the registrant; and (2) add new Item 106(d) of Regulation S–K to require registrants to provide updated disclosure in its periodic reports relating to previously disclosed incidents; and (3) amend Form 20–F and Form 6–K to require FPIs to provide cybersecurity disclosures consistent with the disclosure that we propose to require in the domestic forms.

For disclosures regarding cybersecurity risk management, strategy, and governance, we are proposing the following. First, we propose to amend Regulation S–K to require disclosure specified in proposed new Item 106(b) and (c) regarding: (1) A registrant's policies and procedures if any, for identifying and managing cybersecurity risks, (2) a registrant's cybersecurity governance, including the board of directors' oversight role regarding cybersecurity-related issues, and (3) management's role and expertise in assessing and managing cybersecurity risks and implementing related policies, procedures and strategies. Second, we propose to amend Item 407 of Regulation S–K to require disclosure about cybersecurity expertise of any member of the board.

The discussion below addresses the potential economic effects of the proposed amendments, including the likely benefits and costs, as well as the likely effects on efficiency, competition, and capital formation.[107] At the outset, we note that, where possible, we have attempted to quantify the benefits, costs, and effects on efficiency, competition, and capital formation expected to result from the proposed amendments. In many cases, however, we are unable to quantify the potential economic effects because we lack information necessary to provide a reasonable estimate. Where we are unable to quantify the economic effects of the proposed amendments, we provide a qualitative assessment of the potential effects and encourage commenters to provide data and information that would help quantify the benefits, costs, and the potential impacts of the proposed amendments on efficiency, competition, and capital formation.

B. Economic Baseline

1. Current Regulatory Framework

To assess the economic impact of the proposed rules, the Commission is using as its baseline the existing regulatory framework for cybersecurity disclosure. As discussed in Section I, although a number of rules and regulations impose an obligation on companies to disclose cybersecurity risks and incidents in certain circumstances, the Commission's regulations currently do not explicitly address cybersecurity.

In 2011, the Division of Corporation Finance issued interpretive guidance providing the Division's views concerning operating companies' disclosure obligations relating to cybersecurity risks and incidents.[108] The 2011 Staff Guidance provided an overview of existing specific disclosure obligations that may require a discussion of cybersecurity risks and

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[100] *See supra* note 95 (''Audit Analytics'').

[101] *See infra* note 133.

[102] *See supra* note 15, *EY CEO Imperative Study* (2019). The Ernst & Young survey consisted of interviewing 200 global CEOs amongst the Forbes Global 2000 and Forbes largest private companies as well as interviewing 100 senior investors from global firms that had managed at least $100 billion in assets.

[103] *See* Center for Audit Quality, *Audit Committee Practices Report: Common Threads Across Audit Committees* (Jan. 2022), *available at https://www.thecaq.org/2022-ac-practices-report/.*

[104] *See* Jamie Smith, *How Cybersecurity Risk Disclosures and Oversight are Evolving in 2021,* EY Center for Board Matters (Oct. 5, 2021), *available at https://www.ey.com/en_us/board-matters/cybersecurity-risk-disclosures-and-oversight.*

[105] *See supra* section I.

[106] *See supra* section II.

[107] Section 2(b) of the Securities Act [15 U.S.C. 77b(b)] and Section 3(f) of the Exchange Act [15 U.S.C. 78c(f)] directs the Commission, when engaging in rulemaking where it is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. Further, Section 23(a)(2) of the Exchange Act (15 U.S.C. 78w(a)(2)) requires the Commission, when making rules under the Exchange Act, to consider the impact that the rules would have on competition, and prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the Exchange Act.

[108] *See supra* section I.A and note 26.

cybersecurity incidents, along with examples of potential disclosures.[109] Building on the 2011 Staff Guidance, the Commission issued the 2018 Interpretive Release to assist operating companies in preparing disclosure about cybersecurity risks and incidents under existing disclosure rules.[110] In the 2018 Interpretive Release, the Commission instructed companies to provide timely and ongoing information in periodic reports (Form 10–Q, Form 10–K, and Form 20–F) about material cybersecurity risks and incidents that trigger disclosure obligations. Additionally, the 2018 Interpretive Release encouraged companies to continue to use current reports (Form 8–K or Form 6–K) to disclose material information promptly, including disclosure pertaining to cybersecurity matters. Further, the 2018 Interpretive Release noted that to the extent cybersecurity risks are material to a company's business, the Commission believes that the required disclosure of the company's risk oversight should include the nature of the board's role in overseeing the management of that cybersecurity risk. The 2018 Interpretive Release also stated that a company's controls and procedures should enable them to, among other things, identify cybersecurity risks and incidents and make timely disclosures regarding such risks and incidents. Finally, the 2018 Interpretive Release highlighted the importance of insider trading prohibitions and the need to refrain from making selective disclosures of cybersecurity risks or incidents.

Companies currently may also be subject to other cybersecurity incident disclosure requirements adopted by various industry regulators and contractual counterparties. For example, federal contractors may be required to monitor and report cybersecurity incidents and breaches or face liability under the False Claims Act.[111] The Health Insurance Portability and Accountability Act (HIPAA) requires covered entities and their business associates to provide notification following a breach of unsecured protected health information.[112] Similar rules require vendors of personal health records and related entities to report data breaches to affected individuals and the Federal Trade Commission.[113] All 50 states have data breach laws that require businesses to notify individuals of security breaches involving their personally identifiable information.[114] There are other rules that companies must follow in international jurisdictions that are similar in scope to the proposed rules. For example, in the European Union, the General Data Protection Regulation mandates disclosure of cybersecurity breaches.[115] All of the aforementioned data breach disclosure requirements may cover some of the material incidents that companies would need to report under the proposed amendments, but not all incidents. Additionally, the timeliness and public reporting requirements of these requirements vary, making it difficult for investors and other market participants to be alerted to the breaches, and to be provided with an adequate understanding of the impact of such incidents to registrants.

Some companies are also subject to other mandates to fulfill a basic level of cybersecurity risk management, strategy, and governance. For instance, government contractors may be subject to the Federal Information Security Modernization Act, and use the National Institute of Standards and Technology framework to manage information and privacy risks.[116] Financial institutions may be subject to the Federal Trade Commission's Standards for Safeguarding Customer Information Rule, requiring an information security program and a qualified individual to oversee the security program and to provide periodic reports to a company's board of directors or equivalent governing body.[117] Under HIPAA regulations, covered entities are also subject to rules that require protection against reasonably anticipated threats to electronic protected health information.[118] International jurisdictions also have cybersecurity risk mitigation measures, for example, the GDPR requires basic cybersecurity risk mitigation measures and has governance requirements.[119] These various requirements have varying standards and requirements for reporting cybersecurity risk management, strategy, and governance, and may not provide investors with clear and comparable disclosure regarding how a particular registrant manages its cybersecurity risk profile.

2. Affected Parties

The proposed new disclosure requirements would apply to various filings, including current reports, periodic reports, and certain proxy statements filed with the Commission. Thus, the parties that are likely to be affected by the proposed rules include investors, registrants, other market participants that use the information in these filings (such as financial analysts, investment advisers, and portfolio managers) and external stakeholders such as consumers and other companies in the same industry as affected firms.

We expect the proposed rules to affect all companies with relevant disclosure obligations on Forms 10–K, 10–Q, 20–F, 8–K, or 6–K, and proxy statements. This includes approximately 7,848 companies filing on domestic forms and 973 FPIs filing on foreign forms based on all companies that filed such forms or an amendment thereto during calendar year 2020.[120]

Our textual analysis[121] of all calendar year 2020 Form 10–K filings and amendments (7,683) reveals that out of 6,634 domestic filers approximately 64% (4,272) of them made any cybersecurity-related disclosures. The filers' average size in terms of total assets and market capitalization was

[109] *Id.*

[110] *See supra* section I.A and note 27.

[111] *See* Department of Justice, Office of Public Affairs, *Justice News: Deputy Attorney General Lisa O. Monaco Announces New Civil Cyber-Fraud Initiative,* (Oct. 6, 2021), *available at https://www.justice.gov/opa/pr/deputy-attorney-general-lisa-o-monaco-announces-new-civil-cyber-fraud-initiative; see, e.g.,* FAR 52.239–1 (requiring contractors to ''immediately'' notify the federal government if they become aware of ''new or unanticipated threats or hazards . . . or if existing safeguards have ceased to function'').

[112] *See* 45 CFR 164.400–164.414 (Notification in the Case of Breach of Unsecured Protected Health Information).

[113] *See* 16 CFR 318 (Health Breach Notification Rule).

[114] Note that there are carve outs to these rules, and not every company may fall under any particular rule. *See Security Breach Notification Laws,* National Conference of State Legislatures (Jan. 17, 2022), *available at https://www.ncsl.org/research/telecommunications-and-information-technology/security-breach-notification-laws.aspx.*

[115] *See* Regulation (EU) 2016/679, of the European Parliament and the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation), arts. 33 (Notification of a personal data breach to the supervisory authority), 34 (Communication of a personal data breach to the data subject), 2016 O.J. (L 119) 1 (''GDPR'').

[116] *See NIST Risk Management Framework,* NIST (updated Jan. 31, 2022), *available at https://csrc.nist.gov/projects/risk-management/fisma-background.*

[117] *See* 16 CFR 314.

[118] *See* 45 CFR 164 (Security and Privacy).

[119] *See supra* note 115, GDPR, § 32, § 37.

[120] Estimates of affected registrants here are based on the number of unique CIKs with at least one periodic report, current report, proxy filing, or an amendment to one of the three filed in calendar year 2020.

[121] In performing this analysis, staff executed a combination of computer program-based keyword (and combination of key words) searches followed by manual review to classify disclosures by location within the document. This analysis covered 7,683 Forms 10–K and 10–K/A filed in calendar year 2020 by 6,634 registrants as identified by unique CIK.

approximately $14.1 billion and $7.5 billion, respectively.[122] By comparison, the average size of domestic annual report filers that did not make any cyber disclosures was $892.6 million and $2.2 billion in terms of total assets and market capitalization, respectively. However, the average size of all baseline affected filers was approximately $14.1 billion and $5.6 billion in total assets and market capitalization respectively. The nature of these disclosures is summarized in the table below, which reports the relative frequency of cyber-related disclosures by location within the annual report conditional on a report having at least one discussion of cybersecurity. We note that the average number of reporting locations for registrants making cybersecurity-related disclosures on the annual report is 1.5, and registrants making cybersecurity-related disclosures often only did so in one section of the annual report (64%). However, many annual reports featured cybersecurity discussions in more than one section: 25% had disclosures in 2 sections, 7% in 3 sections, and 1% in 5 or more sections. Because of this, the percentages in Table 1 sum to greater than 100%.

TABLE 1—INCIDENCE OF CYBERSECURITY-RELATED DISCLOSURES BY 10–K LOCATION [a]

Disclosure location	Item description	Percentage
Item 1A	Risk Factors	94.3
Item 1	Description of Business *	20.5
PSLRA	Cautionary Language regarding Forward Looking Statements	16.3
Item 7	Management's Discussion and Analysis *	10.0
Item 10	Directors, Executive Officers and Corporate Governance	3.4
Item 8	Financial Statements and Supplementary Data	2.8
	Exhibits (attached)	0.9
Item 11	Executive Compensation	0.4
Item 15	Exhibits, Financial Statement Schedules	0.4
Item 2	Properties	0.3
Item 3	Legal Proceedings	0.3
Item 9	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure *	0.2
Item 13	Certain Relationships and Related Transactions, and Director Independence	0.2
Item 6	Selected Financial Data	0.2
Item 5	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.	0.1
Item 4	Mine Safety Disclosures	0.1
Item 14	Principal Accountant Fees and Services	0.1
Item 12	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.	0.0

[a] Because of heterogeneity in registrants' labeling of sections, Items other than 1A are grouped only at the numeric level. An asterisk in the table denotes that the identified Item may contain disclosures located in a more specific subsection. Item 1, for instance, includes Item 1B disclosures; Item 7 includes 7A; and Item 9 includes 9A, 9B, and 9C.

As presented in Table 1, approximately 94% (4,029) of Form 10–K or amendment filers that provided any cyber-related disclosures included discussion of cybersecurity as a material risk factor in Item 1A.

We further estimate that, in 2020, approximately 603 domestic companies reported having a director on their board with cybersecurity experience or expertise. This estimate is based on a review of cybersecurity disclosures by registrants that filed either a Form 10–K or an amended Form 10–K in 2020 that included cybersecurity-related language in their Item 10 (Directors and Executive Officers of the Registrant) discussion or provided similar disclosures in a proxy filing instead.[123]

Finally, there were a total of 74,098 Form 8–K filings in 2020, involving 7,021 filers, out of which 40 filings reported material cybersecurity incidents. Similarly, there were a total of 23,373 Form 6–K filings in 2020, involving 979 filers, out of which 27 filings reported material cybersecurity incidents. Filers of annual, quarterly, or current reports (Forms 10–K, 10–Q, 20–F, 8–K, or 6–K) including a cybersecurity discussion in any form included 104 business development companies.

C. Potential Benefits and Costs of the Proposed Amendments

We have considered the potential benefits and costs associated with the proposed amendments. The proposed rules would benefit investors and other market participants by providing more timely and informative disclosures relating to cybersecurity incidents and cybersecurity risk management, strategy, and governance, facilitating investor decision-making and reducing information asymmetry in the market. The proposed amendments also would entail costs. For instance, in addition to the costs of providing the disclosure itself, more detailed disclosure could potentially increase the vulnerability of registrants and the risk of future attacks. A discussion of the anticipated economic costs and benefits of the proposed amendments is set forth in more detail below. We first discuss benefits to investors (and other market participants, such as financial analysts, investment advisers, and portfolio managers) and registrants. We subsequently discuss costs to investors and registrants. We conclude with a discussion of indirect economic effects on registrants and external stakeholders, such as consumers, and companies in the same industry with registrants or those facing similar cybersecurity threats.

We also expect the proposed amendments to affect compliance burdens. The quantitative estimates of changes in those burdens for purposes of the Paperwork Reduction Act of 1995 (''PRA'') are further discussed in Section [IV] below. For purposes of the PRA, we estimate that the proposed amendments would result in an increase of 2,000 and

[122] Market capitalization averages are estimated as of end of calendar year 2020. Total Asset averages are estimated from the value for the most recently completed fiscal year reported by a registrant by year end 2020.

[123] Based on manual review of the total of 15,565 proxy filings filed in 2020 and the 1,600 of them that mentioned cybersecurity.

180 burden hours from the increase in the number Form 8–K and Form 6–K filings respectively.[124] In addition, the estimated increase in the paperwork burden as a result of the proposed amendments for Form 10–Q, Form 10–K, Form 20–F, Schedule 14A, and Schedule 14C would be 3,000 hours, 132,576 hours, 12,028.50 hours, 3,900 hours, and 342 hours respectively.[125]

1. Benefits

Investors would be the main beneficiaries from the enhanced disclosure of both cybersecurity incidents and cybersecurity risk management, strategy, and governance as a result of the proposed amendments. Specifically, investors would benefit because: (1) More informative and timely disclosure would reduce mispricing of securities in the market and facilitate their decision making; and (2) more uniform and comparable disclosures would lower search costs and information processing costs. Other market participants that rely on financial statement information to provide services to investors, such as financial analysts, investment advisers, and portfolio managers, could also benefit. Registrants could benefit, because the enhanced disclosure as a result of the proposed amendments could reduce information asymmetry and potentially lower registrants' cost of capital.

a. Benefits to Investors

(i) More Informative and More Timely Disclosure

More informative and timely disclosures would reduce mispricing of securities in the market and facilitate investor decision making. Information benefits would result from both types of disclosure,[126] and timeliness benefits would result from the proposed cybersecurity incident disclosure.

The proposed amendments would provide more informative disclosures related to cybersecurity incidents and cybersecurity risk management, strategy, and governance compared to the current disclosure framework, benefiting investors. The increase in disclosure would allow investors to better understand a registrant's cybersecurity risks and ability to manage such risks, and thereby make more informed investment decisions. As discussed in Section I, currently, there are no disclosure requirements that explicitly refer to cybersecurity risks or incidents. While existing disclosure requirements may apply to material cybersecurity incidents and various cybersecurity risks and mitigation efforts, as highlighted in the 2011 Staff Guidance and the 2018 Interpretive Release, the existing disclosure requirements are more general in nature, and the resulting disclosures have not been consistently sufficient or necessarily informative.

Specifically, regarding incident reporting, there is concern that material cybersecurity incidents are underreported,[127] and staff has observed that certain cybersecurity incidents were reported in the media but not disclosed in a registrant's filings.[128] Even when registrants have filed Form 8–K to report an incident, the Form 8–K did not necessarily state whether or not the incident was material, and in some cases, the Form 8–K stated that the incident was immaterial.[129] By requiring registrants to disclose material cybersecurity incidents in a current report and disclose any material changes, additions, or updates in a periodic report, the proposed amendments could elicit more incident reporting. Because the proposed incident disclosure requirements also specify that registrants would disclose information such as when the incident was discovered, and the nature and scope of the incident, they could also result in more informative incident reporting.

Similarly, the proposed disclosure about cybersecurity risk management, strategy, and governance would include a number of specific items that registrants must disclose. For instance, the proposed rules would require disclosure regarding a registrant's policies and procedures for identifying and managing cybersecurity risks.[130] The proposed rules would also require disclosure concerning whether and how cybersecurity considerations affect a registrant's selection and oversight of third-party service providers because a significant number of cybersecurity incidents pertain to third party service providers.[131] As a result, the proposed rules related to risk management, strategy, and governance could also lead to more informative disclosure to investors.

We anticipate the proposed cybersecurity incident reporting would also lead to more timely disclosure to investors. As discussed above, currently, it could take months for registrants to disclose a material cybersecurity incident after its discovery.[132] The proposed amendments would require these incidents to be disclosed in a current report on Form 8–K within four business days after the registrant determines that it has experienced a material cybersecurity incident.

More informative and timely disclosure as a result of the proposed amendments would benefit investors because the enhanced disclosure could allow them to better understand the impact of a cybersecurity incident on the registrant, the risk a registrant is facing and its ability to manage the risk. Such information is relevant to the valuation of registrants' securities and thereby investors' decision making. It is well documented in the academic literature that the market reacts negatively to announcements of cybersecurity incidents. For example, one study finds a significant mean cumulative abnormal return of –0.84% in the three days following cyberattack announcements, which, according to the study, translates into an average value loss of $495 million per attack.[133] Another study finds that firms with higher exposure to cybersecurity risk have a higher cost of capital, suggesting

[124] *See infra* section IV.

[125] *Id.*

[126] Throughout this section, we use the term ''both types of disclosure'' to refer to the disclosure of (1) cybersecurity incidents and (2) cybersecurity risk management, strategy, and governance.

[127] *See supra* section II.B and note 46.

[128] *See supra* section I.B.

[129] Based on staff analysis of the current and periodic reports in 2021 for companies identified by as having been affected by a cybersecurity incident.

[130] *See supra* section II.D.

[131] *See supra* section II.D.

[132] *See supra* note 95, section III.A.

[133] *See* Shinichi Kamiya, Jun-Koo Kang, Jungmin Kim, Andreas Milidonis, and René M. Stulz, *Risk Management, Firm Reputation, and the Impact of Successful Cyberattacks on Target Firms,* 139 (3) J. of Fin. Econ. 721, 719–749 (2021). *See also* Lawrence A. Gordon, Martin P. Loeb, and Lei Zhou, *The Impact of Information Security Breaches: Has There Been a Downward Shift in Costs?,* 19 (1) J. of Comput. Sec. 33, 33–56 (2011) (finding ''the impact of the broad class of information security breaches on stock market returns of firms is significant''); *see also* Georgios Spanos and Lefteris Angelis, *The Impact of Information Security Events to the Stock Market: A Systematic Literature Review,* 58 Comput. & Sec. 216–229 (2016) (documenting that the majority (75.6%) of the studies the paper reviewed report statistical significance of the impact of security events to the stock prices of firms). *But see* Katherine Campbell, Lawrence A. Gordon, Martin P. Loeb, and Lei Zhou, *The Economic Cost of Publicly Announced Information Security Breaches: Empirical Evidence From the Stock Market,* 11 (3) J. of Comput. Sec. 432, 431–448 (2003) (while finding limited evidence of an overall negative stock market reaction to public announcements of information security breaches, they also find ''the nature of the breach affects this result'', and ''a highly significant negative market reaction for information security breaches involving unauthorized access to confidential data, but no significant reaction when the breach does not involve confidential information''; they thus conclude that ''stock market participants appear to discriminate across types of breaches when assessing their economic impact on affected firms'').

that this risk is important to investors.[134] Therefore, whether a registrant is prepared for cybersecurity risks and has adequate cybersecurity risk management, strategy, and governance measures in place to reduce the likelihood of future incidents are important information for investors and the market. Delayed or incomplete reporting of cybersecurity incidents and risks could lead to mispricing of the securities and information asymmetry in the market, harming investors.

In addition, the mispricing resulting from delayed or limited disclosure could be exploited by the malicious actors who caused a cybersecurity incident, or those who could access and trade on material information stolen during a cybersecurity incident, causing further harm to investors.[135] Malicious actors may trade ahead of an announcement of a data breach that they caused or pilfer material information to trade on ahead of company announcements. Trading on undisclosed cybersecurity information is particularly pernicious, because profits generated from this type of trading would provide incentives for malicious actors to ''create'' more incidents and proprietary information to trade on.[136] More informative and timely disclosure as a result of the proposed amendments would reduce mispricing and information asymmetry, and thereby reduce opportunities for malicious actors to exploit the mispricing, all of which would enhance investor protection.

Overall, we believe enhanced disclosure as a result of the proposed amendments could benefit investors by allowing them to make more informed decisions. Similarly, other market participants that rely on financial statement information to provide services to investors would also benefit, because more informative and timely disclosure would allow them to better understand a registrant's cybersecurity risks and ability to manage such risks. As a result, they would be able to better evaluate registrants' securities and provide better recommendations.

However, we note that the potential benefit could be reduced to the extent that registrants have already been providing the relevant disclosures.

We are unable to quantify the potential benefit to investors and other market participants as a result of the increase in disclosure and improvement in pricing under the proposed amendments. The estimation requires information about the fundamental value of securities and the extent of the mispricing. We do not have access to such information, and therefore cannot provide a reasonable estimate.

(ii) Greater Uniformity and Comparability

The proposed disclosure about cybersecurity incidents and cybersecurity risk management, strategy, and governance could also lead to more uniform and comparable disclosures, benefiting investors by lowering their search costs and information processing costs. As discussed in Section I, while some registrants currently file Form 8–K to report an incident, their reporting practices vary widely.[137] Some provide a discussion of materiality, the estimated costs of an incident, or the remedial steps taken as a result of an incident, while others do not provide such disclosure or provide much less detail in their disclosure. Disclosures related to risk management, strategy, and governance also vary significantly across registrants—such information could be disclosed in places such as the risk factors section, or in the management's discussion and analysis section of Form 10–K, or not at all. Investors currently may find it costly to compare the disclosures of different companies because they would have to spend time to search and retrieve information from different locations. For both types of disclosures, the proposed amendments would specify the topics to be disclosed and the reporting sections to include such disclosures, and as a result, both the incident disclosure and risk management, strategy, and governance disclosure should be more uniform across registrants, making it easier to compare. By specifying a set of topics that registrants should disclose, the proposed disclosure requirement should provide investors and other market participants with a benchmark of a minimum set of information for registrants to disclose, allowing them to better evaluate and compare registrants' cybersecurity risk and disclosure.

We note that to the extent that the disclosures related to cybersecurity risk management, strategy, and governance become too uniform or ''boilerplate,'' the benefit of comparability may be diminished. However, we also note that given the level of the specificity that would be required, the resulting disclosures are unlikely to become boilerplate.

The proposed requirement to tag the cybersecurity disclosure in Inline XBRL would likely augment the aforementioned informational and comparability benefits by making the proposed disclosures more easily retrievable and usable for aggregation, comparison, filtering, and other analysis. XBRL requirements for public operating company financial statement disclosures have been observed to mitigate information asymmetry by reducing information processing costs, thereby making the disclosures easier to access and analyze.[138]

While these observations are specific to operating company financial statement disclosures and not to disclosures outside the financial statements, such as the proposed cybersecurity disclosures, they suggest that the proposed Inline XBRL requirements could directly or indirectly (*i.e.,* through information intermediaries such as financial media, data aggregators, and academic researchers) provide investors with increased insight into cybersecurity-related information at specific companies and across companies, industries, and time periods.[139] Also,

[134] *See* Chris Florakis, Christodoulos Louca, Roni Michaely, and Michael Weber, *Cybersecurity Risk.* (No. w28196), Nat'l Bureau of Econ. Rsch, (2020).

[135] *See* Joshua Mitts and Eric Talley, *Informed Trading and Cybersecurity Breaches,* 9 Harv. Bus. L. Rev. 1 (2019) (''In many respects, then, the cyberhacker plays a role in creating and imposing a unique harm on the targeted company—one that (in our view) is qualitatively different from ''exogenous'' information shocks serendipitously observed by an information trader. Allowing a coordinated hacker-trader team to capture these arbitrage gains would implicitly subsidize the very harm-creating activity that is being ''discovered'' in the first instance.'').

[136] *Id.*

[137] *See supra* section I.B.

[138] *See, e.g.,* J.Z. Chen, H.A. Hong, J.B. Kim, and J.W. Ryou, *Information processing costs and corporate tax avoidance: Evidence from the SEC's XBRL mandate,* 40 J. of Acct. and Pub. Pol'y. 2 (finding XBRL reporting decreases likelihood of firm tax avoidance because ''XBRL reporting reduces the cost of IRS monitoring in terms of information processing, which dampens managerial incentives to engage in tax avoidance behavior''); *see also* P.A. Griffin, H.A., Hong, J–B, Kim, and Jee-Hae Lim, *The SEC's XBRL Mandate and Credit Risk: Evidence on a Link between Credit Default Swap Pricing and XBRL Disclosure,* 2014 American Accounting Association Annual Meeting (2014) (finding XBRL reporting enables better outside monitoring of firms by creditors, leading to a reduction in firm default risk); *see also* E. Blankespoor, *The Impact of Information Processing Costs on Firm Disclosure Choice: Evidence from the XBRL Mandate,* 57 J. of Acc. Res. 919, 919–967 (2019) (finding ''firms increase their quantitative footnote disclosures upon implementation of XBRL detailed tagging requirements designed to reduce information users' processing costs,'' and ''both regulatory and non-regulatory market participants play a role in monitoring firm disclosures,'' suggesting ''that the processing costs of market participants can be significant enough to impact firms' disclosure decisions'').

[139] *See, e.g.,* N. Trentmann, *Companies Adjust Earnings for Covid–19 Costs, but Are They Still a One-Time Expense?,* The Wall Street J. (2020) (citing an XBRL research software provider as a source for the analysis described in the article); *see also Bloomberg Lists BSE XBRL Data,* XBRL.org (2018); *see also* R. Hoitash, and U. Hoitash,

unlike XBRL financial statements (including footnotes), which consist of tagged quantitative and narrative disclosures, the proposed cybersecurity disclosures would consist largely of tagged narrative disclosures.[140] Tagging narrative disclosures can facilitate analytical benefits such as automatic comparison or redlining of these disclosures against prior periods and the performance of targeted artificial intelligence or machine learning assessments (tonality, sentiment, risk words, etc.) of specific cybersecurity disclosures rather than the entire unstructured document.[141]

b. Benefits to Registrants [142]

The proposed amendments regarding both incident reporting and risk management, strategy, and governance disclosure could potentially lower registrants' cost of capital, especially for those who currently have strong cybersecurity risk management, strategy, and governance measures in place. Economic theory suggests that better disclosure could reduce information asymmetry between management and investors, reducing the cost of capital, and thereby improving firms' liquidity and their access to capital markets.[143] In an asymmetric information environment, investors recognize that registrants may take advantage of their position by issuing securities at a price that is higher than justified by the issuer's fundamental value. As a result, investors demand a discount to compensate for the risk of adverse selection. This discount translates into a higher cost of capital.[144] By providing more disclosure, the firm can reduce the risk of adverse selection faced by investors and the discount they demand, ultimately decreasing the firm's cost of capital.[145] Applying this theory to cybersecurity disclosure, the increased disclosure as a result of the proposed amendments could decrease the cost of capital and increase firm value.

The proposed amendments' effect on cost of capital might vary depending on registrants' current level of cybersecurity risk management, strategy, and governance and whether they are already making disclosures regarding their efforts. To the extent that they have not been making the proposed disclosure, registrants with stronger cybersecurity risk management, strategy, and governance measures could be priced more favorably under the proposed amendments because the proposed disclosure would allow the market to better differentiate them from the registrants with less robust measures. To the extent that some registrants are already making disclosures about their robust cybersecurity risk management, strategy, and governance programs, these registrants would benefit less. However, if registrants that previously had less robust cybersecurity risk management, strategy, and governance disclose improvements in their cybersecurity risk management, strategy, and governance in response to the proposed amendments, their cost of capital could also decrease.

Registrants could also benefit from more uniform regulations regarding the timing of disclosures and the types of cybersecurity incident and risk disclosures as a result of the proposed amendments. Currently, the stigma or reputation loss associated with cybersecurity breaches may result in companies limiting reporting about or delaying reporting of cybersecurity incidents.[146] If all registrants are required to report cybersecurity incidents on Form 8–K within four business days as proposed, this could reduce the reputation costs that any one company might suffer after reporting an attack and also reduce the incentives to underreport.

In addition, by formalizing the disclosure requirements related to cybersecurity incidents and cybersecurity risk management, strategy, and governance and specifying the topics to be discussed, the proposed amendments could reduce compliance costs for those registrants who are currently providing disclosure about these topics. The compliance costs would only be reduced to the extent that those registrants may be over-disclosing information, because there is uncertainty about what is required under the current rules. For instance,

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Measuring Accounting Reporting Complexity with XBRL, 93 Account. Rev. 259 (2018).

[140] The proposed cybersecurity disclosure requirements do not expressly require the disclosure of any quantitative values; if a registrant includes any quantitative values that are nested within the required discussion (*e.g.,* disclosing the number of days until containment of a cybersecurity incident), those values would be individually detail tagged, in addition to the block text tagging of the narrative disclosures.

[141] To illustrate, without Inline XBRL, using the search term ''remediation'' to search through the text of all registrants' filings over a certain period of time, so as to analyze the trends in registrants' disclosures related to cybersecurity incident remediation efforts during that period, could return many narrative disclosures outside of the cybersecurity incident discussion (*e.g.,* disclosures related to potential environmental liabilities in the risk factors section). If Inline XBRL is used, however, it would enable a user to search for the term ''remediation'' exclusively within the proposed cybersecurity disclosures, thereby likely reducing the number of irrelevant results.

[142] While registrants are legally distinct entities from investors, benefits and costs to registrants as a result of the proposed amendments would ultimately accrue to their investors.

[143] *See* Douglas W. Diamond and Robert E. Verrecchia, *Disclosure, Liquidity, and the Cost of Capital,* 46 J. Fin. 1325, 1325–1359 (1991) (finding that revealing public information to reduce information asymmetry can reduce a firm's cost of capital through increased liquidity). *See also* Christian Leuz and Robert E. Verrecchia, *The Economic Consequences of Increased Disclosure,* 38 J. Acct. Res. 91 (2000) (providing empirical evidence that increased disclosure lowers the information asymmetry component of the cost of capital in a sample of German firms); *see also* Christian Leuz and Peter D. Wysocki, *The Economics of Disclosure and Financial Reporting Regulation: Evidence and Suggestions for Future Research,* 54 J. Acct. Res. 525 (2016) (providing a comprehensive survey of the literature on the economic effect of disclosure).

[144] *See* Leuz and Verrecchia, *The Economic Consequences of Increased Disclosure,* 38 J. Acct. Res. 91 (2000) (stating: ''A brief sketch of the economic theory is as follows. Information asymmetries create costs by introducing adverse selection into transactions between buyers and sellers of firm shares. In real institutional settings, adverse selection is typically manifest in reduced levels of liquidity for firm shares (*e.g.,* Copeland and Galai [1983], Kyle [1985], and Glosten and Milgrom [1985]). To overcome the reluctance of potential investors to hold firm shares in illiquid markets, firms must issue capital at a discount. Discounting results in fewer proceeds to the firm and hence higher costs of capital. A commitment to increased levels of disclosure reduces the possibility of information asymmetries arising either between the firm and its shareholders or among potential buyers and sellers of firm shares. This, in turn, should reduce the discount at which firm shares are sold, and hence lower the costs of issuing capital (*e.g.,* Diamond and Verrecchia [1991] and Baiman and Verrecchia [1996]).'').

[145] Although disclosure could be beneficial for the firm, several conditions must be met for firms to voluntarily disclose all their private information. *See* Anne Beyer, Daniel A. Cohen, Thomas Z. Lys, and Beverly R. Walther, *The Financial Reporting Environment: Review Of The Recent Literature,* 50 J. Acct. & Econ. 296, 296–343 (2010) (discussing conditions under which firms voluntarily disclose all their private information, and these conditions include ''(1) disclosures are costless; (2) investors know that firms have, in fact, private information; (3) all investors interpret the firms' disclosure in the same way and firms know how investors will interpret that disclosure; (4) managers want to maximize their firms' share prices; (5) firms can credibly disclose their private information; and (6) firms cannot commit ex-ante to a specific disclosure policy.''). Increased reporting could also help determine the effect of investment on firm value. *See* Lawrence A. Gordon, Martin P. Loeb, William Lucyshyn, and Lei Zhou, *The Impact of Information Sharing on Cybersecurity Underinvestment: A Real Options Perspective,* 34 (5) J. Acct. & Pub. Policy 509, 509–519 (2015) (arguing that ''information sharing could reduce the tendency by firms to defer cybersecurity investments.'').

[146] *See supra* note 133, Kamiya, at 720 (Kamiya et al.) (2021), (stating ''we find that successful cyberattacks have potentially economically large reputation costs in that the shareholder wealth loss far exceeds the out-of-pocket costs from the attack''). *See also* Eli Amir, Shai Levi, and Tsafrir Livne, *Do Firms Underreport Information on Cyber-Attacks? Evidence from Capital Markets,* 23 (3) Review of Accounting Studies 1177–1206 (2018) (finding evidence that is consistent with managers withholding information on cyber-attacks, and particularly the information on the more severe attacks).

the staff has observed that some registrants provide Form 8–K filings even when they do not anticipate the incident will have a material adverse impact on their business operations, or financial results.[147]

We are unable to quantify these potential benefits to registrants as a result of the proposed amendments due to lack of data. For example, we are unable to observe the actual cybersecurity risk registrants are facing. Without such information, we cannot provide a reasonable estimate on how registrants' cybersecurity risk and therefore their cost of capital may decrease.

2. Costs

We also recognize that enhanced cybersecurity disclosure could result in costs to registrants, depending on the timing and extent of the disclosure. These costs include potential increases in registrants' vulnerability, information uncertainty, and compliance costs. We discuss these costs below.

First, the proposed disclosure about cybersecurity incidents and cybersecurity risk management, strategy, and governance could potentially increase the vulnerability of registrants. Ever since the issuance of the 2011 Staff Guidance, concerns have been raised that providing detailed disclosures of cybersecurity incidents can create the risk of providing a road map for future attacks.[148] The concern is that malicious actors could use the disclosures to potentially gain insights into a registrant's practices on cybersecurity issues and thus better calibrate future attacks.

The proposed changes to Form 8–K and Form 6–K would require registrants to timely file current reports on these forms to disclose material cybersecurity incidents. The proposed disclosures include, for example, the nature and scope of the disclosed incident and whether the registrant has remediated or is currently remediating the incidents. While we have clarified that we would not expect a registrant to publicly disclose specific, technical information about its planned response to the incident or its cybersecurity systems, related networks and devices, or potential system vulnerabilities in such detail as would impede the registrant's response or remediation of the incident (to the extent that a registrant discloses information that could provide clues to malicious actors regarding a registrant's areas of vulnerability) it may face increased risk. Malicious actors could engage in further attacks based on the information, especially given that registrants would also need to make timely disclosure, which could mean that the underlying security issues might not have been completely resolved, thereby potentially exacerbating the ongoing attack. As a result, the proposed incident disclosure rules could potentially increase the vulnerability of registrants, imposing a cost on them and their investors.

Similar concerns could be raised about the proposed risk management, strategy, and governance disclosure. Specifically, proposed Item 407(j) would require registrants to disclose whether a member of its board of directors has cybersecurity expertise, and proposed new Items 106(b) and (c) would require registrants to provide specified disclosure regarding their cybersecurity policies and procedures and cybersecurity governance by a company's management and board. The required disclosure could provide malicious actors information about which companies lack a board of directors with cybersecurity expertise, and which ones have weak policies and procedures related to cybersecurity risk management, and allow such malicious actors to determine their targets accordingly.

However, academic research so far has not provided evidence that more detailed cybersecurity risk disclosures would necessarily lead to more attacks.[149] For example, one study finds that measures for specificity (*e.g.,* the uniqueness of the disclosure) do not have a statistically significant relation with subsequent cybersecurity incidents.[150] Another study finds that the disclosed security risk factors with risk-mitigation themes are less likely to be related to future breach announcements.[151] On the other hand, we note that the proposed amendments would require more details than under the current rules, and the uniformity of the proposed requirements might also make it easier for malicious actors to identify firms with deficiencies. Therefore, these findings might not be generalizable to the effects of the proposed amendments. Additionally, the costs resulting from this potential vulnerability might be partially mitigated to the extent that registrants may decide to enhance their cybersecurity risk management in anticipation of the increased disclosure.

Second, the proposed cybersecurity incident disclosure could potentially increase information uncertainty related to securities, because the disclosure about the impact of the incident on the registrant's operations may lack the precision needed for investors and the market to properly value these securities. While the proposed changes to Form 8–K could improve the timeliness of cybersecurity incident reporting and result in more disclosure about the impact of the incident on the registrant's operations, the proposed rules do not require registrants to quantify the impact of the incident. As a result, registrants' disclosure about the impact of a cybersecurity incident could be qualitative in nature or lack the precision needed for investors and the market to properly value the securities, potentially leading to information uncertainty, investor under or overreaction to certain disclosures, and thereby mispricing of registrants' securities.[152]

Additionally, while the proposed disclosure could have the overall effect of reducing registrants' cost of capital as discussed in Section III.C.1.b, we also recognize that a subset of registrants might experience an increase in costs of capital. More specifically, under the

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[147] *See supra* note 129 and accompanying text.

[148] *See, e.g.,* Roland L. Trope and Sarah Jane Hughes, *The SEC Staff's Cybersecurity Disclosure Guidance: Will It Help Investors or Cyber-Thieves More,* 2011 Bus. L. Today 2, 1–4 (2011).

[149] We note that the papers we cited below study the effect of voluntary disclosure and 2011 Staff Guidance. The results from these studies might not be generalizable to the mandatory disclosures under the proposed rules.

[150] *See* He Li, Won Gyun No, and Tawei Wang, *SEC's Cybersecurity Disclosure Guidance and Disclosed Cybersecurity Risk Factors,* 30 Int'l. J. of Acct. Info. Sys. 40–55 (2018) (stating: ''while Ferraro (2013) criticizes that the SEC did little to resolve the concern about publicly revealing too much information [that] could provide potential hackers with a roadmap for successful attacks, we find no evidence supporting such claim'').

[151] *See* Tawei Wang, Karthik N. Kannan, and Jackie Rees Ulmer, *The Association Between the Disclosure and the Realization of Information Security Risk Factors,* 24.2 Info. Sys. Rsch. 201, 201–218 (2013).

[152] *See* Daniel Kent, David Hirshleifer, and Avanidhar Subrahmanyam, *Investor Psychology and Security Market under-and Overreactions,* J. of Fin. 1839–1885 (1998) (showing that investor behavioral biases such as overconfidence can cause them to under- or over-react to information); *see* Nicholas Barberis, Andrei Shleifer, and Robert Vishny, *A Model of Investor Sentiment,* 49 (3) J. of Fin. Econ. 307–343 (1998) (presenting a model of investor sentiment to explain the empirical findings of underreaction of stock prices to news such as earnings announcements, and overreaction of stock prices to a series of good or bad news based on two psychological phenomena, conservatism and representativeness heuristic); *see also* David Hirshleifer, *Investor Psychology and Asset Pricing,* 56 J. of Fin. 1533, 1533–1596 (2001) (stating: ''[m]ore generally, greater uncertainty about a set of stocks, and a lack of accurate feedback about their fundamentals, leaves more room for psychological biases. At the extreme, it is relatively hard to misperceive an asset that is nearly risk-free. Thus, the misvaluation effects of almost any mistaken-beliefs model should be strongest among firms about which there is high uncertainty/poor information (cash flow variance is one possible proxy).'').

proposed amendments, registrants with less robust cybersecurity risk management measures might be priced more unfavorably compared to those with stronger measures, potentially leading to an increase in cost of capital for these registrants. This is because the increased transparency as a result of the proposed disclosure could allow investors to better differentiate registrants' preparedness and ability to manage cybersecurity risks. However, except for this scenario, we expect that registrants overall would benefit from reduced cost of capital as a result of the proposed disclosure as discussed in Section III.C.1.b.

Finally, the proposed rules would impose compliance costs for registrants. Registrants would incur one-time and ongoing costs to fulfill the proposed new disclosure requirements under Items 106 and 407 of Regulation S–K. These costs would include costs to gather the information and prepare the disclosures.

Registrants would also incur compliance costs to fulfill the proposed disclosure requirements related to Form 8–K (Form 6–K for FPIs) incident reporting and Form 10–Q/10–K (Form 20–F for FPIs) ongoing reporting.[153] These costs include one-time costs to implement or revise their incident disclosure practices, so that any registrant that determines it has experienced a material cybersecurity incident would disclose such incident with the required information within four business days. Registrants would also incur ongoing costs to disclose in a periodic report any material changes, additions, or updates relating to previously disclosed incidents, and to monitor whether any previously undisclosed immaterial cybersecurity incidents have become material in the aggregate, triggering a disclosure obligation. The costs would be mitigated for registrants whose current disclosure practices match or are similar to those that are proposed. To the extent that registrants fall under other incident reporting requirements or cybersecurity risk management, strategy, and governance mandates as outlined in Section III.B.1, their costs from the proposed amendments would be mitigated as well.

We note that BDCs could be subject to both the proposed rules and rule amendments in the Investment Management Cybersecurity Proposing Release[154] and those proposed in this release if both proposals were to be adopted. To the extent that BDCs would need to provide substantively the same or similar disclosure on both Form 8–K and in registration statements, the compliance costs could be duplicative. However, the potential duplication should not result in a significant increase in compliance costs, because BDCs should be able to provide similar disclosure for both sets of rules.[155]

The compliance costs would also include costs attributable to the Inline XBRL tagging requirements. Various preparation solutions have been developed and used by operating companies to fulfill XBRL requirements, and some evidence suggests that, for smaller companies, XBRL compliance costs have decreased over time.[156] The incremental compliance costs associated with Inline XBRL tagging of cybersecurity disclosures would also be mitigated by the fact that most registrants who would be subject to the proposed requirements are already subject to other Inline XBRL requirements for other disclosures in Commission filings, including financial statement and cover page disclosures in certain periodic reports and registration statements.[157] Such registrants may be able to leverage existing Inline XBRL preparation processes and expertise in complying with the proposed cybersecurity disclosure tagging requirements. Asset-backed securities issuers, however, are not subject to Inline XBRL requirements in Commission filings and would likely incur initial Inline XBRL compliance implementation costs (such as the cost of training in-house staff to prepare filings in Inline XBRL, and the cost to license Inline XBRL filing preparation software from vendors).[158]

Other than the Paperwork Reduction Act costs discussed in Section IV below, we are unable to quantify the potential increase in costs related to the proposed rules due to the lack of data. For example, we lack data to estimate how registrants' cybersecurity vulnerability would change under the proposal, because such change would depend on their current level of vulnerability. We are also unable to estimate the potential increase in mispricing as a result of the information uncertainty, because the level of the uncertainty would depend on registrants' disclosure.

3. Indirect Economic Effects

Besides the direct economic effects on investors, registrants and other market participants we discussed above, we recognize that the proposed amendments could also indirectly affect registrants and external stakeholders, such as consumers, companies in the same industry with registrants or those facing similar cybersecurity threats.

While the proposal would only require disclosures—not changes to registrants' board composition or risk management practices—the disclosures themselves could result in certain indirect benefits. Registrants might respond to the proposed disclosures by devoting more resources to cybersecurity governance and risk management. To the extent that registrants may decide to enhance their cybersecurity risk management in anticipation of the increased disclosure, it could reduce registrants' susceptibility to a cybersecurity-attack and thereby the likelihood of future incidents, indirectly benefiting registrants.

Registrants may also decide to incur certain indirect costs as a result of the proposed amendments. For example, the proposed rules would require disclosure of whether members of the board or management staff have expertise in cybersecurity.

[153] We note that the compliance costs related to Form 6–K filings would be mitigated, because a condition of the form is that the information is disclosed or required to be disclosed elsewhere.

[154] *See* Investment Management Cybersecurity Proposing Release.

[155] *See infra* section VI.E.

[156] An AICPA survey of 1,032 reporting companies with $75 million or less in market capitalization in 2018 found an average cost of $5,850 per year, a median cost of $2,500 per year, and a maximum cost of $51,500 per year for fully outsourced XBRL creation and filing, representing a 45% decline in average cost and a 69% decline in median cost since 2014. *See* Michael Cohn, *AICPA Sees 45% Drop in XBRL Costs for Small Companies,* Accounting Today (Aug. 15, 2018) (stating that a 2018 NASDAQ survey of 151 listed registrants found an average XBRL compliance cost of $20,000 per quarter, a median XBRL compliance cost of $7,500 per quarter, and a maximum, XBRL compliance cost of $350,000 per quarter in XBRL costs per quarter), *available at https://www.accountingtoday.com/news/aicpa-sees-45-drop-in-xbrl-costs-for-small-reporting-companies* (retrieved from Factiva database); Letter from Nasdaq, Inc. (March 21, 2019) (to the Request for Comment on Earnings Releases and Quarterly Reports); *see* Release No. 33–10588 (Dec. 18, 2018) [83 FR 65601 (Dec. 21, 2018)].

[157] *See* 17 CFR 229.601(b)(101) and 17 CFR 232.405 (for requirements related to tagging financial statements, including footnotes and schedules in Inline XBRL). *See* 17 CFR 229.601(b)(104) and 17 CFR 232.406 (for requirements related to tagging cover page disclosures in Inline XBRL).

[158] *See infra* section IV.

Although not required, some registrants may respond by adding a board member or staff to their management team with cybersecurity expertise. Similarly, the proposed rules would require disclosure on policies and procedures to identify and manage cybersecurity risks. While not required under the proposed rules, it is possible that registrants would respond by allocating more resources to devise, implement, or improve their policies and procedures related to cybersecurity to the extent they currently do not have similar policies and procedures in place. Similarly, indirect costs could result if a registrant were to decide to hire a chief information security officer or other individuals with cybersecurity expertise to their management team. Further, if many registrants move to add a board member or staff to their management team with cybersecurity expertise, or a chief information security officer at the same time, the costs to registrants associated with adding such individuals may increase if demand for cybersecurity expertise increases. This is especially true to the extent that certain relevant certifications or degrees are seen as important designations of cybersecurity expertise and there are a limited pool of individuals holding such certifications.

In addition, the proposed requirement to tag the cybersecurity disclosure in Inline XBRL could have indirect effects on registrants. As discussed in section III.C.1.a.(ii), XBRL requirements for public operating company financial statement disclosures could reduce information processing cost. This reduction in information processing cost has been observed to facilitate the monitoring of companies by other market participants, and, as a result, to influence companies' behavior, including their disclosure choices.[159]

The proposed amendments to require registrants to timely disclose material cybersecurity incidents could indirectly benefit external stakeholders such as other companies in the same industry, those facing similar cybersecurity threats or consumers. Cybersecurity incidents could result in costs not only to the company that suffers the incident, but also to other businesses and consumers. For example, a cybersecurity breach at one company may cause a major disruption or shut down of a critical infrastructure industry, such as a gas pipeline, a bank, or power company, resulting in massive losses throughout the economy.[160] Timely disclosure of cybersecurity incidents as proposed could increase awareness by those external stakeholders that the malicious activities are occurring. More specifically, for companies in the same industry as registrants or for those facing similar cybersecurity threats, the proposed disclosure could alert them to a potential threat and allow them to better prepare for a specific potential cybersecurity attack. To the extent that the proposed amendments increase available disclosure, consumers may benefit from learning the extent of a particular cybersecurity breach, and therefore take appropriate actions to limit potential economic costs that they may incur from the breach. For example, there is evidence that increased disclosure of cybersecurity incidents by registrants can reduce the risk of identity theft for individuals.[161] Also, consumers may be able to make better informed decisions about which companies to trust with their personal information.

In addition, the proposed amendments regarding cybersecurity risk management, strategy, and governance disclosure could indirectly benefit external stakeholders through potentially reduced likelihood of future incidents and negative externalities associated with the incidents. As discussed above, to the extent that registrants may decide to enhance their cybersecurity risk management in anticipation of the increased disclosure, it could reduce registrants' susceptibility to a cybersecurity-attack and thereby the likelihood of future incidents, leading to positive spillover effects.

We are unable to quantify the indirect effects as a result of the proposed amendments because we lack data or basis to estimate the potential changes in disclosure of cybersecurity incidents, risk management, strategy, and governance disclosure and the reduction in negative spill-over effects.

D. Anticipated Effects on Efficiency, Competition, and Capital Formation

Overall, we believe the proposed rules could have positive effects on market efficiency. As discussed above, the proposed rules could improve the timeliness and informativeness of cybersecurity risk disclosure. Investors and other market participants could better understand the cybersecurity threats registrants are facing, their potential impact, and registrants' ability to respond to and manage risks under the proposed rules, and thereby better evaluate registrants' securities and make more informed decisions. As a result, the proposed disclosures could reduce information asymmetry and mispricing in the market, improving liquidity and market efficiency. However, we also recognize that, because registrants' disclosure about the impact of a cybersecurity incident could be qualitative in nature and lack the precision needed for investors and the market to properly value the securities, the proposed incident disclosure might lead to information uncertainty and investor overreaction. We believe such effect should be reduced by more informative reporting from other aspects of the proposed disclosure and subsequent updates in periodic reports.

A more efficient market as a result of the proposed rules could promote competition among firms. Because the enhanced incident reporting and cybersecurity risk management, strategy, and governance disclosure could allow investors to better evaluate the relative cybersecurity risks for different registrants, firms that disclose robust cybersecurity risk management, strategy, and governance could benefit from a competitive advantage relative to firms that do not. This could have a secondary effect of further incentivizing firms that to-date have invested less in cybersecurity preparation to invest more, to the benefit of investors, in order to become more competitive.

[159] *See supra* note 138.

[160] *See* Lawrence A. Gordon, Martin P. Loeb, William Lucyshyn, and Lei Zhou, *Externalities and the Magnitude of Cyber Security Underinvestment by Private Sector Firms: A Modification of the Gordon-Loeb Model,* 6 (1) J. of Info. Sec. 24, 24–30 (2014) (stating: ''[f]irms in the private sector of many countries own a large share of critical infrastructure assets. Hence, cybersecurity breaches in private sector firms could cause a major disruption of a critical infrastructure industry (*e.g.,* delivery of electricity), resulting in massive losses throughout the economy, putting the defense of the nation at risk.''). We note that this study focused on private firms; however, same statement could be made about public companies that own a large share of critical infrastructure assets. *See also U.S. Pipeline Cyberattack Forces Closure,* Wall St J., *available at https://www.wsj.com/articles/cyberattack-forces-closure-of-largest-u-s-refined-fuel-pipeline-11620479737.*

[161] *See* Sasha Romanosky, Rahul Telang, and Alessandro Acquisti, *Do Data Breach Disclosure Laws Reduce Identity Theft*?, 30 (2) J. of Pol'y. Analysis and Mgmt. 272, 256–286 (2011) (finding that the adoption of state-level data breach disclosure laws reduced identity theft by 6.1 percent).

More efficient prices and more liquid markets could help allocate capital to its most efficient uses. Enhanced disclosure of cybersecurity incidents and cybersecurity risk management, strategy, and governance could allow investors to make more informed investment decisions. As a result, companies that disclose more robust cybersecurity risk management, strategy, and governance and thus may be less susceptible to cybersecurity incidents may receive more capital allocation. By making information related to material incident available to the public sooner, and reducing the information asymmetry, the proposed amendments could increase public trust in markets, thereby aiding in capital formation.

D. Reasonable Alternatives

1. Website Disclosure

As an alternative to Form 8–K disclosure of material cybersecurity incidents, we considered providing companies with the option of disclosing this information through company websites, instead of through filing a Form 8–K, when the company has disclosed its intention to do so in its most recent annual report and subject to information availability and retention requirements. While this approach may be less costly for the registrant as it may involve fewer compliance costs and less legal liability compared to a filing of a Form 8–K, the website disclosure would not be located in the same place as other companies' disclosures of material cybersecurity incidents. Also, disclosures made on company websites would not be organized into the standardized sections found in Form 8–K and could thus be less uniform.

The lack of a central repository, such as the EDGAR system,[162] and a lack of uniformity of website disclosures could increase the costs for investors and other market participants to search for and process the information to compare cybersecurity risks across registrants. Additionally, such disclosure might not be preserved on the company's website for as long as it would be when the disclosure is filed with the Commission, because companies may not keep historical information available on their websites indefinitely. They also may go out of business, and thus, there could be information loss to investors when disclosures are deleted from websites. Therefore, this approach would be less beneficial to investors, other market participants, and the overall efficiency of the market.

2. Disclosure Through Form 10–Q and Form 10–K

We also considered requiring disclosure of material cybersecurity incidents through Form 10–Q or Form 10–K instead of Form 8–K. Reporting material cybersecurity incidents at the end of the quarter or year would allow registrants more time to assess the financial impact of such incidents. The resulting disclosure might be more specific or informative for investors and other market participants to value the securities and make more informed decisions. The compliance costs would be less under this alternative, because registrants would not have an obligation to file Form 8–K. With lower compliance costs under this alternative, registrants could use the resources that would go towards disclosure on Form 8–K to instead fill gaps in their cybersecurity defenses exposed by the attack, potentially making it less likely that malicious actors would be able to exploit such vulnerabilities.

However, it would lead to less timely reporting on material cybersecurity incidents. As a result, the market would not be able to incorporate the information related to cybersecurity risk into the security prices in as timely a manner, and investors and other market participants would not be able to make as informed decisions as they could under the proposed approach.

3. Exempt Smaller Reporting Companies

We also considered exempting smaller reporting companies from proposed Item 106 and Item 407, because smaller companies might incur a cost that is disproportionally high, compared to larger companies under the proposed rules. As discussed above, proposed disclosure might expose registrants' cybersecurity weakness and increase their vulnerability. To avoid the potential exposure, smaller companies might increase spending related to cybersecurity risk management measures, which could be disproportionately costly. Also, to the extent that they do not have similar disclosure practices in place currently, it might be relatively more costly for smaller companies to implement the proposed disclosure requirements than larger companies, because they may have fewer resources.

However, evidence suggests that smaller companies may have an equal or greater risk than larger companies of being attacked, making the proposed disclosures particularly important for their investors.[163] The financial impact from an attack could also be more detrimental for smaller companies than for larger ones. To the extent that one indirect effect of the proposed disclosure may be that companies take additional steps to address potential vulnerabilities or enhance their cybersecurity risk management, strategy, and governance, any resulting reduction in vulnerability may be particularly beneficial for smaller companies and their investors.

4. Modify Scope of Inline XBRL Requirement

We also considered changing the scope of the proposed tagging requirements, such as by excluding certain subsets of registrants. For example, the proposed tagging requirements could have excluded asset-backed securities issuers, which are not currently required to tag any filings in Inline XBRL.[164] Under such an alternative, asset-backed securities issuers would submit their cybersecurity disclosures in unstructured HTML or ASCII, and thereby avoid the initial Inline XBRL implementation costs (such as the cost of training in-house staff to prepare filings in Inline XBRL, and the cost to license Inline XBRL filing preparation software from vendors) and ongoing Inline XBRL compliance burdens that would result from the proposed tagging requirement.[165] However, narrowing the scope of the proposed tagging requirements, whether based on registrant type, size, or other criteria, would diminish the extent of any informational benefits that would accrue as a result of the proposed disclosure requirements by making the excluded registrants' cybersecurity disclosures comparatively costlier to process and analyze.

[162] EDGAR, the Electronic Data Gathering, Analysis, and Retrieval system, is the primary system for companies and others submitting documents under the Securities Act, the Exchange Act, the Trust Indenture Act of 1939, and the Investment Company Act. EDGAR's public database can be used to research a public company's financial information and operations.

[163] *See supra* note 18.

[164] *See supra* note 157.

[165] *See infra* section IV. The Commission's EDGAR electronic filing system generally requires filers to use ASCII or HTML for their document submissions, subject to certain exceptions. *See* EDGAR Filer Manual (Volume II) version 60 (December 2021), at 5–1; 17 CFR 232.301 (incorporating EDGAR Filer Manual into Regulation S–T). *See also* 17 CFR 232.101 (setting forth the obligation to file electronically on EDGAR). To the extent asset-backed securities issuers are affiliated with registrants that are subject to Inline XBRL requirements, they may be able to leverage those registrants' existing Inline XBRL tagging experience and software, which would mitigate the initial Inline XBRL implementation costs that asset-backed securities issuers would incur under the proposal.

Request for Comment

We request comment on all aspects of our economic analysis, including the potential costs and benefits of the proposed rules and alternatives thereto, and whether the proposed rules, if adopted, would promote efficiency, competition, and capital formation or have an impact on investor protection. In addition, we also seek comment on alternative approaches to the proposed rules and the associated costs and benefits of these approaches. Commenters are requested to provide empirical data, estimation methodologies, and other factual support for their views, in particular, on costs and benefits estimates. Specifically, we seek comment with respect to the following questions:

41. What are the economic effects of the proposed cybersecurity incident and cybersecurity risk management, strategy, and governance disclosures? Would those disclosures provide informational benefits to investors? Would registrants benefit from a potential decrease in cost of capital because of the enhanced disclosure? Are there any other benefits, costs, and indirect effects of the proposed disclosure that we should also consider?

42. Would the proposed cybersecurity incident disclosure provide enough information for investors to assess the impact of a cybersecurity incident in making an investment decision? Because the proposed incident disclosure would not require quantification of an incident's impact, would the lack of quantification create any uncertainty for investors which may cause them to under or overreact to the disclosure? Would investors benefit more if registrants were to provide the disclosure after the incident's impact is quantified or can be reasonably estimated? If so, what metrics should be disclose to help investors understand the impact?

43. Would both types of the proposed disclosure, cybersecurity incident disclosure and cybersecurity risk management, strategy, and governance disclosure, increase the vulnerability of registrants to cybersecurity incidents? Would this effect be mitigated by any of the other effects of the proposal, including indirect effects such as registrants' potential strengthening of cybersecurity risk management measures? What would be the impact of the proposed disclosure on the likelihood of future incidents for registrants? Would that impact be the same for both types of disclosure?

44. Would the proposed incident disclosure increase registrants' compliance costs to fulfill the proposed disclosure requirements related to incident reporting? What would be the magnitude of those costs? Would the proposed cybersecurity risk management, strategy, and governance disclosure lead to indirect costs such as hiring a board member or staff to their management team with cybersecurity expertise, or costs to devise, implement or improve the processes and procedures related to cybersecurity?

45. Would both types of the proposed disclosure lead to indirect economic effects for external stakeholders? Would the magnitude of the indirect effects be greater or less than we have discussed? Are there any other indirect effects that we should consider?

46. Are there any specific data points that would be valuable for assessing the economic effects of the proposed cybersecurity incident and risk management, strategy, and governance that we should consider in the baseline analysis or the analysis of the economic effects? If so, please provide that data.

47. Would any of the economic effects discussed above be more or less significant than in our assessment? Are any of the costs or benefits identified incorrectly for any of the proposed amendments? Are there any other economic effects associated with these proposed rules that we should consider? Are you aware of any data or methodology that can help quantify the benefits or costs of the proposed amendments?

48. Would any of the proposed amendments positively affect efficiency, competition and capital formation as we have discussed? Are there any other effects on efficiency, competition, and capital formation that we should consider?

49. Would any of the proposed amendments have disproportionate costs for smaller reporting companies? Do smaller reporting companies face a different set of cybersecurity risks than other companies?

50. Are there any other alternative approaches to improve disclosure of material cybersecurity incidents, cybersecurity risk management, strategy, or governance that we should consider? If so, what are they and what would be the associated costs or benefits of these alternative approaches?

51. Are there any other costs and benefits associated with alternative approaches that are not identified or are misidentified in the above analysis? Should we consider any of the alternative approaches outlined above instead of the proposed rules? Which approach and why?

IV. Paperwork Reduction Act

A. Summary of the Collection of Information

Certain provisions of our rules and forms that would be affected by the proposed amendments contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[166] The Commission is submitting the proposed amendments to the Office of Management and Budget (''OMB'') for review in accordance with the PRA.[167] The hours and costs associated with preparing and filing the forms constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to comply with, a collection of information unless it displays a currently valid OMB control number. Compliance with the information collections is mandatory. Responses to the information collections are not kept confidential and there is no mandatory retention period for the information disclosed. The titles for the affected collections of information are:

- ''Schedule 14C'' (OMB Control No. 3235–0057);
- ''Schedule 14A'' (OMB Control No. 3235–0059);
- ''Form 8–K'' (OMB Control No. 3235–0060);
- ''Form 10–K'' (OMB Control No. 3235–0063);
- ''Form 10–Q'' (OMB Control No. 3235–0070);
- ''Form 6–K'' (OMB Control No. 3235–0116); and
- ''Form 20–F'' (OMB Control No. 3235–0288).

We adopted the existing forms, pursuant to the Exchange Act. The forms set forth the disclosure requirements for periodic and current reports as well as proxy and information statements filed by issuers to help investors make informed investment and voting decisions. A description of the proposed amendments, including the need for the information and its proposed use, as well as a description of the likely respondents, can be found in Section II above, and a discussion of the economic effects of the proposed amendments can be found in Section III above.

[166] *See* 44 U.S.C. 3501 *et seq.*

[167] 44 U.S.C. 3507(d) and 5 CFR 1320.11.

B. Summary of the Estimated Burdens of the Proposed Amendments on the Collections of Information

Estimated Paperwork Burdens of the Proposed Amendments

The following table summarizes the estimated paperwork burdens associated with the proposed amendments to the affected forms.

PRA TABLE 1—ESTIMATED PAPERWORK BURDEN ASSOCIATED WITH THE PROPOSED NEW RULES AND AMENDMENTS *

Proposed requirements and effects	Affected forms and schedules	Estimated burden per response	Number of estimated affected responses
Form 8–K, Item 1.05:			
• Require disclosure regarding cybersecurity incidents.	Form 8–K	10 Hours	200 Filings.
Form 6–K:			
• Require disclosure regarding cybersecurity incidents.	Form 6–K	9 Hours	20 Filings.
Adding Item 106 Disclosures:			
• Require disclosure regarding policies and procedures. (Item 106(b)).	• Form 10–K	• Form 10–K: 15 Hours **	• Form 10–K: 8,292 Filings.
• Require disclosure regarding board and management oversight of cybersecurity risk. (Item 106(c)).	• Form 20–F	• Form 20–F: 16.5 Hours.	• Form 20–F: 729 Filings.
• Require updated disclosure regarding cybersecurity incidents (Item 106(d)).	• Form 10–Q (Item 106(d)).	• Form 10–Q: 5 Hours.	• Form 10–Q: 600 Filings.
Adding Item 407(j) disclosures:			
• Require disclosure on the cybersecurity expertise of members of the board of directors of the registrant, if any.	• Form 10–K • Schedule 14A • Schedule 14C.	• Form 10–K: 1.5 Hours • Schedule: 14A: 1.5 Hours. • Schedule 14C: 1.5 Hours ±.	• Form 10–K: Filings: 5,464 Filings. • Schedule 14A: 2,600 Filings. • Schedule 14C: 228 Filings.

* All of these burden estimates incorporate the proposed tagging requirements Rule 405 of Regulation S–T.

** We estimate that 600 of these filings will be increased by five hours due to the proposed Item 106(d) disclosure.

± The burden estimate for Form 10–K assumes that Schedules 14A and 14C would be the primary disclosure documents for the information provided in response to proposed Item 407(j) of Regulation S–K in connection with proxy and information statements involving the election of directors. In this case, we assume that the disclosure would be incorporated by reference in Form 10–K from the proxy or information statement.

Not every filing on the affected current forms, Form 6–K and Form 8–K, would include cybersecurity disclosures. These disclosures would be required only when a registrant has made the determination that it has experienced a material cybersecurity incident. Further, in the case of Form 6–K, the registrant would only have to provide the disclosure if it is required to disclose such information elsewhere.

The table below sets forth our estimates of the number of current filings on the forms which will be affected by the proposed rules. We used this data to extrapolate the effect of these changes on the paperwork burden for the listed periodic reports.[168]

PRA TABLE 3—ESTIMATED NUMBER OF AFFECTED FILINGS

Form	Current annual responses in PRA inventory	Estimated number of filings that would include cybersecurity disclosure
Schedule 14A	6,369	2,600
Schedule 14C	569	228
10–K	8,292	8,292
10–Q	22,925	600
20–F	729	729
8–K	118,387	200
6–K	34,794	20

C. Incremental and Aggregate Burden and Cost Estimates

Below we estimate the incremental and aggregate changes in paperwork burden as a result of the proposed amendments. These estimates represent the average burden for all respondents, both large and small. In deriving our estimates, we recognize that the burdens will likely vary among individual respondents based on a number of factors, including the nature of their business.

We calculated the additional burden estimates by multiplying the estimated additional burden per form by the estimated number of responses per form. That additional burden is then added to the existing burden per form. For purposes of the PRA, the burden is

[168] The OMB PRA filing inventories represent a three-year average. Averages may not align with the actual number of filings in any given year.

to be allocated between internal burden hours and outside professional costs. PRA Table 4 below sets forth the percentage estimates we typically use for the burden allocation for each collection of information and the estimated burden allocation for the proposed new collection of information. We also estimate that the average cost of retaining outside professionals is $400 per hour.[169]

PRA TABLE 4—ESTIMATED BURDEN ALLOCATION FOR THE AFFECTED COLLECTIONS OF INFORMATION

Collection of information	Internal (percent)	Outside professionals (percent)
Schedule 14A, Schedule 14C, Form 10–Q, Form 10–K, Form 6–K, and Form 8–K	75	25
Form 20–F	25	75

PRA Table 5 below illustrates the incremental change to the total annual compliance burden of affected forms, in hours and in costs, as a result of the proposed amendments' estimated effect on the paperwork burden per response.

PRA TABLE 5—CALCULATION OF THE INCREMENTAL CHANGE IN BURDEN ESTIMATES OF CURRENT RESPONSES RESULTING FROM THE PROPOSED AMENDMENTS

Collection of information	Number of estimated affected responses (A) [a]	Burden hour increase per response (B)	Change in burden hours (C) = (A) × (B)	Change in company hours (D) = (C) × 0.75 or .25	Change in professional hours (E) = (C) × 0.25 or .75	Change in professional costs (F) = (E) × $400
Schedule 14A	2,600	1.5	3,900	2,925	975	$390,000
Schedule 14C	228	1.5	342	256.50	85.50	34,200
10–K	8,292	15	124,380	93,285	31,095	12,438,000
10–K	5,464	1.5	8,196	6,147	2,049	819,600
10–Q	600	5	3,000	2,250	750	300,000
20–F	729	16.5	12,028.50	3,007.125	9,021.375	3,608,550
8–K	200	10	2,000	1,500	500	200,000
6–K	20	9	180	135	45	18,000

The following tables summarize the requested paperwork burden, including the estimated total reporting burdens and costs, under the proposed amendments.

PRA TABLE 6—REQUESTED PAPERWORK BURDEN UNDER THE PROPOSED AMENDMENTS *

Form	Current burden			Program change			Requested change in burden		
	Current annual responses (A)	Current burden hours (B)	Current cost burden (C)	Number of affected responses (D)	Change in company hours (E)	Change in professional costs (F)	Annual responses (G) = (A)	Burden hours (H) = (B) + (E)	Cost burden (I) = (C) + (F)
Schedule 14A	6,369	777,590	$103,678,712	2,600	2,925	$390,000	6,369	780,515	$104,068,712
Schedule 14C	569	56,356	7,514,944	228	256.50	34,200	569	56,613	7,529,144
Form 10–K	8,292	14,188,040	1,893,793,119	8,292 (Item 106). 5,464 (407(j))	99,432 93,285 (Item 106) 6,147 (407(j))	13,257,600 (12,438,000 + 819,600)	8,292	14,287,432	1,907,050,719
Form 10–Q	22,925	3,182,333	421,490,754	600	2,250	300,000	22,925	3,184,583	421,790,754
Form 20–F	729	479,261	576,824,025	729	3,007.125	3,608,550	729	482,268	580,432,575
Form 8–K	118,387	818,158	108,674,430	200	1,500	200,000	118,387	819,658	108,847,430
Form 6–K	34,794	227,031	30,270,780	20	135	18,000	34,794	227,166	30,288,780

* For purposes of the PRA, the requested change in burden hours (column H) is rounded to the nearest whole number.

Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comment in order to:

- Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility;
- Evaluate whether the Commission's estimates of the burden of the proposed collection of information are accurate;
- Determine whether there are ways to enhance the quality, utility, and

[169] We recognize that the costs of retaining outside professionals may vary depending on the nature of the professional services, but for purposes of this PRA analysis, we estimate that such costs would be an average of $400 per hour. This estimate is based on consultations with several issuers, law firms, and other persons who regularly assist issuers in preparing and filing reports with the Commission.

clarity of the information to be collected;

- Evaluate whether there are ways to minimize the burden of the collection of information on those who respond, including through the use of automated collection techniques or other forms of information technology; and
- Evaluate whether the proposed amendments would have any effects on any other collection of information not previously identified in this section.

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing these burdens. Persons submitting comments on the collection of information requirements should direct their comments to the Office of Management and Budget, Attention: Desk Officer for the U.S. Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and send a copy to Vanessa A. Countryman, Secretary, U.S. Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549, with reference to File No. S7–09–22 Requests for materials submitted to OMB by the Commission with regard to the collection of information requirements should be in writing, refer to File No. S7–09–22 and be submitted to the U.S. Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE, Washington DC 20549. OMB is required to make a decision concerning the collection of information requirements between 30 and 60 days after publication of the proposed amendments. Consequently, a comment to OMB is best assured of having its full effect if the OMB receives it within 30 days of publication.

V. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (''SBREFA''),[170] the Commission must advise OMB as to whether the proposed amendments constitute a ''major'' rule. Under SBREFA, a rule is considered ''major'' where, if adopted, it results or is likely to result in:

- An annual effect on the U.S. economy of $100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individuals industries; or
- Significant adverse effects on competition, investment, or innovation.

We request comment on whether the proposed amendments would be a ''major rule'' for purposes of SBREFA. In particular, we request comment on the potential effect of the proposed amendments on the U.S. economy on an annual basis; any potential increase in costs or prices for consumers or individual industries; and any potential effect on competition, investment or innovation. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VI. Initial Regulatory Flexibility Act Analysis

When an agency issues a rulemaking proposal, the Regulatory Flexibility Act (''RFA'') [171] requires the agency to prepare and make available for public comment an Initial Regulatory Flexibility Analysis (''IRFA'') that will describe the impact of the proposed rule on small entities.[172] This IRFA relates to proposed amendments and/or additions to the rules and forms described in Section II above.

A. Reasons for, and Objectives of, the Proposed Action

The proposed amendments are intended to provide enhanced disclosures regarding registrants' cybersecurity risk governance and cybersecurity incident reporting. They are designed to better inform investors about material cybersecurity risks and incidents on a timely basis and a registrant's assessment, governance, and management of those risks. The proposed amendments are discussed in more detail in Section II above. We discuss the economic impact and potential alternatives to the amendments in Section III, and the estimated compliance costs and burdens of the amendments under the PRA in Section IV above.

B. Legal Basis

The amendments contained in this release are being proposed under the authority set forth in Securities Act Sections 7 and 19(a) and Exchange Act Sections 3(b), 12, 13, 14, 15, and 23(a).

C. Small Entities Subject to the Proposed Rules

The proposed amendments would apply to registrants that are small entities. The Regulatory Flexibility Act defines ''small entity'' to mean ''small business,'' ''small organization,'' or ''small governmental jurisdiction.'' [173] For purposes of the Regulatory Flexibility Act, under our rules, a registrant, other than an investment company, is a ''small business'' or ''small organization'' if it had total assets of $5 million or less on the last day of its most recent fiscal year and is engaged or proposing to engage in an offering of securities that does not exceed $5 million.[174] Under 17 CFR 270.0–10, an investment company, including a BDC, is considered to be a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[175] An investment company, including a BDC,[176] is considered to be a ''small business'' if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[177] Commission staff estimates that, as of June 2021, there were 660 issuers,[178] and 9 BDCs [179] that may be considered small entities that would be subject to the proposed amendments.

D. Projected Reporting, Recordkeeping and Other Compliance Requirements

If adopted, the proposed amendments would apply to small entities to the same extent as other entities, irrespective of size. Therefore, we expect that the nature of any benefits and costs associated with the proposed amendments to be similar for large and small entities. Accordingly, we refer to the discussion of the proposed amendments' economic effects on all affected parties, including small entities, in Section III above. Consistent with that discussion, we anticipate that the economic benefits and costs likely could vary widely among small entities based on a number of factors, such as the nature and conduct of their businesses, which makes it difficult to project the economic impact on small entities with precision. As a general matter, however, we recognize that the costs of the proposed amendments borne by the affected entities could have a proportionally greater effect on small

[170] 5 U.S.C. 801 *et seq.*

[171] 5 U.S.C. 601 *et seq.*

[172] 5 U.S.C. 603(a).

[173] 5 U.S.C. 601(6).

[174] *See* 17 CFR 240.0–10(a).

[175] 17 CFR 270.0–10(a).

[176] BDCs are a category of closed-end investment company that are not registered under the Investment Company Act [15 U.S.C. 80a–2(a)(48) and 80a–53–64].

[177] 17 CFR 270.0–10(a).

[178] This estimate is based on staff analysis of Form 10–K filings on EDGAR, or amendments thereto, filed during the calendar year of Jan. 1, 2020 to Dec. 31, 2020, or filed by Sept. 1, 2021, and on data from XBRL filings, Compustat, and Ives Group Audit Analytics.

[179] These estimates are based on staff analysis of Morningstar data and data submitted by investment company registrants in forms filed on EDGAR as of June 30, 2021.

entities, as they may be less able to bear such costs relative to larger entities.

Compliance with the proposed amendments may require the use of professional skills, including legal skills. We request comment on how the proposed disclosure amendments would affect small entities.

E. Duplicative, Overlapping, or Conflicting Federal Rules

The Commission has also proposed cybersecurity risk management rules and related rule amendments for advisers and funds, including BDCs. To the extent that the proposed rules and rule amendments in the Investment Management Cybersecurity Proposing Release are adopted, BDCs may be subject both to those proposed rules and rule amendments and to certain of the rules proposed in this rulemaking. To the extent that there could be overlap if these proposals are adopted, we would not expect the overlap to result in significant burdens for BDCs (including small BDCs) since they should be able to use their Form 8–K disclosure to more efficiently prepare the corresponding disclosure that would be required by the Investment Management Cybersecurity Proposing Release or, in the alternative, use that corresponding disclosure (if adopted) to prepare their Form 8–K disclosure.

F. Significant Alternatives

The RFA directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. In connection with the proposed amendments, we considered the following alternatives:

- Establishing different compliance or reporting requirements that take into account the resources available to small entities;
- Exempting small entities from all or part of the requirements;
- Using performance rather than design standards; and
- Clarifying, consolidating, or simplifying compliance and reporting requirements under the rules for small entities.

The proposed amendments are intended to better inform investors about cybersecurity incidents and the cybersecurity risk management, strategy, and governance of registrants of all types and sizes which are subject to the Exchange Act reporting requirements. Under current requirements, the nature of registrants' cybersecurity disclosure varies widely, with registrants providing different levels of specificity regarding the cause, scope, impact and materiality of cybersecurity incidents. The timing of disclosure about material cybersecurity incidents also varies in the absence of a specific requirement regarding timely disclosure of such incidents. Further, while registrants generally discuss cybersecurity risks in the risk factor section of their annual reports, the disclosures are sometimes blended with other unrelated disclosures, which makes it more difficult for investors to locate, interpret, and analyze the information provided. The staff also has observed a divergence in these disclosures by industry and that smaller reporting companies generally provide less cybersecurity disclosure as compared to larger registrants.

Exempting small entities from the proposed amendments or establishing different compliance or reporting requirements for small entities could frustrate the goal of providing investors in these companies with more uniform and timely disclosure about material cybersecurity incidents and disclosure about their risk management and governance practices that is comparable to the disclosure provided by other registrants. Further, as stated in Sections II and III of this release, evidence suggests that smaller companies may have an equal or greater risk than larger companies of being attacked, making the proposed disclosures particularly important for investors in these companies.[180] Therefore, our objectives would not be served by establishing different compliance or reporting requirements for small entities or clarifying, consolidating or simplifying compliance and reporting requirements for small entities.

With respect to using performance rather than design standards, the proposed amendments use primarily use design rather than performance standards to promote more consistent and comparable disclosures by all registrants.

Section II of this release includes specific requests for comment on whether certain categories of registrants, including smaller reporting companies, should be exempted from the proposed Regulation S–K Item 106 disclosure regarding cybersecurity risk management, strategy and governance. The release also requests comment on how any exemption would impact investor assessments and comparisons of the cybersecurity risks of registrants. In addition, comment is solicited on whether smaller reporting companies should be exempted from the board expertise disclosure requirement in proposed Item 407(j) and from the requirements to present the proposed disclosure in Inline XBRL.

Request for Comment

We encourage the submission of comments with respect to any aspect of this IRFA. In particular, we request comments regarding:

- The number of small entities that may be affected by the proposed amendments;
- The existence or nature of the potential impact of the proposed amendments on small entities discussed in the analysis;
- How the proposed amendments could further lower the burden on small entities; and
- How to quantify the impact of the proposed amendments.

Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. Comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed amendments are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

Statutory Authority and Text of Proposed Rule and Form Amendments

We are proposing the rule and form amendments contained in this document under the authority set forth in Sections 7 and 19(a) of the Securities Act and Sections 3(b), 12, 13, 14, 15, and 23(a) of the Exchange Act.

List of Subjects in 17 CFR Parts 229, 232, 239, 240, and 249

Reporting and record keeping requirements, Securities.

For the reasons set forth in the preamble, the Commission is proposing to amend title 17, chapter II of the Code of Federal Regulations as follows:

PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975—REGULATION S–K

■ 1. The authority citation for part 229 continues to read as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z–2, 77z–3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78j–3, 78*l*, 78m, 78n, 78n–1, 78o, 78u–5, 78w, 78*ll*, 78mm, 80a–8, 80a–9, 80a–20, 80a–29, 80a–30, 80a–31(c), 80a–37, 80a–38(a), 80a–39, 80b–11 and 7201 *et seq.;* 18 U.S.C. 1350; sec. 953(b), Pub. L. 111–203, 124 Stat. 1904 (2010); and sec. 102(c), Pub. L. 112–106, 126 Stat. 310 (2012).

[180] *See supra* note 18. *See* Section III.E.3.

■ 2. Add § 229.106 to read as follows:

§ 229.106 (Item 106) Cybersecurity.

(a) *Definitions.* For purposes of this section:

Cybersecurity incident means an unauthorized occurrence on or conducted through a registrant's information systems that jeopardizes the confidentiality, integrity, or availability of a registrant's information systems or any information residing therein.

Cybersecurity threat means any potential occurrence that may result in, an unauthorized effort to adversely affect the confidentiality, integrity or availability of a registrant's information systems or any information residing therein.

Information systems means information resources, owned or used by the registrant, including physical or virtual infrastructure controlled by such information resources, or components thereof, organized for the collection, processing, maintenance, use, sharing, dissemination, or disposition of the registrant's information to maintain or support the registrant's operations.

(b) *Risk management and strategy.* Disclose in such detail as necessary to adequately describe the registrant's policies and procedures, if it has any, for the identification and management of risks from cybersecurity threats, including, but not limited to: Operational risk (*i.e.,* disruption of business operations); intellectual property theft; fraud; extortion; harm to employees or customers; violation of privacy laws and other litigation and legal risk; and reputational risk. Disclosure under this section should include, as applicable, a discussion of whether:

(1) The registrant has a cybersecurity risk assessment program, and if so, provide a description of such program;

(2) The registrant engages assessors, consultants, auditors, or other third parties in connection with any cybersecurity risk assessment program;

(3) The registrant has policies and procedures to oversee and identify the cybersecurity risks associated with its use of any third-party service provider, including, but not limited to, those providers that have access to the registrant's customer and employee data. If so, the registrant shall describe these policies and procedures, including whether and how cybersecurity considerations affect the selection and oversight of these providers and contractual and other mechanisms the company uses to mitigate cybersecurity risks related to these providers;

(4) The registrant undertakes activities to prevent, detect, and minimize effects of cybersecurity incidents, and if so, provide a description of the types of activities undertaken;

(5) The registrant has business continuity, contingency, and recovery plans in the event of a cybersecurity incident;

(6) Previous cybersecurity incidents informed changes in the registrant's governance, policies and procedures, or technologies;

(7) Cybersecurity-related risks and previous cybersecurity-related incidents have affected or are reasonably likely to affect the registrant's strategy, business model, results of operations, or financial condition and if so, how; and

(8) Cybersecurity risks are considered as part of the registrant's business strategy, financial planning, and capital allocation, and if so, how.

(c) *Governance.* (1) Describe the board's oversight of cybersecurity risk, including the following as applicable:

(i) Whether the entire board, specific board members, or a board committee is responsible for the oversight of cybersecurity risks;

(ii) The processes by which the board is informed about cybersecurity risks, and the frequency of its discussions on this topic; and

(iii) Whether and how the board or board committee considers cybersecurity risks as part of its business strategy, risk management, and financial oversight.

(2) Describe management's role in assessing and managing cybersecurity-related risks, as well as its role in implementing the registrant's cybersecurity policies, procedures, and strategies. The description should include, but not be limited to, the following information:

(i) Whether certain management positions or committees are responsible for measuring and managing cybersecurity risk, specifically the prevention, mitigation, detection, and remediation of cybersecurity incidents, and the relevant expertise of such persons or members in such detail as necessary to fully describe the nature of the expertise;

(ii) Whether the registrant has a designated chief information security officer, or someone in a comparable position, and if so, to whom that individual reports within the registrant's organizational chart, and the relevant expertise of any such persons in such detail as necessary to fully describe the nature of the expertise;

(iii) The processes by which such persons or committees are informed about and monitor the prevention, mitigation, detection, and remediation of cybersecurity incidents; and

(iv) Whether and how frequently such persons or committees report to the board of directors or a committee of the board of directors on cybersecurity risk.

Instructions to Item 106(c): 1. In the case of a foreign private issuer with a two-tier board of directors, for purposes of paragraph (c) of this section, the term board of directors means the supervisory or non-management board. In the case of a foreign private issuer meeting the requirements of § 240.10A–3(c)(3) of this chapter, for purposes of paragraph (c) of this Item, the term board of directors means the issuer's board of auditors (or similar body) or statutory auditors, as applicable.

2. Relevant experience of management in Item 106(c)(2)(i) and (ii) may include, for example: Prior work experience in cybersecurity; any relevant degrees or certifications; any knowledge, skills, or other background in cybersecurity.

(d) *Updated incident disclosure.* (1) If the registrant has previously provided disclosure regarding one or more cybersecurity incidents pursuant to Item 1.05 of Form 8–K, the registrant must disclose any material changes, additions, or updates regarding such incident in the registrant's quarterly report filed with the Commission on Form 10–Q (17 CFR 249.308a) or annual report filed with the Commission on Form 10–K (17 CFR 249.310) for the period (the registrant's fourth fiscal quarter in the case of an annual report) in which the change, addition, or update occurred. The description should also include, as applicable, but not be limited to, the following information:

(i) Any material effect of the incident on the registrant's operations and financial condition;

(ii) Any potential material future impacts on the registrant's operations and financial condition;

(iii) Whether the registrant has remediated or is currently remediating the incident; and

(iv) Any changes in the registrant's policies and procedures as a result of the cybersecurity incident, and how the incident may have informed such changes.

(2) The registrant should provide the following disclosure to the extent known to management when a series of previously undisclosed individually immaterial cybersecurity incidents has become material in the aggregate:

(i) A general description of when the incidents were discovered and whether they are ongoing;

(ii) A brief description of the nature and scope of the incidents;

(iii) Whether any data was stolen or altered in connection with the incidents;

(iv) The effect of the incidents on the registrant's operations; and

(v) Whether the registrant has remediated or is currently remediating the incidents.

(e) *Structured Data Requirement.* Provide the information required by this Item in an Interactive Data File in accordance with Rule 405 of Regulation S–T and the EDGAR Filer Manual.

■ 3. Amend § 229.407 by adding paragraph (j) to read as follows:

§ 229.407 (Item 407) Corporate Governance.

* * * * *

(j) *Cybersecurity expertise.* (1) If any member of the registrant's board of directors has expertise in cybersecurity, disclose the name(s) of any such director(s), and provide such detail as necessary to fully describe the nature of the expertise. In determining whether a director has expertise in cybersecurity, the registrant should consider, among other things:

(i) Whether the director has prior work experience in cybersecurity, including, for example, prior experience as an information security officer, security policy analyst, security auditor, security architect or engineer, security operations or incident response manager, or business continuity planner;

(ii) Whether the director has obtained a certification or degree in cybersecurity; and

(iii) Whether the director has knowledge, skills, or other background in cybersecurity, including, for example, in the areas of security policy and governance, risk management, security assessment, control evaluation, security architecture and engineering, security operations, incident handling, or business continuity planning.

(2) *Safe harbor.* (i) A person who is determined to have expertise in cybersecurity will not be deemed an expert for any purpose, including, without limitation, for purposes of Section 11 of the Securities Act (15 U.S.C. 77k), as a result of being designated or identified as a director with expertise in cybersecurity pursuant to this Item 407(j).

(ii) The designation or identification of a person as having expertise in cybersecurity pursuant to this Item 407(j) does not impose on such person any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of the board of directors in the absence of such designation or identification.

(iii) The designation or identification of a person as having expertise in cybersecurity pursuant to this Item 407(j) does not affect the duties, obligations, or liability of any other member of the board of directors.

(3) *Structured Data Requirement.* Provide the information required by this Item in an Interactive Data File in accordance with Rule 405 of Regulation S–T and the EDGAR Filer Manual.

* * * * *

Instruction to Item 407(j): In the case of a foreign private issuer with a two-tier board of directors, for purposes of paragraph (j) of this Item, the term board of directors means the supervisory or non-management board. In the case of a foreign private issuer meeting the requirements of § 240.10A–3(c)(3) of this chapter, for purposes of paragraph (j) of this Item, the term board of directors means the issuer's board of auditors (or similar body) or statutory auditors, as applicable.

* * * * *

■ 4. Amend § 229.601 by revising (b)(101)(i)(C)(*1*) as follows:

§ 229.601 (Item 601) Exhibits.

* * * * *

(b) * * *

(101) * * *

(i) * * *

(C) * * *

(*1*) Only when:

(*i*) The Form 8–K contains audited annual financial statements that are a revised version of financial statements that previously were filed with the Commission and that have been revised pursuant to applicable accounting standards to reflect the effects of certain subsequent events, including a discontinued operation, a change in reportable segments or a change in accounting principle. In such case, the Interactive Data File will be required only as to such revised financial statements regardless of whether the Form 8–K contains other financial statements; or

(*ii*) The Form 8–K includes disclosure required to be provided in an Interactive Data File pursuant to Item 1.05(b) of Form 8–K;

* * * * *

PART 232—REGULATION S–T—GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

■ 5. The general authority citation for part 232 continues to read as follows:

Authority: 15 U.S.C. 77c, 77f, 77g, 77h, 77j, 77s(a), 77z–3, 77sss(a), 78c(b), 78l, 78m, 78n, 78o(d), 78w(a), 78ll, 80a–6(c), 80a–8, 80a–29, 80a–30, 80a–37, 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

■ 6. Amend § 232.405 by adding paragraphs (b)(1)(iii) and (b)(4) to read as follows:

§ 232.405 Interactive Data File submissions.

* * * * *

(b) * * *

(1) * * *

(iii) The disclosure set forth in paragraph (4) of this section, as applicable.

* * * * *

(4) An Interactive Data File must consist of the disclosure provided under 17 CFR 229 (Regulation S–K) and related provisions that is required to be tagged, including, as applicable:

(i) The cybersecurity information required by:

(A) Item 106 of Regulation S–K (§ 229.106 of this chapter);

(B) Item 407(j) of Regulation S–K (§ 229.407(j) of this chapter);

(C) Item 1.05 of Form 8–K (§ 249.308 of this chapter); and

(D) Item 16J of Form 20–F (§ 249.220f of this chapter).

* * * * *

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

■ 7. The authority citation for part 239 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77f, 77g, 77h, 77j, 77s, 77z–2, 77z–3, 77sss, 78c, 78*l,* 78m,78n, 78o(d), 78o–7 note, 78u–5, 78w(a), 78*ll,* 78mm, 80a–2(a), 80a–3, 80a–8, 80a–9, 80a–10, 80a–13, 80a–24, 80a–26, 80a–29, 80a–30, and 80a–37; and sec. 107, Pub. L. 112–106, 126 Stat. 312, unless otherwise noted.

■ 8. Amend § 239.13 by revising paragraph (a)(3)(ii) to read as follows:

§ 239.13 Form S–3, for registration under the Securities Act of 1933 of securities of certain issuers offered pursuant to certain types of transactions.

* * * * *

(a) * * *

(3) * * *

(ii) Has filed in a timely manner all reports required to be filed during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement, other than a report that is required solely pursuant to Item 1.01, 1.02, 1.05, 2.03, 2.04, 2.05, 2.06, 4.02(a), 6.01, 6.03 or 6.05 of Form 8–K (§ 249.308 of this chapter). If the registrant has used (during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement) § 240.12b–25(b) of this chapter with respect to a report or a portion of a report, that report or portion thereof has actually been filed within the time period prescribed by that section; and

* * * * *

■ 9. Amend Form S–3 (referenced in § 239.13) by adding General Instruction I.A.3(b) to read as follows:

Note: The text of Form S–3 does not, and this amendment will not, appear in the Code of Federal Regulations.

FORM S–3

* * * * *

INFORMATION TO BE INCLUDED IN THE REPORT

* * * * *

General Instructions

I. Eligibility Requirements for Use of Form S–3

* * * * *

A. Registrant Requirements.

* * * * *

3. * * *

(a) * * *

(b) has filed in a timely manner all reports required to be filed during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement, other than a report that is required solely pursuant to Item 1.01, 1.02, 1.04, 1.05, 2.03, 2.04, 2.05, 2.06, 4.02(a) or 5.02(e) of Form 8–K (§ 249.308 of this chapter). If the registrant has used (during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement) Rule 12b–25(b) (§ 240.12b–25(b) of this chapter) under the Exchange Act with respect to a report or a portion of a report, that report or portion thereof has actually been filed within the time period prescribed by that rule.

* * * * *

■ 10. Amend § 239.45 by revising paragraph (a)(2) to read as follows:

§ 239.45 Form SF–3, for registration under the Securities Act of 1933 for offerings of asset-backed issuers offered pursuant to certain types of transactions.

* * * * *

(a) * * *

(2) To the extent the depositor or any issuing entity previously established, directly or indirectly, by the depositor or any affiliate of the depositor (as defined in Item 1101 of Regulation AB (17 CFR 229.1101)) is or was at any time during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement on this Form subject to the requirements of section 12 or 15(d) of the Exchange Act (15 U.S.C. 78*l* or 78o(d)) with respect to a class of asset-backed securities involving the same asset class, such depositor and each such issuing entity must have filed all material required to be filed regarding such asset-backed securities pursuant to section 13 or 15(d) of the Exchange Act (15 U.S.C. 78m or 78o(d)) for such period (or such shorter period that each such entity was required to file such materials). In addition, such material must have been filed in a timely manner, other than a report that is required solely pursuant to Item 1.01, 1.02, 1.05, 2.03, 2.04, 2.05, 2.06, 4.02(a), 6.01, or 6.03 of Form 8–K (17 CFR 249.308). If § 240.12b–25(b) of this chapter was used during such period with respect to a report or a portion of a report, that report or portion thereof has actually been filed within the time period prescribed by § 240.12b–25(b) of this chapter. Regarding an affiliated depositor that became an affiliate as a result of a business combination transaction during such period, the filing of any material prior to the business combination transaction relating to asset-backed securities of an issuing entity previously established, directly or indirectly, by such affiliated depositor is excluded from this section, provided such business combination transaction was not part of a plan or scheme to evade the requirements of the Securities Act or the Exchange Act. See the definition of ''affiliate'' in § 230.405 of this chapter.

* * * * *

■ 11. Amend Form SF–3 (referenced in § 239.45) by revising General Instruction I.A(2) to read as follows:

Note: The text of Form SF–3 does not, and this addition will not, appear in the Code of Federal Regulations.

FORM SF–3

* * * * *

GENERAL INSTRUCTIONS

I. Eligibility Requirements for Use of Form SF–3

A.

(2) To the extent the depositor or any issuing entity previously established, directly or indirectly, by the depositor or any affiliate of the depositor (as defined in Item 1101 of Regulation AB (17 CFR 229.1101)) is or was at any time during the twelve calendar months and any portion of a month immediately preceding the filing of the registration statement on this Form subject to the requirements of section 12 or 15(d) of the Exchange Act (15 U.S.C. 78(l) or 78o(d)) with respect to a class of asset-backed securities involving the same asset class, such depositor and each such issuing entity must have filed all material required to be filed regarding such asset-backed securities pursuant to section 13 or 15(d) of the Exchange Act (15 U.S.C. 78m or 78o(d)) for such period (or such shorter period that each such entity was required to file such materials). In addition, such material must have been filed in a timely manner, other than a report that is required solely pursuant to Item 1.01, 1.02, 1.05, 2.03, 2.04, 2.05, 2.06, 4.02(a), 6.01, or 6.03 of Form 8–K (17 CFR 249.308). If Rule 12b–25(b) (17 CFR 240.12b–25(b)) under the Exchange Act was used during such period with respect to a report or a portion of a report, that report or portion thereof has actually been filed within the time period prescribed by that rule. Regarding an affiliated depositor that became an affiliate as a result of a business combination transaction during such period, the filing of any material prior to the business combination transaction relating to asset-backed securities of an issuing entity previously established, directly or indirectly, by such affiliated depositor is excluded from this section, provided such business combination transaction was not part of a plan or scheme to evade the requirements of the Securities Act or the Exchange Act. See the definition of ''affiliate'' in Securities Act Rule 405 (17 CFR 230.405).

* * * * *

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

■ 12. The authority citation for part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77z–3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c–3, 78c–5, 78d, 78e, 78f, 78g, 78i, 78j, 78j–1, 78k, 78k–1, 78*l*, 78m, 78n, 78n–1, 78o, 78o–4, 78o–10, 78p, 78q, 78q–1, 78s, 78u–5, 78w, 78x, 78dd, 78*ll*, 78mm, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4, 80b–11, and 7201 *et seq.,* and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; Pub. L. 111–203, 939A, 124 Stat. 1376 (2010); and Pub. L. 112–106, sec. 503 and 602, 126 Stat. 326 (2012), unless otherwise noted.

* * * * *

Section 240.15d–11 is also issued under secs. 3(a) and 306(a), Pub. L. 107–204, 116 Stat. 745.

* * * * *

■ 13. Amend § 240.13a–11 by revising paragraph (c) to read as follows:

§ 240. 13a–11 Current reports on Form 8–K (§ 249.308 of this chapter).

* * * * *

(c) No failure to file a report on Form 8–K that is required solely pursuant to Item 1.01, 1.02, 1.05, 2.03, 2.04, 2.05, 2.06, 4.02(a), 5.02(e) or 6.03 of Form 8–K shall be deemed to be a violation of 15 U.S.C. 78j(b) and § 240.10b–5.

■ 14. Amend § 240.15d–11 by revising paragraph (c) to read as follows:

§ 240.15d–11 Current reports on Form 8–K (§ 249.308 of this chapter).

* * * * *

(c) No failure to file a report on Form 8–K that is required solely pursuant to Item 1.01, 1.02, 1.05, 2.03, 2.04, 2.05, 2.06, 4.02(a), 5.02(e) or 6.03 of Form 8–K shall be deemed to be a violation of 15 U.S.C. 78j(b) and § 240.10b–5.

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

■ 15. The authority citation for part 249 continues to read, in part, as follows:

Authority: 15 U.S.C. 78a *et seq.* and 7201 *et seq.;* 12 U.S.C. 5461 *et seq.;* 18 U.S.C. 1350; Sec. 953(b), Pub. L. 111–203, 124 Stat. 1904; Sec. 102(a)(3), Pub. L. 112–106, 126 Stat. 309 (2012); Sec. 107, Pub. L. 112–106, 126 Stat. 313 (2012), Sec. 72001, Pub. L. 114–94, 129 Stat. 1312 (2015), and secs. 2 and 3 Pub. L. 116–222, 134 Stat. 1063 (2020), unless otherwise noted.

* * * * *

Section 249.220f is also issued under secs. 3(a), 202, 208, 302, 306(a), 401(a), 401(b), 406 and 407, Pub. L. 107–204, 116 Stat. 745, and secs. 2 and 3, Pub. L. 116–222, 134 Stat. 1063.

* * * * *

Section 249.308 is also issued under 15 U.S.C. 80a–29 and 80a–37.

Section 249.308a is also issued under secs. 3(a) and 302, Pub. L. 107–204, 116 Stat. 745.

* * * * *

Section 249.310 is also issued under secs. 3(a), 202, 208, 302, 406 and 407, Pub. L. 107–204, 116 Stat. 745.

* * * * *

■ 16. Amend Form 20–F (referenced in § 249.220f) by adding Item 16J to read as follows:

Note: The text of Form 20–F does not, and these amendments will not, appear in the Code of Federal Regulations.

FORM 20–F

* * * * *

PART II

* * * * *

Item 16J. Cybersecurity

(a) Definitions. For purposes of this section:

(1) *Cybersecurity incident* means an unauthorized occurrence on or conducted through a registrant's information systems that jeopardizes the confidentiality, integrity, or availability of a registrant's information systems or any information residing therein.

(2) *Cybersecurity threat* means any potential occurrence that may result in, an unauthorized effort to adversely affect the confidentiality, integrity or availability of a registrant's information systems or any information residing therein.

(3) *Information systems* means information resources, owned or used by the registrant, including physical or virtual infrastructure controlled by such information resources, or components thereof, organized for the collection, processing, maintenance, use, sharing, dissemination, or disposition of the registrant's information to maintain or support the registrant's operations.

(b) *Risk management and strategy.*

(1) Disclose in such detail as necessary to adequately describe the registrant's policies and procedures, if it has any, for the identification and management of risks from cybersecurity threats, including, but not limited to: Operational risk (*i.e.,* disruption of business operations); intellectual property theft; fraud; extortion; harm to employees or customers; violation of privacy laws and other litigation and legal risk; and reputational risk. Disclosure under this section should include, as applicable, a discussion of whether:

(i) The registrant has a cybersecurity risk assessment program, and if so, provide a description of such program;

(ii) The registrant engages assessors, consultants, auditors, or other third parties in connection with any cybersecurity risk assessment program;

(iii) The registrant has policies and procedures to oversee and identify the cybersecurity risks associated with its use of any third-party service provider, including, but not limited to, those providers that have access to or have information about the registrant's customer and employee data. If so, the registrant shall describe these policies and procedures, including whether and how cybersecurity considerations affect the selection and oversight of these providers and contractual and other mechanisms the company uses to mitigate cybersecurity risks related to these providers;

(iv) The registrant undertakes activities to prevent, detect, and minimize effects of cybersecurity incidents, and if so, provide a description of the types of activities undertaken;

(v) The registrant has business continuity, contingency, and recovery plans in the event of a cybersecurity incident;

(vi) Previous cybersecurity incidents informed changes in the registrant's governance, policies and procedures, or technologies;

(vii) Cybersecurity related risks and previous cybersecurity related incidents have affected or are reasonably likely to affect the registrant's strategy, business model, results of operations, or financial condition and if so, how; and

(viii) Cybersecurity risks are considered as part of the registrant's business strategy, financial planning, and capital allocation, and if so, how.

(c) *Governance.*

(1) Describe the board's oversight of cybersecurity risk, including the following as applicable:

(i) Whether the entire board, specific board members, or a board committee is responsible for the oversight of cybersecurity risks;

(ii) The processes by which the board is informed about cybersecurity risks, and the frequency of its discussions on this topic; and

(iii) Whether and how the board or board committee considers cybersecurity risks as part of its business strategy, risk management, and financial oversight.

(2) Describe management's role in assessing and managing cybersecurity related risks, as well as its role in implementing the registrant's cybersecurity policies, procedures, and strategies. The description should include, but not be limited to, the following information:

(i) Whether certain management positions or committees are responsible for measuring and managing cybersecurity risk, specifically the prevention, mitigation, detection, and remediation of cybersecurity incidents, and the relevant expertise of such persons or members in such detail as necessary to fully describe the nature of the expertise;

(ii) Whether the registrant has a designated chief information security officer, or someone in a comparable position, and if so, to whom that individual reports within the registrant's organizational chart, and the relevant expertise of any such person in such detail as necessary to fully describe the nature of the expertise;

(iii) The processes by which such persons or committees are informed about and monitor the prevention, mitigation, detection, and remediation of cybersecurity incidents; and

(iv) Whether and how frequently such persons or committees report to the board of directors or a committee of the board of directors on cybersecurity risk.

Instructions to Item 16J(c)

1. In the case of a foreign private issuer with a two-tier board of directors, for purposes of paragraph (c) of this Item, the term board of directors means the supervisory or non-management board. In the case of a foreign private issuer meeting the requirements of § 240.10A–3(c)(3) of this chapter, for purposes of paragraph (c) of this Item, the term board of directors means the issuer's board of auditors (or similar body) or statutory auditors, as applicable.

2. Relevant experience of management in Item 16J(c)(2)(i) and (ii) may include, for example: Prior work experience in cybersecurity; any relevant degrees or certifications; any knowledge, skills, or other background in cybersecurity.

(d) *Updated incident disclosure.*

(1) If the registrant has previously provided disclosure regarding one or more cybersecurity incidents pursuant to Form 6–K, the registrant must disclose any material changes, additions, or updates regarding such incident that occurred during the reporting period. The description should also include, as applicable, but not limited to, the following information:

(i) Any material effect of the incident on the registrant's operations and financial condition;

(ii) Any potential material future impacts on the registrant's operations and financial condition;

(iii) Whether the registrant has remediated or is currently remediating the incident; and

(iv) Any changes in the registrant's policies and procedures as a result of the cybersecurity incident, and how the incident may have informed such changes.

(2) The registrant should provide the following disclosure to the extent known to management regarding any previously undisclosed material cybersecurity incidents that have occurred during the reporting period, including a series of individually immaterial cybersecurity incidents that have become material in the aggregate:

(i) A general description of when the incidents were discovered and whether they are ongoing;

(ii) A brief description of the nature and scope of the incidents;

(iii) Whether any data was stolen or altered in connection with the incidents;

(iv) The effect of the incidents on the registrant's operations; and

(v) Whether the registrant has remediated or is currently remediating the incidents.

(e) *Cybersecurity expertise.*

(1) If any member of the registrant's board of directors has expertise in cybersecurity, disclose the name(s) of any such director(s), and provide such detail as necessary to fully describe the nature of the expertise. In determining whether a director has expertise in cybersecurity, the registrant should consider, among other things:

(i) Whether the director has prior work experience in cybersecurity, including, for example, prior experience as an information security officer, security policy analyst, security auditor, security architect or engineer, security operations or incident response manager, or business continuity planner;

(ii) Whether the director has obtained a certification or degree in cybersecurity; and

(iii) Whether the director has knowledge, skills, or other background in cybersecurity, including, for example, in the areas of security policy and governance, risk management, security assessment, control evaluation, security architecture and engineering, security operations, incident handling, or business continuity planning.

(2) *Safe harbor.*

(i) A person who is determined to have expertise in cybersecurity will not be deemed an expert for any purpose, including, without limitation, for purposes of Section 11 of the Securities Act (15 U.S.C. 77k), as a result of being designated or identified as a director with expertise in cybersecurity pursuant to this Item 16J.

(ii) The designation or identification of a person as having expertise in cybersecurity pursuant to this Item 16J does not impose on such person any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of the board of directors in the absence of such designation or identification.

(iii) The designation or identification of a person as having expertise in cybersecurity pursuant to this Item 16J does not affect the duties, obligations or liability of any other member of the board of directors.

(f) *Structured Data Requirement.* Provide the information required by this Item in an Interactive Data File in accordance with Rule 405 of Regulation S–T and the EDGAR Filer Manual.

Instruction to Item 16J. Item 16J applies only to annual reports, and does not apply to registration statements on Form 20–F.

* * * * *

■ 17. Amend Form 6–K (referenced in § 249.306) by adding the phrase ''cybersecurity incident'' before the phrase ''and any other information which the registrant deems of material importance to security holders.'' in the second paragraph of General Instruction B.

■ 18. Amend Form 8–K (referenced in § 249.308) by:

■ a. Revising General Instruction B.1.; and

■ b. Adding Item 1.05.

The revision and addition read as follows:

Note: The text of Form 8–K does not, and this addition will not, appear in the Code of Federal Regulations.

FORM 8–K

* * * * *

GENERAL INSTRUCTIONS

* * * * *

Instruction B. Events To Be Reported and Time for Filing of Reports

1. A report on this form is required to be filed or furnished, as applicable, upon the occurrence of any one or more of the events specified in the items in Sections 1 through 6 and 9 of this form. Unless otherwise specified, a report is to be filed or furnished within four business days after occurrence of the event. If the event occurs on a Saturday, Sunday or holiday on which the Commission is not open for business, then the four business day period shall begin to run on, and include, the first business day thereafter. A registrant either furnishing a report on this form under Item 7.01 (Regulation FD Disclosure) or electing to file a report on this form under Item 8.01 (Other Events) solely to satisfy its obligations under Regulation FD (17 CFR 243.100 and 243.101) must furnish such report or make such filing, as applicable, in accordance with the requirements of Rule 100(a) of Regulation FD (17 CFR 243.100(a)), including the deadline for furnishing or filing such report. A report pursuant to Item 5.08 is to be filed within four business days after the registrant determines the anticipated meeting date. A report pursuant to Item 1.05 is to be filed within four business days after the registrant determines that it has experienced a material cybersecurity incident.

* * * * *

Item 1.05 Cybersecurity Incidents

(a) If the registrant experiences a cybersecurity incident that is determined by the registrant to be material, disclose the following information to the extent known to the registrant at the time of filing:

(1) When the incident was discovered and whether it is ongoing;

(2) A brief description of the nature and scope of the incident;

(3) Whether any data was stolen, altered, accessed, or used for any other unauthorized purpose;

(4) The effect of the incident on the registrant's operations; and

(5) Whether the registrant has remediated or is currently remediating the incident.

(b) A registrant shall provide the information required by this Item in an Interactive Data File in accordance with Rule 405 of Regulation S–T and the EDGAR Filer Manual.

Instructions to Item 1.05

1. A registrant shall make a materiality determination regarding a cybersecurity incident as soon as reasonably practicable after discovery of the incident.

2. Disclosure of any material changes or updates to information disclosed pursuant to this Item 1.05 is required pursuant to § 229.106(d) [Item 106(d) of Regulation S–K] in the registrant's quarterly report filed with the Commission on Form 10–Q (17 CFR 249.308a) or annual report filed with the Commission on Form 10–K (17 CFR 249.310) for the period (the registrant's fourth fiscal quarter in the case of an annual report) in which the change, addition, or update occurred.

3. The definition of the term ''cybersecurity incident'' in § 229.106(a) [Item 106(a) of Regulation S–K] shall apply to this Item.

* * * * *

■ 19. Amend Form 10–Q (referenced in § 249.308(a) by:

■ a. Redesignating Item 5(b) as Item 5(c); and

■ b. Adding new Item 5(b) to read as follows:

Note: The text of Form 10–Q does not, and these amendments will not, appear in the Code of Federal Regulations.

FORM 10–Q

* * * * *

PART II—OTHER INFORMATION

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Item 5. Other Information

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(b) Furnish the information required by Item 106(d) of Regulation S–K (§ 229.106(d) of this chapter).

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■ 20. Amend Form 10–K (referenced in § 249.310) by:

■ a. Adding Item 1.C to Part I; and

■ b. Revising Item 10 in Part III.

The addition and revision read as follows:

Note: The text of Form 10–K does not, and these amendments will not, appear in the Code of Federal Regulations.

FORM 10–K

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PART I

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Item 1.C. Cybersecurity

(a) Furnish the information required by Item 106 of Regulation S–K (§ 229.106 of this chapter).

(b) An asset-backed issuer as defined in Item 1101 of Regulation AB (§ 229.1101 of this chapter) that does not have any executive officers or directors may omit the information required by Item 106(c) of Regulation S–K (§ 229.106(c) of this chapter).

* * * * *

Item 10. Directors, Executive Officers and Corporate Governance. Furnish the information required by Items 401, 405, 406, and 407(c)(3), (d)(4), (d)(5), and (j) of Regulation S–K (§§ 229.401, 229.405, 229.406, and 229.407(c)(3), (d)(4), (d)(5), and (j) of this chapter).

* * * * *

By the Commission.

Dated: March 9, 2022.

Vanessa A. Countryman,

Secretary.

[FR Doc. 2022–05480 Filed 3–22–22; 8:45 am]

BILLING CODE 8011–01–P

Press Release

SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors

FOR IMMEDIATE RELEASE
2022-46

Washington D.C., March 21, 2022 — The Securities and Exchange Commission today proposed rule changes that would require registrants to include certain climate-related disclosures in their registration statements and periodic reports, including information about climate-related risks that are reasonably likely to have a material impact on their business, results of operations, or financial condition, and certain climate-related financial statement metrics in a note to their audited financial statements. The required information about climate-related risks also would include disclosure of a registrant's greenhouse gas emissions, which have become a commonly used metric to assess a registrant's exposure to such risks.

"I am pleased to support today's proposal because, if adopted, it would provide investors with consistent, comparable, and decision-useful information for making their investment decisions, and it would provide consistent and clear reporting obligations for issuers," said SEC Chair Gary Gensler. "Our core bargain from the 1930s is that investors get to decide which risks to take, as long as public companies provide full and fair disclosure and are truthful in those disclosures. Today, investors representing literally tens of trillions of dollars support climate-related disclosures because they recognize that climate risks can pose significant financial risks to companies, and investors need reliable information about climate risks to make informed investment decisions. Today's proposal would help issuers more efficiently and effectively disclose these risks and meet investor demand, as many issuers already seek to do. Companies and investors alike would benefit from the clear rules of the road proposed in this release. I believe the SEC has a role to play when there's this level of demand for consistent and comparable information that may affect financial performance. Today's proposal thus is driven by the needs of investors and issuers."

The proposed rule changes would require a registrant to disclose information about (1) the registrant's governance of climate-related risks and relevant risk management processes; (2) 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; (3) how any identified climate-related risks have affected or are likely to affect the registrant's strategy, business model, and outlook; and (4) 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 on the financial estimates and assumptions used in the financial statements.

For registrants that already conduct scenario analysis, have developed transition plans, or publicly set climate-related targets or goals, the proposed amendments would require certain disclosures to enable investors to understand those aspects of the registrants' climate risk management.

The proposed rules also would require a registrant to disclose information about its direct greenhouse gas (GHG) emissions (Scope 1) and indirect emissions from purchased electricity or other forms of energy (Scope 2). In addition, a registrant would be required to disclose GHG emissions from upstream and downstream activities in its value chain (Scope 3), if material or if the registrant has set a GHG emissions target or goal that includes Scope 3 emissions. These proposals for GHG emissions disclosures would provide investors with decision-useful information to assess a registrant's exposure to, and management of, climate-related risks, and in particular transition risks. The proposed rules would provide a safe harbor for liability from Scope 3 emissions disclosure and an exemption from the Scope 3 emissions disclosure requirement for smaller reporting companies. The proposed disclosures are similar to those that many companies already provide based on broadly accepted disclosure frameworks, such as the Task Force on Climate-Related Financial Disclosures and the Greenhouse Gas Protocol.

Under the proposed rule changes, accelerated filers and large accelerated filers would be required to include an attestation report from an independent attestation service provider covering Scopes 1 and 2 emissions disclosures, with a phase-in over time, to promote the reliability of GHG emissions disclosures for investors.

The proposed rules would include a phase-in period for all registrants, with the compliance date dependent on the registrant's filer status, and an additional phase-in period for Scope 3 emissions disclosure.

The proposing release will be published on SEC.gov and in the Federal Register. The comment period will remain open for 30 days after publication in the Federal Register, or 60 days after the date of issuance and publication on sec.gov, whichever period is longer.

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Related Materials

- Proposed Rule
- Fact Sheet
- Comments Received

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 210, 229, 232, 239, and 249

[Release Nos. 33–11042; 34–94478; File No. S7–10–22]

RIN 3235–AM87

The Enhancement and Standardization of Climate-Related Disclosures for Investors

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission (''Commission'') is proposing for public comment amendments to its rules under the Securities Act of 1933 (''Securities Act'') and Securities Exchange Act of 1934 (''Exchange Act'') that would require registrants to provide certain climate-related information in their registration statements and annual reports. The proposed rules would require information about a registrant's climate-related risks that are reasonably likely to have a material impact on its business, results of operations, or financial condition. The required information about climate-related risks would also include disclosure of a registrant's greenhouse gas emissions, which have become a commonly used metric to assess a registrant's exposure to such risks. In addition, under the proposed rules, certain climate-related financial metrics would be required in a registrant's audited financial statements.

DATES: Comments should be received on or before May 20, 2022.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

• Use the Commission's internet comment form (*https://www.sec.gov/rules/submitcomments.htm*).

• Send an email to *rule-comments@sec.gov.* Please include File Number S7–xx–xx on the subject line.

Paper Comments

• Send paper comments to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090.

All submissions should refer to File Number S7–10–22. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method of submission. The Commission will post all comments on the Commission's website (*https://www.sec.gov/rules/proposed.shtml*). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549 on official business days between the hours of 10 a.m. and 3 p.m. Operating conditions may limit access to the Commission's Public Reference Room. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on our website. To ensure direct electronic receipt of such notifications, sign up through the ''Stay Connected'' option at *www.sec.gov* to receive notifications by email.

FOR FURTHER INFORMATION CONTACT: Elliot Staffin, Special Counsel, Office of Rulemaking, at (202) 551–3430, in the Division of Corporation Finance; or Anita H. Chan, Professional Accounting Fellow or Shehzad K. Niazi, Acting Deputy Chief Counsel, in the Office of the Chief Accountant, at (202) 551–5300, U.S. Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: We are proposing to add 17 CFR 210.14–01 and 14–02 (Article 14 of Regulation S–X) and 17 CFR 17 CFR 229.1500 through 1506 (subpart 1500 of Regulation S–K) under the Securities Act [1] and the Exchange Act,[2] and amend 17 CFR 239.11 (Form S–1), 17 CFR 239.18 (Form S–11), 17 CFR 239.25 (Form S–4), and 17 CFR 239.34 (Form F–4) under the Securities Act, and 17 CFR 249.210 (Form 10), 17 CFR 249.220f (Form 20–F), 17 CFR 249.306 (Form 6–K), 17 CFR 249.308a (Form 10–Q), and 17 CFR 249.310 (Form 10–K) under the Exchange Act.

Table of Contents

[1] 15 U.S.C. 77a *et seq.*

[2] 15 U.S.C. 78a *et seq.*

I. Introduction

We are proposing to require registrants to provide certain climate-related information in their registration statements and annual reports, including certain information about climate-related financial risks and climate-related financial metrics in their financial statements. The disclosure of this information would provide consistent, comparable, and reliable—and therefore decision-useful—information to investors to enable them to make informed judgments about the impact of climate-related risks on current and potential investments.

The Commission has broad authority to promulgate disclosure requirements that are ''necessary or appropriate in the public interest or for the protection of investors.'' [3] We have considered this statutory standard and determined that disclosure of information about climate-related risks and metrics would be in the public interest and would protect investors. In making this determination, we have also considered whether the proposed disclosures ''will promote efficiency, competition, and capital formation.'' [4]

We are proposing to require disclosures about climate-related risks and metrics reflecting those risks because this information can have an impact on public companies' financial performance or position and may be material to investors in making investment or voting decisions. For this reason, many investors—including shareholders, investment advisers, and investment management companies—currently seek information about climate-related risks from companies to inform their investment decision-making. Furthermore, many companies have begun to provide some of this information in response to investor demand and in recognition of the potential financial effects of climate-related risks on their businesses.

We are concerned that the existing disclosures of climate-related risks do not adequately protect investors. For this reason, we believe that additional disclosure requirements may be necessary or appropriate to elicit climate-related disclosures and to improve the consistency, comparability, and reliability of climate-related disclosures. With respect to their existing climate-related disclosures (to the extent registrants are already disclosing such information), registrants often provide information outside of Commission filings and provide different information, in varying degrees of completeness, and in different documents and formats—meaning that the same information may not be available to investors across different companies. This could result in increased costs to investors in obtaining useful climate-related information and impair the ability to make investment or voting decisions in line with investors' risk preferences. Also, companies may not disclose certain information needed to understand their existing climate-related disclosures, such as the methodologies, data sources, assumptions, and other key parameters used to assess climate-related risks. To the extent companies primarily provide this information separate from their financial reporting, it may be difficult for investors to determine whether a company's financial disclosures are consistent with its climate-related disclosures.[5] In addition, the information provided outside of Commission filings is not subject to the full range of liability and other investor protections that help elicit complete and accurate disclosure by public companies.

Investors need information about climate-related risks—and it is squarely within the Commission's authority to require such disclosure in the public interest and for the protection of investors—because climate-related risks have present financial consequences that investors in public

[3] *See, e.g.,* Section 7 of the Securities Act [15 U.S.C. 77g] and Sections 12, 13, and 15 of the Exchange Act [15 U.S.C. 78*l,* 78m, and 78o].

[4] *See, e.g.,* Section 2(b) of the Securities Act [15 U.S.C. 77b(b)] and Section 3(f) of the Exchange Act [15 U.S.C. 78c(f)].

[5] S&P Global, *Seven ESG Trends to Watch in 2021* (Feb. 7, 2021), available at *https://www.spglobal.com/en/research-insights/featured/seven-esg-trends-to-watch-in-2021.* This study found that approximately 90% of S&P 500 companies publish sustainability reports but only 16% include any reference to ESG factors in their Commission filings.

companies consider in making investment and voting decisions.[6] Investors have noted that climate-related inputs have many uses in the capital allocation decision-making process including, but not limited to, insight into governance and risks management practices,[7] integration into various valuation models, and credit research and assessments.[8] Further, we understand investors often employ diversified strategies, and therefore do not necessarily consider risk and return of a particular security in isolation but also in terms of the security's effect on the portfolio as a whole, which requires comparable data across registrants.[9]

While climate-related risks implicate broader concerns—and are subject to various other regulatory schemes—our objective is to advance the Commission's mission to protect investors, maintain fair, orderly and efficient markets, and promote capital formation, not to address climate-related issues more generally. In particular, the impact of climate-related risks on both individual businesses and the financial system as a whole are well documented.[10] For example, the Financial Stability Oversight Council's (''FSOC's'') Report on Climate-Related Financial Risk 2021 found that businesses, financial institutions, investors, and households may experience direct financial effects from climate-related risks, and observed that the costs would likely be broadly felt as they are passed through supply chains and to customers and as they reduce firms' ability to service debt or produce returns for investors.[11] As a result, these climate-related risks and their financial impact could negatively affect the economy as a whole and create systemic risk for the financial system.[12] SEC-reporting companies and their investors are an essential component of this system.[13]

Climate-related risks can affect a company's business and its financial performance and position in a number of ways. Severe and frequent natural disasters can damage assets, disrupt operations, and increase costs.[14] Transitions to lower carbon products, practices, and services, triggered by changes in regulations, consumer preferences,[15] availability of financing, technology and other market forces,[16]

[6] *See* Financial Stability Oversight Council (''FSOC''), Report on Climate-Related Financial Risk 2021 (Oct. 2021) (''2021 FSOC Report''), available at *https://home.treasury.gov/system/files/261/FSOC-Climate-Report.pdf* (detailing the myriad ways that climate-related risks pose financial threats both at the firm level and financial system level). *See also Managing Climate Risk in the U.S. Financial System,* Report of the Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission (2020), available at *https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf* (''CFTC Advisory Subcommittee Report'') (stating that climate-related risks pose a major risk to the stability of the U.S. financial system and to its ability to sustain the American economy).

[7] *See, e.g.,* letters from Amalgamated Bank (June 14, 2021); and Norges Bank Investment Management (June 13, 2021).

[8] *See, e.g.,* letter from Principles for Responsible Investment (PRI) (Consultation Response) (June 11, 2021).

[9] *See, e.g., id.* (stating that broadly diversified investors evaluating any individual asset for addition to a portfolio need to consider its risk and return characteristics not in isolation, but in terms of the asset's effect on the portfolio as a whole, and providing CalPERS as an example of an asset owner holding a diversified growth-oriented portfolio that has integrated climate risk assessment into its investment process); *see also* letter from Amalgamated Bank (stating that the principal mitigant of investment risk is diversity of exposure and indicating that comprehensive climate disclosures help investors assess systemic risk); and Norges Bank Investment Management (stating that for sustainability information to support investment decisions, risk management processes, and ownership activities across a diversified portfolio, it must be consistent and comparable across companies and over time).

[10] In 2020 alone, a record 22 separate climate-related disasters with at least $1 billion in damages struck across the United States, surpassing the previous annual highs of 16 such events set in 2011 and 2017. *See* NOAA, National Center for Environmental Information, *Billion Dollar Weather and Climate Disasters: Summary Stats* (3rd Quarter release 2021), available at *https://www.ncdc.noaa.gov/billions/summary-stats/US/2020.* In 2021, the United States experienced 20 separate billion-dollar climate-related disasters. *See* NOAA, *U.S. saw its 4th-warmest year on record, fueled by a record-warm December* (Jan. 10, 2022), available at *https://www.noaa.gov/news/us-saw-its-4th-warmest-year-on-record-fueled-by-record-warm-december.*

[11] *See* 2021 FSOC Report, Chapter 1: *From Climate-Related Physical Risks to Financial Risks; From Climate-related Transition Risks to Financial Risks.* We discuss climate-related physical risks and climate-related transition risks in greater detail in Section II.B.1.

[12] *See* 2021 FSOC Report, Chapter 1: An Emerging Consensus Framework for Climate-related Financial Risks (stating that these effects would likely propagate through the financial sector, which may experience credit and market risks associated with loss of income, defaults and changes in the values of assets, liquidity risks associated with changing demand for liquidity, and operational risks associated with disruptions to infrastructure). *See also* Financial Stability Board (''FSB''), The Implications of Climate Change for Financial Stability (Nov. 2020) (stating that climate-related effects may be far-reaching in their breadth and magnitude, and could affect a wide variety of firms, sectors and geographies in a highly correlated manner, indicating that the value of financial assets/liabilities could be affected either by the actual or expected economic effects of a continuation of climate-related physical risks, which could lead to a sharp fall in asset prices and increase in uncertainty, or by risks associated with a transition towards a low-carbon economy, particularly if the transition is disorderly, which could have a destabilizing effect on the global financial system). *See also* Basel Committee on Banking Supervision, *Climate-related Risk Drivers and Their Transmission Channels* (Apr. 2021), at *https://www.bis.org/bcbs/publ/d517.pdf.*

[13] *See, e.g.,* The Editors, *Don't Drag Banks Into the Culture Wars,* The Washington Post (Mar. 7, 2022) (''No doubt, all companies—including those in the financial sector—must do more to manage social and environmental risks, in particular those related to climate change. To that end, the Securities and Exchange Commission is rightly working on climate-risk disclosure rules, so investors will have the information they need to make the best possible decisions and to hold public companies accountable.'').

[14] *See, e.g.,* 2021 FSOC Report, Chapter 1: From Climate-related Physical Risks to Financial Risks.

[15] *See, e.g., Why the automotive future is electric,* McKinsey & Company (Sept. 7, 2021), at *https://www.mckinsey.com/industries/automotive-and-assembly/our-insights/why-the-automotive-future-is-electric* (attributing the shift toward lower emissions forms of transportation, such as electric vehicles, to a combination of regulation, consumer behavior and technology); *A Fifth Of World's Largest Companies Committed To Net Zero Target,* Forbes (Mar. 24, 2021), at *https://www.forbes.com/sites/dishashetty/2021/03/24/a-fifth-of-worlds-largest-companies-committed-to-net-zero-target/?sh=2a72640f662f*; *See also, More than 1,000 companies commit to science-based emissions reductions in line with 1.5 °C climate ambition,* Joint Press Release by the United Nations Global Compact and the Science Based Targets Initiative (Nov. 9, 2021), at *https://finance.yahoo.com/news/more-1-000-companies-commit-000800027.html* (1,045 companies with more than $23 trillion in market capitalization are setting 1.5 °C aligned science based targets). *See also, Why Engage Suppliers on GHG Emissions?,* EPA Center for Corporate Climate Leadership, at *https://www.epa.gov/climateleadership/why-engage-suppliers-ghg-emissions* (''As organizations commit to reduce the carbon footprints of the products and services they provide, they look to their suppliers to align their efforts with the organization's sustainability goals'').

[16] *See, e.g.,* World Economic Forum, *First Movers Coalition is tackling the climate crisis,* at *https://www.weforum.org/our-impact/first-movers-coalition-is-tackling-the-climate-crisis/#:~:text=The%20First%20Movers%20Coalition%2C%20which%20was%20launched%20at,companies%20that%20use%20steel%20to%20build%20wind%20turbines* (''The World Economic Forum is partnering with the US Special Presidential Envoy for Climate John Kerry and over 30 global businesses to invest in innovative green technologies so they are available for massive scale-up by 2030 to enable net-zero emissions by 2050 at the latest.''); *COP26 made net zero a core principle for business. Here's how leaders can act,* McKinsey & Company (Nov. 12, 2021), at What COP26 means for business | McKinsey, at *https://www.mckinsey.com/business-functions/sustainability/our-insights/cop26-made-net-zero-a-core-principle-for-business-heres-how-leaders-can-act* (''The net-zero imperative is no longer in question—it has become an organizing principle for business . . . leaders who put convincing net-zero plans in place can distinguish their companies from peers. To put that another way: the basis of competition has changed, and there is now a premium on sound net-zero planning and execution.''); see also *S&P Dow Jones Indices Launches Net Zero 2050 Climate Transition and Paris-Aligned Select Indices* (Nov. 22, 2021), at *https://finance.yahoo.com/news/p-dow-jones-indices-launches-090000812.html* (The index is designed to ''bring greater transparency in measuring climate-related risks'' and help market participants ''achieve their goals in the path to net zero by 2050'').

can lead to changes in a company's business model.[17] Governments around the world have made public commitments to transition to a lower carbon economy, and efforts towards meeting those greenhouse gas (''GHG'') reduction goals have financial effects that may materially impact registrants.[18] In addition, banking regulators have recently launched initiatives to incorporate climate risk in their supervision of financial institutions.[19] How a company assesses and plans for climate-related risks may have a significant impact on its future financial performance and investors' return on their investment in the company.

Consistent, comparable, and reliable disclosures on the material climate-related risks public companies face would serve both investors and capital markets. Investors would be able to use this information to make investment or voting decisions in line with their risk preferences. Capital allocation would become more efficient as investors are better able to price climate-related risks. In addition, more transparency and comparability in climate-related disclosures would foster competition. Many other jurisdictions and financial regulators around the globe have taken action or reached similar conclusions regarding the importance of climate-related disclosures and are also moving towards the adoption of climate-related disclosure standards.[20]

This proposal builds on the Commission's previous rules and guidance on climate-related disclosures, which date back to the 1970s. In 2010, in response to increasing calls by the public and shareholders for public companies to disclose information regarding how climate change may affect their business and operations, the Commission published guidance (''2010 Guidance'') for registrants on how the Commission's existing disclosure rules may require disclosure of the impacts of climate change on a registrant's business or financial condition.[21] Since that time, as climate-related impacts have increasingly been well-documented and awareness of climate-related risks to businesses and the economy has grown,[22] investors have increased their demand for more detailed information about the effects of the climate on a registrant's business and for more information about how a registrant has addressed climate-related risks and opportunities when conducting its operations and developing its business strategy and financial plans.[23] It is appropriate for us to consider such investor demand in exercising our authority and responsibility to design an effective and efficient disclosure regime under the federal securities laws.

In developing these proposals, we have considered the feedback we have received to date from a wide range of commenters, including comments from investors as to the information they need to make informed investment or voting decisions, as well as concerns expressed by registrants with regard to compliance burdens and liability risk.[24] While our proposals include disclosure requirements designed to foster greater consistency, comparability, and reliability of available information, they also include a number of features designed to mitigate the burdens on registrants, such as phase-in periods for the proposed climate-related disclosure requirements,[25] a safe harbor for certain emissions disclosures,[26] and an exemption from certain emissions reporting requirements for smaller reporting companies.[27] In addition, the existing safe harbors for forward-looking statements under the Securities Act and Exchange Act would be available for aspects of the proposed disclosures.[28]

Although the various requirements we are proposing are supported by overlapping rationales, we emphasize that the different aspects of the proposal serve independent, albeit complementary, objectives. In addition, we have carefully considered how to craft this proposal to best advance investor protection and the public interest, consistent with the Commission's disclosure authority and regulatory mission, and we welcome comments on how we can further achieve that goal.

A. Background

The Commission first addressed the disclosure of material environmental issues in the early 1970s when it issued an interpretive release stating that registrants should consider disclosing in their SEC filings the financial impact of

[17] *See, e.g.,* Juan C.Reboredo and Luis A. Otero, *Are investors aware of climate-related transition risks? Evidence from mutual fund flows,* 189 Ecological Economics (Nov. 2021), available at *https://www.sciencedirect.com/science/article/abs/pii/S0921800921002068#!*; and BlackRock, *Climate risk and the transition to a low-carbon economy,* available at *https://www.blackrock.com/corporate/literature/publication/blk-commentary-climate-risk-and-energy-transition.pdf.*

[18] *See* Antony J. Blinken, Secretary of State, *The United States Officially Rejoins the Paris Agreement,* Press Statement, (Feb. 19, 2021). 191 countries plus the European Union have now signed the Paris Climate Agreement. The central aim of the Paris Climate Agreement is to strengthen the global response to the threat of climate change by keeping a global temperature rise this century to well below 2 °Celsius above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5 ° degrees Celsius. *See* Paris Agreement (Paris, Dec. 12, 2015) (entered into force Nov. 4, 2016). Moreover, at the UN Climate Change Conference (COP 26), the United States committed to become net zero by 2050, China by 2060, and India by 2070. Further, over 100 countries formed a coalition to reduce methane emissions by 30 percent by 2030. *See* Environment+Energy Leader, *COP26 Net Zero Commitments will Speed Energy Transition, Increase Pressure on Industries, According to Moody's Report* (Nov. 17, 2021).

[19] *See, e.g.,* OCC announcement: Risk Management: Principles for Climate-Related Financial Risk Management for Large Banks; Request for Feedback | OCC (treas.gov), available at *https://www.occ.treas.gov/news-issuances/bulletins/2021/bulletin-2021-62.html;* and Principles for Climate-Related Financial Risk Management for Large Banks (treas.gov) (Dec. 16, 2021), available at *https://www.occ.treas.gov/news-issuances/bulletins/2021/bulletin-2021-62a.pdf.*

[20] *See infra* Section I.C.2.

[21] *See* Commission Guidance Regarding Disclosure Related to Climate Change, Release No. 33–9106 (Feb. 2, 2010) [75 FR 6290 (Feb. 8, 2010)]. We discuss the 2010 Guidance in greater detail in Section I.A. below.

[22] *See, e.g., supra* notes 6, 10, and 12.

[23] *See, e.g.,* Larry Fink, *A Fundamental Reshaping of Finance,* 2020 Letter to CEOs, at *https://www.blackrock.com/corporate/investor-relations/2020-larry-fink-ceo-letter*, available at *https://www.blackrock.com/corporate/investor-relations/2020-larry-fink-ceo-letter* (stating that climate risk is investment risk and asking the companies that BlackRock invests in to, among other matters, disclose climate-related risks in line with the recommendations of the Task Force on Climate-related Financial Disclosures); *see also* Climate Action 100+, at *https://www.climateaction100.org/.* Climate Action 100+ is an investor-led initiative composed of 615 investors who manage $60 trillion in assets (as of Nov. 2021), who aim ''to mitigate investment exposure to climate risk and secure ongoing sustainable returns for their beneficiaries.'' *See also* Glasgow Financial Alliance for Net Zero (GFANZ), at *https://www.gfanzero.com/,* a global coalition of leading financial institutions focused on promoting the transition to a net zero global economy. Formed in Apr. 2021, its membership as of Nov. 2021 included over 450 financial firms controlling assets of over $130 trillion. Further, more than 500 investor signatories with assets under management of nearly $100 trillion are signatories to the CDP climate risk disclosure program, *https://cdn.cdp.net/cdp-production/comfy/cms/files/files/000/004/697/original/2021_CDP_Capital_Markets_Brochure_General.pdf.* We discuss the growing investor demand for climate-related information in greater detail in Section I.C below.

[24] *See* Acting Chair Allison Herren Lee Public Statement, *Public Input Welcomed on Climate Change Disclosures* (Mar. 15, 2021), available at *https://www.sec.gov/news/public-statement/lee-climate-change-disclosures. See also, e.g., Concept Release: Business and Financial Disclosure Required by Regulation S–K,* Release No. 33–10064 (Apr. 16, 2016), [83 FR 23915 (Apr. 22, 2016)] and related comments, available at *https://www.sec.gov/rules/concept/conceptarchive/conceptarch2016.shtml.*

[25] *See infra* Section II.M.

[26] *See* Section II.G.3.

[27] *See id.*

[28] *See* Securities Act Section 27A [15 U.S.C. 77z–2] and Exchange Act Section 21E [15 U.S.C. 78u–5]. We discuss the application of the existing forward-looking statement safe harbors to the proposed climate-related disclosures primarily in Sections II.C.3–4, II.E, II.G.1, and II.I.

compliance with environmental laws.[29] Throughout the 1970s, the Commission continued to explore the need for specific rules mandating disclosure of information relating to litigation and other business costs arising out of compliance with federal, state, and local laws that regulate the discharge of materials into the environment or otherwise relate to the protection of the environment. These topics were the subject of several rulemaking efforts, extensive litigation, and public hearings, all of which resulted in the rules that now specifically address disclosure of environmental issues.[30]

After almost a decade of consideration, the Commission adopted rules in 1982 mandating disclosure of information relating to litigation and other business costs arising out of compliance with federal, state, and local laws that regulate the discharge of materials into the environment or otherwise relate to the protection of the environment.[31] In addition to these specific disclosure requirements, the Commission's other disclosure rules requiring, for example, information about material risks and a description of the registrant's business, could give rise to an obligation to provide disclosure related to the effects of climate change.[32]

In its 2010 Guidance, the Commission observed that, in response to investor demand for climate-related information, many companies were voluntarily reporting climate-related information outside their filings with the Commission. The Commission emphasized that ''registrants should be aware that some of the information they may be reporting pursuant to these mechanisms also may be required to be disclosed in filings made with the Commission pursuant to existing disclosure requirements.'' [33] Specifically, the 2010 Guidance emphasized that climate change disclosure might, depending on the circumstances, be required in a company's Description of Business, Risk Factors, Legal Proceedings, and Management's Discussion and Analysis of Financial Condition and Results of Operations (''MD&A'').[34] The 2010 Guidance further identified certain climate-related issues that companies may need to consider in making their disclosures, including the direct and indirect impact of climate-related legislation or regulations, international agreements, indirect consequences of business trends including changing demand for goods, and the physical impacts of climate change.

The proposals set forth in this release would augment and supplement the disclosures already required in SEC filings. Accordingly, registrants should continue to evaluate the climate-related risks they face and assess whether disclosures related to those climate-related risks must be disclosed in their Description of Business, Risk Factors, Legal Proceedings, and MD&A as described in the 2010 Guidance. These disclosures should be based on the registrant's specific facts and circumstances. While climate risks impact many issuers across industries, the impacts of those risks on a particular registrant and how the registrant addresses those risks are fact-specific and may vary significantly by registrant.[35] The disclosures required by our existing rules should reflect these company-specific risks.

B. The March 2021 Request for Public Input

On March 15, 2021, Acting Chair Allison Herren Lee requested public input on climate disclosure from investors, registrants, and other market participants.[36] The Acting Chair solicited input on several issues, including how the Commission could best regulate disclosure concerning climate change in order to provide more consistent, comparable, and reliable information for investors, whether the Commission should require the disclosure of certain metrics and other climate-related information, the role that existing third-party climate-related disclosure frameworks should play in the Commission's regulation of such disclosure, and whether and how such disclosure should be subject to assurance.

The Commission received approximately 600 unique letters and over 5800 form letters in response to the Acting Chair's request for public input.[37] We received letters from academics, accounting and audit firms, individuals, industry groups, investor groups, registrants, non-governmental organizations, professional climate advisors, law firms, professional investment advisors and investment management companies, standard-setters, state government officials, and US Senators and Members of the House of Representatives.

Many of these commenters, including investors with trillions of dollars of assets under management collectively,[38]

[29] *See* Release No. 33–5170 (July 19, 1971) [36 FR 13989]. The Commission codified this interpretive position in its disclosure forms two years later. See Release 33–5386 (Apr. 20, 1973) [38 FR 12100] (''1972 Amendments'').

[30] *See* Interpretive Release No. 33–6130 (Sept. 27, 1979) [44 FR 56924], which includes a brief summary of the National Environmental Policy Act of 1969 and the legal and administrative actions taken with regard to the Commission's environmental disclosure during the 1970s. *See also NRDC* v. *SEC,* 606 F.2d 1031, 1036–42 (DC Cir. 1979) (discussing this history). More information relating to the Commission's efforts in this area is chronicled in Release No. 33–6315 (May 4, 1981) [46 FR 25638].

[31] *See* Release No. 33–6383 (Mar. 3, 1982) [47 FR 11380] (''1982 Release'') (adopting 17 CFR 229.103, which requires a registrant to describe its material pending legal proceedings, other than ordinary routine litigation incidental to the business, and indicating that administrative or judicial proceedings arising under federal, state, or local law regulating the discharge of materials into the environment or primarily for the purpose of protecting the environment, shall not be deemed ''ordinary routine litigation incidental to the business'' and must be described if meeting certain conditions). The 1982 Release also moved the information called for by the 1973 Amendments to 17 CFR 229.101(c)(1)(xii), which, as part of a registrant's business description, required the disclosure of the material effects that compliance with Federal, State and local provisions regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, have had upon the registrant's capital expenditures, earnings and competitive position, as well as the disclosure of its material estimated capital expenditures for environmental control facilities. In 2020, the Commission amended 17 CFR 229.101(c)(1) to require, to the extent material to an understanding of the business taken as a whole, disclosure of the material effects that compliance with government regulations, including environmental regulations, may have upon the capital expenditures, earnings, and competitive position of the registrant and its subsidiaries. *See Modernization of Regulation S–K Items 101, 103, and 105,* Release No. 33–10825 (Aug. 26, 2020) [85 FR 63726 (Oct. 8, 2020)] (''2020 Release'').

[32] *See* Release No. 33–9106, Section III.

[33] *See* Release No. 33–9106, Section I.

[34] The 2010 Guidance also applies to corresponding disclosure requirements in Form 20–F by foreign private issuers.

[35] Our recent amendments to Item 105 of Regulation S–K discourage the presentation of generic risks that could apply generally to any registrant or offering. The fact that climate risks are broad-based does not, in our view, cause them to be generic. For example, thousands of companies in Houston were impacted by Hurricane Harvey. However, (1) their flood risk varied and some companies may have been far more impacted than others (and would be more vulnerable to future catastrophic storms); (2) their operations were different and some may have been more disrupted as a result than others—*e.g.,* a services business on the 10th floor of a building may have experienced just a few days of disruption while an oil refinery may have been shut down for weeks; and (3) their risk management processes may have been different—two similarly situated companies may have different continuity of operations plans or may have taken steps to mitigate those types of risks. In sum, while the source of the risk may be common to many companies, the impact is not.

[36] *See* Acting Chair Allison Herren Lee Public Statement, Public Input Welcomed on Climate Change Disclosures.

[37] The comment letters are available at *https://www.sec.gov/comments/climate-disclosure/cll12.htm.* Except as otherwise noted, references to comments in this release pertain to these comments.

[38] *See, e.g.,* letters from BlackRock (June 11, 2021) ($9T); Ceres (June 10, 2021) (representing Investor Network on Climate Risk and Sustainability) ($37T); Council of Institutional Investors (June 11,

supported implementation of climate-related disclosure rules. A number of commenters [39] stated that mandated disclosures are necessary because climate change poses significant financial risks to registrants and their investors.[40] According to one of the commenters, 68 out of 77 industries are likely to be significantly affected by climate risk.[41] Many commenters criticized the current disclosure practice, in which some issuers voluntarily provide climate disclosures based on a variety of different third-party frameworks, because it has not produced consistent, comparable, reliable information for investors and their advisors, who otherwise have difficulty obtaining that information.[42]

Other commenters, however, questioned whether climate change posed a risk to companies or their investors. These commenters stated their belief that the assumptions underlying the assessment of the impact of climate change were too uncertain to permit companies to ascertain the real risks to their operations and financial condition caused by climate change.[43] These commenters stated that they opposed implementation of climate-related disclosure rules, and argued that such rules would exceed the Commission's statutory authority. Some of these commenters also argued that such rules are not necessary because registrants are already required to disclose material climate risks, or that such rules would be more costly than the current ''private ordering'' of climate disclosures.[44] Some commenters also argued that mandated climate disclosure rules could violate First Amendment rights.[45]

As noted above, we have considered these comments and other feedback received from the public in formulating the current proposal. As part of its filing review process, the Commission staff also assessed the extent to which registrants currently disclose climate-related risks in their Commission filings. Since 2010, disclosures related to climate change have generally increased, but there is considerable variation in the content, detail, and location (*i.e.,* in reports filed with the Commission, in sustainability reports posted on registrant websites, or elsewhere) of climate-related disclosures. The staff has observed significant inconsistency in the depth and specificity of disclosures by registrants across industries and within the same industry. The staff has found significantly more extensive information in registrants' sustainability reports and other locations such as their websites as compared with their reports filed with the Commission. In addition, the disclosures in registrants' Forms 10–K frequently contain general, boilerplate discussions that provide limited information as to the registrants' assessment of their climate-related risks or their impact on the companies' business.[46]

We are also mindful of the benefits to investors of requiring climate-related information in SEC filings. Providing more extensive climate-related disclosure in sustainability reports, while excluding such relevant information from Forms 10–K, may make it difficult for investors to analyze and compare how climate-related risks and impacts affect registrants' businesses and consolidated financial statements. The inclusion of climate-related disclosures in SEC filings should increase the consistency, comparability, and reliability of climate-related information for investors. The placement of climate-related information in different locations can make it difficult for investors to find comparable climate-related disclosures, whereas inclusion in a registrant's Form 10–K or registration statement should make it easier for investors to find and compare this information.[47] Further, information that is filed with the Commission in Exchange Act periodic reports is subject to disclosure controls and procedures (''DCP''), which help to ensure that a registrant maintains appropriate processes for collecting and communicating the necessary information by which to formulate the climate-related disclosures.[48] Moreover, information filed as part of a registrant's Form 10–K carries certain additional potential liability, which itself can cause registrants to prepare and review information filed in the Form 10–K more carefully than information presented outside SEC filings.[49]

2021) ($4T); Investment Adviser Association (June 11, 2021) ($25T); Investment Company Institute (June 4, 2021) ($30.8T); PIMCO (June 9, 2021) ($2T); SIFMA (June 10, 2021) ($45T); State Street Global Advisors (June 14, 2021) (3.9T); and Vanguard Group, Inc. (June 11, 2021) ($7T).

[39] *See, e.g.,* letters from AllianceBernstein; Amalgamated Bank; Boston Common Asset Management (June 14, 2021); Calvert Research and Management (June 1, 2021); Ceres; the Committee on Mission Responsibility through Investment by Presbyterian Church (June 10, 2021); Katherine DiMatteo (June 1, 2021); Domini Impact Investments (June 14, 2021); Felician Sisters of North America (June 8, 2021); Friends Fiduciary (June 11, 2021); Melanie Bender (May 26, 2021); Miller/Howard Investments (June 11, 2021); Mercy Investment Services, Inc. (June 4, 2021); Parametric Portfolio Associates, LLC (June 4, 2021); San Francisco City and County Employees' Retirement System (June 12, 2021); Seventh Generation Interfaith, Inc. (May 20, 2021); State Street Global Advisors; Sustainability Accounting Standards Board (SASB) (May 19, 2021); the Sustainability Group (June 4, 2021); and Trillium Asset Management (June 9, 2021).

[40] Several commenters referred to various reports by the Intergovernmental Panel on Climate Change (''IPCC'') to demonstrate that there is scientific consensus that climate change is the result of global warming caused by human-induced emissions of greenhouse gases and poses significant global risks. *See, e.g.,* letters from Better Markets (June 14, 2021); Center for Human Rights and Environment (June 9, 2021); Commonwealth Climate and Law Initiative (June 13, 2021); Charles E. Frye (Apr. 3, 2021); Interfaith Center on Corporate Responsibility (June 14, 2021); and Mike Levin and 23 other Members of Congress (June 15, 2021). IPCC's latest report is IPCC, AR6 Climate Change 2021: The Physical Science Basis (Aug. 7, 2021), available at *https://www.ipcc.ch/report/ar6/wg1/.*

[41] *See* letter from SASB.

[42] *See, e.g.,* letters from Amalgamated Bank; Bank of Finland (June 1, 2021); Blueprint Financial (June 11, 2021); Canadian Coalition of Good Governance (June 9, 2021); Center for Climate and Energy Solutions (June 12, 2021); Clean Yield Asset Management (June 11, 2021); Coalition for Inclusive Capitalism (June 14, 2021); Felician Sisters of North America; First Affirmative Financial Network (June 2, 2021); William and Flora Hewitt Foundation (June 9, 2021); Impact Investors, Inc. (June 2, 2021); Impax Asset Management (June 9, 2021); Institute of International Bankers (June 8, 2021); Investment Company Institute; Investment Consultants Sustainability Working Group (June 11, 2021); Miller/Howard Investments; Norge Bank Investment Management (June 13, 2021); Parametric Portfolio Associates; Praxis Mutual Funds and Everence Financial (June 10, 2021); PRI (Consultation Response); Salesforce.com Inc. (June 11, 2021); San Francisco City and County Employees' Retirement System; SASB; Seventh Generation Interfaith, Inc.; S&P Global (June 11, 2021); Trillium Asset Management; World Business Council for Development (WBCSD) (June 11, 2021); Vanguard Group, Inc.; and US Impact Investing Alliance (June 14, 2021).

[43] *See, e.g.,* letters from American Enterprise Institute (June 10, 2021); CO_2 Coalition (June 1, 2021); the Heritage Foundation (June 13, 2021); Steve Milloy (June 1, 2021); Berkeley T. Rulon-Miller (Apr. 9, 2021); and the Texas Public Policy Foundation (June 11, 2021).

[44] *See, e.g.,* letters from American Enterprise Institute; the Cato Institute; the Heritage Foundation; and Texas Public Policy Foundation.

[45] *See, e.g.,* letters from the Institute for Free Speech (June 10, 2021); Patrick Morrisey, West Virginia Attorney General (Mar. 25, 2021); and Texas Public Policy Foundation.

[46] The staff of the Division of Corporation Finance has developed a sample comment letter for registrants to elicit improved disclosure on some of the deficient areas noted in their review of filings. *See* Climate Change Disclosure-Sample Letter, *available at https://www.sec.gov/corpfin/sample-letter-climate-change-disclosures.*

[47] *See, e.g.,* letter from Pricewaterhouse Coopers.

[48] *See* 17 CFR 240.13a–15 and 17 CFR 240.15d–15.

[49] We note that the liability provisions of Section 10(b) and Rule 10b–5 of the Exchange Act can apply to statements made in filings with the SEC or elsewhere, such as in sustainability reports or on company websites. *See, e.g.,* SEC v. *Stinson*, No. 10–3130, 2011 U.S. Dist. LEXIS 65723, 2011 WL 2462038, at 12 (E.D. Pa. June 20, 2011) (finding defendants liable under Section 10(b) when they communicated material misstatements and omissions in direct solicitations via email, a webinar, and various websites). As such, registrants should scrutinize and ensure the accuracy of such statements whether or not filed with the

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Having considered the public feedback and the staff's experience with climate-related disclosures, we believe that the current disclosure system is not eliciting consistent, comparable, and reliable information that enables investors both to assess accurately the potential impacts of climate-related risks on the nature of a registrant's business and to gauge how a registrant's board and management are assessing and addressing those impacts.[50] The Commission has broad authority to promulgate disclosure rules that are in the public interest or for the protection of investors and that promote efficiency, competition, and capital formation.[51] In light of the present and growing significance of climate-related risks to registrants and the inadequacies of current climate disclosures, we are proposing to revise our rules to include climate-related disclosure items and metrics to elicit investment decision-useful information that is necessary or appropriate to protect investors.

We also believe that enhanced climate disclosure requirements could increase confidence in the capital markets and help promote efficient valuation of securities and capital formation by requiring more consistent, comparable, and reliable disclosure about climate-related risks, including how those risks are likely to impact a registrant's business operations and financial performance.[52] The proposed requirements may also result in benefits to registrants, given existing costs to registrants that have resulted from the inconsistent market response to investor demand for climate-related information.[53] In this regard our proposal would provide registrants with a more standardized framework to communicate their assessments of climate-related risks as well as the measures they are taking to address those risks.[54] At the same time, we are open to exploring ways in which registrants could be afforded flexibility in making the necessary disclosures while still providing appropriate consistency and comparability, and are seeking comment in that regard.

C. The Growing Investor Demand for Climate-Related Risk Disclosure and Related Information

1. Major Investor Climate-Related Initiatives

As the Commission recognized in 2010 and earlier, there has been significant investor demand for information about how climate conditions may impact their investments. That demand has been increasing in recent years. Several major institutional investors, which collectively have trillions of dollars in investments under management, have demanded climate-related information from the companies in which they invest because of their assessment of climate change as a risk to their portfolios, and to investments generally, and also to satisfy investor interest in investments that are considered ''sustainable.'' As a result, these investors have sought to include and consider climate risk as part of their investment selection process.[55] These institutional investors have formed investor initiatives to collectively urge companies to provide better information about the impact that climate change has had or is likely to have on their businesses, and to urge governments and companies to take steps to reduce investors' exposure to climate risks. Among these initiatives:[56]

- In 2019, more than 630 investors collectively managing more than $37 trillion signed the Global Investor Statement to Governments on Climate Change urging governments to require climate-related financial reporting;[57]
- This investor initiative continued as the Investor Agenda's 2021 Global Investor Statement to Governments on the Climate Crisis, which was signed by 733 global institutional investors, including some of the largest investors, with more than US $52 trillion in assets under management in the aggregate. This Statement called for governments to implement a number of measures, including mandating climate risk disclosure.[58]
- The UN Principles for Responsible Investment (''PRI'')[59] has acquired over 4,000 signatories who, as of July 13, 2021, have, in the aggregate, assets under management exceeding $120 trillion as of July 13, 2021;[60]
- The Net Zero Asset Managers Initiative, which was formed by an international group of asset managers, has 128 signatories that collectively

Commission. In addition, information filed in a Form 10–K is subject to Section 18 of the Exchange Act. Further, information filed in an annual report on Form 10–K (and other current and periodic reports) can be incorporated by reference in certain Securities Act registration statements, such as those filed on Form S–3, and thereby become subject to the liability provisions of the Securities Act. See Securities Act Section 11 (15 U.S.C. 77k) and Section 12 (15 U.S.C. 77l). *See infra* Section II.C.3–4, II.E, II.G.1, and II.I regarding the application to forward-looking climate disclosures of the safe harbor for forward-looking statements that was added to the Securities Act and Exchange Act pursuant to the Private Securities Litigation Reform Act of 1995.

[50] *See supra* note 42 and accompanying text.

[51] *See* letters from Jill E. Fisch and 18 other law professor signatories (June 11, 2021) (referencing Sections 7, 10, and 19(a) of the Securities Act; and Sections 3(b), 12, 13, 14, 15(d), and 23(a) of the Exchange Act); and Natural Resources Defense Council (June 11, 2021).

[52] *See* letters from Eni SpA (June 12, 2021); Jill. E. Fisch *et al;* Natural Resources Defense Council; SASB; and Value Balancing Alliance (June 28, 2021); *see also infra* Section IV.

[53] *See, e.g.,* letter from SASB (stating that through the ''multiple voluntary disclosure frameworks (*i.e.,* the ''alphabet soup'' decried by companies) . . . and numerous direct requests to companies for information through surveys, the current private ordering-led system has increased the burden on companies—and investors—while still leaving many companies uncertain as to whether they are, in practice, providing the decision-useful information required by investors.''); *see also* letters from Americans for Financial Reform Education Fund and Public Citizen (June 14, 2021) (stating that ''the proliferation of differing frameworks has increased compliance complexities and costs for companies''); Eni SpA (stating that the fragmentation of data fostered by the proliferation of reporting frameworks has multiplied the efforts of companies in satisfying all their requirements); and BSR (June 11, 2021) (providing that ''a fragmented environment is limiting the impact of reporting and creating undue confusion and cost on the part of reporters.'').

[54] Providing a more standardized framework for climate-related disclosures would be consistent with the Recommendation from the Investor-as-Owner Subcommittee of the SEC Investor Advisory Committee Relating to ESG Disclosure (May 14, 2020) (''IAC Recommendation''), available at *https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf.* The term ''ESG'' refers to environmental, social, and governance matters, of which climate-related disclosures is a part. The IAC Recommendation focused on the inadequacies of ESG disclosures broadly, and not just on those involving climate. The IAC Recommendation stated that, to the extent that SEC reporting obligations would require a single standard of material, decision-useful ESG information, as relevant to each issuer, and based upon data that issuers already use to make their business decisions, such an approach would level the playing field between well-financed large issuers and capital constrained small issuers.

[55] *See supra* note 23.

[56] There is some overlap in the signatories to the listed initiatives.

[57] *See* United Nations Climate Change, *631 Institutional Investors Managing More than USD 37 Trillion in Assets Urge Governments to Step up Climate Ambition* (Dec. 9, 2019), available at *https://unfccc.int/news/631-institutional-investors-managing-more-than-usd-37-trillion-in-assets-urge-governments-to-step-up.*

[58] *See* The Investor Agenda, 2021 Global Investor Statement to Governments on the Climate Crisis (Oct. 27, 2021), available at *https://theinvestoragenda.org/wp-content/uploads/2021/09/2021-Global-Investor-Statement-to-Governments-on-the-Climate-Crisis.pdf.*

[59] PRI was created by a UN-sponsored small group of large global investors in 2006. A stated core goal of the PRI is to help investors protect their portfolios from climate-related risks and to take advantage of climate-related opportunities associated with a shift to a low-carbon global economy. *See* PRI, *Climate Change,* available at *https://www.unpri.org/climate-change.*

[60] *See* PRI, *CEO quarterly update: Celebrating 4000 signatories and supporting the evolution of PRI* (July 13, 2021), available at *https://www.unpri.org/pri-blog/ceo-quarterly-update-celebrating-4000-signatories-and-supporting-the-evolution-of-ri/8033.article.*

manage $43 trillion in assets as of July 2021;[61]

- The Climate Action 100+, an investor-led initiative, now comprises 617 global investors that together have more than $60 trillion in assets under management;[62] and
- The Glasgow Financial Alliance for Net Zero (''GFANZ''), a coalition of over 450 financial firms from 45 countries, responsible for assets of over $130 trillion, that are committed to achieving net-zero emissions by 2050, reaching 2030 interim targets, covering all emission scopes and providing transparent climate-related reporting.[63]

Each of these investor initiatives has emphasized the need for improved disclosure by companies regarding climate-related impacts. Each of these initiatives has advocated for mandatory climate risk disclosure requirements aligned with the recommendations of the Task Force on Climate-Related Financial Disclosures (''TCFD'')[64] so that disclosures are consistent, comparable, and reliable. The investor signatories of Climate Action 100+ emphasized that obtaining better disclosure of climate-related risks and companies' strategies to address their exposure to those risks is consistent with the exercise of their fiduciary duties to their respective clients.[65]

At the same time, many companies have made commitments with respect to climate change, such as commitments to reduce greenhouse gas emissions or become ''net zero'' by a particular date.[66] Companies may make these commitments to attract investors, to appeal to customers that prioritize sustainability, or to reduce their exposure to risks posed by an expected transition to a lower carbon economy.[67] In response to these commitments, investors have demanded more detailed information about climate-related targets and companies' plans to achieve them in order to assess the credibility of those commitments and compare companies based on those commitments.[68]

These initiatives demonstrate that investors are using information about climate risks now as part of their investment selection process and are seeking more informative disclosures about those risks. As an increasing number of investors incorporate this information, in particular GHG emissions, into their investment selection or voting decisions, this may in turn create transition risks for companies that are seeking to raise capital.

2. Third-Party Data, Voluntary Disclosure Frameworks, and International Disclosure Initiatives

Despite increasing investor demand for information about climate-related risks and strategies, many investors maintain that they cannot obtain the consistent, comparable, and material information that they need to properly inform their investment or voting decisions.[69] In 2020, the Commission's Investor Advisory Committee (''IAC'') noted the fragmentation of information that has resulted from a rise in third-party data providers that have emerged to try to meet the informational demands of investors.[70] The IAC recommended that the Commission take action to ensure investors have the material, comparable, consistent information about climate and other ESG matters that they need to make investment and voting decisions.

In addition, a diverse group of third parties has developed climate-related reporting frameworks seeking to meet investors' informational demands. These include the Global Reporting Initiative (''GRI''),[71] CDP (formerly the Carbon Disclosure Project),[72] Climate Disclosure Standards Board (''CDSB''),[73] Value Reporting Foundation (formed through a merger of the Sustainability Accounting Standards Board (''SASB'') and the International Integrated Reporting Council (''IIRC'')),[74] and the TCFD.[75]

To some extent, the development of these disparate frameworks has led to an increase in the number of companies that are providing some climate-related disclosures.[76] However, because they

[61] *See* Net Zero Asset Managers Initiative, *Net Zero Asset Managers initiative announces 41 new signatories, with sector seeing 'net zero tipping point'* (July 6, 2021), available at *https://www.netzeroassetmanagers.org/net-zero-asset-managers-initiative-announces-41-new-signatories-with-sector-seeing-net-zero-tipping-point.*

[62] *See* Climate Action 100+, *About Climate Action 100+,* available at *https://www.climateaction100.org/about/* (indicating that the initiative is engaging companies on strengthening climate-related financial disclosures).

[63] *See* GFANZ, *About Us*, available at *https://www.gfanzero.com/about/.* Another organization, the CDP, provides a means for investors to request that companies provide climate-related disclosures through the CDP. In 2021, over 590 investors with $110 trillion in assets under management requested that thousands of companies disclose climate related information to them through the CDP. *See* CDP, *Request Environmental Information,* available at *https://www.cdp.net/en/investor/request-environmental-information#d52d69887a88f63e15931b5db2cbe80d.*

[64] We discuss the TCFD in greater detail in Section I.D.1 below.

[65] *See* Climate Action 100+, *About Climate Action 100+*. Further, commenters noted their fiduciary obligations to consider climate-related risks. *See, e.g.,* letters from PRI (Consultation Response); and California Public Employee Retirement System (CalPERS) (June 12, 2021).

[66] According to one publication, two-thirds of S&P 500 companies had set a carbon reduction target by the end of 2020. *See* Jean Eaglesham, *Climate Promises by Businesses Face New Scrutiny,* The Wall Street Journal (Nov. 5, 2021).

[67] *See* Global Survey Shows Race to Decarbonization is on: Johnson Controls finds Delivering Growth and Competitive Advantage are Main Drivers for Companies to Commit to Net Zero (Dec. 1, 2021), available at *https://ih.advfn.com/stock-market/NYSE/johnson-controls-JCI/stock-news/86696470/global-survey-shows-race-to-decarbonization-is-on#:~:text=Global%20Survey%20Shows%20Race%20to%20Decarbonization%20is%20on%3A,December%2001%202021%20-%2007%3A01AM%20PR%20Newswire%20%28US%29;* and COP26 made net zero a core principle for business. Here's how leaders can act, McKinsey (Nov. 12, 2021), available at *https://www.mckinsey.com/business-functions/sustainability/our-insights/cop26-made-net-zero-a-core-principle-for-business-heres-how-leaders-can-act.*

[68] *See, e.g.,* letters from Ceres; Investor Adviser Association (June 11, 2021); SIFMA Asset Management Group (June 10, 2021); Trillium Asset Management; and T. Rowe Price (June 11, 2021); *see also* letters from Boston University Impact Measurement and Allocation Program (June 7, 2021); CDP (June 11, 2021); Christopher Lish (June 12, 2021); and Pricewaterhouse Coopers (June 10, 2021).

[69] *See supra* note 42.

[70] *See* IAC Recommendation. The IAC Recommendation noted that more than 125 third-party ESG data providers, including ESG ratings firms, have emerged to try to meet the informational demands of investors. According to the IAC Recommendation, these data providers are limited in their ability collectively to provide investors with comparable and consistent information as they use different information sources and different—frequently opaque—methodologies to conduct their analyses, which compromises the usefulness and reliability of the information. This current heterogeneity in practices and disparate demands from investors and ratings firms places a significant burden on companies asked to provide this information in a variety of formats. The IAC Recommendation further observed that many companies feel compelled to respond to the multiple surveys of ESG rating firms because ignoring them or refusing to respond can lead to a low rating, which can adversely affect stock price and access to capital. While the proposed rules would not necessarily eliminate third-party questionnaires, they would help to provide standardized information to all investors and might reduce the need to obtain the information obtained through questionnaires.

[71] *See* GRI, *About GRI,* available at *https://www.globalreporting.org/about-gri/.*

[72] *See* CDP, *About Us,* available at *https://www.cdp.net/en/info/about-us.* In 2018, CDP revised its questionnaire to companies so that it aligns with the TCFD recommended framework. *See* letter from CDP.

[73] *See* CDSB, *About the Climate Disclosure Standards Board,* available at *https://www.cdsb.net/our-story.*

[74] *See* Value Reporting Foundation, *Understanding the Value Reporting Foundation,* available at *https://www.valuereportingfoundation.org/.*

[75] *See* TCFD, *About,* available at *https://www.fsb-tcfd.org/about/.*

[76] For example, according to the CDP, over 3,000 companies have provided climate-related disclosures through the CDP's platform by responding to the CDP's questionnaires that are aligned with the TCFD's disclosure recommendations. *See* letter from CDP. The TCFD

Continued

are voluntary, companies that choose to disclose under these frameworks may provide partial disclosures or they may choose not to participate every year. In addition, the form and content of the disclosures may vary significantly from company to company, or from period to period for the same company. The situation resulting from these multiple voluntary frameworks has failed to produce the consistent, comparable, and reliable information that investors need.[77] Instead, the proliferation of third-party reporting frameworks has contributed to reporting fragmentation, which can hinder investors' ability to understand and compare registrants' climate-related disclosures. An analysis conducted by the World Business Council for Sustainable Development found that investors had difficulty using existing sustainability disclosures because they lack consistency and comparability.[78] In addition, a 2020 study by the Yale Initiative on Sustainable Finance found that the proliferation of reporting frameworks may have made reporting more difficult for issuers.[79] Moreover, given the voluntary nature of these third-party frameworks, there may not be sufficient incentives or external disciplines to ensure that companies are providing complete and robust disclosure under those frameworks.[80]

The staff has reviewed more than a dozen studies of climate-related disclosures conducted by third parties, such as the CDP,[81] KPMG,[82] TCFD[83], and Ernst & Young,[84] which assessed the adherence of the climate-related disclosures to various third-party frameworks, such as the TCFD. These studies have reinforced the staff's observations from their review of filings that there is significant variation across companies and industries with regard to the content of current climate disclosures.[85] Further, much of this climate-related information, particularly GHG emissions and targets, appears outside of Commission filings, in sustainability reports, and on corporate websites. Other analyses of current climate reporting have found a lack of transparency and standardization with regard to the methodologies companies apply in disclosing climate-related information.[86]

The increased fragmentation of climate reporting resulting from the proliferation of third-party reporting frameworks has motivated a number of recent international efforts to obtain more consistent, comparable, and reliable climate-related information for investors. For example:

- A consultation paper published by the IFRS Foundation[87] Trustees in 2020 noted the broad range of voluntary sustainability reporting frameworks that have increased complexity and cost to preparers without improving the quality of the information available to investors;[88]
- Based on the response to the IFRS Foundation consultation paper, the IFRS Foundation took steps toward the establishment of an International Sustainability Standards Board (''ISSB'') operating within the existing governance structure of the IFRS Foundation;
- In 2021, following two roundtables hosted by its Sustainable Finance Task Force, IOSCO[89] issued a report that concluded that companies' current sustainability disclosures do not meet investors' needs, and the proliferation of voluntary disclosure frameworks has led to inconsistency in application of the frameworks and, in some cases ''cherry picking'' of information that might not present an accurate picture of companies' risks.[90]
- A Technical Experts' Group of IOSCO worked with a Technical Readiness Working Group of the IFRS Foundation to assess and fine-tune a prototype climate-related financial disclosure standard (''Prototype'') drafted by an alliance of prominent sustainability reporting organizations and designed as a potential model for

has similarly reported growth in the number of companies and countries supporting its climate-related disclosure recommendations. *See* TCFD, *2021 Status Report* (Oct. 2021), available at *https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Status-Report.pdf* (stating that, as of Oct. 6, 2021, the TCFD had over 2,600 supporters globally, including 1,069 financial institutions responsible for assets of US $194 trillion).

[77] *See supra* note 42.

[78] Dr. Rodney Irwin, Alan McGill, *Enhancing the Credibility of Non-Financial Information,* the Investor Perspective, WBCSD and PwC (Oct. 2018).

[79] Yale Initiative on Sustainable Finance, *Toward Enhanced Sustainability Disclosure: Identifying Obstacles to Broader and More Actionable ESG Reporting* (Sept. 2020), available at *https://pages.fiscalnote.com/rs/109-ILL-989/images/YISF%20ESG%20Reporting%20White%20Paper.pdf.*

[80] *See, e.g.,* TCFD, *2021 Status Report (indicating that there is* a need to improve companies' climate-related disclosures, particularly regarding governance and risk management, to better align with the TCFD's recommendations).

[81] *See* CDP, ANALYSIS OF CA100+ COMPANY DATA (2020), available at *https://cdn.cdp.net/cdp-production/cms/reports/documents/000/005/312/original/Analysis_of_CA100__Data_for_CDP_Investor_Signatories_v5.pdf?1596046258.*

[82] *See* KPMG, *The Time Has Come-The KPMG Survey of Sustainability Reporting 2020* (Dec. 2020), available at https://assets.kpmg/content/dam/kpmg/xx/pdf/2020/11/the-time-has-come.pdf.

[83] *See* TCFD 2020 Status Report (Sept. 2020), available at *https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD_Status-Report.pdf.*

[84] *See* Ernst & Young, *How can climate change disclosures protect reputation and value?-The 2019 EY Global Climate Risk Disclosure Barometer* (Apr. 2020), available at *https://www.ey.com/en_us/climate-change-sustainability-services/how-can-climate-change-disclosures-protect-reputation-and-value.*

[85] For example, the TCFD report found that the average level of disclosure across the TCFD's 11 disclosure categories was 40% for the energy sector, 30% for the materials and building sector, 18% for the consumer goods sector and 13% for the technology sector. The level of disclosure varied among categories with only 4% or reporting companies disclosing the resilience of their strategies in North America and 50% reporting their risks and opportunities (the category with the highest level of disclosure). The Ernst & Young report found many companies in industries considered to have high exposure to climate-related risks lack high quality climate disclosures. The Ernst & Young report graded the average quality of the disclosures at 27 out of 100.

[86] *See, e.g., The SEC's Time to Act,* Center for American Progress (Feb. 19, 2021) (''[T]here is a lack of standardization of the data, assumptions, and methodologies companies use to meet the standards, with much of this information being opaque. Clearly, the current path of climate disclosure will not provide the transparency that an increasing number of investors are seeking and, indeed, a properly functioning market requires—consistency of disclosures across time, comparability of disclosures across companies, and reliability of the information that is disclosed.'') See, also, Andy Green and Andrew Schwartz, *Corporate Long-Termism, Transparency, and the Public Interest* (Oct. 2, 2018) (''[C]orporate disclosure available today is insufficient, not comparable, and unreliable''); and *Managing Climate Risk in the U.S. Financial System,* Report of the Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission (2020) (''Large companies are increasingly disclosing some climate-related information, but significant variations remain in the information disclosed by each company, making it difficult for investors and others to understand exposure and manage climate risks.'').

[87] The *IFRS* Foundation refers to the International Financial Reporting Standards Foundation, which was established to develop a single set of ''high-quality,'' enforceable, and globally accepted accounting standards. *See IFRS—Who we are,* available at *https://www.ifrs.org/about-us/who-we-are/.* The IFRS Foundation was formed in 2010 and succeeded the International Accounting Standards Foundation, which was formed in 2001.

[88] IFRS Foundation, *IFRS Foundation Trustees' Feedback Statement on the Consultation Paper on Sustainability Reporting* (Apr. 2021), available at *https://www.ifrs.org/content/dam/ifrs/project/sustainability-reporting/sustainability-consultation-paper-feedback-statement.pdf.*

[89] IOSCO refers to the International Organization of Securities Commissions, of which the Commission is a member.

[90] IOSCO, *Report on Sustainability-related Issuer Disclosures,* Final Report (June 2021) available at *https://www.iosco.org/library/pubdocs/pdf/IOSCOPD678.pdf.*

standards that an ISSB might eventually develop;[91]

• In November 2021, the IFRS Foundation announced the formation of the ISSB.[92] The ISSB is expected to engage in standard setting to build on the Prototype, including developing climate-specific disclosure standards based on the recommendations of the TCFD.[93]

• Several jurisdictions, including the European Union,[94] are developing or revising their mandatory climate-related disclosure regimes to provide investors with more consistent, useful climate-related financial information, including associated assurance requirements and data tagging to facilitate the use of the information.[95]

These international developments show an increasing global recognition of the need to improve companies' climate-related disclosures, which the proposed rules would help address, as well as the convergence of investors and issuers around the TCFD as a useful framework for communicating information about climate-related risks that companies may face.

D. Development of a Climate-Related Reporting Framework

In recent years, two significant developments have occurred that support and inform the Commission's proposed climate-related reporting rules. The first involves the TCFD, which has developed a climate-related reporting framework that has become widely accepted by both registrants and investors.[96] The second involves the Greenhouse Gas Protocol (''GHG Protocol''), which has become a leading accounting and reporting standard for greenhouse gas emissions.[97] Both the TCFD and the GHG Protocol have developed concepts and a vocabulary that are commonly used by companies when providing climate-related disclosures in their sustainability or related reports. As discussed in greater detail below, the Commission's proposed rules incorporate some of these concepts and vocabulary, which by now are familiar to many registrants and investors.

1. The Task Force on Climate-Related Financial Disclosure

Our proposed climate-related disclosure framework is modeled in part on the TCFD's recommendations. A goal of the proposed rules is to elicit climate-related disclosures that are consistent, comparable, and reliable while also attempting to limit the compliance burden associated with these disclosures. The TCFD framework has been widely accepted by issuers, investors, and other market participants, and, accordingly, we believe that proposing rules based on the TCFD framework may facilitate achieving this balance between eliciting better disclosure and limiting compliance costs.[98]

In April 2015, the Group of 20 Finance Ministers directed the Financial Stability Board (''FSB'') to evaluate ways in which the financial sector could address climate-related concerns.[99] The FSB concluded that better information was needed to facilitate informed investment decisions and to help investors and other market participants to better understand and take into account climate-related risks. The FSB established the TCFD, an industry-led task force charged with promoting better-informed investment, credit, and insurance underwriting decisions.[100] Since then, the framework for climate-related disclosures developed by the TCFD has been refined and garnered global support as a reliable framework for climate-related financial reporting.[101]

In 2017, the TCFD published disclosure recommendations that provide a framework by which to evaluate material climate-related risks and opportunities through an assessment of their projected short-, medium-, and long-term financial impacts on a registrant. The TCFD framework establishes eleven disclosure topics related to four core themes that provide a structure for the assessment, management, and disclosure of climate-related financial risks: Governance, strategy, risk management, and metrics and targets.[102]

[91] *See* CDP, CDSB, GRI, IIRC and SASB, *Reporting on enterprise value Illustrated with a prototype climate-related financial disclosure standard* (Dec. 2020), available at *https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Reporting-on-enterprise-value_climate-prototype_Dec20.pdf;* and IFRS Foundation, *IFRS Foundation announces International Sustainability Standards Board, consolidation with CDSB and VRF, and publication of prototype disclosure requirements,* available at *https://www.ifrs.org/news-and-events/news/2021/11/ifrs-foundation-announces-issb-consolidation-with-cdsb-vrf-publication-of-prototypes/.*

[92] *See* IFRS Foundation, *IFRS Foundation announces International Sustainability Standards Board, consolidation with CDSB and VRF, and publication of prototype disclosure requirements* (Nov. 3, 2021), available at *https://www.ifrs.org/news-and-events/news/2021/11/ifrs-foundation-announces-issb-consolidation-with-cdsb-vrf-publication-of-prototypes/.* At the same time, the IFRS Foundation announced the planned consolidation of the Climate Disclosure Standards Board and the Value Reporting Foundation into the ISSB during 2022. The ISSB is expected to develop reporting standards using the Prototype as a starting point and engaging in rigorous due process under the oversight of the IFRS Foundation Trustees' Due Process Oversight Committee.

[93] *Id.*

[94] *Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting* (Apr. 2021), available at *https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0189.* In proposing revised corporate sustainability reporting requirements, the EU explained that there exists a widening gap between the sustainability information, including climate-related data, companies report and the needs of the intended users of that information, which may mean that investors are unable to take sufficient account of climate-related risks in their investment decisions.

[95] *See* IOSCO, *Report on Sustainability-related Issuer Disclosures,* Final Report (June 2021) (noting progress in several jurisdictions, including Hong Kong, India, Japan, New Zealand and the United Kingdom, to incorporate TCFD's disclosure recommendations into their legal and regulatory frameworks).

[96] A number of registrants recommended basing the Commission's climate-related disclosure rules on the TCFD framework. *See, e.g.,* letters from Adobe; Alphabet Inc. *et al.;* BNP Paribas (June 11, 2021); bp; Chevron (June 11, 2021; ConocoPhilips; and Walmart. Similarly, numerous investors and investor groups recommended the TCFD framework. *See* letters from Alberta Investment Management Corporation; BlackRock; CalPERS; CALSTRS (June 4, 2021); Impact Investors, Inc.; and San Francisco Employees Retirement System. *See also infra* Section II.A.1 for further discussion of the many commenters that recommended basing the Commission's climate-related disclosure rules on the TCFD framework.

[97] *See, e.g.,* letter from Natural Resources Defense Council (stating that most companies providing climate-related information do so using the three-part (scope) framework developed by the GHG Protocol and noting other organizations, such as the CDP, that use the GHG Protocol's framework and methodology); *see also* GHG Protocol, Companies and Organizations, available at *https://ghgprotocol.org/companies-and-organizations* (stating that 92% of companies responding to the CDP in 2016 used the GHG Protocol's standards and guidance).

[98] *See infra* Section II.A.1 and notes 145 through 149.

[99] *See* TCFD, 2020 Status Report (Oct. 2020). The Group of 20 (''G20'') is a group of finance ministers and central bank governors from 19 countries, including the United States, plus the European Union, which was formed in 1999 to promote global economic growth, international trade, and regulation of financial markets. According to the G20, its members represent more than 80% of world GDP, 75% of international trade, and 60% of the world population. *See* G20, About the G20, available at *https://g20.org/about-the-g20/.*

[100] See TCFD, *Recommendations of the Task Force on Climate-related Financial Disclosures* (June 2017), available at *https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf.*

[101] *See, e.g.,* Climate Action 100+, *The Three Asks,* available at *https://www.climateaction100.org/approach/the-three-asks/* (requiring participating investors to ask the companies with which they engage to provide enhanced corporate disclosure in line with the TCFD's recommendations; and CDP, *How CDP is aligned to the TCFD,* available at *https://www.cdp.net/en/guidance/how-cdp-is-aligned-to-the-tcfd* (explaining how the CDP has aligned its questionnaires to elicit disclosures aligned with the TCFD's recommendations).

[102] *See* TCFD, *TCFD_Booklet_FNL_Digital_March-2020.pdf* (*bbhub.io*) (Mar. 2021), available at

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Support for the TCFD's recommendations by companies and other reporting frameworks has grown steadily since the TCFD's formation.[103] As of October 2021 more than 2,600 organizations globally, with a total market capitalization of $25 trillion have expressed support for the TCFD.[104] Further, 1,069 financial institutions, managing assets of $194 trillion, also support the TCFD.[105] In recognition of the widespread adoption by companies of TCFD reporting, a number of countries, including the United Kingdom, New Zealand, and Switzerland, and the European Union that have proposed mandatory climate-risk disclosure requirements have indicated an intention to base disclosure requirements on the TCFD framework.[106] Further, the TCFD's recommendations have been adopted by, and incorporated into, other voluntary climate disclosure frameworks such as the CDP, GRI, CDSB, and SASB frameworks. The TCFD also forms the framework for the Prototype that the IFRS Foundation provided to the ISSB as a potential starting point for its standard setting initiative.[107] The G7 Finance Ministers and Central Bank Governors have also endorsed the TCFD.[108] As a result, although the reporting landscape is crowded with voluntary standards that seek different information in different formats, the TCFD framework has been widely endorsed by U.S. companies and regulators and standard-setters around the world.

2. The Greenhouse Gas Protocol

Quantitative greenhouse gas (''GHG'') emissions data can enable investors to assess a registrant's exposure to climate-related risks, including regulatory, technological, and market risks driven by a transition to a lower-GHG intensive economy.[109] This data also could help investors to assess the progress of registrants with public commitments to reduce GHG emissions, which would be important in assessing potential future capital outlays that might be required to meet such commitments. For these reasons, many investors and other commenters recommended that we require disclosure of a registrant's GHG emissions.[110] Many commenters also recommended that we base any GHG emissions disclosure requirement on the GHG Protocol.[111] These commenters indicated that the GHG Protocol has become the most widely-used global greenhouse gas accounting standard.[112] For example, the Environmental Protection Agency (''EPA'') Center for Corporate Climate Leadership references the GHG Protocol's standards and guidance as resources for companies that seek to calculate their GHG emissions.[113]

The GHG Protocol was created through a partnership between the World Resources Institute and the World Business Council for Sustainable Development, which agreed in 1997 to collaborate with businesses and NGOs to create a standardized GHG accounting methodology.[114] The GHG Protocol has been updated periodically since its original publication and has been broadly incorporated into sustainability reporting frameworks, including the TCFD, Value Reporting Foundation, GRI, CDP, CDSB, and the IFRS Foundation's Prototype.

The GHG Protocol's Corporate Accounting and Reporting Standard provides uniform methods to measure and report the seven greenhouse gasses covered by the Kyoto Protocol—carbon dioxide, methane, nitrous oxide, hydrofluorocarbons, perfluorocarbons, sulfur hexafluoride, and nitrogen trifluoride.[115] The GHG Protocol introduced the concept of ''scopes'' of emissions to help delineate those emissions that are directly attributable to the reporting entity and those that are indirectly attributable to the company's activities.[116] Under the GHG Protocol, Scope 1 emissions are direct GHG emissions that occur from sources owned or controlled by the company. These might include emissions from company-owned or controlled machinery or vehicles, or methane emissions from petroleum operations. Scope 2 emissions are those emissions primarily resulting from the generation of electricity purchased and consumed by the company.[117] Because these emissions derive from the activities of another party (the power provider), they are considered indirect emissions. Scope 3 emissions are all other indirect emissions not accounted for in Scope 2 emissions. These emissions are a consequence of the company's activities but are generated from sources that are neither owned nor controlled by the

https://assets.bbhub.io/company/sites/60/2020/10/TCFD_Booklet_FNL_Digital_March-2020.pdf.

[103] According to the TCFD, ''[for] companies, support is a commitment to work toward their own implementation of the TCFD recommendations.'' *https://www.fsb-tcfd.org/support-tcfd/*

[104] *See* TCFD, 2021 Status Report. A recent survey by Moody's of over 3,800 companies worldwide indicated that the global average disclosure rate of companies that reported across all 11 TCFD's recommendations increased to 22% in 2021 from 16% in 2020. *See* Moody's *State of TCFD Disclosures 2021*, available at *https://assets.website-files.com/5df9172583d7eec04960799a/616d36184f3e6431a424b9df_BX9303_MESG_State%20of%20TCFD%20Disclosures%202021.pdf.* In addition, according to a recent report by the Governance & Accountability Institute, Inc., 70% of companies in the Russell 1000 Index published sustainability reports in 2020, and of those reporters, 30% mentioned or aligned their disclosures with the TCFD framework, and 40% responded to the CDP questionnaires, which are aligned with the TCFD. *See* Governance & Accountability Institute, *Sustainability Reporting in Focus, 2021*, available at *https://www.ga-institute.com/fileadmin/ga_institute/images/FlashReports/2021/Russell-1000/G_A-Russell-Report-2021-Final.pdf?vgo_ee=NK5m02JiOOHgDiUUST7fBRwUnRnlmwiuCIJkd9A7F3A%3D.* We discuss the findings of this report, and other similar findings, in greater detail in Section IV.A.5.c below.

[105] *See* TCFD, *2021 Status Report.*

[106] *See id.*

[107] *See* Climate-related Disclosures Prototype, Developed by the Technical Readiness Working Group, chaired by the IFRS Foundation, to provide recommendations to the International Sustainability Standards Board for consideration (Nov. 2021).

[108] HM Treasury, *G7 Finance Ministers and Central Bank Governors Communique—Policy Paper* (June 2021), available at *https://www.gov.uk/government/publications/g7-finance-ministers-meeting-june-2021-communique/g7-finance-ministers-and-central-bank-governors-communique* (stating their support of mandatory climate-related financial disclosures based on the TCFD framework because of investors' need for high quality, reliable, comparable climate-risk data).

[109] *See, e.g.,* letters from Calvert Research and Management (June 1, 2021); Ceres *et al* (June 10, 2021); NY State Comptroller (June 8, 2021); and SASB (May 19, 2021).

[110] *See infra* Section II.G.1 and note 412.

[111] *See, e.g.,* letters from Apple, Inc. (June 11, 2021); bp (June 11, 2021); Carbon Tracker Initiative (June 14, 2021); Consumer Federation of America (June 14, 2021); ERM CVS (June 11, 2021); Ethic Inc. (June 11, 2021); First Affirmative Financial Network; Regenerative Crisis Response Committee; MSCI, Inc. (June 12, 2021); Natural Resources Defense Council; New York State Society of Certified Public Accountants(June 11, 2021); Paradice Investment Management (June 11, 2021); Stray Dog Capital (June 15, 2021); and Huw Thomas (June 16, 2021).

[112] *See, e.g.,* letters from ERM CVS; and Natural Resources Defense Council; *see also* Greenhouse Gas Protocol, *About Us | Greenhouse Gas Protocol,* available at *https://ghgprotocol.org/about-us.*

[113] *See, e.g.,* EPA Center for Corporate Climate Leadership, *Scope 1 and Scope 2 Inventory Guidance,* at *https://www.epa.gov/climateleadership/scope-1-and-scope-2-inventory-guidance.*

[114] *See* Greenhouse Gas Protocol, *About Us | Greenhouse Gas Protocol* (ghgprotocol.org), available at *https://ghgprotocol.org/about-us.*

[115] *See id.* The Kyoto Protocol, adopted in 1997, implemented the United Nations Framework Convention on Climate Change by obtaining commitments from industrialized countries to reduce emissions of the seven identified gasses according to agreed targets. *See* United Nations Climate Change, What is the Kyoto Protocol?, *available at https://unfccc.int/kyoto_protocol.* The EPA includes these seven greenhouse gases in its greenhouse gas reporting program. *See, e.g.,* EPA, *GHGRP Emissions by GHG,* available at *https://www.epa.gov/ghgreporting/ghgrp-emissions-ghg.*

[116] *See* World Business Council for Sustainable Development and World Resources Institute, *The Greenhouse Gas Protocol, A Corporate Accounting and Reporting Standard* REVISED EDITION, available at *https://ghgprotocol.org/corporate-standard.*

[117] *Id.*

company.[118] These might include emissions associated with the production and transportation of goods a registrant purchases from third parties, employee commuting or business travel, and the processing or use of the registrant's products by third parties.[119]

We have based our proposed GHG emissions disclosure requirement primarily on the GHG Protocol's concept of scopes and related methodology.[120] By basing this requirement on an established GHG emissions reporting framework, we believe the compliance burden would be mitigated, especially for those registrants that are already disclosing or estimating their GHG emissions pursuant to the GHG Protocol.

E. Summary of the Proposed Rules

We are proposing to add a new subpart to Regulation S–K, 17 CFR 229.1500–1507 (''Subpart 1500 of Regulation S–K'') that would require a registrant to disclose certain climate-related information, including information about its climate-related risks that are reasonably likely to have material impacts on its business or consolidated financial statements, and GHG emissions metrics that could help investors assess those risks.[121] A registrant may also include disclosure about its climate-related opportunities. The proposed new subpart to Regulation S–K would include an attestation requirement for accelerated filers [122] and large accelerated filers [123] regarding certain proposed GHG emissions metrics disclosures.[124]

We are also proposing to add a new article to Regulation S–X, 17 CFR 210.14–01 and 02 (''Article 14 of Regulation S–X'') that would require certain climate-related financial statement metrics and related disclosure to be included in a note to a registrant's audited financial statements.[125] The proposed financial statement metrics would consist of disaggregated climate-related impacts on existing financial statement line items. As part of the registrant's financial statements, the financial statement metrics would be subject to audit by an independent registered public accounting firm, and come within the scope of the registrant's internal control over financial reporting (''ICFR'').[126]

1. Content of the Proposed Disclosures

The proposed climate-related disclosure framework is modeled in part on the TCFD's recommendations, and also draws upon the GHG Protocol. In particular, 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; [127]
- 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; [128]
- How any identified climate-related risks have affected or are likely to affect the registrant's strategy, business model, and outlook; [129]
- 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; [130]
- The impact of climate-related events (severe weather events and other natural conditions as well as physical risks identified by the registrant) and transition activities (including transition risks identified by the registrant) on the line items of a registrant's consolidated financial statements and related expenditures,[131] and disclosure of financial estimates and assumptions impacted by such climate-related events and transition activities.[132]
- Scopes 1 and 2 GHG emissions metrics, separately disclosed, expressed:
  - Both by disaggregated constituent greenhouse gases and in the aggregate, and
  - In absolute and intensity terms; [133]
- Scope 3 GHG emissions and intensity, if material, or if the registrant has set a GHG emissions reduction target or goal that includes its Scope 3 emissions; and
- The registrant's climate-related targets or goals, and transition plan, if any.[134]

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.

2. Presentation of the Proposed Disclosures

The proposed rules would require a registrant (both domestic and foreign private issuers): [135]

- To provide the climate-related disclosure in its registration statements and Exchange Act annual reports; [136]

[118] The Scope 3 emissions standard was developed over a three-year period with participation by businesses, government agencies, academics, and NGOs to help companies understand and manage their climate-related risks and opportunities in their upstream and downstream value chains. *See* Greenhouse Gas Protocol, *Corporate Value Chain (Scope 3) Accounting and Reporting Standard, Supplement to the GHG Protocol Corporate Accounting and Reporting Standard* (Sept. 2011), available at *https://ghgprotocol.org/sites/default/files/standards/Corporate-Value-Chain-Accounting-Reporing-Standard_041613_2.pdf.* This standard identified eight upstream and seven downstream emission categories that can give rise to Scope 3 emissions. The GHG Protocol is developing additional guidance that may impact Scope 3 emissions related to land use and land sector activities. *See* Greenhouse Gas Protocol, *Update on Greenhouse Gas Protocol Carbon Removals and Land Sector Initiative* (July 8, 2021), available at *https://ghgprotocol.org/blog/update-greenhouse-gas-protocol-carbon-removals-and-land-sector-initiative.*

[119] *See* Section II.G.1, below, for a more extensive discussion of Scope 3 categories and emissions.

[120] *See id.*

[121] *See infra* Sections II.B through E and II.G through I.

[122] *See* 17 CFR 240.12b–2 (defining ''accelerated filer'' as an issuer after it first meets the following conditions as of the end of its fiscal year: (i) The issuer had an aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates of $75 million or more, but less than $700 million, as of the last business day of the issuer's most recently completed second fiscal quarter; (ii) the issuer has been subject to the requirements of Section 13(a) or 15(d) of the Exchange Act for a period of at least twelve calendar months; (iii) the issuer has filed at least one annual report pursuant to Section 13(a) or 15(d) of the Exchange Act; and (iv) the issuer is not eligible to use the requirements for SRCs under the SRC revenue test).

[123] *See* 17 CFR 240.12b–2 (defining ''large accelerated filer'' as an issuer after it first meets the following conditions as of the end of its fiscal year: (i) The issuer had an aggregate worldwide market value of the voting and non-voting common equity held by its non-affiliates of $700 million or more, as of the last business day of the issuer's most recently completed second fiscal quarter; (ii) the issuer has been subject to the requirements of Section 13(a) or 15(d) of the Exchange Act for a period of at least twelve calendar months; (iii) the issuer has filed at least one annual report pursuant to Section 13(a) or 15(d) of the Exchange Act; and (iv) the issuer is not eligible to use the requirements for SRCs under the SRC revenue test).

[124] *See infra* Section II.H.

[125] *See infra* Section II.F.

[126] *See infra* Sections II.F.2 and 3.

[127] *See infra* Section II.D.

[128] *See infra* Sections II.B and C.

[129] *See infra* Section II.C.

[130] *See infra* Section II.E.

[131] *See infra* Sections II.F.2 and 3.

[132] *See infra* Sections II.F.4.

[133] *See infra* Section II.G.1.

[134] *See infra* Section II.I.

[135] As defined by Commission rules, a foreign private issuer is any foreign issuer other than a foreign government except an issuer meeting the following conditions as of the last business day of its most recently completed second fiscal quarter: More than 50% of the outstanding voting securities of such issuer are directly or indirectly owned of record by residents of the United States; and either the majority of its executive officers or directors are United States citizens or residents, more than 50% of the assets of the issuer are located in the United States, or the business of the issuer is administered principally in the United States. *See* 17 CFR 230.405 and 17 CFR 240.3b–4.

[136] *See infra* Section II.A.2.

• To provide the Regulation S–K mandated climate-related disclosure in a separate, appropriately captioned section of its registration statement or annual report, or alternatively to incorporate that information in the separate, appropriately captioned section by reference from another section, such as Risk Factors, Description of Business, or Management's Discussion and Analysis (''MD&A''); [137]

• To provide the Regulation S–X mandated climate-related financial statement metrics and related disclosure in a note to the registrant's audited financial statements; [138]

• To electronically tag both narrative and quantitative climate-related disclosures in Inline XBRL; [139] and

• To file rather than furnish the climate-related disclosure.[140]

3. Attestation for Scope 1 and Scope 2 Emissions Disclosure

The proposed rules would require an accelerated filer or a large accelerated filer to include, in the relevant filing, an attestation report covering, at a minimum, the disclosure of its Scope 1 and Scope 2 emissions and to provide certain related disclosures about the service provider.[141] As proposed, both accelerated filers and large accelerated filers would have time to transition to the minimum attestation requirements. The proposed transition periods would provide existing accelerated filers and large accelerated filers one fiscal year to transition to providing limited assurance and two additional fiscal years to transition to providing reasonable assurance, starting with the respective compliance dates for Scopes 1 and 2 disclosure described below.[142] The proposed rules would provide minimum attestation report requirements, minimum standards for acceptable attestation frameworks, and would require an attestation service provider to meet certain minimum qualifications. The proposed rules would not require an attestation service provider to be a registered public accounting firm.

4. Phase-In Periods and Accommodations for the Proposed Disclosures

The proposed rules would include:

• A phase-in for all registrants, with the compliance date dependent on the registrant's filer status;

• An additional phase-in period for Scope 3 emissions disclosure;

• A safe harbor for Scope 3 emissions disclosure;

• An exemption from the Scope 3 emissions disclosure requirement for a registrant meeting the definition of a smaller reporting company (''SRC''); [143] and

• A provision permitting a registrant, if actual reported data is not reasonably available, to use a reasonable estimate of its GHG emissions for its fourth fiscal quarter, together with actual, determined GHG emissions data for the first three fiscal quarters, as long as the registrant promptly discloses in a subsequent filing any material difference between the estimate used and the actual, determined GHG emissions data for the fourth fiscal quarter.

The proposed rules would be phased in for all registrants, with the compliance date dependent upon the status of the registrant as a large accelerated filer, accelerated or non-accelerated filer, or SRC, and the content of the item of disclosure. For example, assuming that the effective date of the proposed rules occurs in December 2022 and that the registrant has a December 31st fiscal year-end, the compliance date for the proposed disclosures in annual reports, other than the Scope 3 disclosure, would be:

• For large accelerated filers, fiscal year 2023 (filed in 2024);

• For accelerated and non-accelerated filers, fiscal year 2024 (filed in 2025); and

• For SRCs, fiscal year 2025 (filed in 2026).[144]

Registrants subject to the proposed Scope 3 disclosure requirements would have one additional year to comply with those disclosure requirements.

We welcome feedback and encourage interested parties to submit comments on any or all aspects of the proposed rules. When commenting, it would be most helpful if you include the reasoning behind your position or recommendation.

II. Discussion

A. Overview of the Climate-Related Disclosure Framework

1. Proposed TCFD-Based Disclosure Framework

We have modeled the proposed disclosure rules in part on the TCFD disclosure framework. Building on the TCFD framework should enable companies to leverage the framework with which many investors and issuers are already familiar, which should help to mitigate both the compliance burden for issuers and any burdens faced by investors in analyzing and comparing the new proposed disclosures.

Many commenters that supported climate disclosure rules recommended that we consider the TCFD framework in developing those rules. Numerous commenters stated that the Commission should base its climate-related disclosure rules on the TCFD framework either as a standalone framework,[145] or in conjunction with industry-specific metrics drawn from the SASB [146] or

[137] *See id.*

[138] *See infra* Section II.F.

[139] *See infra* Section II.K.

[140] *See infra* Section II.L.

[141] *See infra* Section II.H.

[142] *See infra* Section II.H.1 (providing further details on the proposed timing of the minimum attestation requirements).

[143] *See infra* Section II.G.3. The Commission's rules define a smaller reporting company to mean an issuer that is not an investment company, an asset-backed issuer, or a majority-owned subsidiary of a parent that is not a smaller reporting company and that: (1) Had a public float of less than $250 million; or (2) had annual revenues of less than $100 million and either: (i) No public float; or (ii) a public float of less than $700 million. *See* 17 CFR 229.10(f)(1), 230.405, and 17 CFR 240.12b–2.

[144] *See infra* Section II.M.

[145] *See, e.g.,* letters from Alphabet Inc., Amazon.com Inc., Autodesk, Inc., eBay Inc., Facebook, Inc., Intel Corporation, and Salesforce.com, Inc. (June 11, 2021) (''Alphabet Inc. *et al.*); the Aluminum Association (June 11, 2021); Amalgamated Bank; Apple, Inc.; Bank of Finland; BNP Paribas; Boston Common Asset Management; Ceres and other signatories representing NGOs, academics, and investors (Ceres *et al.*) (June 11, 2021); Certified B Corporations (June 11, 2021); Chevron; Clean Yield Asset Management; Climate Advisers (June 13, 2021); Climate Governance Initiative (June 12, 2021); Committee on Financial and Capital Markets (Keidenren) (June 13, 2021); Commonwealth Climate and Law Initiative; Crowe LLP (June 11, 2021); E2 (June 14, 2021); ERM CVS; Eumedion (June 11, 2021); Fossil Fuel Divest Harvard (June 14, 2021); Impact Investors, Inc.; Impax Asset Management; Information Technology Industry Council (June 11, 2021); Institutional Limited Partners Association (June 11, 2021); Japanese Bankers Association (June 11, 2021); Keramida (June 11, 2021); Carolyn Kohoot (June 11, 2021); Legal and General Investment Management America (June 11, 2021); Christopher Lish (June 12, 2021); Manifest Climate (June 13, 2021); Mercy Investment Services, Inc.; Miller/Howard Investments; Mirova US LLC (June 14, 2021); M.J. Bradley & Associates, on behalf of Energy Strategy Coalition (June 13, 2021); Morningstar, Inc. (June 9, 2021); MSCI, Inc.; Natural Resources Defense Council (June 11, 2021); Persefoni (June 14, 2021); PRI; S&P Global; Maria Stoica (June 11, 2021); Trillium Asset Management; United Nations Environment Programme (UNEP) (June 9, 2021); Walmart, Inc. (June 11, 2021); and World Business Council for Development (June 11, 2021) (WBCSD).

[146] *See, e.g.,* letters from Adobe Inc. (June 11, 2021); Alberta Investment Management Corporation (June 11, 2021); AllianceBernstein; American Chemistry Council (June 11, 2021); American Society of Adaptation Professionals (June 11, 2021); Baillie Gifford (June 11, 2021); Bank Policy Institute (June 9, 2021); BlackRock; Bloomberg, LP (June 3, 2021); bp; BSR (June 11, 2021); Canadian Bankers Association (June 11, 2021); Canadian Coalition of Good Governance; Capital Group (June 11, 2021); Catavento Consultancy (Apr. 30, 2021); Center for Climate and Energy Solutions; Confluence Philanthropy (June 14, 2021); ConocoPhilips, Inc.

other third-party frameworks.[147] A broad range of commenters, including both issuers [148] and investors,[149] supported basing new climate-related disclosure rules on the TCFD framework.

Commenters provided several reasons for their support of the TCFD framework. First, commenters indicated that, because of the widespread adoption of the framework, issuers and investors have experience making and using TCFD disclosures. As a result, according to commenters, aligning SEC rules with the TCFD could reduce the burden on issuers and increase the consistency and comparability of climate disclosures.[150] Second, commenters stated that the information that the TCFD disclosures elicit is useful for investors to understand companies' exposure to and management of climate-related risks.[151] Third, various jurisdictions around the world have announced their intention to align their domestic disclosure rules with the TCFD.[152] Commenters stated that by aligning with the TCFD framework, the Commission could potentially facilitate higher levels of consistency and comparability of disclosures globally.[153]

The consistency and breadth of these comments comport with our understanding that the TCFD framework has been widely accepted by issuers, investors, and other market participants and reinforce our view that the framework would provide an appropriate foundation for the proposed amendments.[154] Basing the Commission's climate-related disclosure rules on a globally recognized framework should help elicit climate-related disclosures that are consistent, comparable, and reliable while also limiting the compliance burden for registrants that are already providing climate-related disclosures based on this framework.

Similar to the TCFD framework, the proposed climate-related provisions under Regulation S–K would require disclosure of a registrant's: Governance of climate-related risks; [155] any material climate-related impacts on its strategy, business model, and outlook; [156] climate-related risk management; [157] GHG emissions metrics; [158] and climate-related targets and goals, if any.[159]

The proposed climate-related provisions under Regulation S–X would require a registrant to disclose in a note to its financial statements certain disaggregated climate-related financial statement metrics that are mainly derived from existing financial statement line items.[160] The proposed rules would require disclosure falling under the following three categories of information: Financial impact metrics; [161] expenditure metrics; [162] and financial estimates and assumptions.[163] Similar to the TCFD's recommendation regarding financial impacts, the proposed financial statement metrics have the objective of increasing transparency about how climate-related risks impact a registrant's financial statements.[164] The TCFD framework identifies two broad categories of actual and potential financial impacts driven by climate-related risks and opportunities: Financial performance (income statement focused) and financial position (balance sheet focused), and includes suggested metrics such as the amount of capital expenditure deployed toward climate-related risks and opportunities, which is similar to our proposed financial statement metrics.[165]

2. Location of the Climate-Related Disclosure

Many commenters stated that the Commission should amend Regulation S–K or Regulation S–X to include climate-related disclosure requirements.[166] Other commenters

(June 11, 2021); CPP Investments (June 11, 2021); Enbridge, Inc. (June 11, 2021); Energy Workforce and Technology Council (June 11, 2021); Entelligent, Inc. (June 14, 2021); Ethic Inc.; Emmanuelle Haack (Apr. 27, 2021); Harvard Management Company (June 11, 2021); Hermes Equity Ownership Services Limited (June 14, 2021); Douglas Hileman Consulting (June 7, 2021); HP, Inc. (June 14, 2021); Virginia Harper Ho (June 12, 2021); IHS Markit (June 13, 2021); Institute of International Bankers; Institute of International Finance (June 13, 2021); Institute of Management Accountants (June 12, 2021); Invesco (June 10, 2021); Investment Company Institute; Investment Consultants Sustainability Working Group (June 11, 2021); Richard Love (May 20, 2021); Manulife Investment Management (June 11, 2021); NEI Investments (June 11, 2021); Neuberger Berman (June 11, 2021); New York State Society of Certified Public Accountants; Nordea Asset Management (June 11, 2021); Norges Bank Investment Management (June 13, 2021); NY State Comptroller; Paradice Investment Management (June 11, 2021); Parametric Portfolio Associates; PayPal Holdings, Inc. (June 12, 2021); PGIM (June 13, 2021); Reinsurance Association of America (June 9, 2021); Salesforce.com (June 11, 2021); San Francisco Employees Retirement System (June 12, 2021); State Street Global Advisors; Summit Strategy Group (June 11, 2021); Teachers Insurance and Annuity Association of America (June 11, 2021); T Rowe Price (June 11, 2021); Value Reporting Foundation (June 11, 2021); Wellington Management Co. (June 11, 2021); and Westpath Benefits and Assessments (June 11, 2021).

[147] *See, e.g.,* letters from Gabrielle F. Preiser (Mar. 31, 2021) and Worldbenchmarking Alliance (June 11, 2021) (recommending the Global Reporting Initiative (GRI) standards); letter from Mathew Roling and Samantha Tirakian (June 11, 2021) (recommending the CDSB standards); and Pricewaterhouse Coopers and Grant Thornton (June 11, 2021) (recommending the Sustainability Standards Board (SSB) standards once the SSB is established by the IFRS Foundation and others as a global standard-setter and once it promulgates standards).

[148] *See, e.g.,* letters from Adobe; Alphabet Inc. *et al.;* BNP Paribas; bp; Chevron; ConocoPhilips; and Walmart.

[149] *See, e.g.,* letters from Alberta Investment Management Corporation; BlackRock; CalPERS; CALSTRS; Impact Investors, Inc.; and San Francisco Employees Retirement System.

[150] *See, e.g.,* letters from BNP Paribas; Deutsche Bank (June 11, 2021); and Institute of International Bankers.

[151] *See, e.g.,* letters from AllianceBernstein; CALSTRS; Investment Company Institute; and NY State Comptroller.

[152] *See supra* note 95 and accompanying text.

[153] *See, e.g.,* letters from BNP Paribas; bp; and Chevron.

[154] Proponents of the TCFD framework include academics (*see, e.g.,* letters from Jill Fisch *et al.,* J. Robert Gibson (May 26, 2021), and Gina-Gail S Fletcher (June 14, 2021)); accounting and audit firms (*see, e.g.,* letters from AICPA (June 11, 2021), Center for Audit Quality (''CAQ'') (June 11, 2021), and KPMG LLP (June 12, 2021)); foreign firms (*see, e.g.,* letters from Bank of Finland, BNP Paribas, bp, and Deutsche Bank); industry groups (*see, e.g.,* letters from American Chemistry Council, Association of American Railroads (June 11, 2021), and Information Technology Industry Council (June 11, 2021)); investor groups (*see, e.g.,* letters from CalPERS; CALSTRS; and San Francisco Employees Retirement System); individuals (*see, e.g.,* letters from Emmanuelle Haack, Christopher Lish, and Maria Stoica); issuers (*see, e.g.,* letters from Adobe, Alphabet Inc. *et al.,* Apple, and Chevron); NGOs (*see, e.g.,* letters from Ceres *et al.,* Climate Governance Initiative, Natural Resources Defense Council, and UNEP); professional climate advisors (*see, e.g.,* letters from Catavento Consultancy, Douglas Hileman Consulting, ERM CVS, and Ethic Inc.); and professional investment advisors/investment management companies (*see, e.g.,* letters from AllianceBernstein, Impact Investors, Miller/Howard Investments, and Neuberger Berman).

[155] *See* proposed 17 CFR 229.1501.

[156] *See* proposed 17 CFR 229.1502.

[157] *See* proposed 17 CFR 229.1503.

[158] *See* proposed 17 CFR 229.1504.

[159] *See* proposed 17 CFR 229.1506.

[160] *See* proposed 17 CFR 210.14–01 and 14–02.

[161] *See* proposed 17 CFR 210.14–02(c) and (d).

[162] *See* proposed 17 CFR 210.14–02(e) and (f).

[163] *See* proposed 17 CFR 210.14–02(g) and (h).

[164] *See* TCFD, *Recommendations of the Task Force on Climate-related Financial Disclosures* (June 2017), Section B.3 (Financial Impacts).

[165] *See* TCFD, Guidance on Metrics, Targets, and Transition Plans (Oct. 2021), Section F (Financial Impacts), *available at https://assets.bbhub.io/company/sites/60/2021/07/2021-Metrics_Targets_Guidance-1.pdf.* For avoidance of doubt, disclosure of climate-related opportunities is optional, not required, under our proposal.

[166] *See, e.g.,* letters from AllianceBernstein; American Society of Adaptation Professionals; Seema Arora (June 22, 2021); Associated General Contractors of America (June 11, 2021); Baillie Gifford; CalPERS; Cardano Risk Management Ltd. (Apr. 19, 2021); Center for American Progress; Ceres *et al.;* Eni SpA; Jill Fisch (June 3, 2021); George S. Georgiev (June 22, 2021); Hannon Armstrong (June 15, 2021); Henry Schein, Inc.; Hermes Equity Ownership Services Limited; Virginia Harper Ho; Institute for Governance and Sustainable Development (June 9, 2021); Institute for Market Transformation (June 12, 2021); Interfaith Center on Corporate Responsibility; International Corporate Governance Network (June 11, 2021); Japanese Bankers Association; Morrison & Foerster LLP; National Investor Relations Institute (June 11, 2021); Natural Resources Defense Council; Newmont Corporation (June 13, 2021); New York

Continued

recommended that the Commission adopt a new stand-alone regulation for climate-related disclosure.[167] We are proposing to include the climate-related disclosure rules in Regulation S–K and Regulation S–X because the required disclosure is fundamental to investors' understanding the nature of a registrant's business and its operating prospects and financial performance, and therefore, should be presented together with other disclosure about the registrant's business and its financial condition.

Specifically, we are proposing to require a registrant to include climate-related disclosure in Securities Act or Exchange Act registration statements and Exchange Act annual reports in a separately captioned ''Climate-Related Disclosure'' section and in the financial statements.[168] Requiring climate-related disclosure to be presented in this manner would facilitate review of the climate-related disclosure by investors alongside other relevant company financial and non-financial information.

A registrant would be able to incorporate by reference disclosure from other parts of the registration statement or annual report (*e.g.,* Risk Factors, MD&A, or the financial statements) or, in most cases, from other filed or submitted reports into the Climate-Related Disclosure item if it is responsive to the topics specified in Items 1500–1506 of Regulation S–K and if the registrant satisfies the incorporation by reference requirements under the Commission's rules and forms.[169] Allowing incorporation by reference for the Regulation S–K climate-related disclosure would be consistent with the treatment of other types of business disclosure under our rules and would provide some flexibility for registrants while reducing redundancy in disclosure.[170]

Many commenters stated that the Commission should require registrants to discuss and analyze their quantitative climate data in a manner similar to that required for MD&A.[171] These commenters stressed the importance of placing climate-related metrics in the context of other company financial and non-financial information to enable investors to see how those metrics intersect with business operations and industrial processes.[172] Other commenters supported a requirement to discuss and analyze the climate-related metrics, but stated that such discussion should be part of the existing MD&A disclosures.[173] We agree with the commenters supporting a narrative discussion and analysis of the climate-related metrics as means to present these disclosures in context and explain how they relate to the registrant's strategy and management of its climate-related risks. In this way, such a discussion will serve a similar function to the MD&A but will focus on climate-related risk specifically. Our proposed approach, which requires the climate-related disclosure to be included in a specific section but allows registrants to incorporate from disclosure elsewhere (consistent with applicable incorporation by reference requirements), provides some flexibility to the proposed climate-related disclosure scheme while ensuring the disclosure is consistent and comparable across registrants.

Request for Comment

1. Should we add a new subpart to Regulation S–K and a new article to Regulation S–X that would require a registrant to disclose certain climate-related information, as proposed? Would including the climate-related disclosure in Regulation S–K and Regulation S–X facilitate the presentation of climate information as part of a registrant's regular business reporting? Should we instead place the climate-related disclosure requirements in a new regulation or report? Are there certain proposed provisions, such as GHG emissions disclosure requirements, that would be more appropriate under Regulation S–X than Regulation S–K?

2. If adopted, how will investors utilize the disclosures contemplated in this release to assess climate-related risks? How will investors use the information to assess the physical effects and related financial impacts from climate-related events? How will investors use the information to assess risks associated with a transition to a lower carbon economy?

3. Should we model the Commission's climate-related disclosure framework in part on the framework recommended by the TCFD, as proposed? Would alignment with the TCFD help elicit climate-related disclosures that are consistent, comparable, and reliable for investors? Would alignment with the TCFD framework help mitigate the reporting burden for issuers and facilitate understanding of climate-related information by investors because the framework is widely used by companies in the United States and around the world? Are there aspects of the TCFD framework that we should not adopt? Should we instead adopt rules that are based on a different third-party framework? If so, which framework? Should we base the rules on something other than an existing third-party framework?

4. Do our current reporting requirements yield adequate and sufficient information regarding climate-related risks to allow investors to make informed decisions? In lieu of, or in addition to the proposed amendments, should we provide updated guidance on how our existing rules may elicit better disclosure about climate-related risks?

5. Should we require a registrant to present the climate-related disclosure in an appropriately captioned, separate part of the registration statement or annual report, as proposed? Should this disclosure instead be presented as part of the registrant's MD&A?

6. Should we permit a registrant to incorporate by reference some of the

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State Society of Certified Public Accountants; NY State Comptroller; PayPal Holdings, Inc.; PRI (Consultation Response); PricewaterhouseCoopers LLP; Maria Stoica; Sunrise Bay Area (June 14, 2021); Teachers Insurance and Annuity Association of America; Vert Asset Management LLC (June 14, 2021); WBCSD; and Wespath Benefits and Investments (June 11, 2021).

[167] *See* letters from Bank Policy Institute; Andrew Behar (As You Sow) (June 14, 2021); Entelligent Inc. (June 14, 2021); Impax Asset Management; Information Technology Industry Council; Majedie Asset Management (May 25, 2021); David Marriage (June 15, 2021); and XBRL US (June 15, 2021).

[168] *See infra* Section II.J for a discussion of the registrants and forms to which the proposed rules would apply.

[169] *See* 17 CFR 230.411; 17 CFR 240.12b–23; and the applicable forms.

[170] A registrant that elects to incorporate by reference any of the metrics or narrative disclosure that is subject to XBRL tagging must comply with the electronic tagging requirement in the section of the registration statement or report where the metrics or narrative disclosure appears in full. We discuss the XBRL tagging requirement in Section II.K.

[171] *See, e.g.,* letters from Acadian Asset Management LLC (June 14, 2021); Actual Systems, Inc. (June 11, 2021); Baillie Gifford; Biotechnology Innovation Organization; CDP; ClientEarth US (June 14, 2021); FAIRR Initiative (June 15, 2021); Jill Fisch (June 3, 2021); Hermes Equity Ownership Services Limited; International Corporate Governance Network; Japanese Bankers Association; Majedie Asset Management; Morningstar, Inc.; NEI Investments; NY State Comptroller; Paradice Investment Management; Pre-Distribution Initiative (June 14, 2021); PricewaterhouseCoopers LLP; Matthew Roling and Samantha Tirakian (June 11, 2021); Terra Alpha Investments; Vert Asset Management; and WBCSD.

[172] *See, e.g.,* letters from Pricewaterhouse Coopers Ltd.; Vert Asset Management; and WBCSD.

[173] *See, e.g.,* letters from Canadian Coalition for Good Governance; Clean Production Action and Environmental Health Network (June 11, 2021); Decatur Capital Management; Dimensional Fund Advisors (June 11, 2021); Environmental Industry Group (June 9, 2021); Institute for Governance and Sustainable Development; PRI (Consultation Response); Kenya Rothstein (May 3, 2021); and Maria Stoica. *But see* letter from Sarah Ladin (June 14, 2021) (doubting that a ''sustainability discussion and analysis'' requirement would achieve the desired results and stating that it would be difficult to enforce); and David Marriage (indicating that a discussion and analysis requirement for climate-related data would make the data difficult for the market to absorb).

climate-related disclosure from other parts of the registration statement or annual report, as proposed? Should we permit a registrant to incorporate by reference climate-related disclosure that appears in a sustainability report if the registrant includes the incorporated by referenced disclosure as an exhibit to the registration statement or annual report? Are there some climate-related disclosure items, such as GHG emissions data, that we should not permit a registrant to incorporate by reference? Would requiring a registrant to include all of the proposed climate-related disclosures in a separate, appropriately captioned section, while precluding a registrant from incorporating by reference some or all of the climate-related disclosures, promote comparability and ease of use of the climate-related information for investors?

7. Should we permit a registrant to provide certain of the proposed climate-related disclosures in Commission filings other than the annual report or registration statement? For example, should we permit a registrant to provide information about board and management oversight of climate-related risks in its proxy statement?

B. Disclosure of Climate-Related Risks

As many commenters have noted when seeking more detailed climate-related disclosures,[174] climate events and contingencies can pose financial risks to issuers across industrial sectors.[175] Physical risks may include harm to businesses and their assets arising from acute climate-related disasters such as wildfires, hurricanes, tornadoes, floods, and heatwaves. Companies and their investors may also face chronic risks and more gradual impacts from long-term temperature increases, drought, and sea level rise.

In addition to the physical risks associated with the climate, issuers and investors may also face risks associated with a potential transition to a less carbon intensive economy. These risks may arise from potential adoption of climate-related regulatory policies including those that may be necessary to achieve the national climate goals that may be or have been adopted in the United States and other countries;[176] climate-related litigation; changing consumer, investor, and employee behavior and choices; changing demands of business partners; long-term shifts in market prices; technological challenges and opportunities, and other transitional impacts. Disclosure about a registrant's exposure to transition risks, as well as how the registrant is assessing and managing those risks, would help investors assess and plan for how the registrant would be financially impacted by a transition to a lower-carbon economy.

1. Definitions of Climate-Related Risks and Climate-Related Opportunities

A central focus of the Commission's proposed rules is the identification and disclosure of a registrant's material climate-related risks. The proposed rules would require a registrant to disclose any climate-related risks reasonably likely to have a material impact on the registrant's business or consolidated financial statements.[177] A registrant may also disclose, as applicable, the actual and potential impacts of any climate-related opportunities it is pursuing.[178] The proposed definitions are substantially similar to the TCFD's definitions of climate-related risks and climate-related opportunities.[179] We have based our definitions on the TCFD's definitions because they provide a common terminology that allows registrants to disclose climate-related risks and opportunities in a consistent and comparable way. Grounding our definitions in a framework that is already widely accepted also could help limit the burden on issuers to identify and describe climate-related risks and improve the comparability and usefulness of the disclosures for investors.

As proposed, ''climate-related risks'' means the actual or potential negative impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations, or value chains, as a whole.[180] ''Value chain'' would mean the upstream and downstream activities related to a registrant's operations.[181] Under the proposed definition, upstream activities include activities by a party other than the registrant that relate to the initial stages of a registrant's production of a good or service (*e.g.,* materials sourcing, materials processing, and supplier activities). Downstream activities would be defined to include activities by a party other than the registrant that relate to processing materials into a finished product and delivering it or providing a service to the end user (*e.g.,* transportation and distribution, processing of sold products, use of sold products, end of life treatment of sold products, and investments).[182] We have proposed including a registrant's value chain within the definition of climate-related risks to capture the full extent of a registrant's potential exposure to climate-related risks, which can extend beyond its own operations to those of its suppliers, distributors, and others engaged in upstream or downstream activities.[183]

Climate-related conditions and events can present risks related to the physical impacts of the climate (''physical risks'') and risks related to a potential transition to a lower carbon economy (''transition risks''). As proposed, ''physical risks'' is defined to include both acute and chronic risks to a registrant's business operations or the operations of those with whom it does business.[184] ''Acute risks'' is defined as event-driven risks related to shorter-term extreme weather events, such as hurricanes, floods, and tornadoes.[185] ''Chronic risks'' is defined as those risks that the business may face as a result of longer term weather

[174] *See supra* note 40.

[175] The 2020 CFTC Advisory Subcommittee Report found that climate change currently impacts or is expected to affect every part of the U.S. economy, including agriculture, real estate, infrastructure, and the financial sectors. *See infra* note 361.

[176] A National Climate Taskforce created by the president established commitments to reduce economy-wide net greenhouse gas emissions by 50–52% by 2030 as compared to 2005 levels, and to reach net zero emissions by 2050. *See* The White House, FACT SHEET: *President Biden Sets 2030 Greenhouse Gas Pollution Reduction Target Aimed at Creating Good-Paying Union Jobs and Securing U.S. Leadership on Clean Energy Technologies* (Apr. 22, 2021). An Executive Order also directs the Federal government to achieve net-zero emissions from overall Federal operations by 2050, and a 65% emissions reduction by 2030. *See* The White House, FACT SHEET: *President Biden Signs Executive Order Catalyzing America's Clean Energy Economy Through Federal Sustainability* (Dec. 8, 2021), at *https://www.whitehouse.gov/briefing-room/statements-releases/2021/12/08/fact-sheet-president-biden-signs-executive-order-catalyzing-americas-clean-energy-economy-through-federal-sustainability/.* A growing number of governments and companies have made net zero commitments or announced similar carbon-reduction goals or targets. *See* United Nations Climate Change, *Commitments to Net Zero Double in Less Than a Year* (Sept. 21, 2020), available at *https://unfccc.int/news/commitments-to-net-zero-double-in-less-than-a-year.*

[177] *See* proposed 17 CFR 229.1502(a).

[178] *See id.*

[179] *See* TCFD, *Recommendations of the Task Force on Climate-related Financial Disclosures,* Appendix 5.

[180] *See* proposed 17 CFR 229.1500(c). The reference to 'negative' impact is intended to refer to the actual or potential impact on the registrant's consolidated financial statements, business operations, or value chains as a whole, rather than the mathematical impacts on a specific financial statement line item. *See infra* Section II.F.2 (discussing the proposed financial impact metrics, which focus on the line items in a registrant's consolidated financial statements).

[181] *See* proposed 17 CFR 229.1500(t).

[182] *See id.*

[183] *See, e.g., infra* Section II.G.1.

[184] *See* proposed 17 CFR 229.1500(c)(1).

[185] *See* proposed 17 CFR 229.1500(c)(2).

patterns and related effects, such as sustained higher temperatures, sea level rise, drought, and increased wildfires, as well as related effects such as decreased arability of farmland, decreased habitability of land, and decreased availability of fresh water.[186] Many of these physical risks have already impacted and may continue to impact registrants across a wide range of economic sectors.[187] The proposed rules would define transition risks to mean the actual or potential negative impacts on a registrant's consolidated financial statements, business operations, or value chains attributable to regulatory, technological, and market changes to address the mitigation of, or adaptation to, climate-related risks.[188] Transition risks would include, but are not limited to, increased costs attributable to climate-related changes in law or policy, reduced market demand for carbon-intensive products leading to decreased sales, prices, or profits for such products, the devaluation or abandonment of assets, risk of legal liability and litigation defense costs, competitive pressures associated with the adoption of new technologies, reputational impacts (including those stemming from a registrant's customers or business counterparties) that might trigger changes to market behavior, changes in consumer preferences or behavior, or changes in a registrant's behavior. A registrant that has significant operations in a jurisdiction that has made a GHG emissions reduction commitment would likely be exposed to transition risks related to the implementation of the commitment.[189]

The proposed rules would require a registrant to specify whether an identified climate-related risk is a physical or transition risk so that investors can better understand the nature of the risk [190] and the registrant's actions or plan to mitigate or adapt to the risk.[191] If a physical risk, the proposed rules would require a registrant to describe the nature of the risk, including whether it may be categorized as an acute or chronic risk.[192]

The proposed rules would require a registrant to include in its description of an identified physical risk the location of the properties, processes, or operations subject to the physical risk.[193] The proposed location disclosure would only be required for a physical risk that a registrant has determined has had or is likely to have a material impact on its business or consolidated financial statements. In such instances, a registrant would be required to provide the ZIP code for the location or, if the location is in a jurisdiction that does not use ZIP codes, a similar subnational postal zone or geographic location.[194] Because physical risks can be concentrated in particular geographic areas, the proposed disclosure would allow investors to better assess the risk exposure of one or more registrants with properties or operations in a particular area. One commenter cited location information as a key component of how it, as an investor, assesses the climate risk facing a company, particularly for companies with fixed assets that may be disproportionately exposed to climate-related physical risks.[195] Several other commenters recommended that we require the disclosure of certain climate data to be disaggregated by location using a point source's zip code for risk assessment.[196] Disclosing the zip codes of its identified material climate-related risks, rather than a broader location designation, could help investors more accurately assess a registrant's specific risk exposure.

Some registrants might be exposed to water-related acute physical risks, such as flooding, which could impair a registrant's operations or devalue its property. If flooding presents a material physical risk, the proposed rules would require a registrant to disclose the percentage of buildings, plants, or properties (square meters or acres) that are located in flood hazard areas in addition to their location.[197] This information could help investors evaluate the magnitude of a registrant's exposure to flooding, which, for example, could cause a registrant in the real estate sector to lose revenues from the rental or sale of coastal property or incur higher costs or a diminished ability to obtain property insurance, or a manufacturing registrant to incur increased expenses due to the need to replace water-damaged equipment or move an entire plant.

Additional disclosure would be required if a material risk concerns the location of assets in regions of high or extremely high water stress.[198] For example, some registrants might be impacted by water-related chronic physical risks, such as increased temperatures and changes in weather patterns that result in water scarcity. Registrants that are heavily reliant on water for their operations, such as registrants in the energy sector, materials and buildings sector, or agriculture sector,[199] could face regulatory restrictions on water use, increased expenses related to the acquisition and purchase of alternative sources of water, or curtailment of its operations due to a reduced water supply that diminishes its earning capacity. If the location of assets in regions of high or extremely high water stress presents a material risk, the proposed rules would require a registrant to disclose the amount of assets (*e.g.,* book value and as a percentage of total assets) located in such regions in addition to their location. The registrant would also be required to disclose the percentage of its total water usage from water withdrawn in those regions.[200] These disclosures could help investors understand the magnitude of a registrant's material water-stress risks with a degree of specificity that might not be elicited under our current risk factor disclosure standards.

Any increased temperatures could also materially impact a registrant in other ways. For example, a registrant in the construction industry might be required to disclose the physical risk of increased heat waves that affect the

[186] *See* proposed 17 CFR 229.1500(c)(3). The physical risks described are examples, but registrants may be exposed to many other types of physical risks from climate change depending on their specific facts and circumstances. As such, any reference to certain types of risks should be considered as non-exhaustive examples.

[187] The IPCC's Sixth Assessment Report noted drought, heatwaves, hurricanes, and heavy precipitation. *See* IPCC, *Climate Change 2021, The Physical Science Basis Summary for Policymakers.*

[188] *See* proposed 17 CFR 229.1500(c)(4).

[189] *See* proposed 17 CFR 229.1502(a)(1)(ii).

[190] *See* proposed 17 CFR 229.1502(a)(1).

[191] *See, e.g.,* proposed 17 CFR 229.1502(b)(1) and 229.1503(c)(1) and (2).

[192] *See* proposed 17 CFR 229.1502(a)(1)(i). In some instances, chronic risks might give rise to acute risks. For example, drought (a chronic risk) that increases acute risks, such as wildfires, or increased temperatures (a chronic risk) that increases acute risks, such as severe storms. In such instances, a registrant should provide a clear and consistent description of the nature of the risk and how it may affect a related risk.

[193] *See id.*

[194] *See* proposed 17 CFR 229.1500(k).

[195] *See* letter from Wellington Management Co.

[196] *See* letters from Action Center on Race and Economy (June 14, 2021); Americans for Financial Reform Education Fund; Confluence Philanthropy; Domini Impact Investments; William and Flora Hewlett Foundation; Public Citizen; and Revolving Door Project.

[197] *See* proposed 17 CFR 229.1502(a)(1)(i)(A).

[198] *See* proposed 1502(a)(1)(i)(B).

[199] Registrants in these industry sectors could be particularly susceptible to water-stress risks because operations in these sectors require large amounts of water. *See* TCFD, *Implementing the Recommendations of the Task Force on Climate-Related Financial Disclosures,* Section E (Oct. 2021), available at *https://assets.bbhub.io/company/sites/60/2021/07/2021/TCFD/Implementing_Guidance.pdf* (discussing the listed events and other risks).

[200] *See* proposed 17 CFR 229.1502(a)(1)(i)(B).

ability of its personnel to safely work outdoors, which could result in a cessation or delay of operations, and a reduction in its current or future earnings.[201] A registrant operating in wildfire-prone areas could be exposed to potential disruption of operations, destruction of property, and relocation of personnel in the event of heat-induced wildfires.[202] A registrant in the real estate sector might similarly be required to disclose the likelihood that sea levels could rise faster than expected and reduce the value of its coastal properties.[203]

The proposed rules would require a registrant to describe the nature of transition risks, including whether they relate to regulatory, technological, market (including changing consumer, business counterparty, and investor preferences), liability, reputational, or other transition-related factors, and how those factors impact the registrant.[204] For example, an automobile manufacturer might describe how market factors, such as changing consumer and investor preferences for low-emission vehicles, have impacted or will likely impact its production choices, operational capabilities, and future expenditures. An energy producer might describe how regulatory and reputational factors have impacted or are likely to impact its operational activities, reserve valuations, and investments in renewable energy. An industrial manufacturer might describe how investments in innovative technologies, such as carbon capture and storage, have impacted or are likely to impact its consolidated financial statements, such as by increasing its capital expenditures.

Climate related conditions and any transition to a lower carbon economy may also present opportunities for companies and investors. The proposed rules would define ''climate-related opportunities'' to mean the actual or potential positive impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations, or value chains, as a whole.[205] Efforts to mitigate or adapt to the effects of climate-related conditions and events can produce opportunities, such as cost savings associated with the increased use of renewable energy, increased resource efficiency, the development of new products, services, and methods, access to new markets caused by the transition to a lower carbon economy, and increased resilience along a registrant's supply or distribution network related to potential climate-related regulatory or market constraints. A registrant, at its option, may disclose information about any climate-related opportunities it may be pursuing when responding to the proposed disclosure requirements concerning governance, strategy, and risk management in connection with climate-related risks. We are proposing to treat this disclosure as optional to allay any anti-competitive concerns that might arise from a requirement to disclose a particular business opportunity.[206] By defining ''climate-related opportunities,'' the proposed rules would promote consistency when such opportunities are disclosed, even if such disclosure is not required.

2. Proposed Time Horizons and the Materiality Determination

The proposed rules would require a registrant to disclose whether any climate-related risk is reasonably likely to have a material impact on a registrant, including its business or consolidated financial statements, which may manifest over the short, medium, and long term.[207] Several commenters made a similar recommendation, stating that disclosure of climate-related risks and impacts across short, medium, and long-term time horizons is necessary to fully understand a registrant's susceptibility to material climate-related risks.[208]

As proposed, a registrant would be required to describe how it defines short-, medium-, and long-term time horizons, including how it takes into account or reassesses the expected useful life of the registrant's assets and the time horizons for the registrant's planning processes and goals. We have not proposed a specific range of years to define short-, medium-, and long-term time horizons in order to allow flexibility for a registrant to select the time horizons that are most appropriate to its particular circumstances.

As defined by the Commission and consistent with Supreme Court precedent, a matter is material if there is a substantial likelihood that a reasonable investor would consider it important when determining whether to buy or sell securities or how to vote.[209] As the Commission has previously indicated, the materiality determination is largely fact specific and one that requires both quantitative and qualitative considerations.[210] Moreover, as the Supreme Court has articulated, the materiality determination with regard to potential future events requires an assessment of both the probability of the event occurring and its potential magnitude, or significance to the registrant.[211]

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[201] *See, e.g., How Seasonal Temperature Changes Affect the Construction Industry (constructconnect.com)* (Aug. 15, 2018), available at *https://www.constructconnect.com/blog/seasonal-temperature-changes-affect-construction-industry.*

[202] *See, e.g., The Impact of Wildfires on Business is Enormous | Are You Ready? (alertmedia.com)* (Aug. 27, 2020), available at *https://www.alertmedia.com/blog/the-impact-of-wildfires-on-business/.*

[203] *See, e.g., Climate change and the coming coastal real estate crash—Curbed* (Oct. 16, 2018), available at *https://archive.curbed.com/2018/10/16/17981244/real-estate-climate-change-infrastructure.*

[204] *See* proposed 17 CFR 229.1502(a)(1)(ii).

[205] *See* proposed 17 CFR 229.1500(b). The reference to 'positive' impact is intended to refer to the actual or potential impact on the registrant's consolidated financial statements, business operations, or value chains as a whole, rather than the mathematical impacts on a specific financial statement line item. *See infra* Section II.F.2 (discussing the proposed financial impact metrics, which focus on the line items in a registrant's consolidated financial statements).

[206] Some commenters expressed concern about potential anti-competitive effects of the Commission's possible climate disclosure rules. *See, e.g.,* letters from Association of General Contractors of America (June 11, 2021); and Healthy Markets Association (June 14, 2021).

[207] *See* proposed Item 1502(a) of Regulation S–K.

[208] *See, e.g.,* letters from Boston Common Asset Management; Christian Brothers Investment Services (June 11, 2021); Clean Yield Asset Management; and Miller/Howard Investments; *see also* American Institute of CPAs (AICPA) (June 11, 2021).

[209] *See* 17 CFR 240.12b–2 (definition of ''material''). *See also Basic Inc.* v. *Levinson,* 485 U.S. 224, 231, 232, and 240 (1988) (holding that information is material if there is a substantial likelihood that a reasonable investor would consider the information important in deciding how to vote or make an investment decision; and quoting *TSC Industries, Inc.* v. *Northway, Inc.,* 426 U. S. 438, 449 (1977) to further explain that an omitted fact is material if there is ''a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.'').

[210] *See* Release No. 33–10064, *Business and Financial Disclosure Required by Regulation S–K* (Apr. 13, 2016), [81 FR 23915 (Apr. 22, 2016)] (discussing materiality in the context of, among other matters, restating financial statements). See also Staff Accounting Bulletin No. 99 (Aug. 12, 1999), available at *https://www.sec.gov/interps/account/sab99.htm* (emphasizing that a registrant or an auditor may not substitute a percentage threshold for a materiality determination that is required by applicable accounting principles). Staff accounting bulletins are not rules or interpretations of the Commission, nor are they published as bearing the Commission's official approval. They represent interpretations and practices followed by the Division of Corporation Finance and the Office of the Chief Accountant in administering the disclosure requirements of the Federal securities laws.

[211] *See Basic, Inc.* v. *Levinson,* 485 U.S. 224, 238 (1988). When considering the materiality of different climate-related risks, a registrant might, for example, determine that certain transition risks and chronic physical risks are material when balancing their likelihood and impact. It also might determine that certain acute physical risks are material even if they are less likely to occur if the magnitude of their impact would be high.

The materiality determination that a registrant would be required to make regarding climate-related risks under the proposed rules is similar to what is required when preparing the MD&A section in a registration statement or annual report. The Commission's rules require a registrant to disclose material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be necessarily indicative of future operating results or of future financial condition.[212] As the Commission has stated, MD&A should include descriptions and amounts of matters that have had a material impact on reported operations as well as matters that are reasonably likely to have a material impact on future operations.[213]

The proposed rule serves to emphasize that, when assessing the materiality of a particular risk, management should consider its magnitude and probability over the short, medium, and long term. In the context of climate, the magnitude and probability of such risks vary and can be significant over such time periods. For example, wildfires in California, which recently have become more frequent and more intense, may be a material risk for wineries, farmers, and other property owners.[214] Some insurance companies have withdrawn from certain wildfire prone areas after concluding the risk is no longer insurable.[215] For many investors, the availability of insurance and the potential exposure to damage, loss, and legal liability from wildfires may be a determining factor in their investment decision-making. Moreover, registrants must bear in mind that the materiality determination is made with regard to the information that a reasonable investor considers important to an investment or voting decision.

To help ensure that management considers the dynamic nature of climate-related risks, we are proposing to require a registrant to discuss its assessment of the materiality of climate-related risks over the short, medium, and long term. We recognize that determining the likely future impacts on a registrant's business may be difficult for some registrants. Commenters have noted that the science of climate modelling has progressed in recent years and enabled the development of various software tools and that climate consulting firms are available to assist registrants in making this determination.[216] We also note that, under our existing rules, registrants long have had to disclose forward-looking information, including pursuant to MD&A requirements. To the extent that the proposed climate-related disclosures constitute forward-looking statements, as discussed below,[217] the forward-looking statement safe harbors pursuant to the Private Securities Litigation Reform Act (''PSLRA'') [218] would apply, assuming the conditions specified in those safe harbor provisions are met.[219] We note, however, that there are important limitations to the PSLRA safe harbor. For example, we are proposing that climate-related disclosures would be required in registration statements, including those for initial public offerings, and forward-looking statements made in connection with an initial public offering are excluded from the protections afforded by the PSLRA. In addition, the PSLRA does not limit the Commission's ability to bring enforcement actions.

Request for Comment

8. Should we require a registrant to disclose any climate-related risks that are reasonably likely to have a material impact on the registrant, including on its business or consolidated financial statements, which may manifest over the short, medium, and long term, as proposed? If so, should we specify a particular time period, or minimum or maximum range of years, for ''short,'' ''medium,'' and ''long term?'' For example, should we define short term as 1 year, 1–3 years, or 1–5 years? Should we define medium term as 5–10 years, 5–15 years, or 5–20 years? Should we define long-term as 10–20 years, 20–30 years, or 30–50 years? Are there other possible years or ranges of years that we should consider as the definitions of short, medium, and long term? What, if any, are the benefits to leaving those terms undefined? What, if any, are the concerns to leaving those terms undefined? Would the proposed provision requiring a registrant to specify what it means by the short, medium, and long term mitigate any such concerns?

9. Should we define ''climate-related risks'' to mean the actual or potential negative impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations, or value chains, as proposed? Should we define climate-related risks to include both physical and transition risks, as proposed? Should we define physical risks to include both acute and chronic risks and define each of those risks, as proposed? Should we define transition risks, as proposed? Are there any aspects of the definitions of climate-related risks, physical risks, acute risks, chronic risks, and transition risks that we should revise? Are there other distinctions among types of climate-related risks that we should use in our definitions? Are there any risks that we should add to the definition of transition risk? How should we address risks that may involve both physical and transition risks?

10. We define transition risks to include legal liability, litigation, or reputational risks. Should we provide more examples about these types of risks? Should we require more specific disclosures about how a registrant assesses and manages material legal liability, litigation, or reputational risks that may arise from a registrant's business operations, climate mitigation efforts, or transition activities?

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[212] *See* 17 CFR 229.303(a).

[213] See Release No. 33–10890, *Management's Discussion and Analysis, Selected Financial Data, and Supplementary Financial Information* (Nov. 19, 2020), [86 FR 2080, 2089 (Jan. 11, 2021)].

[214] *See, e.g.,* Daoping Wang, Dabo Guan, Shupeng Zhu, *et al., Economic footprint of California wildfires in 2018,* Nature Sustainability (Dec. 2020) (stating that the frequency and size of wildfires in the western United States has been increasing for several decades, driven by decreases in precipitation and related changes in the moisture in vegetation, which, together with land use and fire management practices, has dramatically increased wildfire risks, culminating in a series of enormously damaging fires in California in 2017, 2018 and 2020); Andrew Freedman, *California wildfires prompt new warnings amid record heat, erratic winds,* the Washington Post (Oct. 1, 2020) (reporting that the ''Glass Fire'' forced about 80,000 to evacuate from Napa and Sonoma Counties and took a heavy toll on the wine industry).

[215] *See* Shelby Vittek, *California Farmers Struggle to Secure Wildfire Insurance Coverage,* Modern Farmer (Aug. 2, 2021), available at *https://modernfarmer.com/2021/08/california-farmers-struggle-to-secure-wildfire-insurance-coverage/*

[216] *See, e.g.,* letters from AIR Worldwide (June 11, 2021); Coastal Risk Consulting (May 3, 2021); CoreLogic (June 12, 2021); Datamaran (June 14, 2021); Dynamhex, Inc. (June 15, 2021); EC-Map (June 12, 2021); FutureProof Technologies, Inc. (June 7, 2021); and right.based on science GmbH (June 12, 2021).

[217] *See, e.g., infra* Sections II.C.4 and II.I.

[218] Pub. Law 104–67, 109 Stat. 737.

[219] *See* Securities Act Section 27A and Exchange Act Section 21E. The statutory safe harbors by their terms do not apply to forward-looking statements included in financial statements prepared in accordance with generally accepted accounting principles (''GAAP''). The statutory safe harbors also would not apply to forward-looking statements made: (i) In connection with an initial public offering; a tender offer; an offering by, or relating to the operations of, a partnership, limited liability company, or a direct participation investment program, an offering of securities by a blank check company; a roll-up transaction; or a going private transaction; or (ii) by an issuer of penny stock. *See* Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act. Also, the statutory safe harbors do not, absent a rule, regulation, or Commission order, apply to forward-looking statements by certain ''bad actor'' issuers under Section 27A(b)(1)(A) of the Securities Act and Section 21E(b)(1)(A) of the Exchange Act.

11. Some chronic risks might give rise to acute risks, *e.g.,* drought (a chronic risk) that increases acute risks, such as wildfires, or increased temperatures (a chronic risk) that increases acute risks, such as severe storms. Should we require a registrant to discuss how the acute and chronic risks they face may affect one another?

12. For the location of its business operations, properties or processes subject to an identified material physical risk, should we require a registrant to provide the ZIP code of the location or, if located in a jurisdiction that does not use ZIP codes, a similar subnational postal zone or geographic location, as proposed? Is there another location identifier that we should use for all registrants, such as the county, province, municipality or other subnational jurisdiction? Would requiring granular location information, such as ZIP codes, present concerns about competitive harm or the physical security of assets? If so, how can we mitigate those concerns? Are there exceptions or exemptions to a granular location disclosure requirement that we should consider?

13. If a registrant determines that the flooding of its buildings, plants, or properties is a material risk, should we require it to disclose the percentage of those assets that are in flood hazard areas in addition to their location, as proposed? Would such disclosure help investors evaluate the registrant's exposure to physical risks related to floods? Should we require this disclosure from all registrants, including those that do not currently consider exposure to flooding to be a material physical risk? Should we require this disclosure from all registrants operating in certain industrial sectors and, if so, which sectors? Should we define ''flood hazard area'' or provide examples of such areas? If we should define the term, should we define it similar to a related definition by the Federal Emergency Management Agency (''FEMA'') as an area having flood, mudflow or flood-related erosion hazards, as depicted on a flood hazard boundary map or a flood insurance rate map? Should we require a registrant to disclose how it has defined ''flood hazard area'' or whether it has used particular maps or software tools when determining whether its buildings, plants, or properties are located in flood hazard areas? Should we recommend that certain maps be used to promote comparability? Should we require disclosure of whether a registrant's assets are located in zones that are subject to other physical risks, such as in locations subject to wildfire risk?

14. If a material risk concerns the location of assets in regions of high or extremely high water stress, should we require a registrant to quantify the assets (*e.g.,* book value and as a percentage of total assets) in those regions in addition to their location, as proposed? Should we also require such a registrant to disclose the percentage of its total water usage from water withdrawn in high or extremely high water stressed regions, as proposed? If so, should we include a definition of a ''high water stressed region'' similar to the definition provided by the World Resource Institute as a region where 40–80 percent of the water available to agricultural, domestic, and industrial users is withdrawn annually? Should we similarly define an ''extremely high water stressed area'' as a region where more than 80 percent of the water available to agricultural, domestic, and industrial users is withdrawn annually? Are there other definitions of high or extremely high water stressed areas we should use for purposes of this disclosure? Would these items of information help investors assess a registrant's exposure to climate-related risks impacting water availability? Should we require the disclosure of these items of information from all registrants, including those that do not currently consider having assets in high water-stressed areas a material physical risk? Should we require these disclosures from all registrants operating in certain industrial sectors and, if so, which sectors?

15. Are there other specific metrics that would provide investors with a better understanding of the physical and transition risks facing registrants? How would investors benefit from the disclosure of any additional metrics that would not necessarily be disclosed or disclosed in a consistent manner by the proposed climate risk disclosures? What, if any, additional burdens would registrants face if they were required to disclose additional climate risk metrics?

16. Are there other areas that should be included as examples in the definitions of acute or chronic risks? If so, for each example, please explain how the particular climate-related risk could materially impact a registrant's operations or financial condition.

17. Should we include the negative impacts on a registrant's value chain in the definition of climate-related risks, as proposed? Should we define ''value chain'' to mean the upstream and downstream activities related to a registrant's operations, as proposed? Are there any upstream or downstream activities included in the proposed definition of value chain that we should exclude or revise? Are there any upstream or downstream activities that we should add to the definition of value chain? Are there any upstream or downstream activities currently proposed that should not be included?

18. Should we define climate-related opportunities as proposed? Should we permit a registrant, at its option, to disclose information about any climate-related opportunities that it is pursuing, such as the actual or potential impacts of those opportunities on the registrant, including its business or consolidated financial statements, as proposed? Should we specifically require a registrant to provide disclosure about any climate-related opportunities that have materially impacted or are reasonably likely to impact materially the registrant, including its business or consolidated financial statements? Is there a risk that the disclosure of climate-related opportunities could be misleading and lead to ''greenwashing''? If so, how should this risk be addressed?

C. Disclosure Regarding Climate-Related Impacts on Strategy, Business Model, and Outlook

1. Disclosure of Material Impacts

Once a registrant has described the climate-related risks reasonably likely to have a material impact on the registrant's business or consolidated financial statements as manifested over the short, medium, and long term as required by proposed Item 1502(a), proposed Item 1502(b) would require the registrant to describe the actual and potential impacts of those risks on its strategy, business model, and outlook.[220] Several commenters stated that many registrants have included largely boilerplate discussions about climate-related risks and failed to provide a meaningful analysis of the impacts of those risks on their businesses.[221] The TCFD's most recent assessment of public companies' voluntary climate reports also noted that a minority of companies disclosed the impacts of climate-related risks and opportunities on their businesses in alignment with the TCFD framework.[222] Because information about how climate-related risks have impacted or are likely to impact a registrant's strategy,

[220] *See* proposed 17 CFR 229.1502(b).

[221] *See, e.g.,* letters from CALSTRS; Cardano Risk Management Ltd.; Climate Risk Disclosure Lab (June 14, 2021); and Colorado PERA (June 11, 2021).

[222] *See* TCFD, *2021 Status Report,* Section B (Oct. 2021) (stating that, based on a review of reports of 1,651 public companies from 2018–2020, while 38–52% of companies surveyed described climate-related risks and opportunities during 2018–2020, only 26–39% disclosed the impacts of those risks and opportunities during this period).

business model, and outlook can be important for purposes of making an investment or voting decision about the registrant, we are proposing the provisions below to elicit robust and company-specific disclosure on this topic.

As proposed, a registrant would be required to disclose impacts on its:

- Business operations, including the types and locations of its operations;
- Products or services;
- Suppliers and other parties in its value chain;
- Activities to mitigate or adapt to climate-related risks, including adoption of new technologies or processes;
- Expenditure for research and development; and
- Any other significant changes or impacts.[223]

A registrant would also be required to disclose the time horizon for each described impact (*i.e.,* as manifested in the short, medium, or long term, as defined by the registrant when determining its material climate-related risks).[224]

The proposed rules would require a registrant to discuss how it has considered the identified impacts as part of its business strategy, financial planning, and capital allocation.[225] A registrant would be required to provide both current and forward-looking disclosures[226] that facilitate an understanding of whether the implications of the identified climate-related risks have been integrated into the registrant's business model or strategy, including how resources are being used to mitigate climate-related risks.[227] The discussion must also include how any of the metrics referenced in proposed Rule 14–02 of Regulation S–X and Item 1504 of Regulation S–K or any of the targets referenced in proposed Item 1506 relate to the registrant's business model or business strategy.[228]

For example, a registrant that operates in a jurisdiction that has imposed or is likely to impose limits on GHG emissions in support of the Paris Agreement might set a long-term target of net zero GHG emissions from its operations in 2050, a medium-term target of reducing its emissions by 30 percent by 2030, and a short-term target of maintaining its emissions at its 2020 rate through 2023. This registrant could face material transition risks due to the estimated costs of the operational changes expected to be implemented to achieve these targets. The registrant would be required to disclose these transition risks and their impacts on its strategy, business model, and outlook.

Some of the described impacts would likely be common across industries and may involve reducing a registrant's Scopes 1 and 2 GHG emissions[229] and incurring increased expenses in the short term related to, for example, acquiring new technology to curb its operational emissions and increasing the amount of electricity purchased from renewable sources. Other described impacts of material transition risks, however, would likely vary by industry. For example, an oil company might determine that a likely change in demand for fossil fuel-based products would require it to modify its business model or alter its product mix to emphasize advanced diesel gas and biofuels in order to maintain or increase its earning capacity, thereby requiring disclosure under the proposed rules. An electric utilities company might disclose an increase in the amount of electricity generated from less carbon-intensive sources, such as wind turbines, nuclear, hydroelectric, or solar power to meet current or likely regulatory constraints.

A registrant would also be required to disclose the material impacts of physical risks on its strategy, business model, and outlook. For example, an agricultural producer or distributor might disclose the likely impacts of drought on its own product mix or that of its suppliers, including increased expenses for additional water or due to the procurement of alternative product sources. Similarly, a mining company that operates in areas susceptible to extreme rise in temperatures might disclose the likely impacts that this temperature rise has on its workforce and on its production schedule, including a reduction in output and future earning capacity. A real estate company that owns coastal property might disclose the likely impacts of rising sea levels on such property, including the potential diminution in value of, and a potential change in its strategy and outlook regarding, such properties.

The proposed rules would require a registrant to provide a narrative discussion of whether and how any of its identified climate-related risks described in response to proposed Item 1502(a) have affected or are reasonably likely to affect the registrant's consolidated financial statements.[230] The discussion should include any of the financial statement metrics disclosed pursuant to proposed Regulation S–X Rule 14–02.[231] As previously noted, many commenters recommended that we require registrants to discuss and analyze their quantitative climate data in a manner similar to that required for MD&A.[232] Proposed 17 CFR 229.1502(d) (Item 1502(d) of Regulation S–K) is intended to provide climate-related disclosure that is similar to MD&A, although, as previously noted, a registrant may provide such disclosure as part of its MD&A.

For example, an automobile manufacturer might discuss an increase in operating costs or capital expenditures due to the need to revamp its assembly lines to build lower emission vehicles to comply with new regulatory guidelines or to meet changing consumer demand. An oil company might discuss a change in the valuation of its proven reserves because of an anticipated reduced demand for fossil fuels. A freight company might discuss impairment charges or early write-offs for older equipment it might need to replace due to anticipated changes in regulation or policy favoring lower emissions equipment. While a registrant may currently have an obligation to make some of these disclosures pursuant to Regulation S–X, the disclosed impacts in the financial statements may not be in disaggregated form and may lack explanation. Proposed Item 1502(d) would require the disclosure in the form of a narrative analysis akin to MD&A that would be more easily accessible for investors.

Moreover, it is likely that any disclosed impacts in the financial statements would be assessed for the fiscal years presented in the financial statements with a focus on near short-term impacts. Because proposed Item 1502 would require a registrant to identify material climate-related impacts that may manifest in the short, medium, and long term, a registrant's narrative discussion of the likely climate-related impacts on its consolidated financial statements

[223] *See* proposed 17 CFR 229.1502(b)(1).

[224] *See* proposed 17 CFR 229.1502(b)(2).

[225] *See* proposed 17 CFR 229.1502(c).

[226] *See infra* Sections II.C.3 and 4, II.E, II.G.1, and II.I regarding the application to forward-looking climate disclosures of the PSLRA safe harbor for forward-looking statements.

[227] *See id.*

[228] *See infra* Sections II.F and II.G for a discussion of the proposed metrics and targets.

[229] *See supra* Section I.D.2 and *infra* Section II.G for a discussion of Scopes 1 and 2 emissions.

[230] *See* proposed 17 CFR 229.1502(d). To the extent that the proposed narrative discussion is provided in its MD&A, a registrant could incorporate by reference that part of the MD&A into the Climate-Related Disclosure section of the registration statement or report. *See supra* Section II.A.2.

[231] *See infra* Section II.F.

[232] *See supra* note 171.

should cover more than just short-term impacts. For example, if a registrant has a transition plan [233] that includes the development of lower carbon products and processes, that registrant might disclose that it expects to incur higher initial capital costs to implement its strategy, but anticipates increased revenues or reduced expenses over the longer term. An automobile manufacturer that transitions from the production of internal combustion engine vehicles to the production of electric vehicles might disclose that it expects to incur costs in the short term to change its manufacturing processes, but over the longer term, it expects to realize increased sales, protect its market share against transition risks, including reputational risks, and potentially avoid regulatory fines or other costs as consumer and regulatory demands change.

2. Disclosure of Carbon Offsets or Renewable Energy Credits if Used

If, as part of its net emissions reduction strategy, a registrant uses carbon offsets or renewable energy credits or certificates (''RECs''), the proposed rules would require it to disclose the role that carbon offsets or RECs play in the registrant's climate-related business strategy.[234] Under the proposed rules, carbon offsets represent an emissions reduction or removal of greenhouse gases in a manner calculated and traced for the purpose of offsetting an entity's GHG emissions.[235] We are proposing to define a REC, consistent with the EPA's commonly used definition, to mean a credit or certificate representing each purchased megawatt-hour (1 MWh or 1000 kilowatt-hours) of renewable electricity generated and delivered to a registrant's power grid.[236] While both carbon offsets and RECs represent commonly used GHG emissions mitigation options for companies, they are used for somewhat different purposes.[237]

Some registrants might plan to use carbon offsets or RECs as their primary means of meeting their GHG reduction goals, including those formulated in response to government law or policy or customer or investor demands. Other registrants, including those that set Science Based Targets pursuant to the Science Based Targets Initiative,[238] might develop strategies to reduce their emissions to the extent possible through operational changes—such as modifications to their product offerings or the development of solar or other renewable energy sources. They then might plan to use carbon offsets or RECs to offset the remainder of their emissions that they cannot reduce through operational changes or to meet their GHG reduction goals while they transition to lower carbon operations.

Understanding the role that carbon offsets or RECs play in a registrant's climate-related business strategy can help investors gain useful information about the registrant's strategy, including the potential risks and financial impacts. A registrant that relies on carbon offsets or RECs to meet its goals might incur lower expenses in the short term but could expect to continue to incur the expense of purchasing offsets or RECs over the long term. It also could bear the risk of increased costs of offsets or RECs if increased demand for offsets or RECs creates scarcity and higher costs to acquire them over time. Alternatively, the value of an offset may decrease substantially and suddenly if, for example, the offset represents protected forest land that burns in a wildfire and no longer represents a reduction in GHG emissions. In that case, the registrant may need to write off the offset and purchase a replacement. In other cases, increased demand for, or scarcity of, offsets and RECs may benefit a registrant that produces or generates offsets or RECs to the extent their prices increase. Accordingly, under the proposed rules, a registrant that purchases offsets or RECs to meet its goals as it makes the transition to lower carbon products would need to reflect this additional set of short and long-term costs and risks in its Item 1502 disclosure, including the risk that the availability or value of offsets or RECs might be curtailed by regulation or changes in the market.

3. Disclosure of a Maintained Internal Carbon Price

Some registrants may use an internal carbon price when assessing climate-related factors. Under the proposed definition, an internal carbon price is an estimated cost of carbon emissions used internally within an organization.[239] Internal carbon pricing may be used by a registrant, among other purposes, as a planning tool to help identify climate-related risks and opportunities, as an incentive to drive energy efficiencies to reduce costs, to quantify the potential costs the company would incur should a carbon price be put into effect, and to guide capital investment decisions. If a registrant uses an internal carbon price, the proposed rules would require it to disclose:

- The price in units of the registrant's reporting currency per metric ton of carbon dioxide equivalent (''CO_2e''); [240]
- The total price, including how the total price is estimated to change over time, if applicable;
- The boundaries for measurement of overall CO_2e on which the total price is based (if different from the GHG emission organizational boundary required pursuant to 17 CFR 229.1504(e)(2); [241] and
- The rationale for selecting the internal carbon price applied.[242]

These proposed items of disclosure would help investors understand the rationale and underlying assumptions for a registrant's internal carbon price and help them assess whether the registrant's use of an internal carbon price as a planning tool is reasonable and effective.

A registrant would also be required to describe how it uses its disclosed internal carbon price to evaluate and

[233] *See infra* Section II.E for proposed disclosure requirements regarding the use of a transition plan.

[234] *See* proposed 17 CFR 229.1502(c).

[235] *See* proposed 17 CFR 229.1500(a).

[236] *See* proposed 17 CFR 229.1500(n). *See, e.g.,* EPA, *Offsets and RECs: What's the Difference?,* available at *https://www.epa.gov/sites/default/files/2018-03/documents/gpp_guide_recs_offsets.pdf.*

[237] A company may purchase carbon offsets to address its direct and indirect GHG emissions (*i.e.,* its Scopes 1, 2, and 3 emissions) by verifying global emissions reductions at additional, external projects. The reduction in GHG emissions from one place (''offset project'') can be used to ''offset'' the emissions taking place somewhere else (at the company's operations). *See, e.g.,* EPA, *Offsets and RECs: What's the Difference?,* available at *https://www.epa.gov/sites/default/files/2018-03/documents/gpp_guide_recs_offsets.pdf.* In contrast, a company may purchase a REC in renewable electricity markets solely to address its indirect GHG emissions associated with purchased electricity (*i.e.,* Scope 2 emissions) by verifying the use of zero- or low-emissions renewable sources of electricity. Each REC provides its owner exclusive rights to the attributes of one megawatt-hour of renewable electricity whether that renewable electricity has been installed on the company's facilities or produced elsewhere. *See id.*

[238] Science Based Targets Initiative (''SBTi'') is a partnership between CDP, the United Nations Global Compact, World Resources Institute (WRI) and the World Wide Fund for Nature (WWF), which defines and promotes best practice in emissions reductions and net-zero targets in line with climate science. SBTi provides technical assistance and its expertise to companies who voluntarily set science-based targets in line with the latest climate science. *See* SBTi, *Who We Are/What We Do,* available at *https://sciencebasedtargets.org/about-us#who-we-are.* The SBTi does not permit offsets to be counted toward a company's emission reduction targets to meet its science-based targets but does permit offsets by companies that wish to finance additional emission reductions beyond their science-based targets. *See SBTi Criteria and Recommendations* (Apr. 2020), available at *https://sciencebasedtargets.org/resources/legacy/2019/03/SBTi-criteria.pdf.*

[239] *See* proposed 17 CFR 229.1500(j).

[240] *See infra* Section II.G for a discussion of our proposal to use CO_2e as a unit of measurement in the proposed requirements.

[241] *See infra* Section II.G.2 for a discussion of the proposed requirements for determining the GHG emission organizational boundary.

[242] *See* proposed 17 CFR 229.1502(e)(1).

manage climate-related risks.[243] If a registrant uses more than one internal carbon price, the proposed rules would require it to provide disclosures for each internal carbon price, and to disclose its reasons for using different prices.[244] For example, a registrant might disclose that it uses different internal carbon prices when considering different climate-related scenarios to help it develop an appropriate business strategy over the short-, medium-, and long-term.[245]

Commenters that addressed the topic of carbon price generally supported requiring its disclosure in some form, such as: (i) Establishing a broad-based carbon price; (ii) requiring companies to maintain and disclose an internal carbon price; (iii) requiring disclosure of any internal carbon price already used by a company; or (iv) requiring disclosure of carbon prices used in the context of scenario analysis.[246] One commenter referred to disclosure of a company's use of internal carbon pricing as one of several ''foundational climate disclosures'' that should be required in any Commission rule.[247] Another commenter also underscored the importance of this information, stating that ''the thorough quantification of climate risk has been hampered by the lack of carbon pricing.'' [248] We agree with commenters that supported the disclosure of carbon pricing as a key data point for evaluating how a registrant is planning for and managing climate-related risks. However, the proposed rules would not require registrants to maintain an internal carbon price or to mandate a particular carbon pricing methodology. We are aware that many registrants may not currently track this information and recognize that a robust carbon market on which to base such a price may not exist in many contexts.[249] Accordingly, the proposed disclosures would be required only if the registrant otherwise maintains an internal carbon price. For similar reasons, we have not proposed requiring a specific methodology for setting an internal carbon price.

Registrants may choose to use an internal carbon price when quantifying, analyzing, and assessing the financial impacts of climate-related risks and climate-related opportunities. For example, an internal carbon price helps monetize emissions by converting emissions data from CO_2e into a value in the registrant's reporting currency. A registrant may determine that monetization is useful when assessing the costs and benefits of its possible climate-related strategies, as it effectively puts a price on the emission impacts. Disclosure of an internal carbon price, when used by a registrant, would provide investors with material information regarding how the registrant developed a particular business strategy to mitigate or adapt to identified climate-related risks and would help quantify for investors at least part of the transition risks faced by a registrant. We believe that this proposed disclosure requirement would help investors assess whether a registrant's internal carbon pricing practice is reasonable and whether its overall evaluation and planning regarding climate-related factors is sound.[250]

A registrant's disclosure of any internal carbon price necessarily would include assumptions about future events. The carbon price applied should not be viewed as a promise or guarantee with regard to the future costs to the registrant of GHG emissions. Moreover, to the extent that certain information regarding a registrant's internal carbon pricing would constitute forward-looking statements, the PSLRA safe harbors would apply to such statements, assuming all other statutory requirements for those safe harbors are satisfied.

4. Disclosure of Scenario Analysis, if Used

We are proposing to require a registrant to describe the resilience of its business strategy in light of potential future changes in climate-related risks. A registrant also would be required to describe any analytical tools, such as scenario analysis, that the registrant uses to assess the impact of climate-related risks on its business and consolidated financial statements, or to support the resilience of its strategy and business model in light of foreseeable climate-related risks.[251] Scenario analysis is a process for identifying and assessing a potential range of outcomes of future events under conditions of uncertainty.[252] The proposed definition of scenario analysis both states that (i) when applied to climate-related assessments, scenario analysis is a tool used to consider how, under various possible future climate scenarios, climate-related risks may impact a registrant's operations, business strategy, and consolidated financial statements over time; and that (ii) registrants might use scenario analysis to test the resilience of their strategies under future climate scenarios, including scenarios that assume different global temperature increases, such as, for example, 3 °C, 2 °C, and 1.5 °C above pre-industrial levels.[253]

Many commenters recommended that we require a registrant to conduct scenario analysis and disclose the results of such analysis.[254] One commenter stated that scenario analysis was useful because it allows companies to test their business strategy against a spectrum of hypothetical future climate scenarios and develop a better informed view of implications for their enterprise value and value chains. The same commenter further indicated that disclosure of the scenarios used by a company was necessary to inform investors about the reliability, reasonableness, and resiliency of the company's plans to address climate-related risks and opportunities.[255]

Another commenter stated that the Commission should require disclosure of a registrant's climate scenario analysis by no later than 2025, and recommended that companies engage in scenario analysis involving a base case, worse case, better case, and ''Black

[243] *See* proposed 17 CFR 229.1502(e)(2).

[244] *See* proposed 17 CFR 229.1502(e)(3).

[245] *See infra* Section II.C.4 for the proposed disclosure required if a registrant uses scenario analysis.

[246] *See, e.g.,* letters from Rob Bonta, California Attorney General, on behalf of several state attorney generals (June 14, 2021); Catavento; Center for Climate and Energy Solutions; Ceres; Climate Risk Disclosure Lab; Hermes Equity Ownership Services Limited; Majedie Asset Management; Managed Funds Association; Norges Bank Investment Management; Open Source Climate; PRI (Consultation Response); Regenerative Crisis Response Committee; Total Energies (June 13, 2021); and Trillium Asset Management. *But see* Edison Electric Institute (stating that a '''robust carbon market' does not exist today'' and disclosures based on that market would be ''fraught with risk'').

[247] Letter from Ceres.

[248] Letter from PRI.

[249] *See* Edison Electric Institute.

[250] We also note, based on current voluntary reporting, an increasing trend among public companies to use internal carbon pricing. *See* CDP, *Putting a Price on Carbon* (2021), *available at https://cdn.cdp.net/cdp-production/cms/reports/documents/000/005/651/original/CDP_Global_Carbon_Price_report_2021.pdf?1618938446.*

[251] *See* proposed 17 CFR229.1502(f).

[252] *See, e.g.,* the definition of ''scenario analysis'' in TCFD, *Recommendations of the Task Force on Climate-related Financial Disclosures.*

[253] *See* proposed 17 CFR 229.1500(o).

[254] *See, e.g.,* letters from AllianceBernstein; Americans for Financial Reform Education Fund; R. Ted Atwood (June 23, 2021); BlackRock; Bloomberg, LP; Boston Common Asset Management; Cardano Risk Management Ltd.; Certified B Corporations; Climate Governance Initiative; Climate Risk Disclosure Law and Policy Lab (June 14, 2021); Consumer Federation of America; CPP Investments; E2; ERM CVS; FAIRR Initiative; Forum for Sustainable and Responsible Investment (June 11, 2021); Friends of the Earth *et al.*; George Georgiev; Global Equity Strategy (June 14, 2021); Impax Asset Management; Invesco; Christopher Lish; NY State Comptroller; PRI (Consultation Response); Revolving Door Project; RMI; Trillium Asset Management; UNEP; and Sens. Elizabeth Warren and Rep. Sean Casten (June 11, 2021).

[255] *See* letter from Bloomberg.

Swan'' scenarios related to possible climate transition pathways.[256] Alternatively, the commenter suggested that a company take into account three scenarios: A smooth economic transition to +1.5 °C, which would form the basis of the company's net-zero strategy; a disorderly and, therefore, more costly and disruptive transition to +1.5 °C; and a higher temperature scenario outcome of +3 °C of warming, which would be associated with extreme physical effects and unprecedented economic costs and disruption. This commenter further stated that robust disclosure of a company's scenario analysis was necessary so that investors can understand how longer-term ''climate drivers'' have been incorporated into its corporate strategy and financial disclosures.[257]

Another commenter expressed the view that, although many companies purport to use scenario analysis in the climate context, their reporting regarding such use has been generally deficient. That commenter stated that the assumptions underlying the selected scenarios often are undisclosed and that the analysis tends to be limited and not usefully comparable.[258] The TCFD's most recent assessment of public companies' voluntary climate reporting similarly found that only a small percentage of the surveyed companies disclosed the resilience of their strategies using scenario analysis as recommended by the TCFD.[259]

Some commenters recommended providing certain accommodations in connection with a scenario analysis requirement, such as creating a safe harbor for scenario analysis disclosure[260] or permitting scenario analysis to be furnished in a separate report that would not be subject to the same liability as Commission filings.[261] Other commenters stated that they opposed a scenario analysis requirement because of the lack of a common methodology for scenario analysis;[262] a belief that the underlying methodology would be too difficult for investors to understand;[263] the need for further development of scenario analysis as a discipline;[264] or a belief that the focus of climate-related disclosure should be on historical data, and not on forward-looking information.[265]

We agree with those commenters who stated that information concerning scenario analysis could help investors evaluate the resilience of the registrant's business strategy in the face of various climate scenarios that could impose potentially different climate-related risks. We are not, however, proposing to mandate that registrants conduct scenario analysis. We recognize that not every registrant conducts scenario analysis and that, in certain instances, it may be costly or difficult for some registrants to conduct such scenario analysis. Instead, the proposed rules would require that if a registrant uses scenario analysis or any analytical tools to assess the impact of climate-related risks on its business and consolidated financial statements, and to support the resilience of its strategy and business model, the registrant must disclose certain information about such analysis.[266] We believe this approach strikes an appropriate balance between the various positions expressed by commenters by requiring registrants to share any scenario analysis that they are otherwise conducting for their business operations while avoiding imposing a potentially difficult or burdensome requirement on those registrants that have not yet undertaken to conduct such analysis.

If a registrant uses scenario analysis, the proposed amendments would require disclosure of the scenarios considered (*e.g.,* an increase of no greater than 3°, 2°, or 1.5 °C above pre-industrial levels), including parameters, assumptions, and analytical choices, and the projected principal financial impacts on the registrant's business strategy under each scenario. The disclosure should include both quantitative and qualitative information. Disclosure of the parameters, assumptions, and analytical choices involved in the described scenarios would help investors better understand the various considered scenarios and help them evaluate whether the registrant has a plan to manage the climate-related risks posed by each scenario.

Because a registrant's scenario analysis disclosure would necessarily include predictions and other forward-looking statements based on assumptions concerning future events, we believe that the PSLRA forward-looking safe harbors would apply to much of the disclosure concerning scenario analysis provided the other statutory conditions for application of the safe harbor are met.

We note that there are a number of publicly-available climate-related scenarios that could form the basis of a registrant's scenario analysis. The TCFD has categorized these scenarios as transition scenarios and physical climate scenarios.[267] If a registrant uses scenario analysis to assess the resilience of its business strategy to climate-related risks, investors may benefit from the use of scientifically based, widely accepted scenarios, such as those developed by the IPCC, International Energy Agency (''IEA''),[268] or Network of Central Banks and Supervisors for Greening the Financial System (''NGFS'').[269] Investors may also benefit by the use of more than one climate scenario, including one that assumes a disorderly transition (*i.e.,* one that assumes that climate policies are delayed or divergent across countries and industrial sectors, resulting in higher transition risks to companies). These could enhance the reliability and usefulness of the scenario analysis for investors.

Request for Comment

19. Should we require a registrant to describe the actual and potential impacts of its material climate-related risks on its strategy, business model, and outlook, as proposed? Should we require a registrant to disclose impacts from climate-related risks on, or any resulting significant changes made to, its business operations, including the types and locations of its operations, as proposed?

20. Should we require a registrant to disclose climate-related impacts on, or

[256] *See* letter from Climate Governance Initiative.

[257] *See id.*

[258] *See* letter from Ceres. The CDP similarly reported that, although 54% of the 9,600+ companies that responded to their questionnaires in 2020 reported engaging in scenario analysis, 14% of the companies only considered one scenario with many others considering only slight variations of one scenario. *See* CDP, *3 common pitfalls of using scenario analysis—and how to avoid them* (Mar. 10, 2021), available at *https://www.cdp.net/en/articles/companies/3-common-pitfalls-companies-make-when-using-scenario-analysis-and-how-to-avoid-them.*

[259] *See* TCFD, 2021 Status Report, Section B (indicating that, during 2018–2020, only 5–13% of the surveyed companies disclosed the resilience of their strategies using scenario analysis).

[260] *See* letter from J. Robert Gibson.

[261] *See* letter from NEI Investments.

[262] *See* letter from Information Technology Industry Council.

[263] *See* letter from Dimensional Fund Advisors.

[264] *See* letter from bp.

[265] *See* letter from Nareit (June 11, 2021).

[266] *See* proposed 17 CFR 229.1502(f). One commenter recommended requiring the disclosure of the results of scenario analysis if a registrant has engaged in such analysis. *See* letter from E3G.

[267] *See* TCFD, Technical Supplement, *The Use of Scenario Analysis in Disclosure of Climate-Related Risks and Opportunities* (June 2017), available at *https://assets.bbhub.io/company/sites/60/2020/09/2020-TCFD_Guidance-Scenario-Analysis-Guidance.pdf.*

[268] The TCFD has summarized a number of publicly available scenario analysis models, with particular emphasis on the transition scenarios developed by the IEA and the physical risk scenarios developed by the IPCC. *See id.* at Appendix 1: IEA and IPCC Climate Scenarios.

[269] *See* NGFS, *Scenarios Portal,* available at *https://www.ngfs.net/ngfs-scenarios-portal/.*

any resulting significant changes made to, its products or services, supply chain or value chain, activities to mitigate or adapt to climate-related risks, including adoption of new technologies or processes, expenditure for research and development, and any other significant changes or impacts, as proposed? Are there any other aspects of a registrant's business operations, strategy, or business model that we should specify as being subject to this disclosure requirement to the extent they may be impacted by climate-related factors?

21. Should we require a registrant to specify the time horizon applied when assessing its climate-related impacts (*i.e.,* in the short, medium, or long term), as proposed?

22. Should we require a registrant to discuss whether and how it considers any of the described impacts as part of its business strategy, financial planning, and capital allocation, as proposed? Should we require a registrant to provide both current and forward-looking disclosures to facilitate an understanding of whether the implications of the identified climate-related risks have been integrated into the registrant's business model or strategy, as proposed? Would any of the proposed disclosures present competitive concerns for registrants? If so, how can we mitigate such concerns?

23. Should we require the disclosures to include how the registrant is using resources to mitigate climate-related risks, as proposed? Should the required discussion also include how any of the metrics or targets referenced in the proposed climate-related disclosure subpart of Regulation S–K or Article 14 of Regulation S–X relate to the registrant's business model or business strategy, as proposed? Should we require additional disclosures if a registrant leverages climate-related financing instruments, such as green bonds or other forms of ''sustainable finance'' such as ''sustainability-linked bonds,'' ''transition bonds,'' or other financial instruments linked to climate change as part of its strategy to address climate-related risks and opportunities? For example, should we require disclosure of the climate-related projects that the registrant plans to use the green bond proceeds to fund? Should we require disclosure of key performance metrics tied to such financing instruments?

24. If a registrant has used carbon offsets or RECs, should we require the registrant to disclose the role that the offsets or RECs play in its overall strategy to reduce its net carbon emissions, as proposed? Should the proposed definitions of carbon offsets and RECs be clarified or expanded in any way? Are there specific considerations about the use of carbon offsets or RECs that we should require to be disclosed in a registrant's discussion regarding how climate-related factors have impacted its strategy, business model, and outlook?

25. Should we require a registrant to provide a narrative discussion of whether and how any of its identified climate-related risks have affected or are reasonably likely to affect its consolidated financial statements, as proposed? Should the discussion include any of the financial statement metrics in proposed 17 CFR 210.14–02 (14–02 of Regulation S–X) that demonstrate that the identified climate-related risks have had a material impact on reported operations, as proposed? Should the discussion include a tabular representation of such metrics?

26. Should we require registrants to disclose information about an internal carbon price if they maintain one, as proposed? If so, should we require that the registrant disclose:

• The price in units of the registrant's reporting currency per metric ton of CO_2e;
• The total price;
• The boundaries for measurement of overall CO_2e on which the total price is based if different from the GHG emission organizational boundary required pursuant to 17 CFR 210.14–03(d)(4); and
• The rationale for selecting the internal or shadow carbon price applied, as proposed?

Should we also require registrants to describe the methodology used to calculate its internal carbon price?

27. Should we also require a registrant to disclose how it uses the described internal carbon price to evaluate and manage climate-related risks, as proposed? Should we further require a registrant that uses more than one internal carbon price to provide the above disclosures for each internal carbon price, and disclose its reasons for using different prices, as proposed? Are there other aspects regarding the use of an internal carbon price that we should require to be disclosed? Would disclosure regarding any internal carbon price maintained by a registrant elicit important or material information for investors? Would requiring the disclosure of the registrant's use of an internal carbon price raise competitive harm concerns that would act as a disincentive from the use of an internal carbon price? If so, should the Commission provide an accommodation that would mitigate those concerns? For example, are there exceptions or exemptions to an internal carbon price disclosure requirement that we should consider?

28. To the extent that disclosure that incorporates or is based on an internal carbon price constitutes forward-looking information, the PSLRA safe harbors would apply. Should we adopt a separate safe harbor for internal carbon price disclosure? If so, what disclosures should such a safe harbor cover and what should the conditions be for such a safe harbor?

29. Should we require all registrants to disclose an internal carbon price and prescribe a methodology for determining that price? If so, what corresponding disclosure requirements should we include in connection with such mandated carbon price? What methodology, if any, should we prescribe for calculating a mandatory internal or shadow carbon price? Would a different metric better elicit disclosure that would monetize emissions?

30. Should we require a registrant to disclose analytical tools, such as scenario analysis, that it uses to assess the impact of climate-related risks on its business and consolidated financial statements, and to support the resilience of its strategy and business model, as proposed? What other analytical tools do registrants use for these purposes, and should we require disclosure of these other tools? Are there other situations in which some registrants should be required to conduct and provide disclosure of scenario analysis? Alternatively, should we require all registrants to provide scenario analysis disclosure? If a registrant does provide scenario analysis disclosure, should we require it to follow certain publicly available scenario models, such as those published by the IPCC, the IEA, or NGFS and, if so, which scenarios? Should we require a registrant providing scenario analysis disclosure to include the scenarios considered (*e.g.,* an increase of global temperature of no greater than 3°, 2°, or 1.5 °C above pre-industrial levels), the parameters, assumptions, and analytical choices, and the projected principal financial impacts on the registrant's business strategy under each scenario, as proposed? Are there any other aspects of scenario analysis that we should require registrants to disclose? For example, should we require a registrant using scenario analysis to consider a scenario that assumes a disorderly transition? Is there a need for us to provide additional guidance regarding scenario analysis? Are there any aspects of scenario analysis in our proposed required disclosure that we should exclude? Should we also require a registrant that

does not use scenario analysis to disclose that it has not used this analytical tool? Should we also require a registrant to disclose its reasons for not using scenario analysis? Will requiring disclosure of scenario analysis if and when a registrant performs scenario analysis discourage registrants from conducting scenario analysis? If so, and to the extent scenario analysis is a useful tool for building strategic resilience, how could our regulations prevent such consequences?

31. Would the PSLRA forward-looking statement safe harbors provide adequate protection for the proposed scenario analysis disclosure? Should we instead adopt a separate safe harbor for scenario analysis disclosure? If so, what disclosures should such a safe harbor cover that would not be covered by the PSLRA safe harbors and what should the conditions be for such a safe harbor?

32. Should we adopt a provision similar to 17 CFR 229.305(d) that would apply the PSLRA forward-looking statement safe harbor to forward-looking statements made in response to specified climate-related disclosure items, such as proposed Item 1502 and Item 1505 (concerning targets and goals) of Regulation S–K? If so, which proposed items should we specifically include in the safe harbor?

33. As proposed, a registrant may provide disclosure regarding any climate-related opportunities when responding to any of the provisions under proposed 17 CFR 229.1502 (Item 1502). Should we require disclosure of climate-related opportunities under any or all of the proposed Item 1502 provisions?

D. Governance Disclosure

Similar to the TCFD framework, the proposed rules would require a registrant to disclose, as applicable, certain information concerning the board's oversight of climate-related risks, and management's role in assessing and managing those risks.[270] Many commenters asserted that climate-related issues should be subject to the same level of board oversight as other financially material matters.[271] Most of these commenters supported robust disclosure of a board's and management's governance of climate-related risks and opportunities, consistent with the TCFD framework.[272]

Our proposed disclosure requirements are based on specific recommendations of the TCFD. We agree with commenters that a comprehensive understanding of a board's oversight, and management's governance, of climate-related risks is necessary to aid investors in evaluating the extent to which a registrant is adequately addressing the material climate-related risks it faces, and whether those risks could reasonably affect the value of their investment.[273] We also note that, despite the importance of governance disclosure, according to the TCFD, only a small percentage of issuers that voluntarily provided climate-related information presented governance disclosure aligned with the TCFD's recommendations.[274] While the proposed rules are intended to provide investors with additional insight into a board's and management's governance of climate-related risks, they are similar to the Commission's existing rules under Regulation S–K that call for disclosure about corporate governance in that they are intended to provide investors with relevant information about a registrant's board, management, and principal committees.[275]

1. Board Oversight

The proposed rules would require a registrant to disclose a number of board governance items, as applicable. The first item would require a registrant to identify any board members or board committees responsible for the oversight of climate-related risks.[276] The responsible board committee might be an existing committee, such as the audit committee or risk committee, or a separate committee established to focus on climate-related risks. The next proposed item would require disclosure of whether any member of a registrant's board of directors has expertise in climate-related risks, with disclosure required in sufficient detail to fully describe the nature of the expertise.[277]

Another proposed item would require a description of the processes and frequency by which the board or board committee discusses climate-related risks.[278] The registrant would have to disclose how the board is informed about climate-related risks, and how frequently the board considers such risks. These proposed disclosure items could provide investors with insight into how a registrant's board considers climate-related risks and any relevant qualifications of board members.[279]

The proposed rule also would require disclosure about whether and how the board or board committee considers climate-related risks as part of its business strategy, risk management, and financial oversight.[280] This disclosure could enable an investor to understand whether and how the board or board committee considers climate-related risks when reviewing and guiding business strategy and major plans of action, when setting and monitoring implementation of risk management policies and performance objectives, when reviewing and approving annual budgets, and when overseeing major expenditures, acquisitions, and divestitures. In this way, the proposed disclosure requirement could help investors assess the degree to which a board's consideration of climate-related risks has been integrated into a registrant's strategic business and financial planning and its overall level of preparation to maintain its shareholder value.

Finally, the proposed rule would require disclosure about whether and how the board sets climate-related targets or goals and how it oversees

[270] *See* proposed 17 CFR 229.1501.

[271] *See, e.g.,* letters from Americans for Financial Reform Education Fund; Baillie Gifford; Andrew Behar; Bloomberg, LP; Canadian Coalition for Good Governance; Cardano Risk Management Ltd.; CDP NA (June 11, 2021); Center for American Progress; CAQ; Ceres *et al.*; Climate Disclosure Standards Board (June 14, 2021); Climate Governance Initiative; Climate Risk Disclosure Lab; Eni SpA; ERM CVS; Friends of the Earth, Amazon Watch, and Rainforest Action Network (June 11, 2021); Regenerative Crisis Response Committee; Hermes Equity Ownership Limited; William and Flora Hewlett Foundation (June 9, 2021); Impax Asset Management; Institute of Internal Auditors (May 23, 2021); Institutional Shareholder Services (June 14, 2021); Interfaith Center on Corporate Responsibility; International Corporate Governance Network; Morningstar, Inc.; International Organization for Standardization (June 11, 2021); Natural Resources Defense Council; NEI Investments; NY City Comptroller (June 14, 2021); NY State Comptroller; NY State Department of Financial Services (June 14, 2021); Oregon State Treasury (June 4, 2021); PRI (Consultation Response); Pricewaterhouse Coopers; Revolving Door Project (June 11, 2021); George Serafeim (June 9, 2021); Maria Stoica; TotalEnergies (June 13, 2021); Value Balancing Alliance; WBCSD; and World Benchmarking Alliance.

[272] *See, e.g.,* letters from Baillie Gifford; Bloomberg, LP; Ceres et al.; Climate Disclosure Standards Board; Climate Governance Initiative; Climate Risk Disclosure Lab; Eni SpA; William and Flora Hewlett Foundation; Impax Asset Management; Institute for Governance and Sustainable Development; International Corporate Governance Network; Richard Love; Morningstar, Inc.; Natural Resources Defense Council; NEI Investments; NY State Comptroller; Maria Stoica; TotalEnergies; and WBCSD. *But see* letter from Amanda Rose (stating that federalizing aspects of corporate governance could inhibit the ability of states to compete for corporate charters).

[273] *See, e.g.,* letters from Bloomberg, LP; and Natural Resources Defense Council.

[274] *See* TCFD, *2021 Status Report* (Oct. 2021) (finding that 9% of surveyed companies provided TCFD-recommended board disclosure in 2018, which increased to 25% in 2020; and 9% provided TCFD-recommended management disclosure in 2018, which increased to 18% in 2020).

[275] *See, e.g.,* 17 CFR 229.401 and 229.407.

[276] *See* proposed 17 CFR 229.1501(a)(1)(i).

[277] *See* proposed 17 CFR 229.1501(a)(1)(ii).

[278] *See* proposed 17 CFR 229.1501(a)(1)(iii).

[279] *See, e.g.,* letters from Bloomberg, LP; NY State Comptroller; and Vanguard Group, Inc.

[280] *See* proposed 17 CFR 229.1501(a)(1)(iv).

progress against those targets or goals, including the establishment of any interim targets or goals.[281] Such a target might be, for example, to achieve net-zero carbon emissions for all or a large percentage of its operations by 2050 or to reduce the carbon intensity of its products by a certain percentage by 2030 in order to mitigate transition risk. This proposed requirement would help investors evaluate whether and how a board is preparing to mitigate or adapt to any material transition risks, and whether it is providing oversight for the registrant's potential transition to a lower carbon economy. If applicable, a registrant can elect also to discuss the board's oversight of climate-related opportunities.

2. Management Oversight

Similar to the proposed required disclosures on board oversight, the proposed rules would require a registrant to disclose a number of items, as applicable, about management's role in assessing and managing any climate-related risks. For example, a registrant would be required to disclose, as applicable, whether certain management positions or committees are responsible for assessing and managing climate-related risks and, if so, to identify such positions or committees and disclose the relevant expertise of the position holders or members in such detail as necessary to fully describe the nature of the expertise.[282] This proposed requirement would give investors additional information to assess the extent to which management addresses climate-related risks, which could help them to make better informed investment or voting decisions.

Similar to the proposed board oversight provision described above, another proposed item would require disclosure about the processes by which the responsible managers or management committees are informed about and monitor climate-related risks.[283] Such a discussion might include, for example, whether there are specific positions or committees responsible for monitoring and assessing specific climate-related risks, the extent to which management relies on in-house staff with the relevant expertise to evaluate climate-related risks and implement related plans of action, and the extent to which management relies on third-party climate consultants for these same purposes.

The final proposed management governance item would require disclosure about whether the responsible positions or committees report to the board or board committee on climate-related risks and how frequently this occurs.[284] These proposed disclosure items could help investors evaluate whether management has adequately implemented processes to identify, assess, and manage climate-related risks. If applicable, a registrant may elect also to describe management's role in assessing and managing climate-related opportunities.

Several commenters recommended that we require a registrant to disclose whether it has connected a portion of its executive remuneration with the achievement of climate-related targets or goals.[285] Other commenters expressed the view that such a requirement is unnecessary, because a registrant could implement other measures to motivate progress towards climate-related targets[286] or connect executive remuneration with climate-related achievements as a discretionary matter for the registrant.[287] We are not proposing a compensation-related disclosure requirement at this time, because we believe that our existing rules requiring a compensation discussion and analysis should already provide a framework for disclosure of any connection between executive remuneration and achieving progress in addressing climate-related risks.[288]

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34. Should we require a registrant to describe, as applicable, the board's oversight of climate-related risks, as proposed? Should the required disclosure include whether any board member has expertise in climate-related risks and, if so, a description of the nature of the expertise, as proposed? Should we also require a registrant to identify the board members or board committee responsible for the oversight of climate-related risks, as proposed? Do our current rules, which require a registrant to provide the business experience of its board members, elicit adequate disclosure about a board member's or executive officer's expertise relevant to the oversight of climate-related risks?

35. Should we require a registrant to disclose the processes and frequency by which the board or board committee discusses climate-related risks, as proposed?

36. Should we require a registrant to disclose whether and how the board or board committee considers climate-related risks as part of its business strategy, risk management, and financial oversight, as proposed? Would the proposed disclosure raise competitive harm concerns? If so, how could we address those concerns while requiring additional information for investors about how a registrant's board oversees climate-related risks?

37. Should we require a registrant to disclose whether and how the board sets climate-related targets or goals, as proposed? Should the required disclosure include how the board oversees progress against those targets or goals, including whether it establishes any interim targets or goals, as proposed? Would the proposed disclosure raise competitive harm concerns? If so, how could we address those concerns while requiring additional information for investors about how a registrant's board oversees the setting of any climate-related targets or goals?

38. Should we require a registrant to describe, as applicable, management's role in assessing and managing climate-related risks, as proposed? Should the required disclosure include whether certain management positions or committees are responsible for assessing and managing climate-related risks and, if so, the identity of such positions or committees, and the relevant expertise of the position holders or members in such detail as necessary to fully describe the nature of the expertise, as proposed? Should we require a registrant to identify the executive officer(s) occupying such position(s)? Or do our current rules, which require a registrant to provide the business experience of its executive officers, elicit adequate disclosure about management's expertise relevant to the oversight of climate-related risks?

39. Should we require a registrant to describe the processes by which the management positions or committees responsible for climate-related risks are

[281] *See* proposed 17 CFR 229.1501(a)(1)(v).

[282] *See* proposed 17 CFR 229.1501(b)(1)(i).

[283] *See* proposed 17 CFR 229.1501(b)(1)(ii).

[284] *See* proposed 17 CFR 229.1501(b)(1)(iii).

[285] *See, e.g.,* letters from Baillie Gifford; Andrew Behar; CDP; Climate Governance Initiative; E3G (June 14, 2021); Interfaith Center on Corporate Responsibility; Majedie Asset Management; NEI Investments; NY State Comptroller; PRI (Consultation Response); RMI (June 11, 2021); Maria Stoica; and Value Balancing Alliance.

[286] *See* letter from Richard Love.

[287] *See* letter from Western Energy Alliance (June 12, 2021).

[288] *See* 17 CFR 229.402(b) (requiring disclosure of all material elements of a registrant's executive compensation, including the objectives of the registrant's compensation programs and what each compensation program is designed to reward). Further, the Commission recently decided to reopen the comment period on rules to implement section 953(a) of the Dodd-Frank Act, which requires disclosure of the relationship between executive compensation and the performance of the issuer. *See* Release No. 34–94074, *Reopening of Comment Period for Pay Versus Performance* (Jan. 27, 2021).

informed about and monitor climate-related risks, as proposed? Should we also require a registrant to disclose whether and how frequently such positions or committees report to the board or a committee of the board on climate-related risks, as proposed?

40. Should we specifically require a registrant to disclose any connection between executive remuneration and the achievement of climate-related targets and goals? Is there a need for such a requirement in addition to the executive compensation disclosure required by 17 CFR 229.402(b)?

41. As proposed, a registrant may disclose the board's oversight of, and management's role in assessing and managing, climate-related opportunities. Should we require a registrant to disclose these items?

E. Risk Management Disclosure

1. Disclosure of Processes for Identifying, Assessing, and Managing Climate-Related Risks

The proposed rules would require a registrant to describe any processes the registrant has for identifying, assessing, and managing climate-related risks.[289] Risk disclosure is a long-standing disclosure concept under our regulations.[290] Several commenters recommended that we adopt decision-useful disclosure requirements concerning a registrant's climate-related risk management practices.[291] More granular information regarding any climate-related risk management could allow investors to better understand how a registrant identifies, evaluates, and addresses climate-related risks that may materially impact its business. Such information could also permit investors to ascertain whether a registrant has made the assessment of climate-related risks part of its regular risk management processes. Despite the importance of climate-related risk management information, only a minority of registrants currently include such information in their voluntary climate reports.[292]

When describing the processes for identifying and assessing climate-related risks, the registrant would be required to disclose, as applicable:

• How it determines the relative significance of climate-related risks compared to other risks;

• How it considers existing or likely regulatory requirements or policies, such as GHG emissions limits, when identifying climate-related risks;

• How it considers shifts in customer or counterparty preferences, technological changes, or changes in market prices in assessing potential transition risks; and

• How it determines the materiality of climate-related risks, including how it assesses the potential size and scope of any identified climate-related risk.[293]

When describing any processes for managing climate-related risks, a registrant would be required to disclose, as applicable:

• How it decides whether to mitigate, accept, or adapt to a particular risk;

• How it prioritizes addressing climate-related risks; and

• How it determines how to mitigate a high priority risk.[294]

Together, these proposed disclosures would help investors evaluate whether a registrant has implemented adequate processes for identifying, assessing, and managing climate-related risks so that they may make better informed investment or voting decisions. As part of this risk management description, if a registrant uses insurance or other financial products to manage its exposure to climate-related risks, it may need to describe its use of these products.[295]

The proposed rules would also require a registrant to disclose whether and how climate-related risks are integrated into the registrant's overall risk management system or processes.[296] If a separate board or management committee is responsible for assessing and managing climate-related risks, a registrant would be required to disclose how that committee interacts with the registrant's board or management committee governing risks.[297] These proposed disclosures would help investors assess whether the registrant has centralized the processes for managing climate-related risks, which may indicate to investors how the board and management may respond to such risks as they unfold.

2. Transition Plan Disclosure

Adoption of a transition plan to mitigate or adapt to climate-related risks may be an important part of a registrant's climate-related risk management strategy, particularly if it operates in a jurisdiction that has made commitments under the Paris Agreement to reduce its GHG emissions. Many commenters recommended that we require disclosure regarding a registrant's transition plan, stating that such disclosure would help investors evaluate whether a registrant has an effective strategy to achieve its short-, medium-, or long-term climate-related targets or goals.[298]

The proposed rules would define a ''transition plan'' to mean a registrant's strategy and implementation plan to reduce climate-related risks.[299] A transition plan may include a plan to reduce its GHG emissions in line with a registrant's commitments or commitments of jurisdictions within which it has significant operations.[300] Transition plans may also be important to registrants and their shareholders to the extent transition risk arises from changes in customer or business counterparty preferences, technological change, or changes in market prices. If a registrant has adopted a transition plan, the proposed rules would require it to describe its plan, including the relevant metrics and targets used to identify and manage physical and transition risks.[301] This information could help investors understand how a registrant intends to address identified climate-related risks and any transition to a lower carbon economy while managing and assessing its business operations and financial condition.

[289] *See* proposed 17 CFR 229.1503(a).

[290] Risk factor disclosure has been part of the Commission's Securities Act disclosure requirements since prior to and from adoption of its integrated disclosure system. *See* Release No. 33–6383, *Adoption of Integrated Disclosure System* (Mar. 3, 1982). The Commission added risk factor disclosure to its Exchange Act registration and annual reporting requirements in 2005. *See* Release No. 33–8591, *Securities Offering Reform* (July 19, 2005) [70 FR 44722 (Aug. 3, 2005)].

[291] *See, e.g.,* letters from Rob Bonta, California Attorney General *et al.;* Boston Common Asset Management; Carbon Tracker Initiative; Confluence Philanthropy; Hermes Equity Ownership Services Ltd.; The Institute for Policy Integrity (''Policy Integrity'') at New York University School of Law, Environmental Defense Fund (''EDF''), the Initiative on Climate Risk and Resilience Law (''ICRRL''), and Professors Madison Condon, Jim Rossi, and Michael Vandenbergh (June 14, 2021) (''Institute for Policy Integrity, Environmental Defense Fund, Initiative on Climate Risk & Resilience Law''); and Total Energies.

[292] *See* TCFD, *2021 Status Report,* Section B (indicating that, during 2018–2020, 16–30% of surveyed public companies disclosed their climate risk identification and assessment processes, 14–29% disclosed their risk management processes, and 10–27% disclosed whether their climate risk management processes were integrated into their overall risk management).

[293] *See* proposed 17 CFR 229.1503(a)(1).

[294] *See* proposed 17 CFR 229.1503(a)(2).

[295] To the extent loss of insurance coverage or increases in premiums is reasonably likely to have a material impact on the registrant, the registrant would be required to disclose that risk pursuant to proposed Item 1502(a).

[296] *See* proposed 17 CFR 229.1503(b).

[297] *See id.*

[298] *See, e.g.,* letters from As You Sow; BlackRock; Clean Yield Asset Management; Climate Advisers; Climate Governance Initiative; Fiends of the Earth *et al.*; Institute for Governance and Sustainable Development; Miller/Howard Investments; Trillium Asset Management; and World Benchmarking Alliance.

[299] *See* proposed 17 CFR 229.1500(s).

[300] *See id.*

[301] *See* proposed 17 CFR 229.1503(c)(1).

Because transition planning inherently requires judgments and predictions about the future, forward-looking statements made as part of a registrant's discussion of its transition plan would be eligible for the PSLRA forward-looking statement safe harbors provided all applicable conditions are met.[302]

If a registrant has adopted a transition plan as part of its climate-related risk management strategy, the proposed rules would require the registrant to discuss, as applicable, how it plans to mitigate or adapt to any physical risks identified in the filing, including but not limited to those concerning exposure to sea level rise, extreme weather events, wildfires, drought, and severe heat.[303] For example, a company with significant operations in areas vulnerable to sea level rise might plan to relocate its vulnerable operations as part of any transition plan. A company operating in areas subject to severe storms might have a transition plan that includes reinforcing its physical facilities to better withstand such weather events, or a plan to relocate those facilities. An agricultural producer that operates in areas subject to increasing water stress might discuss its plans to adjust its business strategy or operations, for example by developing or switching to drought-resistant crops, developing technologies to optimize the use of available water, or acquiring land in other areas.[304]

The proposed rules would also require a registrant that has adopted a transition plan as part of its climate-related risk management strategy to discuss, as applicable, how it plans to mitigate or adapt to any identified transition risks, including the following:

- Laws, regulations, or policies that:
  - Restrict GHG emissions or products with high GHG footprints, including emissions caps; [305] or
  - Require the protection of high conservation value land or natural assets; [306]
- Imposition of a carbon price; [307] and
- Changing demands or preferences of consumers, investors, employees, and business counterparties.[308]

While each of these transition risks may not be applicable to each registrant and its particular transition plan, the above examples are intended to guide registrants in providing meaningful disclosure about its risk management strategies that is not generic or boilerplate. In this regard, it is important for investors to understand how a registrant plans to mitigate or adapt to any identified transition risks in its transition plan given the potential associated costs and burdens and their impact on the registrant's business.

The proposed rules would require a registrant that has adopted a transition plan as part of its climate-related management strategy to update its disclosure about its transition plan each fiscal year by describing the actions taken during the year to achieve the plan's targets or goals.[309] This is intended to provide investors with information that can help them better understand the registrant's effectiveness in implementing any transition plan and the potential risks and costs associated with what it still needs to accomplish.

A registrant that has adopted a transition plan as part of its climate-related risk management strategy may also describe how it plans to achieve any identified climate-related opportunities, such as:

- The production of products that facilitate the transition to a lower carbon economy, such as low emission modes of transportation and supporting infrastructure;
- The generation or use of renewable power;
- The production or use of low waste, recycled, or other consumer products that require less carbon intensive production methods;
- The setting of conservation goals and targets that would help reduce GHG emissions; and
- The provision of goods or services related to any transition to a lower carbon economy.[310]

For example, an energy company might discuss how, due to actual or potential regulatory constraints, it intends to take advantage of climate-related opportunities by increasing the amount of electricity purchased that is produced using renewable energy sources, reducing its medium and long-range fossil fuel exploration and production, increasing the percentage of its products consisting of biofuels and other lower emissions fuels, or investing in carbon capture and storage technologies. A transportation company might discuss how, to mitigate reputational risk, it plans to realize any climate-related opportunities presented by switching its existing fleet to one composed of low- or no-emission vehicles by a certain date.[311]

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42. Should we require a registrant to describe its processes for identifying, assessing, and managing climate-related risks, as proposed?

43. When describing the processes for identifying and assessing climate-related risks, should we require a registrant to disclose, as applicable, as proposed:

- How the registrant determines the relative significance of climate-related risks compared to other risks?
- How it considers existing or likely regulatory requirements or policies, such as emissions limits, when identifying climate-related risks?
- How it considers shifts in customer or counterparty preferences, technological changes, or changes in market prices in assessing potential transition risks?
- How the registrant determines the materiality of climate-related risks, including how it assesses the potential size and scope of an identified climate-related risk? Are there other items relevant to a registrant's identification and assessment of climate-related risks that we should require it to disclose instead of or in addition to the proposed disclosure items?

44. When describing the processes for managing climate-related risks, should we require a registrant to disclose, as applicable, as proposed:

- How it decides whether to mitigate, accept, or adapt to a particular risk?
- How it prioritizes climate-related risks?
- How it determines to mitigate a high priority risk?

Are there other items relevant to a registrant's management of climate-related risks that we should require it to disclose instead of or in addition to the proposed disclosure items?

45. Should we require a registrant to disclose whether and how the processes described in response to proposed 17 CFR 229.1503(a) are integrated into the registrant's overall risk management system or processes, as proposed? Should we specify any particular aspect of this arrangement that a registrant

[302] *See supra* note 219.

[303] *See* proposed 17 CFR 229.1503(c)(2)(i).

[304] A registrant would be required to disclose the expected impact of any potential reduction on its results of operations or financial condition pursuant to proposed 17 CFR 229.1502 to the extent it believes the likely impact would be material. Such quantified disclosure may be eligible for the PSLRA safe harbors if the conditions of the safe harbors are met.

[305] *See* proposed 17 CFR 229.1503(c)(2)(ii)(A)(*1*).

[306] *See* proposed 17 CFR 229.1503(c)(2)(ii)(A)(*2*).

[307] *See* proposed 17 CFR 229.1503(c)(2)(ii)(B).

[308] *See* proposed 17 CFR 229.1503(c)(2)(ii)(C).

[309] *See* proposed 17 CFR 229.1503(c)(1).

[310] *See* proposed 17 CFR 229.1503(c)(3)(i) through (v).

[311] A registrant would be required to disclose the expected impact of any transition opportunity on its results of operations or financial condition, *e.g.,* increased costs or expenditures, pursuant to proposed 17 CFR 229.1502 to the extent it believes they would be reasonably likely to have a material impact.

should disclose, such as any interaction between, and corresponding roles of, the board or any management committee responsible for assessing climate-related risks, if there is a separate and distinct committee of the board or management, and the registrant's committee in charge, generally, of risk assessment and management?

46. If a registrant has adopted a transition plan, should we require the registrant to describe the plan, including the relevant metrics and targets used to identify and manage physical and transition risks, as proposed? Would this proposed disclosure requirement raise any competitive harm concerns and, if so, how can we mitigate such concerns? Would any of the proposed disclosure requirements for a registrant's transition plan act as a disincentive to the adoption of such a plan by the registrant?

47. If a registrant has adopted a transition plan, should we require it, when describing the plan, to disclose, as applicable, how the registrant plans to mitigate or adapt to any identified physical risks, including but not limited to those concerning energy, land, or water use and management, as proposed? Are there any other aspects or considerations related to the mitigation or adaption to physical risks that we should specifically require to be disclosed in the description of a registrant's transition plan?

48. If a registrant has adopted a transition plan, should we require it to disclose, if applicable, how it plans to mitigate or adapt to any identified transition risks, including the following, as proposed:

- Laws, regulations, or policies that:
  - Restrict GHG emissions or products with high GHG footprints, including emissions caps; or
  - Require the protection of high conservation value land or natural assets?
- Imposition of a carbon price?
- Changing demands or preferences of consumers, investors, employees, and business counterparts?

Are there any other transition risks that we should specifically identify for disclosure, if applicable, in the transition plan description? Are there any identified transition risks that we should exclude from the plan description?

49. If a registrant has adopted a transition plan, when describing the plan, should we permit the registrant also to discuss how it plans to achieve any identified climate-related opportunities, including, as proposed:

- The production of products that facilitate the transition to a lower carbon economy, such as low emission modes of transportation and supporting infrastructure?
- The generation or use of renewable power?
- The production or use of low waste, recycled, or environmentally friendly consumer products that require less carbon intensive production methods?
- The setting of conservation goals and targets that would help reduce GHG emissions?
- The provision of services related to any transition to a lower carbon economy?

Should we require a registrant to discuss how it plans to achieve any of the above, or any other, climate-related opportunities when describing its transition plan?

50. If a registrant has disclosed its transition plan in a Commission filing, should we require it to update its transition plan disclosure each fiscal year by describing the actions taken during the year to achieve the plan's targets or goals, as proposed? Should we require a registrant to provide such an update more frequently, and if so, how frequently? Would the proposed updating requirement act as a disincentive to the adoption of a transition plan by the registrant?

51. To the extent that disclosure about a registrant's transition plan constitutes forward-looking information, the PSLRA safe harbors would apply. Should we adopt a separate safe harbor for transition plan disclosure? If so, what disclosures should such a safe harbor cover and what should the conditions be for such a safe harbor?

F. Financial Statement Metrics

1. Overview

If a registrant is required to file the disclosure required by subpart 229.1500 in a form that also requires audited financial statements,[312] under our proposal it would be required to disclose in a note to its financial statements certain disaggregated climate-related financial statement metrics that are mainly derived from existing financial statement line items.[313] In particular, the proposed rules would require disclosure falling under the following three categories of information:

- Financial Impact Metrics;
- Expenditure Metrics; and
- Financial Estimates and Assumptions.

The proposed financial statement metrics disclosures would involve estimation uncertainties that are driven by the application of judgments and assumptions, similar to other financial statement disclosures (*e.g.,* estimated loss contingencies, fair value measurement of certain assets, etc.). Accordingly, for each type of financial statement metric, the proposed rules would require the registrant to disclose contextual information to enable a reader to understand how it derived the metric, including a description of significant inputs and assumptions used, and if applicable, policy decisions made by the registrant to calculate the specified metrics.[314]

A number of existing accounting standards could elicit climate-related disclosure in the financial statements, as highlighted by the FASB in a Staff Educational Paper and by the IFRS in a similar document.[315] Nevertheless, we believe the proposed rules would benefit registrants by specifying when to provide such disclosures. Furthermore, the proposed rules may increase the consistency and comparability of such disclosures by prescribing accounting principles for preparing the proposed climate-related financial statement metrics disclosures, including, among other things, provisions that would specify the basis of calculation for such metrics and their presentation.[316]

[312] For example, the climate-related note to the financial statements would not be required in a Form 10–Q filing. *See* proposed 17 CFR 210.14–01(a). *See infra* note 690 and accompanying text, which discusses the applicability of the proposed rules to foreign private issuers.

[313] *See* FASB Concepts Statement No. 8, Chapter 8, par. D8 (''[T]he primary purpose of notes to financial statements is to supplement or further explain the information on the face of financial statements by providing financial information relevant to existing and potential investors, lenders, and other creditors for making decisions about providing resources to an entity.'').

[314] *See* proposed 17 CFR 210.14–02(a). Inputs and assumptions may include the estimation methodology used to disaggregate the amount of impact on the financial statements between the climate-related events and activities and other factors. Policy decisions referenced herein may include a registrant's election to disclose the impacts from climate-related opportunities. *See also infra* Section II.F.2 for an example of contextual information that would be required.

[315] *See* FASB Staff Educational Paper, Intersection of Environmental, Social, and Governance Matters with Financial Accounting Standards (Mar. 2021), available at *https://fasb.org/jsp/FASB/Document_C/DocumentPage&cid=1176176379917. See also* IFRS, Effects of climate-related matters on financial statements (Nov. 2020), available at *https://www.ifrs.org/content/dam/ifrs/supporting-implementation/documents/effects-of-climate-related-matters-on-financial-statements.pdf#:~:text=IFRS%20Standards%20do%20not%20refer%explicitly%20to%20climate-related,significant%20judgements%20and%20estimates%20that%20%20has%20made.*

[316] The Commission has broad authority to set accounting standards and principles. *See, e.g.,* 15 U.S.C. 77s; 15 U.S.C. 7218(c); and *Policy Statement: Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter,* Release No. 33–8221

Continued

To avoid potential confusion, maintain consistency with the rest of the financial statements, and aid comparability, registrants would be required to calculate the proposed financial statement metrics using financial information that is consistent with the scope of the rest of the registrant's consolidated financial statements included in the filing.[317] Therefore, registrants would have to include in any such calculation financial information from consolidated subsidiaries.[318]

For the avoidance of doubt, and to further promote consistency in the preparation of the financial statements, the proposed basis of calculation requirements would also specify that a registrant would be required to apply the same set of accounting principles that it is required to apply in preparation of the rest of its consolidated financial statements included in the filing, whenever applicable.[319] Although 17 CFR 210.4–01(a)(1) already states that financial statements filed with the Commission that are not prepared in accordance with GAAP will be presumed misleading or inaccurate unless the Commission has otherwise provided, clarifying the application of this concept in the proposed rules may be helpful, given the possible confusion that may arise between the current body of GAAP and the proposed requirements.[320]

The proposed rules would also require disclosure to be provided for the registrant's most recently completed fiscal year and for the historical fiscal year(s) included in the registrant's consolidated financial statements in the applicable filing.[321] For example, a registrant that is required to include balance sheets as of the end of its two most recent fiscal years and income statements and cash flow statements at the end of its three most recent fiscal years would be required to disclose two years of the climate-related financial statement metrics that correspond to balance sheet line items and three years of the climate-related financial statement metrics that correspond to income statement or cash flow statement line items. If the registrant is an emerging growth company (''EGC'') [322] or SRC, only two years would be required.[323]

A registrant, however, would not need to provide a corresponding historical metric for a fiscal year preceding its current reporting fiscal year if it is eligible to take advantage of the accommodation in 17 CFR 230.409 (''Rule 409'') or 17 CFR 240.12b–21 (''Rule 12b–21''). For example, if a registrant has not previously presented such metric for such fiscal year and the historical information necessary to calculate or estimate such metric is not reasonably available to the registrant without unreasonable effort or expense, the registrant may be able to rely on Rule 409 or Rule 12b–21 to exclude a corresponding historical metric. Requiring disclosure of current and, when known or reasonably available, historical periods, should allow investors to analyze trends in the climate-related impacts on the consolidated financial statements and to better evaluate the narrative trend disclosure provided pursuant to proposed Subpart 1500 of Regulation S–K.[324]

Request for Comment

52. Should we require a registrant to provide contextual information, including a description of significant inputs and assumptions used, and if applicable, policy decisions made by the registrant to calculate the specified metrics, as proposed? Should we revise the proposed requirement to provide contextual information to require specific information instead? We provide some examples of contextual information disclosure in Sections II.F.2 and II.F.3 below. Would providing additional examples or guidance assist registrants in preparing this disclosure?

53. The proposed rules would specify the basis of calculation for the climate-related financial statement metrics. Is it clear how to apply these accounting principles when calculating the proposed climate-related financial statement metrics, or should we provide additional guidance? Should we require a registrant to report these metrics with reference to its consolidated financial statements, as proposed? If not, how should registrants report these metrics? If we were to establish accounting principles (*e.g.,* the basis for reporting these metrics) in a manner that differs from the principles applicable to the rest of the consolidated financial statements, would the application of those principles to the proposed metrics make climate-related disclosures less clear, helpful, or comparable for investors?

54. Should we also require such metrics to be calculated at a reportable segment level when a registrant has more than one reportable segment (as defined by the FASB ASC Topic 280 *Segment Reporting*)? In addition, should we require such metrics to be presented by geographic areas that are consistent with the registrant's reporting pursuant to FASB ASC Topic 280–10–50–41? How would investors use such information?

55. The proposed rules would require disclosure for the registrant's most recently completed fiscal year and for the corresponding historical fiscal years included in the registrant's consolidated financial statements in the filing. Should disclosure of the climate-related financial statement metrics be required for the fiscal years presented in the registrant's financial statements, as proposed? Instead, should we require the financial statement metrics to be calculated only for the most recently

(Apr. 25, 2003) [68 FR 23333 (May 1, 2003)], at 23334 (''While the Commission consistently has looked to the private sector in the past to set accounting standards, the securities laws, including the Sarbanes-Oxley Act, clearly provide the Commission with authority to set accounting standards for public companies and other entities that file financial statements with the Commission.''). *See also* FASB Accounting Standards Codification (''FASB ASC'') Topic 105–10–10–1 (''Rules and interpretive releases of the Securities and Exchange Commission . . . are also sources of authoritative GAAP for SEC registrants.'').

[317] *See* proposed 17 CFR 210.14–01(c)(1).

[318] *See, e.g.,* 17 CFR 210.3–01(a) (''There shall be filed, for the registrant and its subsidiaries consolidated, audited balance sheets as of the end of each of the two most recent fiscal years.'').

[319] *See* proposed 17 CFR 210.14–01(c)(2). Foreign private issuers that file consolidated financial statements under home country GAAP and reconcile to U.S. GAAP, would be required to use U.S. GAAP (including the provisions of the proposed rules) as the basis for calculating and disclosing the proposed climate-related financial statement metrics. Foreign private issuers that file consolidated financial statements under IFRS as issued by the IASB, would apply IFRS and the proposed rules as the basis for calculating and disclosing the proposed climate-related financial statement metrics. For simplicity, we do not refer to the corresponding IFRS in each instance where we refer to a FASB ASC. Accordingly, references in this release to a FASB ASC should be read to also refer to the corresponding IFRS for foreign private issuers applying those standards. *See also infra* note 690 which discusses proposed amendments to Form 20–F.

[320] *See also* 17 CFR 210.4–01(a)(2) (discussing the application of U.S. GAAP, IFRS, and the use of other comprehensive sets of accounting principles (with reconciliation to U.S. GAAP)).

[321] *See* proposed 17 CFR 210.14–01(d).

[322] An EGC is a registrant that had total annual gross revenues of less than $1.07 billion during its most recently completed fiscal year and has not met the specified conditions for no longer being considered an EGC. *See* 17 CFR 230.405; 17 CFR 240.12b–2; 15 U.S.C. 77b(a)(19); 15 U.S.C. 78c(a)(80); and *Inflation Adjustments and Other Technical Amendments under Titles I and III of the JOBS Act,* Release No. 33–10332 (Mar. 31, 2017) [82 FR 17545 (Apr. 12, 2017)].

[323] An EGC is only required to provide audited statements of comprehensive income and cash flows for each of the two fiscal years preceding the date of the most recent audited balance sheet (or such shorter period as the registrant has been in existence). *See* 17 CFR 210.3–02(a). A similar accommodation is provided to SRCs. *See* 17 CFR 210.8–02.

[324] *See supra* Section II.C.

completed fiscal year presented in the relevant filing? Would requiring historical disclosure provide important or material information to investors, such as information allowing them to analyze trends? Are there other approaches we should consider?

56. Should information for all periods in the consolidated financial statements be required for registrants that are filing an initial registration statement or providing climate-related financial statement metrics disclosure for historical periods prior to the effective date or compliance date of the rules? Would the existing accommodation in Rules 409 and 12b–21 be sufficient to address any potential difficulties in providing the proposed disclosures in such situations?

57. Should we provide additional guidance as to when a registrant may exclude a historical metric for a fiscal year preceding the current fiscal year?

58. In several instances, the proposed rules specifically point to existing GAAP and, in this release, we provide guidance with respect to the application of existing GAAP. Are there other existing GAAP requirements that we should reference? Are there instances where it would be preferable to require an approach based on TCFD guidance or some other framework, rather than requiring the application of existing GAAP?

2. Financial Impact Metrics

As discussed above, proposed Item 1502(d) of Regulation S–K would require a registrant to provide a narrative discussion of whether and how any of its identified climate-related risks have affected or are reasonably likely to affect the registrant's consolidated financial statements.[325] The term ''climate-related risks'' would be defined, in part, as the actual or potential negative impacts of climate-related conditions and events on a registrant's consolidated financial statements.[326] ''Climate-related risks'' would also be defined to include physical risks, such as extreme weather events, and transition risks.[327] To complement this proposed requirement in Regulation S–K to provide narrative disclosure about impacts on a registrant's consolidated financial statements, we are proposing to amend Regulation S–X to require a registrant to include disaggregated information about the impact of climate-related conditions and events, and transition activities, on the consolidated financial statements included in the relevant filing,[328] unless such impact is below a specified threshold.

We are proposing to require disclosure of the impacts from severe weather events and other natural conditions and transition activities, which should capture a broad spectrum of these two types of climate-related risks (physical risks and transition risks). In addition, the proposed rules would require disclosure of the impacts of any climate-related risks identified pursuant to proposed Item 1502(a)—both physical risks (''identified physical risks'') and transition risks (''identified transition risks'')—on any of the financial statement metrics.[329] Among the examples of severe weather events and other natural conditions that we have highlighted in the proposed rule are those that the Commission identified more than a decade ago in the 2010 Guidance as potentially affecting a registrant's operations and results.[330] In addition, although not specifically mentioned in the 2010 Guidance, we are including wildfires as an example because it is well recognized as another type of natural event that can have significant impacts on a registrant's financial statements.[331] Providing examples of severe weather events, other natural conditions, and transition activities in the proposed rule would aid in the comparability of the resulting disclosure while assisting issuers in making the disclosures.

Specifically, we are proposing that impacts on any relevant line item in the registrant's consolidated financial statements during the fiscal years presented arising from severe weather events and natural conditions, and the identified physical risks (collectively, ''climate-related events''), would trigger the proposed disclosure requirement discussed below. Specific examples of such severe weather events and natural conditions may include the following:

- Flooding;
- Drought;
- Wildfires;
- Extreme temperatures; and
- Sea level rise.[332]

As discussed, above, there has been increased recognition of the current and potential effects, both positive and negative, of these events and the associated physical risks on a registrant's business as well as its financial performance and position. For example, as mentioned above, the 2010 Guidance discusses the potential impacts on a registrant's business and financial performance from climate-related events, including, for example, severe weather events, that could negatively impact a registrant's supply chain or distribution chain and lead to higher input costs or delayed product deliveries.[333] The 2010 Guidance also points to credit risks for banks driven by borrowers with assets located in high risk coastal areas.[334] More recently, the FSOC's Report on Climate-Related Financial Risk 2021 discusses significant costs from the types of events included in proposed Rule 14–02(c).[335] The TCFD, in a recent publication, also discusses the potential financial impacts of such climate-related events.[336] Furthermore, the TCFD provides examples of disclosures already being made by some companies (including registrants) of the financial statement impact of the climate-related events discussed above in their standalone sustainability (or equivalent) reports.[337]

Generally, climate-related events such as severe weather events and other natural conditions, and climate-related risks more generally, are linked to negative impacts on a registrant's financial performance and position.

[325] *See* proposed 17 CFR 229.1502(d).

[326] *See supra* Section II.B.1 (discussing the definition of ''climate-related risks'').

[327] *See* proposed 17 CFR 229.1500(c) (defining ''climate related risks'' to include ''physical risks'' and ''transition risks'').

[328] For example, the impact on the income statement line items for the periods presented in the financial statements in a registrant's Form 10–K.

[329] *See* proposed 17 CFR 210.14–02(i).

[330] *See, e.g.,* 2010 Guidance, 26 (''Significant physical effects of climate change, such as effects on the severity of weather (for example, floods or hurricanes), [and] sea levels . . . have the potential to affect a registrant's operations and results.''). Temperature extremes and drought are also discussed in the 2010 Guidance. *See, e.g., id.* at 6–7.

[331] *See, e.g.,* Aurora A. Gutierrez et al., *Wildfire response to changing daily temperature extremes in California's Sierra Nevada,* Science Advances, Vol. 7, Issue 47 (Nov. 17, 2021) (''Our work supports the conclusion that considerable potential exists for an increase in fire activity as a consequence of climate warming in the absence of changes in fire and ecosystem management.''); U.S. Geological Survey, *Will global warming produce more frequent and more intense wildfires?* (''[R]esearchers have found strong correlations between warm summer temperatures and large fire years, so there is general consensus that fire occurrence will increase with climate change.''), available at *https://www.usgs.gov/faqs/will-global-warming-produce-more-frequent-and-more-intense-wildfires.*

[332] *See* proposed 17 CFR 210.14–02(c).

[333] *See* 2010 Guidance, 6.

[334] *See id.*

[335] *See, e.g.,* 2021 FSOC Report, Chapter 1: *From Climate-related Physical Risks to Financial Risks* (discussing the listed events and other risks).

[336] TCFD, Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures (Oct. 2021), Section A.4 *Assessing Financial Impacts of Climate-Related Risks and Opportunities.*

[337] *See, e.g.,* TCFD, Guidance on Metrics, Targets, and Transition Plans (Oct. 2021), 23 (Figure C6), Appendix 2, available at *https://assets.bbhub.io/company/sites/60/2021/07/2021-Metrics_Targets_Guidance-1.pdf* (providing examples, mostly from sustainability (or equivalent) reports, that illustrate the feasibility of some of the disclosures that would be required by the proposed rules).

There could be situations, however, where such events result in positive impacts. For example, if a registrant's business is to conduct post-disaster cleanup and reconstruction, the occurrence of such severe weather events would generate additional revenues for the registrant.

In addition to the physical risks associated with climate change, registrants and investors also face climate-related transition risks. As government leaders across the globe have made public commitments to transition to a lower carbon economy, investors have sought information about the impact such a transition may have on registrants.[338] In addition to public commitments, these impacts may be prompted by regulatory, technological, market (including changing consumer, business counterparty, and investor preferences), liability, reputational, or other transition-related factors.[339] For example, significant shifts in modes of production may occur in GHG intensive economic sectors, such as the transportation, electricity generation, and heavy manufacturing sectors.[340] A registrant that is engaged in transition activities may experience business losses or, conversely, may benefit from such transition activities.[341] In response, some companies are already providing disclosure of the impact of transition-related activities on their financial statements and some have publicly made commitments related to this transition.[342] In light of these transition risks, the proposed rules would also require a registrant to disclose the financial impact of the impact of any identified transition risks and any efforts to reduce GHG emissions or otherwise mitigate exposure to transition risks (collectively, ''transition activities'') on any relevant line items in the registrant's consolidated financial statements during the fiscal years presented.[343]

A registrant may also disclose the impact of any opportunities arising from severe weather events and other natural conditions, any impact of efforts to pursue climate-related opportunities associated with transition activities, and the impact of any other climate-related opportunities, including those identified by the registrant pursuant to proposed Item 1502(a), on any of the financial statement metrics.[344] If a registrant makes a policy decision to disclose the impact of a climate-related opportunity on the proposed financial statement metrics, it must do so consistently (*e.g.,* for each fiscal year presented in the consolidated financial statements, for each financial statement line item, for all relevant opportunities identified by the registrant) and must follow the same presentation and disclosure threshold requirements applicable to the required disclosures related to financial impact metrics and expenditure metrics, as discussed below.[345]

The financial impact metric disclosure requirements in proposed Rules 14–02(c), (d), and (i) would require a registrant to disclose the financial impacts of severe weather events, other natural conditions, transition activities, and identified climate-related risks on the consolidated financial statements included in the relevant filing unless the aggregated impact of the severe weather events, other natural conditions, transition activities, and identified climate-related risks is less than one percent of the total line item for the relevant fiscal year.[346] The proposed threshold would provide a bright-line standard for registrants and should reduce the risk of underreporting such information. The proposed quantitative threshold could also promote comparability and consistency among a registrant's filings over time and among different registrants compared to a principles-based approach. The Commission has used similar one percent thresholds in other contexts.[347] More generally, in addition to the approach in Article 5 of Regulation S–X discussed below, other rules such as 17 CFR 229.103 and 17 CFR 229.404 use quantitative disclosure thresholds to facilitate comparability, consistency, and clarity in determining when information must be disclosed.[348]

A registrant would be required to determine the impacts of the severe weather events, other natural conditions, transition activities, and identified climate-related risks described above on each consolidated financial statement line item.[349] Within each category (*i.e.,* climate-related events or transition activities), impacts would, at a minimum, be required to be disclosed on an aggregated, line-by-line basis for all negative impacts and, separately, on an aggregated, line-by-line basis for all positive impacts.[350] However, for purposes of determining whether the disclosure threshold has been met, a registrant would be required to aggregate the absolute value of the positive and negative impacts on a line-by-line basis, which we believe would better reflect the significance of the impact of the climate-related events and transition activities on a registrant's financial performance and position.[351]

For example, when evaluating the line-by-line impact, a registrant may determine that its cost of revenue is impacted by Events A, B, and C, and Transition Activity D in the following manner:

- Cost of revenue was impacted negatively by Events A and B by $300,000, driven by increased input costs impacted by severe weather events that strained the registrant's main supplier;
- Cost of revenue was impacted positively by Event C by $70,000, driven by technology that improved the registrant's ability to manage the impact of severe heat on certain raw materials, which resulted in more efficient production; and
- Cost of revenue was impacted positively by Transition Activity D, which reduced production costs for certain products by $90,000 through advanced technology that improved energy efficiency during the production process.[352]

[338] *See supra* Section I.C.1.

[339] *See supra* Section II.B.

[340] *See, e.g.,* 2021 FSOC Report, Chapter 1, *From Climate-related Transition Risks to Financial Risks.*

[341] *See id.*

[342] *See, e.g.,* TCFD, Guidance on Metrics, Targets, and Transition Plans (Oct. 2021), Appendix 2.

[343] *See* proposed 17 CFR 210.14–02(d).

[344] *See* proposed 17 CFR 210.14–02(j).

[345] *See id.*

[346] *See* proposed 17 CFR 210.14–02(b). The registrant would be required to evaluate the impact on a line-by-line basis consistent with the line items presented in its consolidated financial statements. *See* proposed 17 CFR 210.14–02(c) and (d).

[347] The Commission currently uses a 1% threshold in other contexts for disclosure of certain items within the financial statements and without. *See, e.g.,* 17 CFR 210.5–03.1(a) (stating that if the total of sales and revenues reported under this caption includes excise taxes in an amount equal to 1% or more of such total, the amount of such excise taxes shall be shown on the face of the statement parenthetically or otherwise); 17 CFR 210.12–13 (requiring disclosure of open option contracts by management investment companies using a 1% of net asset value threshold, based on the notional amounts of the contracts); and 17 CFR 229.404(d) (requiring disclosure of transactions between a SRC and related persons in which the amount involved exceeds the lesser of $120,000 or 1% of the average of the SRC's total assets at year-end for the last two completed fiscal years).

[348] *See* 17 CFR 229.103(b)(2), (c)(3)(iii) and 17 CFR 229.404(a).

[349] Examples of such line items include revenue, cost of revenue, selling, general and administrative expenses, sale of property, plant, and equipment (in statement of cash flows), inventories, intangible assets, long-term debt, or contingent liabilities.

[350] *See* proposed 17 CFR 210.14–02(c) and (d).

[351] *See* proposed 17 CFR 210.14–02(b).

[352] This example illustrates a situation where the registrant has elected to include impacts from transition opportunities.

For purposes of determining whether the impacts from the example above would trigger the disclosure threshold requirements, the registrant would perform the analysis illustrated in the following table:

F/S line-item	F/S balance (from consolidated financial statements)	Impact of events A and B	Impact of event C	Impact of transition activity D	Absolute value of impacts	Percentage impact
Cost of revenue	$10,000,000	−$300,000	+$70,000	+$90,000	$460,000	4.6%

Although some of the impacts (*e.g.,* impact of Event C, impact of Transition Activity D) do not individually meet the one percent threshold, the absolute value of the aggregated impacts from the events and transition activities on the line item in the above example is $460,000 and thus exceeds one percent of the corresponding line-item threshold; therefore, disclosure for that specific line item would be required. The registrant's disclosure of such impacts may be provided, for example, as illustrated in the following table (excluding disclosure of contextual information):

Note X. Climate-related financial metrics:

F/S line-item	Total negative impact from climate-related events	Total positive impact from climate-related events	Total negative impact from climate-related transition activities	Total positive impact from climate-related transition activities and climate-related opportunities *
Cost of revenue	(Debit) $300,000	(Credit) $70,000		(Credit) $90,000

* As discussed earlier, a registrant may elect to include the impact of climate-related opportunities when calculating its climate-related financial impact metrics. This example illustrates a situation where the registrant has elected to include impacts from transition opportunities.

In this example, contextual information may include disclosure such as the registrant's election to include the impact from opportunities in its disclosure analysis and calculation, the specific events that were aggregated for purposes of determining the impact on the cost of revenue and, if applicable, a discussion of the estimation methodology used to disaggregate the amount of impact on the cost of revenue between the climate-related events, transition activities, and other factors.

To provide additional clarity, the proposed rule would include the following examples of disclosures that may be required to reflect the impact of the severe weather events and other natural conditions on each line item of the registrant's consolidated financial statements (*e.g.,* line items of the consolidated income statement, balance sheet, or cash flow statement): [353]

- Changes to revenue or costs from disruptions to business operations or supply chains;
- Impairment charges and changes to the carrying amount of assets (such as inventory, intangibles, and property, plant and equipment) due to the assets being exposed to severe weather, flooding, drought, wildfires, extreme temperatures, and sea level rise;
- Changes to loss contingencies or reserves (such as environmental reserves or loan loss allowances) due to impact from severe weather events; and
- Changes to total expected insured losses due to flooding or wildfire patterns.[354]

With respect to the financial impacts of transition activities, the proposed rule would include the following examples of potential impacts:

- Changes to revenue or cost due to new emissions pricing or regulations resulting in the loss of a sales contract;
- Changes to operating, investing, or financing cash flow from changes in upstream costs, such as transportation of raw materials;
- Changes to the carrying amount of assets (such as intangibles and property, plant, and equipment), for example, due to a reduction of the asset's useful life or a change in the asset's salvage value by being exposed to transition activities; and
- Changes to interest expense driven by financing instruments such as climate-linked bonds issued where the interest rate increases if certain climate-related targets are not met.[355]

Many commenters stated that climate-related financial disclosure is material and should be reflected separately in the financial statements.[356] For example, one commenter stated that it is critical to investors and others in assessing a company's risk profile, estimating its risk-adjusted returns, and completing other relevant financial analyses to include information on how climate-related risks and climate-related opportunities may affect companies' income statements, cash flow statements, and balance sheets.[357]

Other commenters, however, generally expressed the view that if such disclosures are material, they would already be required by existing financial statement disclosure requirements.[358] For example, some of these commenters stated that they opposed new climate-specific disclosure rules because, in their view, the traditional concept of materiality already requires the disclosure of climate-related impacts that materially

[353] The examples below, like all of the examples in this release (including examples in the text of the proposed rules), are non-exclusive and should not be interpreted as a checklist for compliance with any proposed rule.

[354] *See* proposed 17 CFR 210.14–02(c)(1) through (4).

[355] *See* proposed 17 CFR 210.14–02(d)(1) through (4).

[356] *See, e.g.,* letters from Americans for Financial Reform Education Fund *et al.;* BlackRock; CalPERS; Ceres; Climate Accounting Project; Climate Governance Initiative; Eni SpA; Friends of the Earth, Amazon Watch and RainForest Coalition; Initiative on Climate Risk and Resilience Law; International Corporate Governance Network; Investment Company Institute; Natural Resources Defense Council; Policy Working Group; Sens. Brian Schatz and Sheldon Whitehouse (June 10, 2021); Ted Atwood; The Forum for Sustainable and Responsible Investment; The Revolving Door Project; The Washington State Investment Board; UNEP—FI; Union of Concerned Scientists; and WBCSD.

[357] *See* letter from Bloomberg.

[358] *See, e.g.,* letters from the American Fuel Petrochemical Manufacturers (June 13, 2021); Environmental Bankers Association; Heritage Foundation; National Mining Association (June 11, 2021); Society for Mining, Metallurgy, & Exploration (June 13, 2021); and The Associated General Contractors of America.

affect the issuer's financial condition and results of operations.[359]

Although we agree that registrants are currently required to disclose material financial impacts on the financial statements, the proposed climate-related financial statement metrics should provide additional transparency into the impact of climate-related events on information reported in the financial statements that would be relevant to investors when making investment or voting decisions.[360] Such disclosure would also provide investors with additional insights into the nature of a registrant's business, the implementation of the registrant's targets and goals, and material trends in climate-related impacts. Furthermore, separately stating the financial statement impacts from the climate-related events and transition activities could improve comparability across both the registrant's year-to-year disclosures and the disclosures of different registrants.

We further note that the proposed requirement to separately disclose the financial impacts of the climate-related events and transition activities may be necessary not only because climate-related risks may have significant impacts on individual registrants, but also because the risks presented by the climate-related events and transition activities may be correlated across different, similarly situated registrants.[361] Climate-related risks present the potential for a high correlation and therefore concentration of risk within a portfolio. Separate disclosure of climate-related risks could help to provide investors with information to help them more effectively evaluate their portfolio risk. In this regard, we note that an analogous approach to disaggregated, or separately stated, disclosure has been taken in other contexts within the financial statements and elsewhere.[362] For example, in segment reporting, a registrant must present within its consolidated financial statements a separate presentation of certain financial statement line items for each segment.[363] The Commission has noted the importance of disaggregated disclosure in the segment reporting context, stating that it ''has long been aware of the importance of meaningful segment information to reasoned investment decision-making.'' [364]

The importance of disaggregated disclosure in a registrant's financial statements is also supported by the concepts set forth in FASB ASC Topic 606 *Revenue from Contracts with Customers* and IFRS 15 *Revenue from Contracts with Customers,* which require, among other things, disclosure of disaggregated revenue recognized from contracts with customers into categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors. As noted earlier, the Commission also requires disaggregation of certain financial statement line items in Article 5 of Regulation S–X. Specifically, Article 5 requires separate disclosures of specific balance sheet and income statement line items when practicable or when certain percentage thresholds are met, depending on the nature of the information.[365] Those conditions on when separate disclosure is required are analogous to the proposed condition that financial impacts result from the climate-related events and transition activities.

Request for Comment

59. Should we require registrants to disclose the financial impact metrics, as proposed? Would presenting climate-specific financial information on a separate basis based on climate-related events (severe weather events and other natural conditions and identified physical risks) and transition activities (including identified transition risks) elicit decision-useful or material information for investors? Are there different metrics that would result in disclosure of more useful information about the impact of climate-related risks and climate-related opportunities on the registrant's financial performance and position?

60. Would the impact from climate-related events and transition activities yield decision-useful information for investors? Would the climate-related events (including the examples provided) and transition activities result in impacts that are easier to quantify or disaggregate than climate-related risks more generally? Would a registrant be able to quantify and provide the proposed disclosure when the impact may be the result of a mixture of factors (*e.g.,* a factory shutdown due to an employee strike that occurs simultaneously with a severe weather event)? If there are situations where disaggregation would not be practicable, should we require a registrant to disclose that it was unable to make the required determination and why, or to make a reasonable estimate and provide disclosure about the assumptions and information that resulted in the estimate?

61. Alternatively, should we not require disclosure of the impacts of identified climate-related risks and only require disclosure of impacts from

[359] *See* letters from American Fuel Petrochemical Manufacturers; Environmental Bankers Association; and The Associated General Contractors of America.

[360] Certain commenters, in response to FASB's 2021 Agenda Consultation, were also supportive of more disaggregated disclosures within the financial statements. *See, e.g.,* letters from CalPERS (Sept. 22, 2021); CFA Institute (Oct. 7, 2021); and CII (Sept. 16, 2021). Comment letters in response to FASB's invitation to comment are available at *https://www.fasb.org/jsp/FASB/CommentLetter_C/CommentLetterPage&cid=1218220137090&project_id=2021-004&page_number=1.*

[361] *See, e.g.,* Madison Condon, *Market Myopia's Climate Bubble,* 2022 Utah L. Rev. 63 (2021). *See also* 2020 CFTC Advisory Subcommittee Report (''Climate change is expected to affect multiple sectors, geographies, and assets in the United States, sometimes simultaneously and within a relatively short timeframe. As mentioned earlier, transition and physical risks—as well as climate and non-climate-related risks—could interact with each other, amplifying shocks and stresses. This raises the prospect of spillovers that could disrupt multiple parts of the financial system simultaneously.'').

[362] The analogies presented are not intended to imply that FASB ASC Topic 280, IFRS 8 or other concepts would have to be applied when accounting for and disclosing the climate-related financial statement metrics. The analogies are also not intended to imply that the determination of when disclosure may be required and how that determination is made is the same across all of these concepts. *See, e.g., infra* note 363 (discussing management's evaluation under FASB ASC Topic 280 *Segment Reporting* and IFRS 8 *Operating Segments*) and the discussion below of FASB ASC Topic 606, IFRS 15, and Article 5 of Regulation S–X.

[363] *See* FASB ASC Topic 280 *Segment Reporting* and IFRS 8 *Operating Segments* (requiring segment reporting disclosures to be included in the audited financial statements). FASB ASC 280–10–10–1 states that the objective of segment reporting is to provide information about the different types of business activities in which a registrant engages and the different economic environments in which it operates to help users of financial statements: (i) Better understand the public entity's performance; (ii) better assess its prospects for future net cash flows; and (iii) make more informed judgments about the public entity as a whole. FASB ASC Topic 280 and IFRS 8 focus on the chief operating decision maker's view when evaluating the registrant and prescribes certain qualitative and quantitative considerations when determining what constitutes an operating segment. Similarly, the proposed rule would require an initial determination by the registrant of the relevant climate-related events and transition activities, and their impact on the registrant's financial statements.

[364] *See Industry and Homogenous Geographic Segment Reporting,* Release No. 33–6514 (Feb. 15, 1984) [49 FR 6737–01 (Feb. 23, 1984)], at 6738. Robust segment reporting disclosures are important as they can provide crucial transparency to investors that are reviewing financial statements. *See also* Gary Buesser, *For the Investor: Segment Reporting,* FASB OUTLOOK (Apr. 2019) (''[I]nvestors normally model a company at the segment level rather than at the consolidated level. More segments and greater information about an operating segment improve an analyst's ability to forecast a company's revenue, margins and assets—which serves as the basis for valuing a company.'').

[365] *See supra* note 347 for examples of the Commission's use of a 1% threshold in other contexts.

severe weather events and other natural conditions? Should we require a registrant to disclose the impact on its consolidated financial statements of only certain examples of severe weather events and other natural conditions? If so, should we specify which severe weather events and other natural conditions the registrant must include? Would requiring disclosure of the impact of a smaller subset of climate-related risks be easier for a registrant to quantify without sacrificing information that would be material to investors?

62. Should impact from climate-related opportunities be required, instead of optional, as proposed? We are proposing to require a registrant that elects to disclose the impact of an opportunity to do so consistently (*e.g.,* for each fiscal year presented in the consolidated financial statements, for each financial statement line item, and for all relevant opportunities identified by the registrant). Are there any other requirements that we should include to enhance consistency? Should we only require consistency between the first fiscal period in which opportunities were disclosed and subsequent periods?

63. Is it clear which climate-related events would be covered by ''severe weather events and other natural conditions''? If not, should we provide additional guidance or examples about what events would be covered? Should we clarify that what is considered ''severe weather'' in one region may differ from another region? For example, high levels of rainfall may be considered ''severe weather'' in a typically arid region.

64. Are the proposed requirements for calculating and presenting the financial impact metrics clear? Should the analysis be performed and disclosed in a manner other than on a line-by-line basis referring to the line items of the registrant's consolidated financial statements?

65. We are proposing to allow a registrant to aggregate the absolute value of negative and positive impacts of all climate-related events and, separately, transition activities on a financial statement line item. Should we instead require separate quantitative disclosure of the impact of each climate-related event or transition activity? Should we require separate disclosure of the impact of climate-related opportunities that a registrant chooses to disclose?

66. The proposed financial impact metrics would not require disclosure if the absolute value of the total impact is less than one percent of the total line item for the relevant fiscal year. Is the proposed threshold appropriate? Should we use a different percentage threshold (*e.g.,* three percent, five percent) or use a dollar threshold (*e.g.,* less than or greater than $1 million)? Should we use a combination of a percentage threshold and a dollar threshold? Should we only require disclosure when the financial impact exceeds the threshold, as proposed, or should we also require a determination of whether an impact that falls below the proposed quantitative threshold would be material and should be disclosed?

67. For purposes of determining whether the disclosure threshold has been met, should impacts on a line item from climate-related events and transition activities be permitted to offset (netting of positive and negative impacts), instead of aggregating on an absolute value basis as proposed? Should we prescribe how to analyze positive and negative impacts on a line item resulting from the same climate-related event or the same transition activity (*e.g.,* whether or not netting is permitted at an event or activity level)? Should we permit registrants to determine whether or not to offset as a policy decision (netting of the positive and negative impact within an event or activity) and provide relevant contextual information? Should we require the disclosure threshold to be calculated separately for the climate-related events and transition activities, rather than requiring all of the impacts to be aggregated as proposed?

68. Instead of including a quantitative threshold, as proposed, should we require disaggregated disclosure of *any* impact of climate-related risks on a particular line item of the registrant's consolidated financial statements? Alternatively, should we just use a materiality standard?

69. Should we require a registrant to disclose changes to the cost of capital resulting from the climate-related events? If so, should we require a registrant to disclose its weighted average cost of capital or any internal cost of capital metrics? Would such disclosure elicit decision-useful or material information for investors?

70. We have not proposed defining the term ''upstream costs'' as used in the proposed examples for the financial impact metrics and elsewhere. Should we define that term or any others? If so, how should we define them?

71. Are the proposed examples in the financial impact metrics helpful for understanding the types of disclosure that would be required? Should we provide different or additional examples or guidance?

3. Expenditure Metrics

The proposed expenditure metrics would refer to the positive and negative impacts associated with the same climate-related events, transition activities, and identified climate-related risks as the proposed financial impact metrics.[366] As proposed, the expenditure metrics would require a registrant to separately aggregate amounts of (i) expenditure expensed and (ii) capitalized costs incurred during the fiscal years presented.[367] For each of those categories, a registrant would be required to disclose separately the amount incurred during the fiscal years presented (i) toward positive and negative impacts associated with the climate-related events (*i.e.,* severe weather events and other natural conditions and identified physical risks) and (ii) toward transition activities, specifically, to reduce GHG emissions or otherwise mitigate exposure to transition risks (including identified transition risks).[368] The registrant may also choose to disclose the impact of efforts to pursue climate-related opportunities associated with transition activities.[369] As discussed above, if a registrant elects to disclose the impact of an opportunity, it must do so consistently and must follow the same presentation and disclosure threshold requirements applicable to the required disclosures of expenditure metrics associated with transition risks. The amount of expenditure disclosed pursuant to the proposed metrics would be a portion, if not all, of the registrant's total recorded expenditure (expensed or capitalized), as calculated pursuant to the accounting principles applicable to the registrant's financial statements.[370]

The proposed expenditure metrics would be subject to the same disclosure threshold as the financial impact metrics, which we believe would promote comparability, consistency, and clarity in determining when information must be disclosed. For purposes of calculating the disclosure threshold for the expenditure metrics, a registrant would be permitted to separately determine the amount of expenditure expensed and the amount of expenditure capitalized; however, a registrant would be required to

[366] *See* proposed 17 CFR 210.14–02(e), (f), and (i).

[367] *See id.* These metrics are focused on expenditures (spending) incurred in each reported fiscal year(s). We therefore believe the number of periods of the expenditure metrics should correspond to the number of years of income statement or cash flow statement presented in the consolidated financial statements.

[368] *See id.*

[369] *See* proposed 17 CFR 210.14–02(j).

[370] *See* 17 CFR 210.4–01(a)(1) and (2).

aggregate expenditure related to climate-related events and transition activities within the categories of expenditure (*i.e.,* amount capitalized and amount expensed). This approach should better reflect the significance of climate-related expenditure compared to a calculation approach that would allow for a disclosure threshold to be measured at the individual event or activity level, which may result in more limited disclosures.

For example, assume a registrant capitalized $200,000 of expenditure incurred related to Event D and capitalized another $100,000 of expenditure incurred related to Activity E. The registrant also expensed $25,000 of expenditure incurred related to Event F (which is an identified transition risk disclosed by the registrant). The registrant would determine whether the impacts would trigger the disclosure requirements based on the proposed thresholds, as illustrated below:

Expenditure category	Current fiscal year balances (from consolidated financial statements) *	Event D	Activity E	Event F	Percentage impact
Capitalized costs (total expenditure incurred during the year that was capitalized)	$8,000,000	$200,000	$100,000		** 3.85%
Expense (total expenditure incurred during the year that was expensed)	$3,000,000			$25,000	0.8%

* As expenditures capitalized and expensed are recorded in various financial statement line items, we expect the "total" to be used for disclosure threshold calculation purposes for each category to represent the aggregated expenditures capitalized during the fiscal year and aggregated expenditures expensed during the fiscal year. See below for additional discussion regarding associated contextual information that may be required.

** Calculated based on total impact on capitalized costs from Event D ($200,000), Activity E ($100,000), and Event F ($0): $300,000/$8,000,000.

In the above example, the expenditure incurred toward Event D was $200,000 (capitalized) and the expenditure incurred toward Activity E and Event F were $100,000 (capitalized) and $25,000 (expensed). The amount of capitalized costs equaled the proposed one percent threshold, and thus the disclosure would be required for that category of expenditure. No disclosure would be required for the expenditure incurred that was expensed (related to Event F in this example), because it was below the one percent threshold. The registrant's resulting disclosure of such expenditure (capitalized or expensed) may be provided, for example, as illustrated in the following table (excluding disclosure of contextual information):

Note X. Climate-related financial metrics:

	Expenditure incurred for climate-related events	Expenditure incurred for climate-related transition activities
Capitalized costs	$200,000	$100,000

In this example, contextual information may include disclosure such as the specific climate-related events and transition activities that were aggregated for purposes of determining the impacts on the capitalized or expensed expenditure amounts and, if applicable, policy decisions made by a registrant to determine the amount of climate-related events or transition activities that are categorized as expenditure capitalized versus expenditure expensed or whether impact from pursuing any climate-related opportunities are included in the analysis. Contextual information may also include a discussion of the composition of the total expenditure expensed and total expenditure capitalized, which were used to calculate whether the disclosure threshold was met, and, if applicable, a discussion of the estimation methodology used to disaggregate the amount of impact between the climate-related events, transition activities, and other factors, including if an event or an activity impacted both capitalized and expensed costs.

The proposed rules would clarify that a registrant may be required to disclose the amount of expenditure expensed or capitalized costs, as applicable, incurred for the climate-related events to increase the resilience of assets or operations, retire or shorten the estimated useful lives of impacted assets, relocate assets or operations at risk, or otherwise reduce the future impact of severe weather events and other natural conditions on business operations.[371] The proposed rules would also clarify that a registrant may be required to disclose the amount of expenditure expensed or capitalized costs, as applicable, incurred for climate-related transition activities related to research and development of new technologies, purchase of assets, infrastructure, or products that are intended to reduce GHG emissions, increase energy efficiency, offset emissions (purchase of energy credits), or improve other resource efficiency.[372]

Several commenters recommended taking a similar approach, stating that we should require disclosure of climate-related capital expenditure (*i.e.,* capitalized assets),[373] or both climate-related expenses and capitalized assets.[374] Consistent with these comments, and for similar reasons to those stated above with respect to the financial impact metrics, separate disclosure of total expense and total capitalized costs incurred toward the climate-related events and transition activities should provide important

[371] *See* proposed 17 CFR 210.14–02(e).

[372] *See* proposed 17 CFR 210.14–02(f).

[373] *See, e.g.,* letters from Amalgamated Bank; Interfaith Center on Corporate Responsibility; and Natural Resources Defense Council.

[374] *See, e.g.,* letters from Calvert; Climate Risk Disclosure Lab; and World Benchmarking Alliance.

information to help investors make better informed investment or voting decisions. Moreover, the financial impacts of expenditure typically appear in different places within the financial statements (*e.g.,* in an asset line item(s) on the balance sheet or in an expense line item(s) in the income statement). The proposed approach is intended to address this dispersed presentation by requiring registrants to first identify the relevant climate-related expenditures and then compile those impacts in one location. Similar to the proposed financial impact metrics, such an approach should provide insight into, and context for understanding, the nature of a registrant's business, including any disclosed strategy for addressing and managing the specified risks—particularly in the context of transition planning.[375]

Request for Comment

72. Should we require registrants to disclose the expenditure metrics, as proposed? Would presenting the expenditure metrics separately in one location provide decision-useful information to investors? Is there a different type of metric that would result in more useful disclosure of the expense or capitalized costs incurred toward climate-related events and transition activities or toward climate-related risks more generally?

73. Would the disclosure required by the expenditure metrics overlap with the disclosure required by the financial impact metrics? If so, should we require the disclosure to be provided pursuant to only one of these types of metrics?

74. Should the same climate-related events (including severe weather events and other natural conditions and identified physical risks) and transition activities (including identified transition risks) that we are proposing to use for the financial impact metrics apply to the expenditure metrics, as proposed? Alternatively, should we not require a registrant to disclose expenditure incurred towards identified climate-related risks and only require disclosure of expenditure relating to severe weather events and other natural conditions? Should we require a registrant to disclose the expenditure incurred toward only certain examples of severe weather events and other natural conditions? If so, should we specify which severe weather events and other natural conditions the registrant must include? Would requiring disclosure of the expenditure relating to a smaller subset of climate-related risks be easier for a registrant to quantify without sacrificing information that would be material to investors?

75. Should the proposed rules instead require a registrant to disclose the aggregate amounts of expensed and capitalized costs incurred toward *any* climate-related risks? Should expenditures incurred towards climate-related opportunities be optional based on a registrant's election to disclose such opportunities, as proposed?

76. Should we apply the same disclosure threshold to the expenditure metrics and the financial impact metrics? Is the proposed threshold for expenditure metrics appropriate? Should we use a different percentage threshold (*e.g.,* three percent, five percent) or use a dollar threshold (*e.g.,* less than or greater than $1 million)? Should we use a combination of a percentage threshold and a dollar threshold? Should we only require disclosure when the amount of climate-related expenditure exceeds the threshold, as proposed, or should we also require a determination of whether an amount of expenditure that falls below the proposed quantitative threshold would be material and should be disclosed? Should we require separate aggregation of the amount of expense and capitalized costs for purposes of the threshold, as proposed? Should we require separate aggregation of expenditure relating to the climate-related events and transition activities, as proposed?

77. Instead of including a quantitative threshold, as proposed, should we require disaggregated disclosure of *any* amount of expense and capitalized costs incurred toward the climate-related events and transition activities, during the periods presented? Alternatively, should we just use a materiality standard?

78. Are the proposed requirements for calculating and presenting the expenditure metrics clear? Should the analysis be performed and disclosed in a different manner, other than separately based on capitalized costs and amount of expenditure expensed and separately based on the climate-related events and transition activities? Should disclosure of expenditure incurred be required for both the amount of capitalized costs and the amount of expenditure expensed if only one of the two types of expenditure meets the disclosure threshold? Should we require separate disclosure of expenditure incurred toward each climate-related event and transition activity?

79. The proposed rule does not specifically address expensed or capitalized costs that are *partially* incurred towards the climate-related events and transition activities (*e.g.,* the expenditure relates to research and development expenses that are meant to address both the risks associated with the climate-related events and other risks). Should we prescribe a particular approach to disclosure in such situations? Should we require a registrant to provide a reasonable estimate of the amount of expense or capitalized costs incurred toward the climate-related events and transition activities and to provide disclosure about the assumptions and information that resulted in the estimate?

80. Are the proposed terms and examples used in the expenditure metrics helpful for understanding the types of disclosures that would be required? Should we provide different or additional examples?

4. Financial Estimates and Assumptions

The proposed rules would require a registrant to disclose whether the estimates and assumptions used to produce the consolidated financial statements were impacted by exposures to risks and uncertainties associated with, or known impacts from, climate-related events (including identified physical risks and severe weather events and other natural conditions), such as flooding, drought, wildfires, extreme temperatures, sea level rise.[376] If so, the registrant would be required to provide a qualitative description of how such events have impacted the development of the estimates and assumptions used by the registrant in the preparation of such financial statements. Similar to the other proposed financial statement metrics, the proposed rules would include a provision that would require separate disclosure focused on transition activities (including identified transition risks).[377] Further, if a registrant elects to disclose the impact of an opportunity on its financial estimates and assumptions, it must do so consistently and must follow the same presentation and disclosure requirements applicable to the required disclosures herein.[378]

If the estimates and assumptions a registrant used to produce the consolidated financial statements were

[375] *See supra* Section II.C, which discusses our proposals to require the registrant to describe the actual and potential impacts of the identified climate-related risks (and climate-related opportunities if the registrant elects to do so) on its strategy, business model, and outlook. Further, such disclosure could also provide additional context to other narrative disclosures such as the discussion of risk factors required by 17 CFR 229.105.

[376] *See* proposed 17 CFR 210.14–02(g) and (i).

[377] *See* proposed 17 CFR 210.14–02(h) and (i).

[378] *See* proposed 17 CFR 210.14–02(j).

impacted by risks and uncertainties associated with, or known impacts from, a potential transition to a lower carbon economy or any climate-related targets it has disclosed, the registrant would be required to provide a qualitative description of how the development of the estimates and assumptions were impacted by such a potential transition or the registrant's disclosed climate-related targets.

Estimates and assumptions are currently required for accounting and financial reporting purposes (*e.g.,* projected financial information used in impairment calculations, estimated loss contingencies, estimated credit risks, commodity price assumptions, etc.). The proposed disclosures could provide decision-useful information and transparency to investors about the impact of the climate-related events and transition activities, including disclosed targets and goals,[379] on such estimates and assumptions. Moreover, in addition to providing insight into impacts on the registrant's financial statements, such disclosure could allow investors to evaluate the reasonableness of the registrant's estimates and assumptions, which are used to prepare the registrant's financial statements. Although current accounting standards require registrants to consider how climate-related matters may intersect with and affect the financial statements, including their impact on estimates and assumptions,[380] the nature of the climate-related events and transition activities discussed in the proposed rules, which may manifest over a longer time horizon, necessitate targeted disclosure requirements to elicit decision-useful information for investors in a consistent manner. We also note that some registrants have already provided disclosure along the lines of the proposed requirements, which lends support to the feasibility of making such disclosures.[381]

By way of example, the proposed climate-related events and impacts relating to a transition away from greenhouse gas producing products and activities could affect a registrant's asset values and may result in asset impairments. The effect on asset values and the resulting impairments could, in turn, affect a registrant's assumptions when calculating depreciation expenses or asset retirement obligations associated with the retirement of tangible, long-lived assets. Providing related disclosure could help an investor understand if a registrant would be responsible for removing equipment or cleaning up hazardous materials sooner than originally planned due to a severe weather event. Similarly, a registrant's climate-related targets and related commitments, such as a commitment to achieve net-zero emissions by 2040, may impact certain accounting estimates and assumptions. For example, if a registrant announced a commitment that would require decommissioning an asset by a target year, then the registrant's depreciation expense should reflect alignment with that commitment. If the registrant believes it can execute a strategy that would allow it to meet the commitment and continue to operate the asset past the target date, then the proposed disclosure requirement could facilitate an investor's understanding and own assessment of the feasibility of that strategy. Other financial statement estimates and assumptions that may require disclosure pursuant to the proposed rules may include those related to the estimated salvage value of certain assets, estimated useful life of certain assets, projected financial information used in impairment calculations, estimated loss contingencies, estimated reserves (such as environmental reserve or loan loss allowances), estimated credit risks, fair value measurement of certain assets, and commodity price assumptions.

Several commenters stated that it was important to provide investors with an understanding of how climate-related events and activities are considered when a registrant develops the assumptions and estimates used to prepare its financial statements.[382] In particular, one commenter stated that investors may face ''substantial risk'' if disclosure on the impact of ''decarbonization'' on the estimates and assumptions underlying asset valuations is not disclosed.[383] Another commenter stated that ''current corporate disclosure is not sufficient, is not readily available in existing financial disclosures, and does not allow investors to make comparable assessments of how companies are evaluating and responding to climate-related risks and opportunities.''[384]

Request for Comment

81. Should we require disclosure of financial estimates and assumptions impacted by the climate-related events and transition activities (including disclosed targets), as proposed? How would investors use this information?

82. Should we instead require disclosure of only significant or material estimates and assumptions that were impacted by the climate-related events and transition activities? Alternatively, should we require disclosure of only estimates and assumptions that were materially impacted by the climate-related events and transition activities?

83. Should we instead require disclosure of financial estimates and assumptions impacts by a subset of climate-related events and transition activities, such as not requiring disclosure related to identified climate-related risks or only requiring disclosure with respect to a subset of severe weather events and natural conditions? If so, how should the subset be defined?

84. Should we instead utilize terminology and thresholds consistent with the critical accounting estimate disclosure requirement in 17 CFR 229.303(b)(3), such as ''estimates made in accordance with generally accepted accounting principles that involve a significant level of estimation uncertainty and have had or are reasonably likely to have a material impact on the financial condition or results of operations of the registrant''? If so, should we only require disclosures of whether and how the climate-related events and transition activities impacted such critical accounting estimates? Should we require only a qualitative description of how the estimates and assumptions were impacted by the climate-related events and transition activities, as proposed? Should we require quantitative disclosures as well? If so, should we require such disclosure

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[379] *See* proposed 17 CFR 229.1506.

[380] *See* FASB Staff Educational Paper, Intersection of Environmental, Social and Governance Matters with Financial Accounting Standards (Mar. 2021), available at *https://fasb.org/jsp/FASB/Document_C/DocumentPage&cid=1176176379917. See also* IFRS, Effects of climate-related matters on financial statements (Nov. 2020), available at *https://www.ifrs.org/content/dam/ifrs/supporting-implementation/documents/effects-of-climate-related-matters-on-financial-statements.pdf#:~:text=IFRS%20Standards%20do%20not%20refer%explicitly%20to%20climate-related,significant%20judgements%20and%20estimates%20that%20%20has%20made.* We also remind registrants of the requirements under FASB ASC Topic 250–10–50–4 for disclosures of changes in accounting estimates, including the requirement that if a change in estimate does not have a material effect in the period of change, but is reasonably certain to have a material effect in later periods, a description of that change in estimate must be disclosed whenever the financial statements of the period of change are presented.

[381] *See* letter from Carbon Tracker (stating that some companies in the European Union and United Kingdom (several of which are registrants) are already providing this information and providing examples).

[382] *See, e.g.,* letters from Carbon Tracker; Climate Accounting Project; ICCR; and Institute for Policy Integrity, Environmental Defense Fund, Initiative on Climate Risk & Resilience Law.

[383] *See* letter from Carbon Tracker.

[384] *See* letter from ICCR.

only if practicable or subject to another qualifier?

85. Should the disclosure of financial estimates and assumptions impacted by climate-related opportunities be optional, as proposed?

86. For the proposed financial statement metrics, should we require a registrant to disclose material changes in estimates, assumptions, or methodology among fiscal years and the reasons for those changes? If so, should we require the material changes disclosure to occur on a quarterly, or some other, basis? Should we require disclosure beyond a discussion of the material changes in assumptions or methodology and the reasons for those changes? Do existing required disclosures already elicit such information? What other approaches should we consider?

5. Inclusion of Climate-Related Metrics in the Financial Statements

The proposed financial statement metrics would be required in the financial statements, and therefore would be (i) included in the scope of any required audit of the financial statements in the relevant disclosure filing, (ii) subject to audit by an independent registered public accounting firm, and (iii) within the scope of the registrant's ICFR.

As discussed above, the proposed disclosures share many characteristics with other complex financial statement disclosures. The financial statement metrics present financial data that is derived from the registrant's consolidated balance sheets, income statements, and statements of cash flows, and would be presented in a similar way to existing financial statement disclosures.[385] Requiring certain climate-related information to be included in a note to the financial statements, and therefore subject to audit and within the scope of ICFR, should enhance the reliability of the proposed financial statement metrics.

Request for Comment

87. We are proposing to require the financial statement metrics to be disclosed in a note to the registrant's audited financial statements. Should we require or permit the proposed financial statement metrics to be disclosed in a schedule to the financial statements? If so, should the metrics be disclosed in a schedule to the financial statements, similar to the schedules required under Article 12 of Regulation S–X, which would subject the disclosure to audit and ICFR requirements? Should we instead require the metrics to be disclosed as supplemental financial information, similar to the disclosure requirements under FASB ASC Topic 932–235–50–2 for registrants that have significant oil- and gas-producing activities? If so, should such supplemental schedule be subject to assurance or ICFR requirements?

88. Instead of requiring the financial statement metrics to be disclosed in a note to the registrant's audited financial statements, should we require a new financial statement for such metrics? For example, should a ''consolidated climate statement'' be created in addition to the consolidated balance sheets, statements of comprehensive income, cash flows, and other traditional financial statements? Would including the proposed metrics in a new financial statement provide more clarity to investors given that the metrics are intended to follow the structure of the existing financial statements (including the line items)? What complications or unintended consequences may arise in practice if such a climate statement is created?

89. Should we require the disclosure to be provided outside of the financial statements? Should we require all of the disclosure to be provided in the proposed separately captioned item in the specified forms?

90. Should we require any additional metrics or disclosure to be included in the financial statements and subject to the auditing and ICFR requirements as described above? For example, should any of the disclosures we are proposing to require outside of the financial statements (such as GHG emissions metrics) be included in the financial statements? If so, should such metrics be disclosed in a note or a schedule to the financial statements? If in a schedule, should such schedule be similar to the schedules required under Article 12 of Regulation S–X and subject to audit and ICFR requirements? Should we instead require the metrics to be disclosed as supplemental financial information in a supplemental schedule? If so, should such supplemental schedule be subject to assurance or ICFR requirements?

91. Under the proposed rules, PCAOB auditing standards would be applicable to the financial statement metrics that are included in the audited financial statements, consistent with the rest of the audited financial statements. What, if any, additional guidance or revisions to such standards would be needed in order to apply PCAOB auditing standards to the proposed financial statement metrics? For example, would guidance on how to apply existing requirements, such as materiality, risk assessment, or reporting, be needed? Would revisions to the auditing standards be necessary? What additional guidance or revisions would be helpful to auditors, preparers, audit committee members, investors, and other relevant participants in the audit and financial reporting process?

92. Would it be clear that the climate-related financial statement metrics would be included in the scope of the audit when the registrant files financial statements prepared in accordance with IFRS as issued by the IASB? Would it be clear that the proposed rules would not alter the basis of presentation of the financial statements as referred to in an auditor's report? Should we amend Form 20–F, other forms, or our rules to clarify the scope of the audit or the basis of presentation in this context? For example, should we amend Form 20–F to state specifically that the scope of the audit must include any notes prepared pursuant to Article 14 of Regulation S–X? What are the costs for accounting firms to provide assurance with respect to the financial statement metrics? Would those costs decrease over time?

G. GHG Emissions Metrics Disclosure

1. GHG Emissions Disclosure Requirement

a. Overview

In addition to the other proposed climate-related disclosures, the proposed rules would require a registrant to disclose its GHG emissions for its most recently completed fiscal year.[386] As institutional investors and other commenters have indicated, GHG emissions information is important to investment decisions for various reasons, including because GHG emissions data is quantifiable and comparable across industries and can be particularly useful in conducting a transition risk analysis;[387] it can be used to evaluate the progress in meeting net-zero commitments and assessing any associated risks;[388] and it may be relevant to investment or voting decisions because GHG emissions could impact the company's access to financing, as well as its ability to reduce

[385] *See supra* Section II.F.2 for additional discussion of shared characteristics that the financial statement metrics have with existing financial statement disclosures and commenters' views.

[386] *See proposed* 17 CFR 229.1504(a). As discussed below, the proposed rules would also require a registrant to disclose its GHG emissions for the historical fiscal years included in its consolidated financial statements.

[387] *See, e.g., infra* note 432 and accompanying text.

[388] *See, e.g., infra,* note 433 and accompanying text.

its carbon footprint in the face of regulatory, policy, and market constraints.[389] Thus, while the justifications for the proposed GHG emissions disclosures overlap in some respects with the justifications for the other proposed climate-related disclosure rules, the GHG emissions requirements are intended to address separate challenges and are supported by the particular justifications discussed in detail in the following sections.

The proposed rules would establish certain requirements regarding the measurement and reporting of GHG emissions that would promote the comparability of such disclosure. We have based the proposed GHG emissions disclosure rules on the concept of scopes, which are themselves based on the concepts of direct and indirect emissions, developed by the GHG Protocol. We also have proposed definitions of Scope 1, Scope 2, and Scope 3 emissions that are substantially similar to the corresponding definitions provided by the GHG Protocol. Commenters indicated that the GHG Protocol has become the leading accounting and reporting standard for GHG emissions.[390] By sharing certain basic concepts and a common vocabulary with the GHG Protocol, the proposed rules should help limit the compliance burden for those registrants that are already disclosing their GHG emissions pursuant to the GHG Protocol.[391] Similarly, to the extent that registrants elect to follow GHG Protocol standards and methodologies, investors already familiar with the GHG Protocol may also benefit.

The proposed rules would define ''greenhouse gases'' as carbon dioxide (''CO_2''); methane (''CH_4''); nitrous oxide (''N_2O''); nitrogen trifluoride (''NF_3''); hydrofluorocarbons (''HFCs''); perfluorocarbons (''PFCs''); and sulfur hexafluoride (''SF_6'').[392] The greenhouse gases included in the proposed definition reflect the gases that are currently commonly referenced by international, scientific, and regulatory authorities as having significant climate impacts. In addition to being consistent with the GHG Protocol,[393] the list of constituent greenhouse gases would be consistent with the gases identified by widely used frameworks, such as the Kyoto Protocol, the UN Framework Convention on Climate Change, the U.S. Energy Information Administration, and the EPA.[394]

The proposed rules would define GHG emissions to mean direct and indirect emissions of greenhouse gases.[395] Pursuant to the proposed definition of GHG emissions, direct emissions are GHG emissions from sources that are owned or controlled by a registrant,[396] whereas indirect emissions are GHG emissions that result from the activities of the registrant, but occur at sources not owned or controlled by the registrant.[397] Similar to the GHG Protocol, the proposed rules would define: [398]

• Scope 1 emissions as direct GHG emissions from operations that are owned or controlled by a registrant; [399]

• Scope 2 emissions as indirect GHG emissions from the generation of purchased or acquired electricity, steam, heat, or cooling that is consumed by operations owned or controlled by a registrant; [400] and

• Scope 3 emissions as all indirect GHG emissions not otherwise included in a registrant's Scope 2 emissions, which occur in the upstream and downstream activities of a registrant's value chain.[401] Upstream emissions include emissions attributable to goods and services that the registrant acquires, the transportation of goods (for example, to the registrant), and employee business travel and commuting. Downstream emissions include the use of the registrant's products, transportation of products (for example, to the registrant's customers), end of life treatment of sold products, and investments made by the registrant.

As previously noted, the EPA uses the concept of scopes, and refers to the GHG Protocol, when providing guidance to companies regarding their GHG emissions inventories.[402] Because GHG emissions data compiled for the EPA's own GHG emissions reporting program would be consistent with the GHG Protocol's standards, and thus with the proposed rules, a registrant may use that data in partial fulfillment of its GHG emissions disclosure obligations pursuant to the proposed rules.

The proposed rules would require a registrant to disclose its total Scope 1 emissions separately from its total Scope 2 emissions after calculating them from all sources that are included in the registrant's organizational and operational boundaries.[403] A registrant would also be required to disclose separately its total Scope 3 emissions for the fiscal year if those emissions are material, or if it has set a GHG emissions reduction target or goal that includes its Scope 3 emissions.[404] For each of its Scopes 1, 2, and 3 emissions, the proposed rules would require a registrant to disclose the emissions both disaggregated by each constituent greenhouse gas (*e.g.,* by carbon dioxide

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[389] *See, e.g., infra* note 455 and accompanying text.

[390] *See supra* note 112 and accompanying text.

[391] In addition, as discussed in Section II.G.2.d, the proposed rules would permit a registrant, if actual reported data is not reasonably available, to use a reasonable estimate of its GHG emissions for its fourth fiscal quarter, together with actual, determined GHG emissions data for the first three fiscal quarters, as long as the registrant promptly discloses in a subsequent filing any material difference between the estimate used and the actual, determined GHG emissions data for the fourth fiscal quarter. *See* proposed 17 CFR 229.1504(e)(4)(i). This proposed provision should also help mitigate the GHG emissions compliance burden for registrants.

[392] *See* proposed 17 CFR 229.1500(g).

[393] In Feb. 2013 the GHG Protocol amended the required greenhouse gas inventory list to align with the seven gases required by the Kyoto Protocol (consistent with the proposed definition of greenhouse gases). *See* GHG Protocol, *Required Greenhouse Gases in Inventories: Accounting and Reporting Standard Amendment* (Feb. 2013), *available at https://www.ghgprotocol.org/sites/default/files/ghgp/NF3-Amendment_052213.pdf.* Nevertheless, the GHG Protocol's Corporate Accounting and Reporting Standard, which was updated in 2015, continues to refer to only six greenhouse gases. We believe the common understanding of the GHG Protocol's Corporate Accounting and Reporting Standard is that the earlier amendment (reflecting seven gases) applies despite the subsequent 2015 update to the standard.

[394] *See* UN Framework Convention on Climate Change (''UNFCCC'')—*Reporting requirements* (last visited Nov. 4, 2021), *available at https://unfccc.int/process-and-meetings/transparency-and-reporting/reporting-and-review-under-the-convention/greenhouse-gas-inventories-annex-i-parties/reporting-requirements.* The Kyoto Protocol is the international agreement linked to the UNFCCC. *See also* U.S. Energy Information Administration—*Where greenhouse gases come from* (last updated May 21, 2021), *available at https://www.eia.gov/energyexplained/energy-and-the-environment/where-greenhouse-gases-come-from.php;* and EPA—*Overview of Greenhouse Gases* (last visited Nov. 4, 2021), *available at https://www.epa.gov/ghgemissions/overview-greenhouse-gases.*

[395] *See* proposed 17 CFR 229.1500(h).

[396] *See* proposed 17 CFR 229.1500(h)(1).

[397] *See* proposed 17 CFR 229.1500(h)(2).

[398] Sources of emissions can include transportation, electricity production, industrial processes, commercial and residential use, agriculture, and land use changes (including deforestation). *See, e.g.,* EPA, *Sources of Greenhouse Gas Emissions,* available at *https://www.epa.gov/ghgemissions/sources-greenhouse-gas-emissions.*).

[399] *See* proposed 17 CFR 229.1500(p).

[400] *See* proposed 17 CFR 229.1500(q).

[401] *See* proposed 17 CFR 229.1500(r).

[402] *See supra* note 113. The EPA requires the disclosure of direct GHG emissions primarily from large industrial sources as well as emissions from fuel and industrial gas suppliers and CO_2 injection sites in the United States. *See* EPA, *Greenhouse Gas Reporting Program,* available at *https://www.epa.gov/ghgreporting.*

[403] *See* proposed 17 CFR 229.1504(b)(1). We discuss the setting of a registrant's organizational and operational boundaries in Section II.G.2. below.

[404] *See* proposed 17 CFR 229.1504(c)(1). As discussed in greater detail below, for many companies, these emissions may be material for assessing the companies' exposure to climate-related risks, particularly transition risks, and their strategy to reduce their carbon footprint in the face of regulatory, policy, and market constraints. *See infra* Section II.G.1.b.

(CO_2), methane (CH_4), nitrous oxide (N_2O), nitrogen trifluoride (NF_3), hydrofluorocarbons (HFCs), perfluorocarbons (PFCs), and sulfur hexafluoride (SF_6)) and in the aggregate.[405] By requiring the disclosure of GHG emissions both disaggregated by the constituent greenhouse gases and in the aggregate, investors could gain decision-useful information regarding the relative risks to the registrant posed by each constituent greenhouse gas in addition to the risks posed by its total GHG emissions by scope. For example, if a government targets reduction of a specific greenhouse gas, knowing that a registrant has significant emissions of such gas would provide insight into potential impacts on the registrant's business.[406] Because measuring the constituent greenhouse gases is a necessary step in calculating a registrant's total GHG emissions per scope, the proposed disaggregation by each constituent greenhouse gas should not create significant additional burdens.

Consistent with the GHG Protocol, the proposed rules would require a registrant to express each scope of its GHG emissions in terms of carbon dioxide equivalent (''CO_2e'').[407] CO_2e is the common unit of measurement used by the GHG Protocol to indicate the global warming potential (''GWP'')[408] of each greenhouse gas, expressed in terms of the GWP of one unit of carbon dioxide (CO_2).[409] Requiring a standard unit of measurement for GHG emissions, rather than different units of measurement for the different greenhouse gases, should simplify the disclosure for investors and enhance its comparability across registrants with different types of GHG emissions.

For all scopes of GHG emissions, the proposed rules would require a registrant to disclose GHG emissions data in gross terms, excluding any use of purchased or generated offsets.[410] Because the value of offsets can vary depending on restrictions that are or may be imposed by regulation or market conditions, disclosing GHG emissions data in this manner would allow investors to assess the full magnitude of climate-related risk posed by a registrant's GHG emissions and the registrant's plans for managing such risk. This proposed approach also is consistent with the approach taken by the GHG Protocol.[411]

Commenters generally supported requiring disclosure of a registrant's Scope 1 and Scope 2 emissions, with many also supporting disclosure of Scope 3 emissions.[412] A common reason asserted by commenters for requiring GHG emissions disclosure is that quantitative data, such as GHG emissions data, is useful for assessing a registrant's exposure to climate-related risks and accordingly its ability to transition to a lower carbon economy.[413] Investors that are currently using GHG emissions data do so because the data provides insight into a registrant's exposure to climate-related risks, and transition risks in particular—risks that have implications for a registrant's financial condition and results of operations.[414] An increasing number of investors have identified GHG emissions as material to their investment decision-making and are either purchasing this information from third-party providers or engaging with companies to obtain the information directly. In each situation, there is a lack of consistency, comparability, and reliability in those data that our proposal seeks to address.[415]

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[405] *See* proposed 17 CFR 229.1504(a)(1).

[406] For example, the White House has recently launched an initiative to reduce methane emissions in the United States. *See* the White House Office of Domestic Climate Policy, *U.S. Methane Emissions Reductions Action Plan* (Nov. 2021), available at *https://www.whitehouse.gov/wp-content/uploads/2021/11/US-Methane-Emissions-Reduction-Action-Plan-1.pdf.*

[407] *See id.*

[408] The proposed rules would define global warming potential to mean a factor describing the global warming impacts of different greenhouse gases. It is a measure of how much energy will be absorbed in the atmosphere over a specified period of time as a result of the emission of one ton of a greenhouse gas, relative to the emissions of one ton of carbon dioxide (CO_2). *See* proposed 17 CFR 229.1500(f).

[409] *See* proposed 17 CFR 229.1500(d).

[410] *See* proposed 17 CFR 229.1504(a)(2). The proposed rules would define carbon offsets to represent an emissions reduction or removal of greenhouse gases in a manner calculated and traced for the purpose of offsetting an entity's GHG emissions. *See* proposed 17 CFR 229.1500(a).

[411] *See* GHG Protocol, *Corporate Accounting and Reporting* Standard, Chapter 9.

[412] *See, e.g.,* letters from Actual Systems, Inc.; Adobe Inc.; AICPA; Curt Albright (June 13, 2021); AllianceBernstein; Alphabet *et al.;* Amalgamated Bank; Americans for Financial Reform Education Fund; Andrew Behar; Apple; Ted Atwood; Baillie Gifford; Bank of America Corporation; BlackRock; Bloomberg, LP; Blueprint Financial; BNP Paribas; Rob Bonta, California Attorney General *et al.*; Boston Common Asset Management; BSR; CalPERS; CALSTRS; Calvert Research and Management; Carbon4 Finance (June 14, 2021); Carbon180 (June 13, 2021); Carbon Tracker Initiative; Cardano Risk Management Ltd.; Carolyn Kohoot; CDP NA; Center for American Progress; Center for Climate and Energy Solutions; Center for Law and Social Policy and a New Deal for Youth (June 15, 2021); Ceres *et al.*; Certified B Corporations; Chevron; Christopher Lish; Clean Yield Asset Management; Climate Advisers; Climate Governance Initiative Climate Risk Disclosure Law and Policy Lab; Climate Policy Ocean Conservancy (June 14, 2021); Coalition on Material Emissions Transparency (COMET) (June 10, 2021); Confluence Philanthropy; Consumer Federation of America; Crake Asset Management (June 4, 2021); Credit Suisse (June 11, 2021); Daniel Cain; Katherine DiMatteo; Domini Impact Investments LLC; Douglas Hileman Consulting, LLC; Dow (June 4, 2021); Dynamhex Inc.; Energy Infrastructure Council (June 14, 2014); Environmental Bankers Association; E2; E3G; ERM CVS; Etsy, Inc.; FAIRR Initiative; First Affirmative Financial Network; Regenerative Crisis Response Committee; the Forum for Sustainable and Responsible Investment; Friends of the Earth, Amazon Watch, and RainForect Action Network; Generation Investment Management LLP (June 14, 2021); Georgetown Climate Center (June 14, 2021); George S. Georgiev; Emmanuelle Haack; Hannon Armstrong; Hermes Equity Ownership Services Limited; HP, Inc.; IHS Markit; Impact Investors, Inc.; Impax Asset Management; Institute for Governance and Sustainable Development; Institute for Market Transformation; Interfaith Center on Corporate Responsibility; International Corporate Governance Network; Invesco; Investment Consultants Sustainability Working Group-U.S.; Investor Advocates for Social Justice (June 14, 2021); Janice Shade (June 22, 2021); Japanese Bankers Association; Keramida *et al.*; Majedie Asset Management; Manifest Climate; Mercy Investment Services, Inc.; Microsoft Corporation; Miller/Howard Investments; Mirova US LLC; Morningstar, Inc.; MSCI Inc.; Natural Resources Defense Council; NEI Investments; Newground Social Investment (June 14, 2021); New York City Comptroller; New York State Society of Certified Public Accountants; Nia Impact Capital (June 14, 2021); Norges Bank Investment; NY State Comptroller; Oxfam America (June 13, 2021); Paradice Investment Management; PayPal Holdings, Inc.; Pension Investment Association of Canada (June 14, 2021); Michael S. Pieciak, Vermont Commissioner of Financial Regulation (June 14, 2021); PRI (Consultation Response); Private Equity Stakeholder Project (June 14, 2021); Public Citizen and 57 other signatories (June 14, 2021); Publish What you Pay (US) (June 13, 2021); Revolving Door Project; RMI; Salesforce.com, Inc.; SASB; Schroder Investment Management North America (June 14, 2021); Seventh Generation Interfaith, Inc.; State Street Global Advisors; Maria Stoica; Stray Dog Capital; Sunrise Bay Area; Sustainable Inclusive Solutions (June 13, 2021); Terra Alpha Investor Group; the organization Green America and 14,600 Individual Americans (June 14, 2021); TotalEnergies; Trillium Asset Management; Union of Concerned Scientists (June 14, 2021); Unovis Asset Management (June 11, 2021); Value Balancing Alliance; Vert Asset Management LLC; Wellington Management Co.; Wespath Benefits and Investments; William and Flora Hewlett Foundation; W.K. Associates, Inc. (June 14, 2021); World Benchmarking Alliance; and WBCSD.

[413] *See, e.g.,* letters from Calvert Research and Management; Ceres *et al.*; NY State Comptroller; and SASB.

[414] *See, e.g.,* letters from Bloomberg, LP (stating that GHG emissions are critical components of any climate-related financial disclosure scheme, and that understanding the emissions contributions of a company is an important factor for understanding how financially vulnerable they may be to shifts in regulation, technology, and markets during any transition to a lower-carbon economy); CalPers (indicating the use of GHG emissions data by asset managers to evaluate potential transition risks); and Credit Suisse (supporting mandatory disclosure of Scopes 1, 2, and 3 emissions for key industries as such information is critical for financial market participants to have a better understanding of their total climate-related exposure to the highest emitting sectors).

[415] *See, e.g.,* letters from CALSTRS (indicating the use by asset managers of third-party derived climate data, the expense and lack of consistency regarding such data, and the need for publicly available climate data so that the commenter may more efficiently and cost-effectively allocate capital to lower climate risk assets in line with its investment

Continued

Some of these commenters supported requiring disclosure of Scope 1 emissions at the individual greenhouse gas level.[416] Although commenters noted an increase in the voluntary reporting of climate-related disclosure, several also stated that significant gaps remain in the disclosure, particularly regarding Scope 3 emissions, which, for certain industries, can comprise a majority of GHG emissions.[417]

Many commenters recommended basing any GHG emissions disclosure requirement on the GHG Protocol.[418] Several of these commenters stated that the GHG Protocol's framework for reporting GHG emissions, delineated as Scopes 1, 2, and 3 emissions, has become the globally-accepted standard used by numerous companies for reporting their GHG emissions.[419] Commenters also indicated that a mandatory standard for reporting GHG emissions based on the GHG Protocol would help in producing consistent, comparable, and reliable climate-related information for investors.[420] Some commenters also stated that mandating GHG emissions pursuant to a standardized approach, such as the GHG Protocol, would help mitigate instances of greenwashing.[421]

Some commenters indicated that the Commission should mandate disclosure of only Scopes 1 and 2 emissions.[422] Other commenters suggested limiting the mandatory disclosure of Scope 3 emissions to registrants in certain industries,[423] larger registrants, or when a registrant's Scope 3 emissions comprise 40 percent of its total emissions.[424] These commenters pointed to difficulties in obtaining the necessary data from third parties and methodological uncertainties as reasons for limiting or not requiring disclosure of Scope 3 emissions. Other commenters and research support a requirement for disclosure of Scope 3 emissions that is independent of an individual company's materiality assessment.[425]

A few commenters stated that the Commission should require the disclosure of only Scope 1 emissions.[426] One commenter stated that this approach would be consistent with the Greenhouse Gas Reporting Program overseen by the EPA, which they stated requires the tracking of facility-level Scope 1 emissions from ''large greenhouse gas emitters.'' [427] Another commenter opposed a requirement to disclose any GHG emissions, asserting that GHG emissions do not serve as adequate indicators for the actual risks faced by a registrant.[428]

We agree with the many commenters that indicated that GHG emissions disclosure could provide important information for investors to help them evaluate the climate-related risks faced by registrants and to understand better how registrants are planning to mitigate or adapt to those risks.[429] The proposed GHG emissions disclosures could be important to an investor's understanding of other disclosures that would be required by the proposed rules, such as disclosure of the likely impacts of climate-related risks as well as any targets and goals disclosure.[430]

We propose requiring disclosure of registrants' Scopes 1 and 2 emissions because, as several institutional investor commenters stated, investors need and many investors currently use this information to make investment or voting decisions.[431] One of those commenters stated that GHG emissions information serves as the starting point for transition risk analysis because it is quantifiable and comparable across companies and industries.[432] The commenter, an institutional investor, indicated that it uses GHG emissions data to rank companies within industries based on their GHG emissions intensity to better assess transition risk exposure of companies in its portfolio and make informed investment decisions. This commenter also indicated that Scopes 1 and 2 emissions information is more broadly available than Scope 3 emissions data because of the challenges of collecting the latter data.

As previously mentioned, several large institutional investors and financial institutions, which collectively have trillions of dollars in assets under management, have formed initiatives and made commitments to achieve a net-zero economy by 2050, with interim targets set for 2030.[433] These initiatives further support the notion that investors currently need and use GHG emissions data to make informed investment decisions. These investors and financial institutions are working to reduce the GHG emissions of companies in their portfolios or of their counterparties and need GHG emissions data to evaluate the progress made regarding their net-zero commitments and to assess any

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objectives); Credit Suisse (stating that the lack of consistent and reliable climate-related data has created significant challenges in the ability of financial market participants to adequately assess and compare the performance of reporting companies, as well as efficiently allocate capital towards low-carbon solutions); and Norges Bank Investment Management (indicating their reliance on companies' climate-related data to assess their exposure to the effects of climate and how they manage climate-related risks and opportunities, and stating that the scope and quality of companies' climate-related disclosures varies significantly and that their climate-related data is often incomplete and/or not comparable).

[416] *See, e.g.,* letters from Amazon Watch and Rainforest Action Network; Dimensional; Friends of the Earth; and ICCR.

[417] *See, e.g.,* letters from Ceres (''In land-intensive sectors, deforestation, forest degradation, and land-use change are important financial risks associated with climate change. In these sectors—for example food and forest management—currently Scope 3 GHG emissions are not regularly disclosed, despite comprising upwards of 90% of emissions from companies.''); *see also* letters from Apple (stating that Scope 3 emissions ''represent the overwhelming majority of most companies' carbon footprint and are therefore critical to include''); Natural Resources Defense Council; NY State Comptroller; and Teachers Insurance and Annuity Association of America.

[418] *See, e.g.,* letters from Apple; bp; Carbon Tracker Initiative; Consumer Federation of America; ERM CVS; Ethic Inc.; First Affirmative Financial Network; Regenerative Crisis Response Committee; MSCI, Inc.; Natural Resources Defense Council; New York State Society of Certified Public Accountants; Paradice Investment Management; Stray Dog Capital; and Huw Thomas.

[419] *See, e.g.,* letters from ERM CVS; and Natural Resources Defense Council.

[420] *See, e.g.,* letters from BNP Paribas; Natural Resources Defense Council; and New York State Society of Certified Public Accountants.

[421] *See, e.g.,* letters from BNP Paribas; Center for Law and Social Policy (June 15, 2021); and Dimensional Fund Advisors. *See also* Section IV.C below for further discussion of the practice of greenwashing.

[422] *See, e.g.,* letters from Acadian Asset Management LLC; American Bankers Association; American Exploration Production Council (June 11, 2021); Seema Arora; Bank Policy Institute; Biotechnology Innovation Organization; Business Roundtable (June 11, 2021); Cisco (June 11, 2021); Conning (June 11, 2021); CPP Investments; Decatur Capital Management; Dimensional Fund Advisors; Ethic Inc.; Freeport-McMoran (June 11, 2021); Harvard Management Company; Information Technology Industry Council; Institute of International Bankers; Investment Adviser Association; Manulife Investment Management; PGIM; PIMCO; Real Estate Roundtable (June 9, 2021); Matthew Roling and Samantha Tirakian; SIFMA Asset Management Group; the Vanguard Group, Inc.; and Walmart, Inc.

[423] *See, e.g.,* letters from Teachers Insurance and Annuity Association of America (recommending requiring Scope 3 disclosure from issuers in the financial, energy, transportation, materials and buildings, and agriculture, food, and forest products sectors; and Sens. Schatz and Whitehouse (recommending requiring Scope 3 disclosure for financed emissions).

[424] *See* letter from Catavento Consultancy.

[425] *See, e.g.,* letters from Uber Technologies (Apr. 27, 2021); and Americans for Financial Reform Education Fund. *See also* TCFD, *Guidance on Metrics, Targets, and Transition Plans* (stating that 47% of respondents surveyed supported disclosure of Scope 3 GHG emissions independent of a materiality assessment).

[426] *See* letters from American Petroleum Institute; Virginia Harper Ho; and David Marriage.

[427] *See* letter from American Petroleum Institute.

[428] *See* letter from Richard Love.

[429] *See supra* notes 412 and 413.

[430] *See supra* Section II.C and *infra* Section II.I.

[431] *See, e.g.,* letters from PIMCO; State Street Global Advisors; Trillium Asset Management; and Wellington Management Co.

[432] *See* Wellington Management Co.

[433] *See supra* Section I.C.1 (discussing, in particular, Climate Action 100+ and GFANZ).

associated potential asset devaluation or loan default risks.[434] A company's GHG emissions footprint also may be relevant to investment or voting decisions because it could impact the company's access to financing or signal potential changes in its financial planning as governments, financial institutions, and other investors make demands to reduce GHG emissions.

We also agree with commenters that basing the Commission's proposed GHG emissions disclosure rules on concepts used in the GHG Protocol could help provide investors with consistent, comparable, and reliable information about a registrant's GHG emissions.[435] In this regard, we note that several studies have found that GHG emissions data prepared pursuant to the GHG Protocol have become the most commonly referenced measurements of a company's exposure to climate-related risks.[436]

However, we are not proposing to adopt all of the features of the GHG Protocol into the Commission's proposed climate-related disclosure rules. As explained in greater detail below, in one significant respect the proposed rules differ from the approach taken by the GHG Protocol regarding the methodology that a registrant would be required to use when calculating its GHG emissions. This difference better suits the U.S. financial reporting regime and the needs of investors.[437] We recognize that the methodologies pertaining to the measurement of GHG emissions, particularly Scope 3 emissions, are evolving. While we expect that many registrants would choose to follow the standards and guidance provided by the GHG Protocol when calculating their GHG emissions, the proposed rules would not require registrants to do so. Allowing for some flexibility in the choice of GHG emissions methodologies would permit registrants to adapt to new approaches, such as those pertaining to their specific industry, as they emerge.

b. The Treatment of Scopes 1 and 2 Emissions Compared to Scope 3 Emissions

We are proposing to require all registrants to disclose their Scopes 1 and 2 emissions. Those types of emissions result directly or indirectly from facilities owned or activities controlled by a registrant. The relevant data for calculating Scopes 1 and 2 emissions should be reasonably available to registrants, and the relevant methodologies are fairly well-developed. Registrants with large stationary sources of emissions already report Scope 1 emissions data to the EPA, and the EPA provides detailed methodologies for a range of industries with significant Scope 1 emissions.[438] The EPA also provides detailed guidance for the calculation of Scope 2 emissions, which, although classified as "indirect emissions," are generated by direct activities of the registrant in using purchased energy.[439]

Unlike Scopes 1 and 2 emissions, Scope 3 emissions typically result from the activities of third parties in a registrant's value chain[440] and thus collecting the appropriate data and calculating these emissions would potentially be more difficult than for Scopes 1 and 2 emissions. At the same time, in many cases Scope 3 emissions disclosure may be necessary to present investors a complete picture of the climate-related risks—particularly transition risks—that a registrant faces and how GHG emissions from sources in its value chain, which are not included in its Scopes 1 and 2 emissions, may materially impact a registrant's business operations and associated financial performance. Scope 3 emissions can augment the information provided in Scopes 1 and 2 emissions and help to reflect the total emissions associated with a registrant's operations, including inputs from upstream activities, such as those of its suppliers, and outputs from downstream activities, such as those involving the distribution, use, and disposal of a registrant's products or services.[441]

Scope 3 emissions are indirect, but registrants can and do take steps to limit Scope 3 emissions and the attendant risks. Although a registrant may not own or control the operational activities in its value chain that produce Scope 3 emissions, it nevertheless may influence those activities, for example, by working with its suppliers and downstream distributors to take steps to reduce those entities' Scopes 1 and 2 emissions (and thus help reduce the registrant's Scope 3 emissions) and any attendant risks. As such, a registrant may be able to mitigate the challenges of collecting the data required for Scope 3 disclosure.[442] Such data may reveal changes in a registrant's Scope 3 emissions over time that could be informative for investors in discerning how the registrant is managing transition risks. For example, a registrant could seek to reduce the potential impacts on its business of its upstream emissions by choosing to purchase from more GHG emission-efficient suppliers or by working with existing suppliers to reduce emissions. A registrant could also seek to reduce the potential impacts on its business of downstream emissions by producing products that are more energy efficient or involve less GHG emissions when consumers use them, or by contracting with distributors that use shorter transportation routes. Being able to compare Scope 3 emissions over time could thus be a valuable tool for investors in tracking a registrant's progress in mitigating transition and other climate-related risks.

To balance the importance of Scope 3 emissions with the potential relative difficulty in data collection and measurement, the proposed rules would require disclosure of Scope 3 emissions only if those emissions are material, or if the registrant has set a GHG emissions reduction target or goal that includes its

[434] *See, e.g.,* Climate Action 100+, *The Three Asks.*

[435] *See supra* note 420.

[436] *See, e.g.,* Kauffmann, C., C. Tébar Less and D. Teichmann (2012), *Corporate Greenhouse Gas Emission Reporting: A Stocktaking of Government Schemes,* OECD Working Papers on International Investment, 2012/01, OECD Publishing, at 8, *available at http://dx.doi.org/10.1787/5k97g3x674lq-en* ("For example, the use of scope 1, 2, 3 to classify emissions as defined by the GHG Protocol has become common language and practice today.").

[437] *See infra* Section II.G.2 (discussing the proposed treatment for determining ownership or control for the purpose of setting a registrant's organizational boundaries when measuring its Scopes 1 and 2 emissions).

[438] *See* EPA, *Direct Emissions from Stationary Combustion Sources* (Dec. 2020), available at *https://www.epa.gov/sites/default/files/2020-12/documents/stationaryemissions.pdf.*

[439] *See* EPA, *Indirect Emissions from Purchased Electricity* (Dec. 2020), available at *https://www.epa.gov/sites/default/files/2020-12/documents/electricityemissions.pdf.*

[440] As previously mentioned, the proposed rules would define a registrant's value chain to mean the upstream and downstream activities related to a registrant's operations. Upstream activities include activities that relate to the initial stages of producing a good or service (*e.g.,* materials sourcing, materials processing, and supplier activities). Downstream activities include activities that relate to processing materials into a finished product and delivering it or providing a service to the end user (*e.g.,* transportation and distribution, processing of sold products, use of sold products, end of life treatment of sold products, and investments). *See* proposed 17 CFR 229.1500(t).

[441] *See, e.g.,* letter from Wellington Management Co.

[442] *See, e.g.,* letter from Apple (referencing its *2021 Environmental Progress Report,* available at *https://www.apple.com/environment/pdf/Apple_Environmental_Progress_Report_2021.pdf,* which states that 109 suppliers across 24 countries have committed to manufacturing Apple products with 100 percent renewable energy, and indicating Apple's development of detailed life cycle assessment models, which help the company identify its top product component contributors of carbon emissions and facilitate its providing a comprehensive account of its relevant Scope 3 emissions).

Scope 3 emissions.[443] As explained in greater detail below, this latter proposed disclosure requirement could assist investors in tracking the progress of the registrant toward reaching the target or goal so that investors can better understand potential associated costs.[444]

Consistent with the Commission's definition of ''material'' and Supreme Court precedent, a registrant would be required to disclose its Scope 3 emissions if there is a substantial likelihood that a reasonable investor would consider them important when making an investment or voting decision.[445] In articulating this materiality standard, the Supreme Court recognized that ''[d]oubts as to the critical nature'' of the relevant information ''will be commonplace.'' But ''particularly in view of the prophylactic purpose'' of the securities laws,'' and ''the fact that the content'' of the disclosure ''is within management's control, it is appropriate that these doubts be resolved in favor of those the statute is designed to protect,'' namely investors.[446]

When recommending that the Commission require the disclosure of Scope 3 emissions, some commenters indicated that Scope 3 emissions represent the relatively large source of overall GHG emissions for many companies.[447] Given their relative magnitude, we agree that, for many registrants, Scope 3 emissions may be material to help investors assess the registrants' exposure to climate-related risks, particularly transition risks,[448] and whether they have developed a strategy to reduce their carbon footprint in the face of regulatory, policy, and market constraints.[449]

Scope 3 emissions information may be material in a number of situations to help investors gain a more complete picture of the transition risks to which a registrant may be exposed. In certain industries, a transition to lower-emission products or processes may already be underway, triggered by existing laws or regulations, changes in weather, policy initiatives, a shift in consumer preferences, technological changes, or other market forces, such that financial risks are reasonably foreseeable for registrants in those industries based on the emissions in their value chain. For example, some registrants may need to allocate capital to invest in lower emissions equipment. Investors thus need and use information about the full GHG emissions footprint and intensity of a registrant to determine and compare how exposed a registrant is to the financial risks associated with any transition to lower-emission products.

For example, in the automobile industry, the vast majority of car manufacturers' GHG emissions footprint comes from tailpipe emissions of cars driven by customers, as compared to the emissions from manufacturing the cars.[450] There is already a transition underway to reduce tailpipe emissions through the adoption of stricter fuel efficiency regulations[451] and by governmental initiatives that encourage the manufacture and demand for electric vehicles.[452] Demand for electric vehicles is increasing in the United States and globally,[453] and leading automobile manufacturers have announced plans to increase the manufacture of electric vehicles, with many setting commitments to manufacture all-electric fleets or achieve net-zero emissions.[454] This transition raises financial risks for automobile manufacturers, which can be gauged, in part, by their Scope 3 emissions. Investors can use Scope 3 emissions data concerning a car manufacturer's suppliers and the use of its sold products to assess whether a particular manufacturer is taking steps to mitigate or adapt to the risks posed by a transition to lower emission vehicles.

Changes in requirements by financial institutions and institutional investors can present similar financial risks for companies. As many financial institutions and investors begin to set their own GHG emissions reduction goals, they may consider the total GHG emissions footprint of companies that they finance or invest in to build portfolios to meet their goals.[455] Financial institutions and investors may focus on Scopes 1 and 2 emissions for companies in some industries, particularly for industries in which Scopes 1 and 2 represent the majority of companies' total GHG emissions footprint. For other industries, however, Scope 3 emissions represent a relatively significant portion of companies' total GHG footprint, and therefore may reflect a more complete picture of companies' exposure to transition risks than Scopes 1 and 2 emissions alone. For oil and gas product manufacturers, for example, Scope 3 emissions are likely to be material and thus necessary to an

[443] *See* proposed 17 CFR 229.1504(c)(1). As explained below, we are also proposing a safe harbor for Scope 3 disclosures. *See infra* Section II.G.3.

[444] *See infra* note 461 and accompanying text.

[445] *See supra* note 209.

[446] *TSC Industries, Inc. v Northway,* 426 U.S. at 448.

[447] *See, e.g.,* letters from Apple; and WK Associates.

[448] *See, e.g.,* letter from Wellington Management Co.

[449] *See* Eric Rosenbaum, *Climate experts are worried about the toughest carbon emissions for companies to capture* (Aug. 18, 2021) (''Scope 3 carbon emissions, or those not part of operations or under direct control, represent the majority of the carbon footprint for most companies, in some cases as high as 85% to 95%''), *available at https://www.cnbc.com/2021/08/18/apple-amazon-exxon-and-the-toughest-carbon-emissions-to-capture.html#:~:text=Scope%203%20carbon%20emissions%2C%20or,as%2085%25%to%2095%25. See also* MSCI, *Emissions: Seeing the Full Picture* (Sept. 17, 2020) (''For some companies and industries, Scope 3 emissions dominate the overall carbon footprint. For example, the Scope 3 emissions of the integrated oil and gas industry . . . are more than six times the level of its Scope 1 and 2 emissions.''), *available at https://www.msci.com/www/blog-posts/scope-3-carbon-emissions-seeing/02092372761;* letter from WK Associates, Inc. (June 14, 2021) (stating that Scope 3 emissions account for approximately 70–90% of lifecycle emissions from oil products and 60–85% of those from natural gas, according to the International Energy Agency).

[450] *See, e.g.,* TCFD, *Guidance on Metrics, Targets, and Transition Plans* (Oct. 2021), Appendix 1, Figure A1–1 (*Importance of Scope 3 GHG Emissions in Certain Sectors*) (showing that, for the automobiles and components sector, the majority of GHG emissions result from downstream product use), available at *https://assets.bbhub.io/company/sites/60/2021/07/2021-Metrics_Targets_Guidance-1.pdf.*

[451] *See, e.g.,* Coral Davenport, *E.P.A. Announces Tightest-Ever Auto Pollution Rules,* N.Y. Times, Dec. 20, 2021, available at *https://www.nytimes.com/2021/12/20/climate/tailpipe-rules-climate-biden.html?searchResultPosition=25* (reporting that the EPA announced strengthened limits on pollution from automobile tailpipes). In addition, more than a dozen states have adopted low emission vehicle standards. *See* California Air Resources Board, *States that have Adopted California's Vehicle Standards under Section 177 of the Federal Clean Air Act,* available at *https://ww2.arb.ca.gov/resources/documents/states-have-adopted-californias-vehicle-standards-under-section-177-federal.*

[452] *See, e.g.,* Catherine Lucey and Andrew Duehren, *Biden Touts Build Back Better in Meeting With CEOs,* Wall Street Journal, Jan. 26, 2022, available at *https://www.wsj.com/articles/biden-touts-build-back-better-in-meeting-with-ceos-11643227677?mod=Searchresults_pos1&page=* (reporting efforts to obtain Federal tax incentives to promote the use of electric and hydrogen-power vehicles).

[453] *See* Jack Ewing, *Sales of Electric Vehicles Surpass Diesel in Europe, a First,* N.Y. Times, Jan. 17, 2022 (stating that sales of battery-powered cars soared in Europe, the United States, and China in 2021), available at *https://www.nytimes.com/2022/01/17/business/electric-vehicles-europe.html?searchResultPosition=1.*

[454] *See, e.g.,* Tom Krisher and Aamer Madhani, *US automakers pledge huge increase in electric vehicles,* AP News, Aug. 5, 2021, available at *https://apnews.com/article/technology-joe-biden-business-environment-and-nature-economy-88fe6ca8e333f3d00f6d2e98c6652cea* (reporting that General Motors aspires to sell only electric passenger vehicles by 2035 and Ford and Stellantis (formerly Fiat Chrysler) each expect that 40% of global sales to be electric vehicles by 2030); *see also https://www.caranddriver.com/news/g35562831/ev-plans-automakers-timeline/*; and Jim Motavalli, *Every Automaker's EV Plans Through 2035 And Beyond,* Forbes, Oct. 4, 2021, available at *https://www.forbes.com/wheels/news/automaker-ev-plans/.*

[455] *See supra* Section I.C.1.

understanding of a registrant's climate-related risks.

When assessing the materiality of Scope 3 emissions, registrants should consider whether Scope 3 emissions make up a relatively significant portion of their overall GHG emissions. While we are not proposing a quantitative threshold for determining materiality, we note that some companies rely on, or support reliance on, a quantitative threshold such as 40 percent when assessing the materiality of Scope 3 emissions.[456] However, even when Scope 3 emissions do not represent a relatively significant portion of overall GHG emissions, a quantitative analysis alone would not suffice for purposes of determining whether Scope 3 emissions are material. Consistent with the concept of materiality in the securities laws, this determination would ultimately need to take into account the total mix of information available to investors, including an assessment of qualitative factors. Accordingly, Scope 3 emissions may make up a relatively small portion of a registrant's overall GHG emissions but still be material where Scope 3 represents a significant risk, is subject to significant regulatory focus, or ''if there is a substantial likelihood that a reasonable [investor] would consider it important.'' [457] Moreover, if a materiality analysis requires a determination of future impacts, *i.e.,* a transition risk yet to be realized, then both the probability of an event occurring and its magnitude should be considered. Even if the probability of an adverse consequence is relatively low, if the magnitude of loss or liability is high, then the information in question may still be material.

If a registrant determines that its Scope 3 emissions are not material, and therefore not subject to disclosure, it may be useful to investors to understand the basis for that determination. Further, if a registrant determines that certain categories of Scope 3 emissions are material, registrants should consider disclosing why other categories are not material. If, however, Scope 3 emissions are material, then understanding the extent of a registrant's exposure to Scope 3 emissions, and the choices it makes regarding them, would be important for investors when making investment or voting decisions.

Several commenters stated that disclosure of a registrant's Scope 3 emissions is essential to making an informed investment decision because Scope 3 emissions can indicate a registrant's exposure to climate-related transition risks.[458] For example, if policy changes lead to mandatory emissions reductions or carbon pricing, a registrant with high Scope 3 emissions could experience higher costs in sourcing key inputs. Similarly, if consumer preferences change to favor products that are less carbon intensive, a registrant could see a significant change in demand for its products. Registrants that do not account for these risks, or make suboptimal choices regarding them, could become less profitable in the future than registrants that acknowledge these risks and successfully mitigate them.[459] Thus, Scope 3 emissions disclosure could help convey to investors the potential financial risks facing a company related to any transition to a lower carbon economy. With Scope 3 information disclosed, investors would be able to assess, in conjunction with reported financial information, how GHG emissions impact the registrant's operations as well as its overall business strategy so that they can make more informed investment or voting decisions.[460]

Disclosure of Scope 3 emissions could also highlight instances where a registrant attempts to reduce its total Scopes 1 and 2 emissions by outsourcing carbon intensive activities. For example, a registrant could contract out certain high-emissions production activities so that its own Scope 1 or 2 emissions are lower than a similar company that has retained direct ownership and control over more of its production activities. Thus, Scope 3 emissions reporting could provide greater transparency and help preclude any efforts by registrants to obscure for investors the full magnitude of the climate-related risks associated with their GHG emissions.

The proposed rules would also require a registrant to disclose its Scope 3 emissions if it has set a GHG emissions reduction target or goal that includes Scope 3 emissions.[461] This disclosure requirement would enable investors to understand the scale and scope of actions the registrant may need to take to fulfill its commitment to reduce its Scope 3 emissions and the potential financial impact of that commitment on the registrant. It would also enable an investor to assess the registrant's strategy for meeting its Scope 3 emissions target or goal and its progress towards that target or goal, which may affect the registrant's business.

Scope 3 emissions disclosures would help investors to understand and assess the registrant's strategy. For example, Scope 3 emissions disclosures would allow an investor to better understand how feasible it would be for the registrant to achieve its targets through its current strategy, to track the registrant's progress over time, and to understand changes the registrant may make to its strategy, targets, or goals. Scope 3 emissions disclosures would thus be important to evaluating the financial effects of the registrant's target or goal. In addition, this disclosure could help prevent instances of greenwashing or other misleading claims concerning the potential impact of Scope 3 emissions on a registrant's business because investors, and the market would have access to a quantifiable, trackable metric.

A registrant's Scope 3 emissions disclosure, together with the proposed financial statement metrics, would also enable an investor to assess the efficiency and efficacy of the registrant's actions to achieve its target or goal (*e.g.,* by comparing the registrant's expenditures or other investments in lower carbon transition activities from year to year with any corresponding reduction in its Scope 3 emissions). If a registrant has a relatively ambitious Scope 3 emissions target, but discloses little investment in transition activities in its financial statements and little or no reduction in Scope 3 emissions from year to year, these disclosures could indicate to investors that the registrant may need to make a large expenditure or significant change to its business operations as it gets closer to its target date, or risk missing its target. Both potential outcomes could have financial ramifications for the registrant and, accordingly, investors.

The proposed disclosure requirement should also give investors the ability to evaluate whether a registrant's target or goal and its plan for achieving that target or goal could have an adverse impact on the registrant. For example, an investor might conclude that the financial costs of a registrant's plan would outweigh any benefits to the

[456] *See, e.g.,* letter from Uber Technologies; *see also* TCFD, *Guidance on Metrics, Targets, and Transition Plans,* at note 40, citing SBTi, *SBTi Criteria and Recommendations* (Oct. 2021), available at *https://sciencebasedtargets.org/resources/files/SBTi-criteria.pdf.*

[457] *TSC Industries* v. *Northway,* 426 U.S. at 449.

[458] *See, e.g.,* letters from Confluence Philanthropy; Forum for Sustainable and Responsible Investment; Mirova US LLC; NY City Comptroller; and Wellington Management Co.

[459] *See id.*

[460] For example, registrants that choose to mitigate climate-related risks by undertaking research and development activities to source inputs involving less GHG emissions might incur expenses in the short-term but could achieve potential long-term cost savings by implementing more energy-efficient production processes and avoiding potential penalties imposed by regulation.

[461] *See* proposed 17 CFR 229.1504(c)(1).

business, and factor that into how the registrant's securities fit into the investor's own investment portfolio given the investor's risk tolerance and other investment goals. Thus, the objective of this disclosure is not to drive targets, goals, plans, or conduct, but to provide investors with the tools to assess the implications of any targets, goals, or plans on the registrant in making investment or voting decisions.

This disclosure requirement could also enable investors to better compare firms. For example, two registrants may have the same total GHG emissions and have made the same commitments to reduce total GHG emissions from Scopes 1, 2, and 3 emissions combined. However, if the registrants have different proportions of emissions from Scope 1 and 2 versus Scope 3, investors might determine that there would be different costs and effects for these registrants from their disclosed plans to reduce their overall emissions.

Scope 3 emissions disclosures could also enable investors to better compare registrants' plans to achieve their Scope 3 emissions targets or goals. For example, registrants in the retail industry may have a relatively large portion of their Scope 3 emissions derived from customer travel to the registrant's stores and shipping products or goods to customers or stores. If a registrant in this industry has set Scope 3 emissions targets or goals, in order to meet those targets or goals it may choose to relocate its stores to be closer to public transportation. Another similarly situated registrant may elect to switch to using electric vehicles for shipping. A third similarly situated registrant might elect to take neither action, but instead assume Scope 3 emissions reductions based on customers' change in behavior. Investors could assess the likelihood of each of these three registrants meeting their Scope 3 emissions target or goal—as well as the likely financial and operational impact—which could depend on the amount and type of their Scope 3 emissions. Investors could also compare the potential impacts of these plans on the three different registrants. Without disclosures of the amount and type of Scope 3 emissions, investors would face difficulty assessing the likely impacts of a target or goal that includes Scope 3 emissions on registrants and comparing the relative impacts across registrants.

If required to disclose Scope 3 emissions, a registrant would be required to identify the categories of upstream and downstream activities that have been included in the calculation of its Scope 3 emissions. Consistent with the GHG Protocol,[462] the proposed rules identify several categories of activities that can give rise to Scope 3 emissions. Upstream activities from which Scope 3 emissions might result include:

- A registrant's purchased goods and services;
- A registrant's capital goods;
- A registrant's fuel and energy related activities not included in Scope 1 or Scope 2 emissions;
- Transportation and distribution of purchased goods, raw materials, and other inputs;
- Waste generated in a registrant's operations;
- Business travel by a registrant's employees;
- Employee commuting by a registrant's employees; and
- A registrant's leased assets related principally to purchased or acquired goods or services.[463]

Downstream activities from which Scope 3 emissions might result include:

- Transportation and distribution of a registrant's sold products, goods or other outputs;
- Processing by a third party of a registrant's sold products;
- Use by a third party of a registrant's sold products;
- End-of-life treatment by a third party of a registrant's sold products;
- A registrant's leased assets related principally to the sale or disposition of goods or services;
- A registrant's franchises; and
- Investments by a registrant.[464]

The list of upstream and downstream activities set forth in proposed Item 1500(r) is non-exclusive. If any upstream or downstream activities were significant to the registrant when calculating its Scope 3 emissions, the proposed rules would require it to identify such categories and separately disclose Scope 3 emissions data for each of those categories together with a total of all Scope 3 emissions.[465] For example, an energy company that produces oil and gas products may find that a significant category of activity resulting in Scope 3 emissions relates to the end use of its sold products. A manufacturer might find that a significant category of activities resulting in Scope 3 emissions relate to the emissions of its suppliers in the production of purchased goods or services, the processing of its sold products, or by the fuel consumed by its third-party transporters and distributors of those goods and services and of its sold products. In some cases, the category in which an emissions source belongs may be unclear, or the source might fit within more than one category. In those cases, registrants would need to use their best judgment as to the description of the emissions source and provide sufficient transparency as to the reasoning and methodology to facilitate investor understanding of the emissions category and source.

If required to disclose Scope 3 emissions, a registrant would also be required to describe the data sources used to calculate those emissions, including the use of any of the following:

- Emissions reported by parties in the registrant's value chain, and whether such reports were verified by the registrant or a third party, or unverified;
- Data concerning specific activities,[466] as reported by parties in the registrant's value chain; and
- Data derived from economic studies, published databases, government statistics, industry associations, or other third-party sources outside of a registrant's value chain, including industry averages of emissions, activities, or economic data.[467]

This information is intended to assist investors in assessing the reliability and accuracy of the registrant's Scope 3 emissions disclosure. For example, an investor might find emissions data related to the downstream transportation and distribution of a registrant's sold products more reliable if based on specific distances traveled by the registrant's transportation and distribution partners and company-specific emissions factors rather than estimates of distances traveled based on industry-average data and using national average emission factors. Although we recognize that a registrant may sometimes need to use industry- and national-average data when calculating its Scope 3 emissions, information about the data sources for its Scope 3 emissions would help

[462] See WBCSD and World Resources Institute, Greenhouse Gas Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard (Sept. 2011).

[463] *See* proposed 17 CFR 229.1500(r).

[464] *See id.* The "investments" category would capture what are commonly referred to as "financed emissions."

[465] *See* proposed 17 CFR 229.1504(c)(1).

[466] Activity data refers to a quantitative measure of a level of activity that results in GHG emissions. Depending on the activity, such data could be expressed, for example, as: Liters of fuel consumed; kilowatt-hours of electricity consumed; kilograms of material consumed; kilometers of distance traveled; hours of time operated; square meters of area occupied; kilograms of waste generated; kilograms of product sold; or quantity of money spent. *See* GHG Protocol, *Corporate Value Chain (Scope 3) Accounting and Reporting Standard,* Chapter 7.

[467] *See* proposed 17 CFR 229.1504(c)(2).

investors better understand the risk exposure posed by the registrant's value chain in comparison with other registrants and make more informed investment decisions.

We acknowledge that a registrant's material Scope 3 emissions is a relatively new type of metric, based largely on third-party data, that we have not previously required. We are proposing the disclosure of this metric because we believe capital markets have begun to assign financial value to this type of metric, such that it can be material information for investors about financial risks facing a company. Scope 3 emissions disclosure is an integral part of both the TCFD[468] framework and the GHG Protocol,[469] which are widely accepted. It also has been widely recognized that, for some companies, disclosure of just Scopes 1 and 2 emissions could convey an incomplete, and potentially misleading, picture.[470] We have attempted to calibrate our proposal to balance investors' demand for this information with the current limitations of the Scope 3 emissions data.

We also recognize, as discussed below, that the reporting of Scope 3 emissions may present more challenges than the reporting of Scopes 1 and 2 emissions. But in light of the fact that a GHG emissions reporting regime may be incomplete without the reporting of Scope 3 emissions, we are proposing to include them, with an appropriate transition period and safe harbor, at the outset. Although we have not proposed to exclude specific upstream or downstream activities from the scope of the proposed Scope 3 disclosure requirement, we have limited the proposed disclosure requirement to those value chain emissions that overall are material. We also have not proposed a bright-line quantitative threshold for the materiality determination as suggested by some commenters[471] because whether Scope 3 emissions are material would depend on the particular facts and circumstances, making it difficult to establish a ''one size fits all'' standard.

[468] See, *e.g.,* TCFD, Guidance on Metrics, Targets, and Transition Plans (Oct. 2021), Appendix 1.

[469] *See, e.g.,* GHG Protocol, *Corporate Value Chain (Scope 3) Accounting and Reporting Standard.*

[470] *See, e.g.,* TCFD, *Guidance on Metrics, Targets, and Transition Plans* (Oct. 2021), Appendix 1; and letters from Apple; NY City Comptroller; and Wellington Investment Co.

[471] *See, e.g.,* letter from Catavento Consultancy (stating that Scope 3 emissions disclosure should be mandatory for larger companies and for those in which Scope 3 emissions account for more than 40% of total emissions).

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93. How would investors use GHG emissions disclosures to inform their investment and voting decisions? How would such disclosures provide insight into a registrant's financial condition, changes in financial condition, and results of operations? How would such disclosures help investors evaluate an issuer's climate risk-related exposure? Would such disclosures enable investors to better assess physical risks associated with climate-related events, transition risks, or both types of risks?

94. Should we require a registrant to disclose its GHG emissions both in the aggregate, per scope, and on a disaggregated basis for each type of greenhouse gas that is included in the Commission's proposed definition of ''greenhouse gases,'' as proposed? Should we instead require that a registrant disclose on a disaggregated basis only certain greenhouse gases, such as methane (CH_4) or hydrofluorocarbons (HFCs), or only those greenhouse gases that are the most significant to the registrant? Should we require disaggregated disclosure of one or more constituent greenhouse gases only if a registrant is obligated to separately report the individual gases pursuant to another reporting regime, such as the EPA's greenhouse gas reporting regime or any foreign reporting regime? If so, should we specify the reporting regime that would trigger this disclosure?

95. We have proposed defining ''greenhouse gases'' as a list of specific gases that aligns with the GHG Protocol and the list used by the EPA and other organizations. Should other gases be included in the definition? Should we expand the definition to include any other gases to the extent scientific data establishes a similar impact on climate change with reasonable certainty? Should we require a different standard to be met for other greenhouse gases to be included in the definition?

96. Should we require a registrant to express its emissions data in CO_2e, as proposed? If not, is there another common unit of measurement that we should use? Is it important to designate a common unit of measurement for GHG emissions data, as proposed, or should we permit registrants to select and disclose their own unit of measurement?

97. Should we require a registrant to disclose its total Scope 1 emissions and total Scope 2 emissions separately for its most recently completed fiscal year, as proposed? Are there other approaches that we should consider?

98. Should we require a registrant to disclose its Scope 3 emissions for the fiscal year if material, as proposed? Should we instead require the disclosure of Scope 3 emissions for all registrants, regardless of materiality? Should we use a quantitative threshold, such as a percentage of total GHG emissions (*e.g.,* 25%, 40%, 50%) to require the disclosure of Scope 3 emissions? If so, is there any data supporting the use of a particular percentage threshold? Should we require registrants in particular industries, for which Scope 3 emissions are a high percentage of total GHG emissions, to disclose Scope 3 emissions?

99. Should we require a registrant that has made a GHG emissions reduction commitment that includes Scope 3 emissions to disclose its Scope 3 emissions, as proposed? Should we instead require registrants that have made any GHG emissions reduction commitments, even if those commitments do not extend to Scope 3, to disclose their Scope 3 emissions? Should we only require Scope 3 emissions disclosure if a registrant has made a GHG emissions reduction commitment that includes Scope 3 emissions?

100. Should Scope 3 emissions disclosure be voluntary? Should we require Scope 3 emissions disclosure in stages, *e.g.,* requiring qualitative disclosure of a registrant's significant categories of upstream and downstream activities that generate Scope 3 emissions upon effectiveness of the proposed rules, and requiring quantitative disclosure of a registrant's Scope 3 emissions at a later date? If so, when should we require quantitative disclosure of a registrant's Scope 3 emissions?

101. Should we require a registrant to exclude any use of purchased or generated offsets when disclosing its Scope 1, Scope 2, and Scope 3 emissions, as proposed? Should we require a registrant to disclose both a total amount with, and a total amount without, the use of offsets for each scope of emissions?

102. Should we require a registrant to disclose its Scope 3 emissions for each separate significant category of upstream and downstream emissions as well as a total amount of Scope 3 emissions for the fiscal year, as proposed? Should we only require the disclosure of the total amount of Scope 3 emissions for the fiscal year? Should we require the separate disclosure of Scope 3 emissions only for certain categories of emissions and, if so, for which categories?

103. Should the proposed rules include a different standard for

requiring identification of the categories of upstream and downstream emissions, such as if those categories of emissions are significant to total GHG emissions or total Scope 3 emissions? Are there any other categories of, or ways to categorize, upstream or downstream emissions that a registrant should consider as a source of Scope 3 emissions? For example, should we require a registrant to disclose Scope 3 emissions only for categories of upstream or downstream activities over which it has influence or indirect control, or for which it can quantify emissions with reasonable reliability? Are there any proposed categories of upstream or downstream emissions that we should exclude as sources of Scope 3 emissions?

104. Should we, as proposed, allow a registrant to provide their own categories of upstream or downstream activities? Are there additional categories, other than the examples we have identified, that may be significant to a registrant's Scope 3 emissions and that should be listed in the proposed rule? Are there any categories that we should preclude, *e.g.,* because of lack of accepted methodologies or availability of data? Would it be useful to allow registrants to add categories that are particularly significant to them or their industry, such as Scope 3 emissions from land use change, which is not currently included in the Greenhouse Gas Protocol's Scope 3 categories? Should we specifically add an upstream emissions disclosure category for land use?

105. Should we require the calculation of a registrant's Scope 1, Scope 2, and/or Scope 3 emissions to be as of its fiscal year end, as proposed? Should we instead allow a registrant to provide its GHG emissions disclosures according to a different timeline than the timeline for its Exchange Act annual report? If so, what should that timeline be? For example, should we allow a registrant to calculate its Scope 1, Scope 2, and/or Scope 3 emissions for a 12-month period ending on the latest practicable date in its fiscal year that is no earlier than three months or, alternatively, six months prior to the end of its fiscal year? Would allowing for an earlier calculation date alleviate burdens on a registrant without compromising the value of the disclosure? Should we allow such an earlier calculation date only for a registrant's Scope 3 emissions? Would the fiscal year end calculations required for a registrant to determine if Scope 3 emissions are material eliminate the benefits of an earlier calculation date? Should we instead require a registrant to provide its GHG emissions disclosures for its most recently completed fiscal year one, two, or three months after the due date for its Exchange Act annual report in an amendment to that report?

106. Should we require a registrant that is required to disclose its Scope 3 emissions to describe the data sources used to calculate the Scope 3 emissions, as proposed? Should we require the proposed description to include the use of: (i) Emissions reported by parties in the registrant's value chain, and whether such reports were verified or unverified; (ii) data concerning specific activities, as reported by parties in the registrant's value chain; and (iii) data derived from economic studies, published databases, government statistics, industry associations, or other third-party sources outside of a registrant's value chain, including industry averages of emissions, activities, or economic data, as proposed? Are there other sources of data for Scope 3 emissions the use of which we should specifically require to be disclosed? For purposes of our disclosure requirement, should we exclude or prohibit the use of any of the proposed specified data sources when calculating Scope 3 emissions and, if so, which ones?

107. Should we require a registrant to provide location data for its disclosed sources of Scope 1, Scope 2, and Scope 3 emissions if feasible? If so, should the feasibility of providing location data depend on whether it is known or reasonably available pursuant to the Commission's existing rules (Securities Act Rule 409 and Exchange Act Rule 12b–21)? Would requiring location data, to the extent feasible, assist investors in understanding climate-related risks, and in particular, likely physical risks, associated with a registrant's emissions' sources? Would a requirement to disclose such location data be duplicative of any of the other disclosure requirements that we are proposing?

108. If we require a registrant to provide location data for its GHG emissions, how should that data be presented? Should the emissions data be grouped by zip code separately for each scope? Should the disclosure be presented in a cartographic data display, such as what is commonly known as a ''heat map''? If we require a registrant to provide location data for its GHG emissions, should we also require additional disclosure about the source of the emissions?

c. GHG Intensity

In addition to requiring the disclosure of its GHG emissions in gross terms, the proposed rules would also require a registrant to disclose the sum of its Scopes 1 and 2 emissions in terms of GHG intensity.[472] If required to disclose Scope 3 emissions, a registrant would also be required to separately disclose its Scope 3 emissions in terms of GHG intensity.[473] GHG intensity disclosure should provide context to a registrant's emissions in relation to its business scale (*e.g.,* emissions per economic output). For example, car manufacturer A may generate more emissions in terms of CO_2e than car manufacturer B; however, when analyzing an intensity metric (emissions per unit of production), it becomes apparent that car manufacturer A actually has a lower emission rate per car produced than car manufacturer B, which indicates a registrant's emission efficiency. Because emission efficiency can be a potential indicator of the likelihood of the registrant being impacted by transition risks, such GHG intensity disclosure could provide decision-useful information to investors. In addition, the proposed GHG intensity disclosure would provide a standardized method for presenting such measure of efficiency across registrants, which should facilitate comparability of the registrant's emissions efficiency over time.

The proposed rules would define ''GHG intensity'' (or ''carbon intensity'') to mean a ratio that expresses the impact of GHG emissions per unit of economic value (*e.g.,* metric tons of CO_2e per unit of total revenues, using the registrant's reporting currency) or per unit of production (*e.g.,* metric tons of CO_2e per unit of product produced).[474] For purposes of standardizing the disclosure and facilitating its comparability, we are proposing to require the disclosure of GHG intensity in terms of metric tons of CO_2e per unit of total revenue and per unit of production for the fiscal year.[475] Total revenue is one of the most commonly used and understood financial metrics when investors analyze a registrant's financial results and applies to most registrants (depending on the nature and maturity of the business) and therefore would be a good common denominator for the

[472] *See* proposed 17 CFR 229.1504(d)(1).

[473] *See* proposed 17 CFR 229.1504(d)(2). The proposed safe harbor for Scope 3 emissions disclosure would apply to this proposed GHG intensity metric for Scope 3 emissions. *See infra* Section II.C.3.

[474] *See* proposed 17 CFR 229.1500(i). We derived this proposed definition from the GHG Protocol. *See* GHG Protocol, *A Corporate Accounting and Reporting Standard,* Chapter 9.

[475] *See* proposed 17 CFR 229.1504(d)(1).

intensity calculation. The selected unit of production should be relevant to the registrant's industry to facilitate investor comparison of the GHG intensity of companies within an industry without regard to registrant size. Investors may find such a comparison to be useful to making informed investment decisions to the extent that a registrant within a particular industry that has a lower GHG intensity relative to its peers that face fewer climate-related risks.

If the registrant has no revenue for a fiscal year, it would be required to calculate its GHG intensity with another financial measure (*e.g.,* total assets), with an explanation of why the particular measure was used. Similarly, if the registrant does not have a unit of production, it would be required to calculate its GHG intensity with another measure of economic output, depending on the nature of its business (*e.g.,* data processing capacity, volume of products sold, or number of occupied rooms) with an explanation of why the particular measure was used.[476]

A registrant could also voluntarily disclose other additional measures of GHG intensity, including non-financial measures such as economic output, provided it includes an explanation of the reasons why those particular GHG intensity measures were used and why the registrant believes such measures provide useful information to investors.[477] In all cases, the registrant would be required to disclose the methodology and other information required pursuant to the proposed GHG emissions metrics instructions.[478]

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109. Should we require a registrant to disclose the intensity of its GHG emissions for the fiscal year, with separate calculations for (i) the sum of Scope 1 and Scope 2 emissions and, if applicable (ii) its Scope 3 emissions (separately from Scopes 1 and 2), as proposed? Should we define GHG intensity, as proposed? Is there a different definition we should use for this purpose?

110. Should we require the disclosed GHG intensity to be expressed in terms of metric tons of CO_2e per unit of total revenue, as proposed? Should we require a different financial measure of GHG intensity and, if so, which measure? For example, should GHG intensity be expressed in terms of metric tons of CO_2e per unit of total assets?

111. Should we require the disclosed GHG intensity to be expressed in terms of metric tons of CO_2e per unit of production, as proposed? Would such a requirement facilitate the comparability of the disclosure? Should we require a different economic output measure of GHG intensity and, if so, which measure? For example, should GHG intensity be expressed in terms of metric tons of CO_2e per number of employees? Should we require the GHG intensity to be expressed per unit of production relevant to the registrant's business (rather than its industry)? Is further guidance needed on how to comply with the proposed requirement? Would requiring GHG intensity to be expressed in terms of metrics tons of CO_2e per unit of production require disclosure of commercially sensitive or competitively harmful information?

112. Should we require a registrant with no revenue or unit of production for a fiscal year to disclose its GHG intensity based on, respectively, another financial measure or measure of economic output, as proposed? Should we require such a registrant to use a particular financial measure, such as total assets, or a particular measure of economic output, such as total number of employees? For registrants who may have minimal revenue, would the proposed calculation result in intensity disclosure that is confusing or not material? Should additional guidance be provided with respect to such instances?

113. Should we permit a registrant to disclose other measures of GHG intensity, in addition to the required measures, as long as the registrant explains why it uses the particular measure of GHG intensity and discloses the corresponding calculation methodology used, as proposed?

d. GHG Emissions Data for Historical Periods

The proposed rules would require disclosure to be provided for the registrant's most recently completed fiscal year and for the historical fiscal years included in the registrant's consolidated financial statements in the applicable filing, to the extent such historical GHG emissions data is reasonably available.[479] Requiring historical GHG emissions data, to the extent available, would provide useful information for investors by enabling investors to track over time the registrant's exposure to climate-related impacts represented by the yearly emissions data, and to assess how it is managing the climate-related risks associated with those impacts. Requiring GHG emissions disclosure for current and, when reasonably available, historical periods should enable investors to analyze trends in the impacts of material climate-related risks and to evaluate the narrative disclosure provided pursuant to proposed Item 1502.[480] Historical GHG emissions data also could be particularly useful when a registrant has announced a target or goal for reducing GHG emissions by a certain date by helping investors assess its progress in meeting that target or goal and the related impacts on the registrant.

Linking the required number of years of historical GHG emissions data to the historical periods required in the consolidated financial statements should benefit investors by requiring emissions data that is consistent with the financial statement metrics in the filing. This should help investors connect GHG emissions with the financial performance of a registrant in the same period, including the proposed financial statement metrics. Moreover, although we are not proposing to require the GHG emissions data to be included in the registrant's consolidated financial statements, we nevertheless believe that the GHG emissions data is relevant to, and would be read in conjunction with, information included in the consolidated financial statements. Just as data about a registrant's revenues and expenses on its income statement reflect its activities in financial terms for a given year, a registrant's emissions data reflect its carbon footprint activities for that year. For this reason, we have proposed requiring a registrant to provide its GHG emissions data for the same number of years as it is required to provide data on its income statement and cash flow statement, to the extent such emissions data is reasonably available. For example, a registrant that is required to include income statements and cash flow statements at the end of its three most recent fiscal years would be required to disclose three years of its Scope 1, Scope 2 and, if material to the registrant or if it has set a GHG emissions target or goal that includes its Scope 3 emissions, its Scope 3 emissions, expressed both in absolute terms and in terms of intensity.[481] If the registrant is a SRC,

[476] *See* proposed 17 CFR 229.1504(d)(3).

[477] *See* proposed 17 CFR 229.1504(d)(4).

[478] *See* proposed 17 CFR 229.1504(e)(1) and *infra* Section II.G.2 for the proposed disclosure requirements pertaining to GHG emissions methodology.

[479] *See* proposed 17 CFR 229.1504(a).

[480] *See supra* Section II.C for a discussion of proposed 17 CFR 229.1502.

[481] Alternatively, if a registrant has no revenue, and it decides to calculate GHG intensity using total assets, we believe it would be appropriate for that registrant to provide its GHG intensity for the same number of years as are required on its balance sheets (*i.e.,* two years if not a SRC).

only two years of Scopes 1 and 2 emissions metrics would be required.[482]

A registrant, however, would not otherwise be required to provide a corresponding GHG emissions metric for a fiscal year preceding its current reporting fiscal year if, for example, it was not required to and has not previously presented such metric for such fiscal year and the historical information necessary to calculate or estimate such metric is not reasonably available to the registrant without unreasonable effort or expense.[483]

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114. Should we require GHG emissions disclosure for the registrant's most recently completed fiscal year and for the appropriate, corresponding historical fiscal years included in the registrant's consolidated financial statements in the filing, to the extent such historical GHG emissions data is reasonably available, as proposed? Should we instead only require GHG emissions metrics for the most recently completed fiscal year presented in the relevant filing? Would requiring historical GHG emissions metrics provide important or material information to investors, such as information allowing them to analyze trends?

2. GHG Emissions Methodology and Related Instructions

The proposed rules would require a registrant to describe the methodology, significant inputs, and significant assumptions used to calculate its GHG emissions metrics.[484] As proposed, the description of the registrant's methodology must include the registrant's organizational boundaries, operational boundaries, calculation approach, and any calculation tools used to calculate the registrant's GHG emissions.[485] Organizational boundaries would be defined to mean the boundaries that determine the operations owned or controlled by a registrant for the purpose of calculating its GHG emissions.[486] Operational boundaries would be defined to mean the boundaries that determine the direct and indirect emissions associated with the business operations owned or controlled by a registrant.[487] This information should help investors understand the scope of a registrant's operations included in its GHG emissions metrics and how those metrics were measured. With this information, investors could more knowledgeably compare a registrant's GHG emissions metrics with the GHG emissions metrics of other registrants and make more informed investment decisions.

a. The Setting and Disclosure of Organizational Boundaries

The proposed rules would require a registrant to disclose its Scope 1 emissions and its Scope 2 emissions separately after calculating them from all sources that are included in the registrant's organizational and operational boundaries.[488] An initial step for many registrants may be to set their organizational boundaries.[489] Those boundaries determine the business operations owned or controlled by a registrant to be included in the calculation of its GHG emissions.[490] Because both Scope 1 and Scope 2 emissions relate to the operations owned or controlled by a registrant, setting a registrant's organizational boundaries is an important part of determining its Scopes 1 and 2 emissions.

Several commenters stated that the GHG Protocol's standards and guidance would provide an appropriate framework for reporting GHG emissions if the Commission required disclosure of GHG emissions.[491] A company following the GHG Protocol would base its organizational boundaries on either an equity share approach or a control approach.[492] Our proposed approach, however, would require a registrant to set the organizational boundaries for its GHG emissions disclosure using the same scope of entities, operations, assets, and other holdings within its business organization as those included in, and based upon the same set of accounting principles applicable to, its consolidated financial statements.[493]

For similar reasons to those noted above regarding the proposed time periods required for GHG emissions disclosure, we propose requiring the scope of consolidation and reporting to be consistent for financial data and GHG emissions data. This would be accomplished by applying existing GAAP.[494] Requiring a consistent approach should help avoid potential investor confusion about the reporting scope used in determining a registrant's GHG emissions and the reporting scope used for the financial statement metrics, which are included in the financial statements. Applying existing GAAP could help limit the compliance burden for registrants as they would be able to use familiar concepts from financial reporting when preparing their required GHG emissions disclosures. Requiring registrants to follow the scope of reporting used in their financial statements should also enhance comparability across registrants when compared with the multiple options available under the GHG Protocol.

Thus, as proposed, the scope of reporting for a registrant's GHG emissions metrics would be consistent with the scope of reporting for the proposed financial statement metrics and other financial data included in its consolidated financial statements in order to provide investors a consistent view of the registrant's business across its financial and GHG emissions disclosures. For example, a registrant that prepares its financial statements pursuant to U.S. GAAP would apply relevant guidance from U.S. GAAP (*e.g.,* FASB ASC Topic 810 *Consolidation* and FASB ASC Topic 323 *Investments—Equity Method and Joint Ventures*) when determining which entities would be subject to consolidation or which investments qualify for equity method accounting or proportionate consolidation.[495] Therefore, under the proposed rules a registrant would be required to include all of the emissions from an entity that it consolidates.[496] For an equity method investee or an

[482] We are proposing to exempt SRCs from Scope 3 disclosures. *See infra* Section II.G.3.

[483] *See* Securities Act Rule 409 and Exchange Act Rule 12b–21.

[484] *See* proposed 17 CFR 229.1504(e)(1).

[485] *See id.*

[486] *See* proposed 17 CFR 229.1500(m).

[487] *See* proposed 17 CFR 229.1500(l).

[488] *See* proposed 17 CFR 229.1504(b)(1).

[489] See GHG Protocol, Corporate Accounting and Reporting Standard, Chapter 3.

[490] *See* proposed 17 CFR 229.1500(m).

[491] *See supra* note 111.

[492] Under the GHG Protocol's equity share approach, a company accounts for GHG emissions from operations according to its share of equity in the operation. Under the GHG Protocol's control approach, a company accounts for 100% of the GHG emissions from operations over which it has control. A company can choose to define control either in financial or operational terms. *See GHG Protocol, Corporate Accounting and Reporting Standard,* Chapter 3.

[493] *See* proposed 17 CFR 229.1504(e)(2).

[494] Foreign private issuers that file consolidated financial statements under IFRS as issued by the IASB would apply IFRS under the proposed rules as the basis for setting its organizational boundaries for the purpose of providing the proposed GHG emissions disclosure.

[495] Issuers that are permitted to, and do, apply IFRS issued by the International Accounting Standards Board would apply the IASB's equivalent standards. *See, e.g.,* IFRS 10 *Consolidated Financial Statements,* IFRS 11 *Joint Arrangements* and International Accounting Standards (''IAS'') 28 *Investments in Associates and Joint Ventures. See supra* note 319, which states that foreign private issuers that file consolidated financial statements under home country GAAP and reconcile to U.S. GAAP, would be required to use U.S. GAAP as the basis for calculating and disclosing the proposed climate-related financial statement metrics. The same requirement would apply for the purpose of determining the proposed GHG emissions metrics.

[496] *See* proposed 17 CFR 229.1504(e)(2).

operation that is proportionally consolidated, the registrant would be required to include its share of emissions based on its percentage ownership of such investee or operation.[497] For a registrant that applies the equity method to an investee, the percentage of ownership interest used to record its share of earnings or losses in the investee must be the same for measuring its share of GHG emissions by the equity method investee.[498] The proposed rules would permit a registrant to exclude emissions from investments that are not consolidated, are not proportionately consolidated, or that do not qualify for the equity method of accounting in the registrant's consolidated financial statements.[499]

For example, a registrant might own or control several plants but have only a minority ownership in another plant over which it has no control. For the plants that are owned or controlled by the registrant, all of those plants' direct and indirect emissions should be included in its Scopes 1 and 2 emissions disclosure (regardless of ownership percentage that resulted in consolidation for financial statement purposes).[500] If the registrant's proportional interest in the latter plant is reflected in its consolidated financial statements (*e.g.,* the investment qualifies for the equity method or a proportionate consolidation approach), when calculating its Scopes 1 and 2 emissions the registrant should include such proportional share (based on ownership interest) of that plant's emissions in the total of each of its Scopes 1 and 2 emissions.[501]

A related provision under the proposed rules would require a registrant to use the same organizational boundaries when calculating its Scope 1 emissions and Scope 2 emissions[502] since both sets of emissions relate to operations that a registrant owns or controls. If required to disclose its Scope 3 emissions, a registrant would also be required to apply the same organizational boundaries used when determining its Scopes 1 and 2 emissions as an initial step in identifying the sources of indirect emissions from activities in its value chain over which it lacks ownership and control and which must be included in the calculation of its Scope 3 emissions.[503] Requiring a registrant to use the same organizational boundaries when calculating its Scopes 1, 2 and 3 emissions should help limit investor confusion over those operations or activities over which it has ownership or control (sources of its Scopes 1 and 2 emissions) and those activities in its value chain over which it lacks ownership or control (sources of its Scope 3 emissions). The proposed provision also would provide that, once a registrant has determined its organizational (and operational) boundaries, it must consistently use those boundaries when calculating its GHG emissions.[504] This proposed provision should help investors track and compare a registrant's GHG emissions over time.

b. The Setting and Disclosure of Operational Boundaries

When describing the methodology, significant inputs, and significant assumptions used to calculate its GHG emissions metrics, a registrant is required to describe its operational boundaries.[505] This would involve identifying emissions sources within its plants, offices, and other operational facilities that fall within its organizational boundaries, and then categorizing the emissions as either direct or indirect emissions. For example, a registrant might have direct emissions from one or more of the following sources that it owns or controls:

- Stationary equipment (from the combustion of fuels in boilers, furnaces, burners, turbines, heaters, and incinerators);
- Transportation (from the combustion of fuels in automobiles, trucks, buses, trains, airplanes, boats, ships, and other vessels);
- Manufacturing processes (from physical or chemical processes, such as CO_2 from the calcination process in cement manufacturing or from catalytic cracking in petrochemical processing, and PFC emissions from aluminum smelting); and
- Fugitive emission sources (equipment leaks from joints, seals, packing, gaskets, coal piles, wastewater treatment, pits, cooling towers, and gas processing facilities, and other unintentional releases).[506]

Most registrants would likely have emission sources from stationary equipment and transportation devices. Registrants in certain industrial sectors, such as cement, aluminum, and other manufacturers, or oil and gas production and refining, are likely also to produce emissions from physical or chemical processes. Some registrants would likely have emissions from all four types of sources, particularly if they have their own power generation or waste treatment facilities.[507]

The proposed rules would require a registrant to include its approach to categorizing its emissions and emissions sources when describing its methodology to determine its operational boundaries.[508] A registrant could use the above non-exclusive list of emissions sources or other categories of emissions sources as long as it describes how it determined the emissions to include as direct emissions, for the purpose of calculating its Scope 1 emissions, and indirect emissions, for the purpose of calculating its Scope 2 emissions.[509] For most registrants, purchased electricity would likely constitute a large percentage of their Scope 2 emissions. Although Scope 2 emissions are generated from a source external to a registrant, the electricity (or steam, heat, or cooling) is consumed by the registrant's operations that it owns or controls.

c. The Selection and Disclosure of a GHG Emissions Calculation Approach, Including Emission Factors

In addition to setting its organizational and operational boundaries, a registrant would need to select a GHG emissions calculation approach. While the direct measurement of GHG emissions from a source by monitoring concentration and flow rate is likely to yield the most accurate calculations, due to the expense of the direct monitoring of emissions, an acceptable and common method for calculating emissions involves the application of published emission factors to the total amount of purchased fuel consumed by a particular source.[510] The proposed rules would define ''emission factor'' as a multiplication factor allowing actual GHG emissions to be calculated from available activity data or, if no activity data is available, economic data, to

[497] *See id.*

[498] *See id.*

[499] *See* proposed 17 CFR 229.1504(b)(2).

[500] *See* proposed 17 CFR 229.1500(m) (defining organizational boundaries as the boundaries that determine the operations owned or controlled by a registrant) and 17 CFR 229.1504(b)(1) (requiring the disclosure of Scopes 1 and 2 emissions separately after calculating them from all sources included in a registrant's organizational and operational boundaries).

[501] *See* proposed 17 CFR 229.1504(e)(2).

[502] *See* proposed 17 CFR 229.1504(e)(3).

[503] *See id.*

[504] *See id.*

[505] *See* proposed Item 1504(e)(1).

[506] This non-exclusive list of possible emissions sources is based on categories of emissions sources provided in the GHG Protocol. *See* GHG Protocol, *Corporate Accounting and Reporting Standard,* Chapter 6.

[507] *See id.*

[508] *See* proposed 17 CFR 229.1504(e)(1).

[509] *See id.*

[510] *See, e.g.,* GHG Protocol, Corporate Accounting and Reporting Standard, Chapter 6.

derive absolute GHG emissions.[511] Emission factors are ratios that typically relate GHG emissions to a proxy measure of activity at an emissions source. Examples of activity data reflected in emission factors include kilowatt-hours of electricity used, quantity of fuel used, output of a process, hours of operation of equipment, distance travelled, and floor area of a building.[512] If no activity data is available, a registrant may use an emission factor based on economic data.[513] For example, when calculating Scope 3 emissions from purchased goods or services, a registrant could determine the economic value of the goods or services purchased and multiply it by an industry average emission factor (expressed as average emissions per monetary value of goods or services).[514]

The EPA has published a set of emission factors based on the particular type of source (*e.g.,* stationary combustion, mobile combustion, refrigerants, and electrical grid, among others) and type of fuel consumed (*e.g.,* natural gas, coal or coke, crude oil, and kerosene, among many others).[515] The GHG Protocol's own set of GHG emission calculation tools are based in part on the EPA's emission factors.[516] Whatever set of emission factors a registrant chooses to use, it must identify the emission factors and its source.[517]

After a registrant has selected a calculation approach (*i.e.,* direct measurement or application of emissions factors), the registrant would determine what data must be collected and how to conduct the relevant calculations, including whether to use any publicly-available calculation tools. In this regard, we note that there are a number of publicly-available calculation tools a registrant may elect to utilize in determining its GHG emissions.[518] Finally, a registrant would gather and report GHG emissions up to the corporate level.

For example, when determining its Scope 1 emissions for a particular plant, a registrant might add up the amount of natural gas consumed by furnaces and other stationary equipment during its most recently completed fiscal year and then apply the CO_2 emission factor for natural gas to that total amount to derive the amount of GHG emissions expressed in CO_2e. The registrant would repeat this process for each type of fuel consumed and for each type of source. If a registrant owns a fleet of trucks, it might total the amount of diesel fuel or other type of gasoline consumed for the fiscal year and apply the appropriate CO_2 emission factor for that vehicle and type of fuel. A registrant that uses refrigerants also might apply the appropriate emission factor for the particular type of refrigerant to the total amount of that refrigerant used during the fiscal year. As part of the roll-up process for a registrant with multiple entities and emission sources, once it has determined the amount of CO_2e for each type of direct emissions source and for each facility within its organizational and operational boundaries, the registrant would then add them together to derive the total amount of Scope 1 emissions for the fiscal year.[519]

A registrant would undergo a similar process when calculating its Scope 2 emissions for its most recently completed fiscal year. There are two common methods for calculating Scope 2 emissions for purchased electricity: The market-based method and the location-based method.[520] Pursuant to the market-based method, a registrant would calculate its Scope 2 emissions based on emission factors and other data provided by the generator of electricity from which the registrant has contracted to purchase the electricity and which are included in the contractual instruments. Pursuant to the location-based method, a registrant would calculate its Scope 2 emissions based on average energy generation emission factors for grids located in defined geographic locations, including local, subnational, or national boundaries.[521] A registrant could use either of these methods, both methods, a combination, or another method as long as it identifies the method used and its source.[522] For example, if using the location-based method, the registrant would apply an appropriate emission factor for the electricity grid in its region to the total amount of electricity purchased from that grid during its fiscal year.[523] The registrant would then calculate the amount of CO_2e from purchased steam/heat, if any, by applying the appropriate emission factor for that type of energy source to the total amount consumed.[524] The registrant would report the sum of its CO_2e from purchased electricity and steam/heat as its total Scope 2 emissions for the fiscal year.

As noted above, in all instances a registrant would be required to describe its methodology, including its organizational and operational boundaries, calculation approach (including any emission factors used and the source of the emission factors), and any calculation tools used to calculate the GHG emissions.[525] Requiring a registrant to describe its methodology for determining its GHG emissions should provide investors with important information to assist them in evaluating the registrant's GHG emissions disclosure as part of its overall business and financial disclosure. Such disclosure should enable investors to evaluate the reasonableness and accuracy of the emission disclosures, and should promote consistency and comparability over time. For example, an investor

[511] *See* proposed 17 CFR 229.1500(e).

[512] *See id.*

[513] *See id.*

[514] *See, e.g.,* Greenhouse Gas Protocol, *Corporate Value Chain (Scope 3) Accounting and Reporting Standard, Supplement to the GHG Protocol Corporate Accounting and Reporting Standard,* Chapter 1 (describing the ''spend-based method'' for calculating emissions from purchased goods or services).

[515] *See* EPA, Emission Factors for Greenhouse Gas Inventories (Apr. 2021), available at *https://www.epa.gov/sites/default/files/2021-04/documents/emission-factors_apr2021.pdf.*

[516] *See, e.g.,* The Greenhouse Gas Protocol, *GHG Emission Calculation Tool* (Mar. 2021), *available at https://ghgprotocol.org/calculation-tools.*

[517] *See* proposed 17 CFR 229.1504(e)(1).

[518] *See, e.g.,* GHG Protocol, *Corporate Accounting and Reporting Standard, Chapter* 6 (providing an overview of calculation tools by type of source (*e.g.,* for stationary combustion, mobile combustion, and air conditioning and refrigeration use) and by sector (*e.g.,* for aluminum production, iron and steel production, cement manufacturing, and pulp and paper production), which are available on the GHG Protocol website at *https://ghgprotocol.org/.* The EPA also has published a Simplified GHG Emissions Calculator that is designed as a simplified calculation tool to help small businesses and low emitter organizations estimate and inventory their annual GHG emissions. *See* EPA, Simplified GHG Emissions Calculator (2021), available at *https://www.epa.gov/climateleadership/simplified-ghg-emissions-calculator.*

[519] As noted earlier, a registrant that is required to report its direct emissions to the EPA may be able to use the EPA-provided data, together with data for any direct emissions not reported to the EPA, to help fulfill the Commission's proposed Scope 1 emission disclosure requirement.

[520] *See* World Resources Institute, *GHG Protocol Scope 2 Guidance* (2015), Chapter 4, available at *https://ghgprotocol.org/sites/default/files/standards/Scope%202%20Guidance_Final_Sept26.pdf.*

[521] *See id.*

[522] We note that, pursuant to the GHG Protocol, and as referenced by the EPA, a company that determines its Scope 2 emissions using a market-based approach would also calculate those emissions using the location-based method to provide a more complete picture of the company's Scope 2 emissions. *See* World Resources Institute, *GHG Protocol Scope 2 Guidance,* Chapter 7; and EPA Center for Corporate Climate Leadership, *Scope 1 and Scope 2 Inventory Guidance.*

[523] *See, e.g.,* EPA, *Emission Factors for Greenhouse Gas Inventories,* Table 6, which provides emission factors for regional electrical grids.

[524] *See, e.g.,* EPA, *Emission Factors for Greenhouse Gas Inventories,* Table 7, which provides emission factors for steam and heat.

[525] *See* proposed 17 CFR 229.1504(e)(1).

would be able to evaluate both if the registrant's selection of an emission factor is reasonable given the registrant's industry sector and whether changes in reported emissions reflect changes in actual emissions in accordance with its strategy or simply a change in calculation methodology.

Like registrants in other sectors, registrants in the financial sector would be required to disclose their Scope 3 emissions if those emissions are material and to describe the methodology used to calculate those emissions. A financial registrant's Scope 3 emissions disclosures would likely include the emissions from companies that the registrant provides debt or equity financing to (''financed emissions''). While financial registrants may use any appropriate methodology to calculate its Scope 3 emissions, the Partnership for Carbon Accounting Financials' Global GHG Accounting & Reporting Standard (the ''PCAF Standard'') provides one methodology that complements the GHG Protocol and assists financial institutions in calculating their financed emissions.[526] The PCAF Standard was developed to work with the calculation of Scope 3 emissions for the ''investment'' category of downstream emissions and was endorsed by the drafters of the GHG Protocol.[527] The PCAF Standard covers six asset classes: Listed equity and corporate bonds; business loans and unlisted equity; project finance; commercial real estate; mortgages; and motor vehicle loans.[528]

At this time, we are not proposing to require a particular methodology for the financial sector in order to provide a financial sector registrant the flexibility to choose the methodology that best suits its particular portfolio and financing activities. We believe the proposed requirement to disclose the methodology used (*e.g.,* the PCAF Standard or another standard) would provide sufficient information to an investor.

d. Additional Rules Related to Methodology Disclosure

We are proposing additional rules related to the methodology for calculating GHG emissions. Some of these rules would apply generally to the determination of GHG emissions while some would apply specifically to the calculation of Scope 3 emissions. For example, one proposed rule would provide that a registrant may use reasonable estimates when disclosing its GHG emissions as long as it also describes the assumptions underlying, and its reasons for using, the estimates.[529] While we encourage registrants to provide as accurate a measurement of its GHG emissions as is reasonably possible, we recognize that, in many instances, direct measurement of GHG emissions at the source, which would provide the most accurate measurement, may not be possible.

Several commenters indicated that a registrant may find it difficult to complete its GHG emissions calculations for its most recently completed fiscal year in time to meet its disclosure obligations for that year's Exchange Act annual report.[530] The proposed rules would permit a registrant to use a reasonable estimate of its GHG emissions for its fourth fiscal quarter if no actual reported data is reasonably available, together with actual, determined GHG emissions data for its first three fiscal quarters when disclosing its GHG emissions for its most recently completed fiscal year, as long as the registrant promptly discloses in a subsequent filing any material difference between the estimate used and the actual, determined GHG emissions data for the fourth fiscal quarter.[531] We believe that this proposed provision would help address the concerns of commenters about the timely completion of both the work required to disclose a registrant's GHG emissions as of its fiscal year-end and to meet its other Exchange Act annual reporting obligations.[532]

Another proposed provision would require a registrant to disclose, to the extent material and as applicable, any use of third-party data when calculating its GHG emissions, regardless of the particular scope of emissions.[533] While this proposed provision would be most relevant to the disclosure of Scope 3 emissions, where the use of third-party data is common, it would apply in other instances when third-party data is material to the GHG emissions determination, such as when determining Scope 2 emissions using contractual, supplier-provided emission factors for purchased electricity. When disclosing the use of third-party data, a registrant would be required to identify the source of the data and the process the registrant undertook to obtain and assess such data.[534] This information would help investors better understand the basis for, and assess the reasonableness of, the GHG emissions determinations and, accordingly, evaluate the GHG disclosures as part of a registrant's business and financial information.

One proposed provision would require a registrant to disclose any material change to the methodology or assumptions underlying its GHG emissions disclosure from the previous fiscal year.[535] For example, if a registrant uses a different set of emission factors, or develops a more direct method of measuring GHG emissions, which results in a material change to the GHG emissions produced from the previous year under (or assuming) the same organizational and operational boundaries, it would be required to report that change. This should help investors more knowledgeably compare the emissions data from year to year and better understand the nature and significance of a material change in emissions (*i.e.,* was the change primarily due to an implementation of strategy or a change in methodology).

Another proposed provision would require a registrant to disclose, to the extent material and as applicable, any gaps in the data required to calculate its GHG emissions.[536] This proposed provision would be particularly relevant to a registrant's Scope 3 emissions. While a registrant's GHG emissions disclosure should provide investors with a reasonably complete understanding of the registrant's GHG emissions in each scope of emissions, as previously noted, we recognize that a

[526] *See* PCAF, *Global GHG Accounting & Reporting Standard for the Financial Industry* (2020), available at *https://carbonaccountingfinancials.com/files/downloads/PCAF-Global-GHG-Standard.pdf.*

[527] *See id. See also* GHG Protocol Press Release, *New Standard Developed to Help Financial Industry Measure and Report Emissions* (Mar. 2021), *available at https://ghgprotocol.org/blog/new-standard-developed-help-financial-industry-measure-and-report-emissions.*

[528] While the guidance provided by the PCAF Standard for each asset class differs in certain respects, the PCAF Standard applies a common set of principles across the various asset classes. A key principle is that the GHG emissions from a client's activities financed by loans or investments attributable to the reporting financial institution should be allocated to that institution based on its proportional share of lending or investment in the borrower or investee through the application of an ''attribution factor.'' *See* PCAF, *Global GHG Accounting & Reporting Standard for the Financial Industry* (2020), Sections 4.2 and 5.

[529] *See* proposed 17 CFR 229.1504(e)(4).

[530] *See, e.g.,* letters from Cisco; Dow; Energy Infrastructure Council; National Mining Association; Newmont Corporation; and United Airlines Holdings, Inc.

[531] *See* proposed 17 CFR 229.1504(e)(4)(i). One commenter made a similar recommendation when stating that a registrant should be required to follow the same timeline for disclosure of its GHG emissions as for its Exchange Act annual reporting obligations. *See* letter from Pricewaterhouse Coopers.

[532] *See supra* note 530.

[533] *See* proposed 17 CFR 229.1504(e)(5).

[534] *See id.*

[535] *See* proposed 17 CFR 229.1504(e)(6).

[536] *See* proposed 17 CFR 229.1504(e)(7).

registrant may encounter data gaps, particularly when calculating its Scope 3 emissions. The proposed provision would require the registrant to disclose the data gaps and discuss whether it used proxy data or another method to address such gaps. A registrant would also be required to discuss how its accounting for any data gaps has affected the accuracy or completeness of its GHG emissions disclosure.[537] This information should help investors understand certain underlying uncertainties and limitations, and evaluate the corresponding reliability, of a registrant's GHG emissions disclosure, particularly for its Scope 3 emissions, as part of their assessment of the registrant's business and financial information.

One proposed provision would provide that, when determining whether its Scope 3 emissions are material, and when disclosing those emissions, in addition to emissions from activities in its value chain, a registrant must include GHG emissions from outsourced activities that it previously conducted as part of its own operations, as reflected in the financial statements for the periods covered in the filing.[538] This proposed approach, which is consistent with the GHG Protocol,[539] would help ensure that investors receive a complete picture of a registrant's carbon footprint by precluding the registrant from excluding emissions from activities that are typically conducted as part of operations over which it has ownership or control but that are outsourced in order to reduce its Scopes 1 or 2 emissions.

Another proposed provision would provide that, if a registrant is required to disclose Scope 3 emissions, and if there was any significant overlap in the categories of activities producing the Scope 3 emissions, the registrant must describe the overlap, how it accounted for the overlap, and its disclosed total Scope 3 emissions.[540] For example, a mining registrant may mine and process iron ore for conversion into steel products. Because the processing of iron ore and steelmaking both require the use of coal, GHG emissions would arise both from the downstream activities involving the processing of sold products and the use of sold products (*i.e.,* the use of iron ore in the production of steel). If the registrant has allocated GHG emissions to both categories (*i.e.,* processing of sold products and use of sold products), it would be required to describe the overlap in emissions between the two categories of downstream activities, how it accounted for the overlap, and the effect on its disclosed total Scope 3 emissions. For example, if the total reported Scope 3 emissions involved some double-counting because of the overlap, a registrant would be required to report this effect. This information could help investors better understand the true extent of a registrant's disclosed Scope 3 emissions and, thus, the climate-related risks faced by the registrant.

Finally, a proposed provision would provide that a registrant may present its estimated Scope 3 emissions in terms of a range as long as it discloses its reasons for using the range and the underlying assumptions.[541] This proposed provision reflects our understanding that, because a registrant may encounter more difficulties obtaining all of the data required for determining its Scope 3 emissions compared to determining its Scopes 1 and 2 emissions, presenting its Scope 3 emissions in terms of a range may be a reasonable means of estimating these emissions when faced with such gaps in the data.

Request for Comment

115. Should we require a registrant to disclose the methodology, significant inputs, and significant assumptions used to calculate its GHG emissions metrics, as proposed? Should we require a registrant to use a particular methodology for determining its GHG emission metrics? If so, should the required methodology be pursuant to the GHG Protocol's Corporate Accounting and Reporting Standard and related standards and guidance? Is there another methodology that we should require a registrant to follow when determining its GHG emissions? Should we base our climate disclosure rules on certain concepts developed by the GHG Protocol without requiring a registrant to follow the GHG Protocol in all respects, as proposed? Would this provide flexibility for registrants to choose certain methods and approaches in connection with GHG emissions determination that meet the particular circumstances of their industry or business or that emerge along with developments in GHG emissions methodology as long as they are transparent about the methods and underlying assumptions used? Are there adjustments that should be made to the proposed methodology disclosure requirements that would provide flexibility for registrants while providing sufficient comparability for investors?

116. Should we require a registrant to disclose the organizational boundaries used to calculate its GHG emissions, as proposed? Should we require a registrant to determine its organizational boundaries using the same scope of entities, operations, assets, and other holdings within its business organization as that used in its consolidated financial statements, as proposed? Would prescribing this method of determining organizational boundaries avoid potential investor confusion about the reporting scope used in determining a registrant's GHG emissions and the reporting scope used for the financial statement metrics, which are included in the financial statements? Would prescribing this method of determining organizational boundaries result in more robust guidance for registrants and enhanced comparability for investors? If, as proposed, the organizational boundaries must be consistent with the scope of the registrant's consolidated financial statements, would requiring separate disclosure of the organizational boundaries be redundant or otherwise unnecessary?

117. Except for calculating Scope 3 emissions, the proposed rules would not require a registrant to disclose the emissions from investments that are not consolidated, proportionately consolidated, or that do not qualify for the equity method of accounting. Should we require such disclosures for Scopes 1 and 2 emissions, and if so, how?

118. Could situations arise where it is impracticable for a registrant to align the scope of its organizational boundaries for GHG emission data with the scope of the consolidation for the rest of its financial statements? If so, should we allow a registrant to take a different approach to determining the organizational boundaries of its GHG emissions and provide related disclosure, including an estimation of the resulting difference in emissions disclosure (in addition to disclosure about methodology and other matters that would be required by the proposed GHG emissions disclosure rules)?

119. Alternatively, should we require registrants to use the organizational boundary approaches recommended by the GHG Protocol (*e.g.,* financial control, operational control, or equity share)? Do those approaches provide a clear enough framework for complying with the proposed rules? Would such an

[537] *See id.*

[538] *See* proposed 17 CFR 229.1504(e)(8).

[539] *See* Greenhouse Gas Protocol, *Corporate Value Chain (Scope 3) Accounting and Reporting Standard, Supplement to the GHG Protocol Corporate Accounting and Reporting Standard,* Chapter 6.

[540] *See* proposed 17 CFR 229.1504(e)(9).

[541] *See* proposed 17 CFR 229.1504(e)(4)(ii).

approach cause confusion when analyzing information in the context of the consolidated financial statements or diminish comparability? If we permit a registrant to choose one of the three organizational boundary approaches recommended by the GHG Protocol, should we require a reconciliation with the scope of the rest of the registrant's financial reporting to make the disclosure more comparable?

120. Should we require a registrant to disclose its operational boundaries, as proposed? Should we require a registrant to discuss its approach towards the categorization of emissions (*e.g.,* as direct or indirect emissions) and emissions sources (*e.g.,* stationary or mobile) when describing its operational boundaries, as proposed?

121. The proposed operational boundaries disclosure is based largely on concepts developed by the GHG Protocol. Would requiring a registrant to determine its organizational boundaries pursuant to the GAAP applicable to the financial statement metrics included in the financial statements but its operational boundaries largely pursuant to concepts developed by the GHG Protocol cause confusion? Should we require a registrant to apply the GAAP applicable to its financial statements when determining whether it ''controls'' a particular source pursuant to the definition of Scope 1 emissions, or particular operations pursuant to the definition of Scope 2 emissions, as proposed? If not, how should ''control'' be determined and would applying a definition of control that differs from applicable GAAP result in confusion for investors?

122. Should we require a registrant to use the same organizational boundaries when calculating its Scopes 1 and 2 emissions, as proposed? Are there any circumstances when a registrant's organizational boundaries for determining its Scope 2 emissions should differ from those required for determining its Scope 1 emissions? Should we also require a registrant to apply the same organizational boundaries used when determining its Scopes 1 and 2 emissions as an initial step in identifying the sources of indirect emissions from activities in its value chain over which it lacks ownership and control and which must be included in the calculation of its Scope 3 emissions, as proposed? Are there any circumstances where using a different organizational boundary for purposes of Scope 3 emissions disclosure would be appropriate?

123. Should we require a registrant to be consistent in its use of its organizational and operational boundaries once it has set those boundaries, as proposed? Would the proposed requirement help investors to track and compare the registrant's GHG emissions over time?

124. Should we require a registrant to disclose the methodology for calculating the GHG emissions, including any emission factors used and the source of the emission factors, as proposed? Should we require a registrant to use a particular set of emission factors, such as those provided by the EPA or the GHG Protocol?

125. Should we permit a registrant to use reasonable estimates when disclosing its GHG emissions as long as it also describes the assumptions underlying, and its reasons for using, the estimates, as proposed? Should we permit the use of estimates for only certain GHG emissions, such as Scope 3 emissions? Should we permit a registrant to use a reasonable estimate of its GHG emissions for its fourth fiscal quarter if no actual reported data is reasonably available, together with actual, determined GHG emissions data for its first three fiscal quarters when disclosing its GHG emissions for its most recently completed fiscal year, as long as the registrant promptly discloses in a subsequent filing any material difference between the estimate used and the actual, determined GHG emissions data for the fourth fiscal quarter, as proposed? If so, should we require a registrant to report any such material difference in its next Form 10–Q if domestic, or in a Form 6–K, if a foreign private issuer? Should we permit a domestic registrant to report any such material difference in a Form 8–K if such form is filed (rather than furnished) with the Commission? Should any such reasonable estimate be subject to conditions to help ensure accuracy and comparability? If so, what conditions should apply?

126. Should we require a registrant to disclose, to the extent material, any use of third-party data when calculating its GHG emissions, regardless of the particular scope of emissions, as proposed? Should we require the disclosure of the use of third-party data only for certain GHG emissions, such as Scope 3 emissions? Should we require the disclosure of the use of third-party data for Scope 3 emissions, regardless of its materiality to the determination of those emissions? If a registrant discloses the use of third-party data, should it also be required to identify the source of such data and the process the registrant undertook to obtain and assess the data, as proposed?

127. Should we require a registrant to disclose any material change to the methodology or assumptions underlying its GHG emissions disclosure from the previous year, as proposed? If so, should we require a registrant to restate its GHG emissions data for the previous year, or for the number of years for which GHG emissions data has been provided in the filing, using the changed methodology or assumptions? If a registrant's organizational or operational boundaries, in addition to methodology or assumptions, change, to what extent should we require such disclosures of the material change, restatements or reconciliations? In these cases, should we require a registrant to apply certain accounting standards or principles, such as FASB ASC Topic 250, as guidance regarding when retrospective disclosure should be required?

128. Should we require a registrant to disclose, to the extent material, any gaps in the data required to calculate its GHG emissions, as proposed? Should we require the disclosure of data gaps only for certain GHG emissions, such as Scope 3 emissions? If a registrant discloses any data gaps encountered when calculating its Scope 3 emissions or other type of GHG emissions, should it be required to discuss whether it used proxy data or another method to address such gaps, and how its management of any data gaps has affected the accuracy or completeness of its GHG emissions disclosure, as proposed? Are there other disclosure requirements or conditions we should adopt to help investors obtain a reasonably complete understanding of a registrant's exposure to the GHG emissions sourced by each scope of emissions?

129. When determining the materiality of its Scope 3 emissions, or when disclosing those emissions, should a registrant be required to include GHG emissions from outsourced activities that it previously conducted as part of its own operations, as reflected in the financial statements for the periods covered in the filing, in addition to emissions from activities in its value chain, as proposed? Would this requirement help ensure that investors receive a complete picture of a registrant's carbon footprint by precluding the registrant from excluding emissions from activities that are typically conducted as part of operations over which it has ownership or control but that are outsourced in order to reduce its Scopes 1 or 2 emissions? Should a requirement to include outsourced activities be subject to certain conditions or exceptions and, if so, what conditions or exceptions?

130. Should we require a registrant that must disclose its Scope 3 emissions to discuss whether there was any

significant overlap in the categories of activities that produced the Scope 3 emissions? If so, should a registrant be required to describe any overlap, how it accounted for the overlap, and its effect on the total Scope 3 emissions, as proposed? Would this requirement help investors assess the accuracy and reliability of the Scope 3 emissions disclosure?

131. Should we permit a registrant to present its Scope 3 emissions in terms of a range as long as it discloses its reasons for using the range and the underlying assumptions, as proposed? Should we place limits or other parameters regarding the use of a range and, if so, what should those limits or parameters be? For example, should we require a range to be no larger than a certain size? What other conditions or guidance should we provide to help ensure that a range, if used, is not overly broad and is otherwise reasonable?

132. Should we require a registrant to follow a certain set of published standards for calculating Scope 3 emissions that have been developed for a registrant's industry or that are otherwise broadly accepted? For example, should we require a registrant in the financial industry to follow PCAF's Global GHG Accounting & Reporting Standard for the Financial Industry when calculating its financed emissions within the ''Investments'' category of Scope 3 emissions? Are there other industry-specific standards that we should require for Scope 3 emissions disclosure? Should we require a registrant to follow the GHG Protocol's Corporate Value Chain (Scope 3) Accounting and Reporting Standard if an industry-specific standard is not available for Scope 3 emissions disclosure? If we should require the use of a third-party standard for Scope 3 emissions reporting, or any other scope of emissions, how should we implement this requirement?

3. The Scope 3 Emissions Disclosure Safe Harbor and Other Accommodations

We recognize that the calculation and disclosure of Scope 3 emissions may pose difficulties compared to Scopes 1 and 2 emissions, which has caused concern for some commenters.[542] It may be difficult to obtain activity data from suppliers and other third parties in a registrant's value chain, or to verify the accuracy of that information. It may also be necessary to rely heavily on estimates and assumptions to generate Scope 3 emissions data. For example, registrants may need to rely on assumptions about how customers will use their products in order to calculate Scope 3 emissions from the use of sold products.

Depending on the size and complexity of a company and its value chain, the task of calculating Scope 3 emissions could be challenging.[543] We expect that some of these challenges may recede over time. For example, as more companies make their Scope 1 and 2 emissions data publicly available, these data can serve as the input for other companies' Scope 3 calculations. In addition, large companies that are voluntarily disclosing Scope 3 emissions information currently are also working with suppliers to increase access to emissions data and improve its reliability,[544] which could have positive spillover effects for other companies that use the same suppliers. Furthermore, within certain industries, there is work underway to improve methodologies and share best practices to make Scope 3 calculations less burdensome and more reliable.[545] Notwithstanding these anticipated developments, calculating and disclosing Scope 3 emissions could represent a challenge for certain registrants, in particular those that do not currently report such information on a voluntary basis.

To balance concerns about reporting Scope 3 emissions with the need for decision-useful emissions disclosure, we are proposing the following accommodations for Scope 3 emissions disclosure:

- A safe harbor for Scope 3 emissions disclosure from certain forms of liability under the Federal securities laws; [546]
- An exemption for smaller reporting companies (''SRCs'') from the Scope 3 emissions disclosure provision; [547] and
- A delayed compliance date for Scope 3 emissions disclosure.[548]

We are proposing a safe harbor for Scope 3 emissions disclosure to alleviate concerns that registrants may have about liability for information that would be derived largely from third parties in a registrant's value chain. Many commenters recommended that the Commission adopt a safe harbor for climate-related disclosures.[549] These commenters asserted that a safe harbor would encourage registrants to provide meaningful, quantitative metrics and analysis. Other commenters focused their recommendation for a safe harbor on certain types of climate-related disclosures, such as those pertaining to scenario analysis, third-party derived data (such as Scope 3 emissions),[550] or forward-looking statements generally.[551] With respect to Scope 3 emissions specifically, commenters recommended that the Commission provide a safe harbor due to the reliance on estimates and data needed for Scope 3 emissions reporting that are outside of the registrant's control.[552]

While we are not proposing a broad safe harbor for all climate-related disclosures, many of which are similar

[542] *See, e.g.,* letter from Dimensional Fund Advisors; *see also supra* note 422.

[543] While there may be less challenging approaches, such as using industry averages or proxies for activity data (such as economic data), the result may be less accurate and could obscure the impact of choices that companies may make to reduce their Scope 3 emissions. For example, if a company uses industry averages to calculate Scope 3 emissions from shipping its products, it may have difficulty communicating to investors how its selection of a shipping company that runs on lower emissions fuel or picks more efficient routes has lowered its Scope 3 emissions.

[544] *See, e.g.,* Apple, *Environmental Social Governance Report* (2021), available at *https://s2.q4cdn.com/470004039/files/doc_downloads/2021/08/2021_Apple_ESG_Report.pdf* (stating that Apple works with its suppliers to help address Apple's environmental commitments, such as becoming carbon neutral by 2030 across its entire product footprint).

[545] *See, e.g.,* PCAF, *The Global GHG Accounting and Reporting Standard for the Financial Industry.* In addition, the American Petroleum Institute has developed an overview of Scope 3 methodologies to inform oil and gas companies about Scope 3 estimation approaches. *See* API and IPIECA, *Estimating petroleum industry value chain (Scope 3) greenhouse gas emissions,* available at *https://www.api.org/~/media/Files/EHS/climate-change/Scope-3-emissions-reporting-guidance-2016.pdf.* Finally, an initiative launched by food and beverage companies, Danone and Mars, together with the Science Based Targets Initiative, aims to provide Scope 3 guidance to companies in difference industries, starting with the food and beverage industry. *See* SB, *Serious About Scope 3: Pioneering Companies Embracing Complexity, Reaping the Benefits,* available at *https://sustainablebrands.com/read/supply-chain/serious-about-scope-3-pioneering-companies-embracing-complexity-reaping-the-benefits.*

[546] *See* 17 CFR 229.1504(f).

[547] *See* proposed 17 CFR 229.1504(c)(3).

[548] *See infra* Section II.M.

[549] *See, e.g.,* letters from ACCO Brands Corp.; American Bankers Association; American Petroleum Institute; American Property Casualty Insurance Association; Associated General Contractors of America; Bank of America Corporation; Biotechnology Innovation Organization; ConocoPhillips; Delta Airlines, Inc. (June 16, 2021); Deutsches Bank AG; Dow; Enbridge Inc.; Energy Infrastructure Council; Etsy, Inc.; Freeport-McMoran; KPMG LLP; Managed Funds Association; Nacco Industries; National Investor Relations Institute; National Ocean Industries Association; Neuberger Berman; NIRI Los Angeles; Oshkosh Corporation; Salesforce.com; SASB; SIFMA (June 10, 2021); Society for Corporate Governance; United Airlines Holdings, Inc. (June 11, 2021); and Wachtell Rosen Lipton & Katz.

[550] *See, e.g.,* letters from Business Council for Sustainable Energy; Dimensional Fund Advisors; and Independent Community Bankers of America.

[551] *See, e.g.,* letters from AICPA; BlackRock; Center for Climate and Energy Solutions; Crowe LLP; Energy Strategy Coalition; Institute of Management Accountants; Japanese Bankers Association; Nareit; National Mining Association; and Newmont Corporation.

[552] *See, e.g.,* letters from Dimensional Fund Advisors; and International Capital Markets Association (June 15, 2021).

to other business and financial information required by Commission rules, we are proposing a targeted safe harbor for Scope 3 emissions data in light of the unique challenges associated with this information. The proposed safe harbor would provide that disclosure of Scope 3 emissions by or on behalf of the registrant would be deemed not to be a fraudulent statement unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.[553] The safe harbor would extend to any statement regarding Scope 3 emissions that is disclosed pursuant to proposed subpart 1500 of Regulation S–K and made in a document filed with the Commission.[554] For purposes of the proposed safe harbor, the term ''fraudulent statement'' would be defined to mean a statement that is an untrue statement of material fact, a statement false or misleading with respect to any material fact, an omission to state a material fact necessary to make a statement not misleading, or that constitutes the employment of a manipulative, deceptive, or fraudulent device, contrivance, scheme, transaction, act, practice, course of business, or an artifice to defraud as those terms are used in the Securities Act or the Exchange Act or the rules or regulations promulgated thereunder.[555] The proposed safe harbor is intended to mitigate potential liability concerns associated with providing emissions disclosure based on third-party information by making clear that registrants would only be liable for such disclosure if it was made without a reasonable basis or was disclosed other than in good faith. It also may encourage more robust Scope 3 emissions information, to the extent registrants feel reassured about relying on actual third-party data as opposed to national or industry averages for their emissions estimates.

Several commenters expressed concern that the Commission would impose a ''one size fits all'' approach, which could disproportionately impact smaller registrants, when adopting climate-related disclosure rules.[556] Several commenters recommended that the Commission phase-in or scale down the climate-related disclosure requirements for smaller registrants.[557]

Although we are not proposing to exempt SRCs from the full scope of the proposed climate-related disclosure rules, we are proposing to exempt SRCs from the proposed Scope 3 emissions disclosure requirement.[558] We believe that exempting SRCs from the proposed Scope 3 emissions disclosure requirement would be appropriate in light of the proportionately higher costs they could incur, compared to non-SRCs, to engage in the data gathering, verification, and other actions associated with Scope 3 emissions reporting, many of which may have fixed cost components.

To further ease the burden of complying with the proposed Scope 3 disclosure requirement, we are also proposing a delayed compliance date for this requirement. As explained in greater detail below, all registrants, regardless of their size, would have an additional year to comply initially with the Scope 3 disclosure requirement beyond the compliance date for the other proposed rules. Moreover, because a registrant's Scope 3 emissions consist of the Scopes 1 and 2 emissions of its suppliers, distributors, and other third parties in the registrant's value chain, to the extent those parties become subject to the proposed rules, the increased availability of Scopes 1 and 2 emissions data following the rules' effectiveness should help ease the burden of complying with the Scope 3 emissions disclosure requirement.

Finally, we note that Securities Act Rule 409 and Exchange Act Rule 12b–21, which provide accommodations for information that is unknown and not reasonably available, would be available for the proposed Scope 3 emissions disclosures.[559] These rules allow for the conditional omission of required information when such information is unknown and not reasonably available to the registrant, either because obtaining the information would involve unreasonable effort or expense, or because the information rests peculiarly within the knowledge of another person not affiliated with the registrant.[560]

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133. Should we provide a safe harbor for Scope 3 emissions disclosure, as proposed? Is the scope of the proposed safe harbor clear and appropriate? For example, should the safe harbor apply to any registrant that provides Scope 3 disclosure pursuant to the proposed rules, as proposed? Should we limit the use of the safe harbor to certain classes of registrants or to registrants meeting certain conditions and, if so, which classes or conditions? For example, should we require the use of a particular methodology for calculating and reporting Scope 3 emissions, such as the PCAF Standard if the registrant is a financial institution, or the GHG Protocol Scope 3 Accounting and Reporting Standard for other types of registrants? Should we clarify the scope of persons covered by the language ''by or on behalf of a registrant'' by including language about outside reviewers retained by the registrant or others? Should we define a ''fraudulent statement,'' as proposed? Is the level of diligence required for the proposed safe harbor (*i.e.,* that the statement was made or reaffirmed with a reasonable basis and disclosed in good faith) the appropriate standard? Should the safe harbor apply to other climate-related disclosures, such as Scopes 1 and 2 emissions disclosures, any targets and goals disclosures in response to proposed Item 1505 (discussed below), or the financial statement metrics disclosures required pursuant to Proposed Article 14 of Regulation S–X? Should the safe harbor apply indefinitely, or should we include a sunset provision that would eliminate the safe harbor some number of years, (*e.g.,* five years) after the effective date or applicable compliance date of the rules? Should the safe harbor sunset after certain conditions are satisfied? If so, what types of conditions should we consider? What other approaches should we consider?

134. Should we provide an exemption from Scope 3 emissions disclosure for SRCs, as proposed? Should the exemption not apply to a SRC that has set a target or goal or otherwise made a commitment to reduce its Scope 3 emissions? Are there other classes of registrants we should exempt from the

[553] *See* proposed 17 CFR 229.1504(f)(1).

[554] *See* proposed 17 CFR 229.1504(f)(2).

[555] *See* proposed 17 CFR 229.1504(f)(3). This definition is based on the definition of fraudulent statement in 17 CFR 230.175.

[556] *See, e.g.,* letters from Elisha Doerr (May 24, 2021); Freedomworks Foundation (June 14, 2021); Roger Hawkins (May 24, 2021); and Jonathan Skee (May 26, 2021).

[557] *See, e.g.,* letters from American Bankers Association (June 11, 2021); Biotechnology Innovation Organization (June 15, 2021); BNP Paribas; Cardano Risk Management Ltd.; Catavento Consultancy; Chamber of Commerce (June 11, 2021); Credit Roundtable (June 11, 2021); Douglas Hileman Consulting; Environmental Bankers Association (June 9, 2021); Grant Thornton; Virginia Harper Ho; Manulife Investment Management; Mirova US; Morrison & Foerster; NEI Investments (June 11, 2021); New York State Society of Certified Public Accountants; PIMCO; and SIFMA.

[558] *See* proposed 17 CFR 229.1504(c)(3). We also are proposing a later compliance date for SRCs. *See infra* Section II.M.

[559] *See* 17 CFR 230.409 and 17 CFR 240.12b–21.

[560] *See id.* We expect, however, that a registrant that requires emissions data from another registrant in its value chain would be able to obtain that data without unreasonable effort or expense because of the increased availability of Scopes 1 and 2 emissions data for registrants following the effectiveness of the proposed rules.

Scope 3 emissions disclosure requirement? For example, should we exempt EGCs, foreign private issuers, or a registrant that is filing or has filed a registration statement for its initial public offering during its most recently completed fiscal year from the Scope 3 disclosure requirement? Instead of an exemption, should we provide a longer phase in for the Scope 3 disclosure requirements for SRCs than for other registrants?

H. Attestation of Scope 1 and Scope 2 Emissions Disclosure

1. Overview

The proposed rules would require a registrant, including a foreign private issuer, that is an accelerated filer or large accelerated filer to include in the relevant filing an attestation report covering the disclosure of its Scope 1 and Scope 2 emissions [561] and to provide certain related disclosures about the service provider.[562] As proposed, the attestation engagement must, at a minimum, be at the following assurance level for the indicated fiscal year for the required GHG emissions disclosure:[563]

Limited assurance	Reasonable assurance
Fiscal Years 2 and 3 after Scopes 1 and 2 emissions disclosure compliance date.	Fiscal Years 4 and beyond after Scopes 1 and 2 emissions disclosure compliance date.

To provide additional clarity, the following table illustrates the application of the transition periods assuming that the proposed rules will be adopted with an effective date in December 2022 and that the accelerated filer or large accelerated filer has a December 31st fiscal year-end:

Filer type	Scopes 1 and 2 GHG disclosure compliance date *	Limited assurance	Reasonable assurance
Accelerated Filer	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026)	Fiscal year 2027 (filed in 2028).
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)	Fiscal year 2026 (filed in 2027).

* *See infra* Section II.M for a discussion of the proposed disclosure compliance dates for Scopes 1 and 2 GHG emissions disclosure. If the accelerated filer or the large accelerated filer has a non-calendar-year fiscal year-end date that results in its 2024 or 2023 fiscal year, respectively, commencing before the compliance dates of the rules, it would not be required to comply with proposed GHG emissions disclosure requirements until the following fiscal year (as discussed below in Section II.M). Accordingly, for such filers, the time period for compliance with the corresponding attestation requirements under proposed Item 1505 would be one year later than illustrated above.

During the transition period when limited assurance is required, the proposed rules would permit an accelerated filer or a large accelerated filer, at its option, to obtain reasonable assurance of its Scope 1 and 2 emissions disclosure.[564] For example, an accelerated filer or a large accelerated filer may choose to obtain reasonable assurance such that its GHG emissions disclosure receives the same level of assurance as its financial statements.[565]

At its option, an accelerated filer or a large accelerated filer would be able to obtain any level of assurance over its climate-related disclosures that are not required to be assured pursuant to proposed Item 1505(a). For example, an accelerated filer or a large accelerated filer could voluntarily include an attestation report at the limited assurance level for its GHG intensity metrics or its Scope 3 emissions disclosure. To avoid potential confusion, however, the voluntary assurance obtained by such filer would be required to follow the requirements of proposed Item 1505(b)–(d), including using the same attestation standard as the required assurance over Scope 1 and Scope 2.[566] For filings made by accelerated filers and large accelerated filers after the compliance date for the GHG emissions disclosure requirements but before proposed Item 1505(a) requires limited assurance, the filer would only be required to provide the disclosure called for by proposed Item 1505(e). As discussed below in Section II.H.5, a registrant that is not an accelerated filer or a large accelerated filer that obtains voluntary assurance would be required to comply only with proposed Item 1505(e).

Many commenters recommended that we require climate-related disclosures to be subject to some level of assurance to enhance the reliability of the disclosures.[567] Commenters noted that companies are increasingly seeking some type of third-party assurance or

[561] *See* proposed 17 CFR 229.1505(a). In order to attest to the Scopes 1 and 2 emissions disclosure, we believe a GHG emissions attestation provider would need to include in its evaluation relevant contextual information. In particular, the attestation provider would be required to evaluate the registrant's compliance with (i) proposed Item 1504(a), which includes presentation requirements (*e.g.,* disaggregation by each constituent greenhouse gas), (ii) the calculation instructions included in proposed Item 1504(b), and (iii) the disclosure requirements in proposed Item 1504(e) regarding methodology, organizational boundary, and operational boundary. *See infra* Section II.H.3 for further discussion of the criteria against which the Scopes 1 and 2 emissions disclosure are measured or evaluated.

[562] *See* proposed 17 CFR 229.1505(d).

[563] *See* proposed 17 CFR 229.1505(a)(1).

[564] Reasonable assurance is equivalent to the level of assurance provided in an audit of a registrant's consolidated financial statements included in a Form 10–K. Limited assurance is equivalent to the level of assurance (commonly referred to as a ''review'') provided over a registrant's interim financial statements included in a Form 10–Q.

[565] We refer to ''assurance'' broadly when describing the level and scope of assurance to which climate-related disclosures should be subject. Our proposed approach to assurance has been guided by ''attestation'' standards published by organizations including the PCAOB, AICPA, and the International Auditing and Assurance Standards Board (''IAASB''). Such attestation standards apply to engagements other than audit and review of historical financial statements and have been widely used in the current voluntary ESG and GHG assurance market for a number of years.

[566] *See* proposed 17 CFR 229.1505(a)(2). If the accelerated filer or large accelerated filer was required to obtain reasonable assurance over its Scope 1 and Scope 2 emissions disclosures and the attestation provider chose to follow, for example, the AICPA attestation standards, the accelerated filer or large accelerated filer could voluntarily obtain limited assurance over its GHG intensity metric or Scope 3 emissions disclosures, and the attestation provider would be required to follow the AICPA's attestation standard for providing limited assurance.

[567] *See, e.g.,* letters from AICPA; Americans for Financial Reform Education Fund *et al;* Andrew Behar; Baillie Gifford; Carbon Tracker Initiative; Cardano Risk Management Ltd.; CDP; Center for American Progress; Center for Audit Quality; Ceres et al.; Climate Disclosure Standards Board; Climate Governance Initiative; Emmanuelle Haack; Eni SpA; ERM CVS (recommending limited assurance); George Serafeim; Regenerative Crisis Response Committee; Friends of the Earth, Amazon Watch, and Rainforest Action Network; Hermes Equity Ownership Limited; Impax Asset Management; Institutional Shareholder Services; Interfaith Center on Corporate Responsibility (recommending reasonable assurance); International Corporate Governance Institute; International Organization for Standardization; Morningstar, Inc.; Natural Resources Defense Council; NY City Comptroller; NY State Comptroller; Oxfam America; PRI ; Pricewaterhouse Coopers; Revolving Door Project; TotalEnergies (recommending limited assurance); Value Balancing Alliance; WBCSD; William and Flora Hewlett Foundation; and World Benchmarking Alliance.

verification over ESG and climate-related disclosures. For example, according to one commenter, 80 percent of S&P 100 companies currently subject certain items of their ESG information, including climate-related disclosures such as greenhouse gas emissions, to some type of third-party assurance or verification.[568] Several commenters recommended that we require climate-related disclosures to be subject to limited assurance,[569] which provides a lower level of assurance than reasonable assurance, but is less costly, and is the most common form of assurance provided for ESG, including climate-related disclosures, in the current voluntary reporting landscape.[570]

One commenter recommended that, at a minimum, we require a registrant to obtain a limited assurance report for its Scopes 1 and 2 emissions disclosure while encouraging optional verification for other ESG metrics.[571] Another commenter indicated that a limited assurance requirement for climate-related disclosures would be similar to the EU's Corporate Sustainability Reporting Directive proposal that, if adopted, would initially require companies in the European Union to obtain limited assurance on reported sustainability information with an option to move towards reasonable assurance in the future.[572] One commenter stated the view that, while the professional capacity of audit firms might, at this point, be insufficient to provide reasonable assurance of ESG data, it supported a mandatory limited assurance requirement for climate risk reporting.[573] Other commenters recommended that we require climate-related disclosures to be audited at the reasonable assurance level.[574]

Some commenters, however, opposed any third-party assurance requirement for climate-related disclosures because of the significant cost that these commenters asserted it could impose on public companies, and because, in their view, application of assurance standards to data that is different from traditional financial reporting disclosures, such as GHG emissions, would be a relatively new and evolving field.[575] Some of these commenters indicated that, as a first step, registrants should develop their internal controls and disclosure controls and procedures (''DCP'') to include climate-related disclosures, and defer mandated third-party assurance requirements to a later time.[576]

We recognize that requiring GHG emissions disclosure in Commission filings should enhance the consistency, comparability, and reliability of such disclosures due to the application of DCP and the proposed inclusion of certain prescriptive elements that may help improve standardization of GHG emissions calculations. Nevertheless, the evolving and unique nature of GHG emissions reporting involves and, in some cases, warrants varying methodologies, differing assumptions, and a substantial amount of estimation. Certain aspects of GHG emissions disclosure also involve reliance on third-party data. As such, requiring a third party's attestation over these disclosures would provide investors with an additional degree of reliability regarding not only the figures that are disclosed, but also the key assumptions, methodologies, and data sources the registrant used to arrive at those figures. In other contexts, such as mineral resources and oil and gas reserves, the Commission has recognized the value that third parties with specialized expertise in audit and engineering can bring to company disclosures of physical resources or risks.[577]

Our rules typically do not require registrants to obtain assurance over disclosure provided outside of the financial statements, including quantitative disclosure. We believe, however, that there are important distinctions between existing quantitative disclosure required to be provided outside of the financial statements and the proposed GHG emissions disclosure. In contrast to GHG emissions disclosure, quantitative disclosure outside of the financial statements typically is derived, at least in part, from the same books and records that are used to generate a registrant's audited financial statements and accompanying notes and that are subject to ICFR. Accordingly, such quantitative disclosure has been subject to audit procedures as part of the audit of the financial statements in the same filing. Further, the auditor's read and consider obligation requires an evaluation of this quantitative information based on the information obtained through the audit of the financial statements.[578] Unlike other quantitative information that is provided outside of the financial statements, GHG emissions disclosure would generally not be developed from information that is included in the registrant's books and records and, therefore, would not be subjected to audit procedures.[579] In addition, although not an assurance engagement, we have adopted rules requiring an expert to review and provide conclusions on other specialized, quantitative data that is provided outside of the financial statements.[580] Accordingly, to enhance its reliability, we believe it is appropriate to require that GHG emissions disclosure be subject to third-party attestation.

For similar reasons, we also considered proposing to require that management assess and disclose the effectiveness of controls over GHG

[568] *See* letter from CAQ; *see also* CAQ, *S&P 500 and ESG Reporting* (Aug. 9, 2021), available at *https://www.thecaq.org/sp-500-and-esg-reporting/* (stating that more than half of S&P 500 companies had some form of assurance or verification over ESG metrics, including GHG emissions metrics).

[569] *See, e.g.,* letters from Credit Suisse; ERM CVS; PayPal Holdings, Inc.; TotalEnergies; and Walmart.

[570] *See* letter from Energy Infrastructure Council; *see also* CAQ, *S&P 500 and ESG Reporting* (Aug. 9, 2021).

[571] *See* letter from PayPal Holdings, Inc.

[572] *See* letter from CAQ.

[573] *See* letter from Credit Suisse.

[574] *See, e.g.,* letters from Ceres *et al.;* and Interfaith Center on Corporate Responsibility.

[575] *See, e.g.,* letters from American Petroleum Institute; Investment Company Institute; and National Association of Manufacturers.

[576] *See, e.g.,* letters from American Petroleum Institute; and Investment Company Institute. We agree that registrants should develop their DCP to include their GHG emissions disclosures. When the proposed GHG emissions disclosures are included in Form 10–K and Form 20–F annual reports, our rules governing DCP would apply to those disclosures. *See* 17 CFR 240.13a–15 and 240.15d–15.

[577] *See* 17 CFR 229.1302 (requiring a registrant's disclosure of exploration results, mineral resources, or mineral reserves to be based on and accurately reflect information and supporting documentation prepared by a qualified person, which, pursuant to 17 CFR 229.1300, is defined to mean a mineral industry professional with at least five years of relevant experience in the type of mineralization and type of deposit under consideration who meets certain additional criteria); and 17 CFR 229.1202(a)(7) (requiring a registrant to disclose the qualifications of the technical person primarily responsible for overseeing the preparation of the oil and gas reserves estimates or reserves audit).

[578] *See* PCAOB AS 2710 *Other Information in Documents Containing Audited Financial Statements* (requiring an auditor to read the other information (included in an annual report with the audited financial statements) and consider whether such information, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, appearing in the financial statements). For example, disclosure pursuant to 17 CFR 229.303 (Item 303 of Regulation S–K—MD&A) is derived in part from the same books and records that are subject to ICFR and used to generate a registrant's audited financial statements and accompanying notes (*e.g.,* the liquidity and capital resources disclosures are anchored to the audited cash flows information disclosed in the financial statements).

[579] Although GHG emission disclosure would generally not be directly derived from the same books and records that are used to generate a registrant's audited financial statements and accompanying notes and that are subject to ICFR, GHG emission disclosure, as proposed, would be required to use the same organizational and operational boundaries as the registrant's financial statement disclosures. *See* proposed 17 CFR 229.1504(e)(2).

[580] *See Modernization of Property Disclosures for Mining Registrants,* Release No. 33–10570 (Oct. 31, 2018), [83 FR 66344 (Dec. 26, 2018)].

emissions disclosure (apart from the existing requirements with respect to the assessment and effectiveness of DCP). More specifically, in addition to the requirement to assess such controls, we considered whether to require management to include a statement in their annual report regarding their responsibility for the design and evaluation of controls over GHG emissions disclosures, as well as to disclose their conclusion regarding the effectiveness of such controls. We also considered proposing to require a GHG emissions attestation provider's attestation of the effectiveness of controls over GHG emissions disclosure in addition to the proposed attestation over the Scopes 1 and 2 GHG emissions disclosure. Although both such requirements could further enhance the reliability of the related Scopes 1 and 2 GHG emissions disclosure, we are not currently proposing them at this time. We are, however, continuing to consider these alternatives, including: (i) the need to develop guidance for management on conducting such an assessment and (ii) whether appropriate attestation standards exist. Accordingly, we request comment on these and related issues below.

The Commission has long recognized the important role played by an independent audit in contributing to the reliability of financial reporting.[581] Relatedly, studies suggest that investors have greater confidence in information that has been assured, particularly when it is assured at the reasonable assurance level.[582] Although a limited assurance engagement provides a lower level of assurance than a reasonable assurance engagement,[583] studies of ESG-related assurance, which is typically provided at a limited assurance level, have found benefits such as credibility enhancement, lower cost of equity capital, and lower analyst forecast errors and dispersion.[584] Therefore, proposing to require Scope 1 and Scope 2 emissions disclosure by accelerated filers and large accelerated filers be subject to limited assurance initially, with an eventual scaling up to reasonable assurance, could potentially improve both the actual reliability of disclosure and investor confidence in such disclosure.[585]

Increasing investor demand for consistent, comparable, and reliable climate-related financial information appears to have led a growing number of companies to voluntarily obtain third-party assurance over their climate-related disclosures both within the U.S. and globally. For example, according to one study, 53% of the S&P 500 companies had some form of assurance or verification over climate-related metrics, along with other metrics.[586] Another survey of sustainability reporting trends from 5,200 companies across 52 countries (including the United States) stated that, of the top 100 companies (by revenue), 80% have reporting on ESG (including climate), with up to 61% of those companies also obtaining assurance.[587] The prevalence of major companies obtaining assurance in connection with their voluntary sustainability reports suggests that both the companies and their investors are focused on the reliability of such disclosures.

Although many registrants have voluntarily obtained some level of assurance for their climate-related disclosures, current voluntary ESG assurance practices have been varied with respect to the levels of assurance provided (*e.g.,* limited versus reasonable), the assurance standards used, the types of service providers, and the scope of disclosures covered by the assurance. This fragmentation has diminished the comparability of the assurance provided and may require investors to become familiar with many different assurance standards and the varying benefits of different levels of assurance. The consequences of such fragmentation has also been highlighted by certain international organizations,[588] including IOSCO, which stated that the ''perceived lack of clarity and consistency around the purpose and scope of [voluntary] assurance . . . potentially lead[s] to market confusion, including misleading investors and exacerbating the expectations gap.'' [589] For example, investors may see that a service provider has produced an assurance report for a registrant's GHG emissions disclosure and have an expectation that such assurance will enhance the reliability of that disclosure without always understanding the service provider's qualifications for producing the report, what level of assurance (*e.g.,* limited versus reasonable) is being provided, what scope of assurance (*e.g.,* the disclosures covered by the assurance) is being provided with respect to the registrant's GHG emissions disclosure, and the methodologies and procedures that the attestation provider used. While some experienced assurance providers may be proficient in applying attestation standards to GHG emissions disclosures, other assurance providers may lack GHG emissions expertise. Similarly, some service providers providing assurance may have expertise in GHG emissions but have minimal assurance experience. Moreover, some service providers may use standards that are

[581] *See Qualifications of Accountants,* Release No. 33–10876 (Oct. 16, 2020) [85 FR 80508 (Dec. 11, 2020)], at 80508. *See also* Statement of Paul Munter, Acting Chief Accountant, *The Importance of High Quality Independent Audits and Effective Audit Committee Oversight to High Quality Financial Reporting to Investors* (Oct. 26, 2021), available at *https://www.sec.gov/news/statement/munter-audit-2021/10/26.*

[582] *See, e.g.,* Carol Callaway Dee, et al., *Client Stock Market Reaction to PCAOB Sanctions against a Big Four Auditor,* 28 Contemp. Acct. Res. 263 (Spring 2011) (''Audits are valued by investors because they assure the reliability of and reduce the uncertainty associated with financial statements.''); Center for Audit Quality, *2019 Main Street Investor Survey* (''[I]nvestors continue to register high degrees of confidence in the ability of public company auditors to fulfill their investor-protection roles. Eighty-three percent of US retail investors view auditors as effective in their investor-protection role within the US capital markets, up from 81% in 2018); and CFA Institute, *CFA Institute Member Survey Report—Audit Value, Quality, and Priorities* (2018).

[583] *See infra* note 604 for a discussion of the key differences between limited and reasonable assurance engagements.

[584] *See, e.g.,* Ryan J. Casey, et al., *Understanding and Contributing to the Enigma of Corporate Social Responsibility (CSR) Assurance in the United States,* 34 Auditing: A Journal of Practice and Theory 97, 122 (Feb. 2015) (finding that corporate social responsibility (''CSR'') assurance results in lower cost-of-capital along with lower analyst forecast errors and dispersion, and that financial analysts find related CSR reports to be more credible when independently assured). *See also infra* note 592 for statistics illustrating that limited assurance is more commonly obtained voluntarily in the current market than reasonable assurance over ESG-related information.

[585] *See, e.g.,* letter from Institute for Policy Integrity, Environmental Defense Fund, Initiative on Climate Risk & Resilience Law (''Voluntary frameworks typically lack independent auditing requirements, which is one reason many investors perceive current disclosures to be unreliable or uneven.''). *See also* EVORA Global and SIERA, *Investor Survey 2021: Part 2 ESG Data Challenge* (2021), 7, available at *https://evoraglobal.com/wp-content/uploads/2021/12/ESG-Data-Challenge-Investor-Survey-Part-2.pdf* (''Investors are integrating ESG across the investment lifecycle, for the purposes of strategy, reporting, peer benchmarking, etc., however the majority (86%) are not sure of their ESG data quality. About 52% of the investors consider that their ESG data is partially investment-grade.''); State Street Global Advisors, *The ESG Data Challenge* (Mar. 2019), available at *https://www.ssga.com/investment-topics/environmental-social-governance/2019/03/esg-data-challenge.pdf.*

[586] *See* CAQ, *S&P 500 and ESG Reporting* (Aug. 9, 2021).

[587] *See* KPMG, *The KPMG Survey of Sustainability Reporting 2020,* available at https://home.kpmg/xx/en/home/insights/2020/11/the-time-has-come-survey-of-sustainability-reporting.html.

[588] International Federation of Accountants, *The State of Play in Sustainability Assurance* (June 23, 2021), available at *https://www.ifac.org/knowledge-gateway/contributing-global-economy/discussion/state-play-sustainability-assurance;* Lawrence Heim, International Federation of Accountants, *IFAC: Poor ESG Assurance an ''Emerging Financial Stability Risk''* (July 1, 2021), available at *https://practicalesg.com/2021/07/ifac-poor-esg-assurance-an-emerging-financial-stability-risk/.*

[589] IOSCO, *Report on Sustainability-related Issuer Disclosures* (June 2021).

developed by accreditation bodies with notice and public comment and other robust due process procedures [590] for standard setting, while other service providers may use privately developed ''verification'' standards.[591]

To improve accuracy, comparability, and consistency with respect to the proposed GHG emissions disclosure, we are proposing to require a minimum level of attestation services for accelerated filers and large accelerated filers including: (1) Limited assurance for Scopes 1 and 2 emissions disclosure that scales up to reasonable assurance after a specified transition period; (2) minimum qualifications and independence requirements for the attestation service provider; and (3) minimum requirements for the accompanying attestation report. These proposed requirements would be minimum standards that the GHG emissions attestation provider engaged by accelerated filers and large accelerated filers must meet, but, as mentioned above, would not prevent a registrant from obtaining a heightened level of assurance over its climate-related disclosures (prior to the transition to reasonable assurance) or to obtain assurance over climate-related disclosures other than Scope 1 and Scope 2 emissions.

By specifying minimum standards for the attestation provided with respect to GHG emissions disclosure by accelerated filers and large accelerated filers, the proposed rules should improve accuracy and consistency in the reporting of this information, while also providing investors with an enhanced level of reliability against which to evaluate the disclosure. In addition to the proposed minimum standards for attestation services, the proposed additional disclosure requirements for registrants, described below, should further assist investors in understanding the qualifications and suitability of the GHG emissions attestation provider selected by the registrant, particularly in light of the broad spectrum of attestation providers that would be permitted to provide attestation services under the proposed rules.

Although we are proposing certain minimum standards for attestation services, this proposal does not aim to create or adopt a specific attestation standard for assuring GHG emissions, just as this proposal does not define a single methodology for calculating GHG emissions. This is because both the reporting and attestation landscapes are currently evolving and it would be premature to adopt one approach and potentially curtail future innovations in these two areas. The evolving nature of GHG emissions calculations and attestation standards could suggest that it may also be premature to require assurance. We are soliciting comment on the feasibility of our proposal and will consider any public feedback received, but we have preliminarily determined that the phased-in approach that we are proposing, along with an extended period for disclosure compliance for accelerated filers, balances the benefits of third-party review with the costs of seeking assurance in this evolving space.

The proposed minimum standards for attestation services and the proposed additional disclosure requirements would not eliminate fragmentation with respect to assurance or obviate the need for investors to assess and compare multiple attestation standards. Nevertheless, we believe some flexibility in our approach is warranted at this time given the unique and evolving nature of third-party assurance for climate-related disclosures. We believe the proposed minimum standards and additional disclosure requirements would enable investors to better understand the assurance that has been provided.

We are cognizant of the fact that the calculation and disclosure of GHG emissions would be new for many registrants, as would be the application of assurance standards to GHG emissions disclosure. For these reasons and the reasons discussed in greater detail below, we are proposing to require assurance (1) only for accelerated filers and large accelerated filers, (2) only with respect to Scope 1 and Scope 2 emissions, and (3) with an initial transition period for limited assurance and a subsequent transition period for reasonable assurance.

Although we have considered the challenges that mandatory assurance of GHG emissions disclosure could present, accelerated filers and large accelerated filers should have the necessary resources to devote to complying with such requirements over the proposed implementation timetable. For the many large accelerated filers that are already voluntarily obtaining some form of assurance over their GHG emissions, any cost increases associated with complying with the proposed rules would be mitigated.[592] Furthermore, larger issuers generally bear proportionately lower compliance costs than smaller issuers due to the fixed cost components of such compliance.[593]

The proposed transition periods would also provide existing accelerated filers and large accelerated filers one fiscal year to transition to limited assurance [594] and two additional fiscal years to transition to reasonable assurance.[595] For existing accelerated filers, this transition period would be in addition to the one additional year they will have to comply with the Scopes 1 and 2 emission disclosure requirements (compared to large accelerated filers). As such, these filers would have significant time to develop processes to support their GHG emissions disclosure requirements and the relevant DCP, as well as to adjust to the incremental costs and efforts associated with escalating levels of assurance. During this transition period, GHG emissions attestation providers would also have time to prepare themselves for providing such services in connection with Commission filings.

In addition to the challenges posed by the newness of calculating and disclosing GHG emissions, we believe that only requiring assurance over Scope 1 and Scope 2 emissions would be appropriate because the emissions result directly or indirectly from

[590] *See infra* Section II.H.3.

[591] *See, e.g.,* CAQ, *S&P 500 and ESG Reporting* (Aug. 9, 2021) (pointing to the use of assurance methodologies developed by individual service providers, which in some cases were based on IAASB International Standard on Assurance Engagements (ISAE) 3000 with modifications).

[592] *See, e.g.,* CAQ, *S&P 500 and ESG Reporting* (Aug. 9, 2021) (providing statistics on limited assurance versus reasonable assurance obtained voluntarily in the current market (*e.g.,* at least 26 of 31 companies that obtained assurance from public company auditors obtained limited assurance; at least 174 of 235 companies that obtained assurance or verification from other service providers (non-public company auditors) obtained limited assurance)). For similar information on the S&P 100, see CAQ, *S&P 100 and ESG Reporting* (Apr. 29, 2021), available at *https://www.thecaq.org/sp-100-and-esg-reporting/.* Based on an analysis by Commission staff on Mar. 3, 2022, a substantial number of the S&P 500 companies (460+) are large accelerated filers and therefore would be subject to the proposed assurance requirements.

[593] *See infra* note 955 in Section IV.C of the Economic Analysis for further discussion on proportionate costs between different types of filers.

[594] *See infra* note 604 for a discussion of the key differences between limited and reasonable assurance engagements.

[595] By limiting the assurance requirements to accelerated filers and large accelerated filers, a new registrant would not be required to provide assurance until it has been subject to the requirements of Section 13(a) or 15(d) of the Exchange Act for a period of at least twelve calendar months and it has filed at least one annual report pursuant to Section 13(a) or 15(d) of the Exchange Act. *See* 17 CFR 240.12b–2. Therefore, no registrant would be required to provide assurance covering its GHG emissions disclosure during an initial public offering. However, any registrant that voluntarily includes an attestation report for GHG emissions disclosure would be required to comply with proposed Item 1505(e).

facilities owned or activities controlled by a registrant, which makes it relatively more accessible and easier to subject to the registrant's DCP compared to Scope 3 data. Further, as discussed earlier, many registrants already voluntarily seek assurance over their GHG emissions disclosure (predominately Scope 1 and Scope 2 disclosures),[596] which further supports the feasibility and readiness of Scope 1 and Scope 2 emissions disclosure for mandatory assurance. In contrast, we are not proposing to require assurance of Scope 3 emissions disclosure at this time because the preparation of such disclosure presents unique challenges.[597] Depending on the size and complexity of a company and its value chain, the task of calculating Scope 3 emissions could be relatively more burdensome and expensive than calculating Scope 1 and Scope 2 emissions. In particular, it may be difficult to obtain activity data from suppliers, customers, and other third parties in a registrant's value chain, or to verify the accuracy of that information compared to disclosures of Scope 1 and Scope 2 emissions data, which are more readily available to a registrant.

We are proposing to require accelerated filers and large accelerated filers to obtain limited assurance, with an eventual scaling up to reasonable assurance. The objective of a limited assurance engagement is for the service provider to express a conclusion about whether it is aware of any material modifications that should be made to the subject matter (*e.g.,* the Scopes 1 and 2 emissions disclosure) in order for it to be fairly stated or in accordance with the relevant criteria (*e.g.,* the methodology and other disclosure requirements specified in proposed 17 CFR 229.1504 (Item 1504 of Regulation S–K).[598] In such engagements, the conclusion is expressed in the form of negative assurance regarding whether any material misstatements have been identified.[599] In contrast, the objective of a reasonable assurance engagement, which is the same level of assurance provided in an audit of a registrant's consolidated financial statements, is to express an opinion on whether the subject matter is in accordance with the relevant criteria, in all material respects. A reasonable assurance opinion provides positive assurance that the subject matter is free from material misstatement.[600]

Reasonable assurance is feasible whenever limited assurance can be provided on a subject,[601] and as noted above the voluntary attestation obtained by some registrants has been at the reasonable assurance level.[602] We understand, however, that a limited assurance engagement is less extensive and is currently the level of assurance most commonly provided[603] in the voluntary assurance market for climate-related disclosure.[604] Therefore, prior to the transition to reasonable assurance, the additional compliance efforts required to comply with the proposed assurance requirement should be limited for the many registrants that—according to commenters and others—are already obtaining limited assurance for their climate-related disclosures.[605] Furthermore, although reasonable assurance provides a significantly higher level of assurance than limited assurance, we believe limited assurance would benefit investors during the initial transition period by enhancing the reliability of a registrant's Scopes 1 and 2 emissions disclosure, in light of the benefits that assurance provides, as discussed above. Moreover, under the proposed rules, accelerated filers and large accelerated filers would not be prevented from obtaining reasonable assurance for their climate disclosures earlier than required. After the transition to mandatory reasonable assurance, investors would have the benefits of a higher level of assurance with smaller incremental costs to accelerated filers and large accelerated filers than moving directly to a reasonable assurance requirement.

Request for Comment

135. Should we require accelerated filers and large accelerated filers to obtain an attestation report covering their Scope 1 and Scope 2 emissions disclosure, as proposed? Should we require accelerated filers and large accelerated filers to obtain an attestation report covering other aspects of their climate-related disclosures beyond Scope 1 and 2 emissions? For example, should we also require the attestation of GHG intensity metrics, or of Scope 3

[596] For specific examples, *see, e.g.,* Etsy, Inc. FY 2021 Form 10–K, available at *https://s22.q4cdn.com/941741262/files/doc_financials/2021/q4/ETSY-12.31.2021-10K.pdf* (external third-party attestation report available at *https://s22.q4cdn.com/941741262/files/doc_financials/2021/q4/PwC/Limited-Assurance-Report-Assertion-Etsy-FY21_2.24.22_final-signed_final.pdf*); Johnson Controls International plc 2021 Sustainability Report, available at *https://www.johnsoncontrols.com/2021sustainability* (external third-party verification report available at *https://www.johnsoncontrols.com/-/media/jci/corporate-sustainability/reporting-and-policies/gri/2020/ghg-jci-fy-2020-verification-statement.pdf*); Norfolk Southern Corporation 2021 GHG Emissions Report, available at *http://www.nscorp.com/content/dam/nscorp/get-to-know-ns/about-ns/environment/2020-GHG-Emissions-Report.pdf;* Koninklijke Philips NV (Royal Philips) Annual Report 2021, at 269, available at *https://www.results.philips.com/publications/ar21/downloads/pdf/en/Philips/English.pdf?v=20220225104533;* Starbucks Coffee Company FY 2020 GHG emissions inventory assurance report, at 2, available at *https://stories.starbucks.com/uploads/2021/04/StaFY20/Third-Party-Independent-Verification-and-Assurance-Reports.pdf;* and Vornado Realty Trust FY 2020 ESG report, available at *https://books.vno.com/books/idpn/#p=1. See also supra* note 592 for S&P 100 and S&P 500 related statistics.

[597] *See supra* Section II.G.3 for further discussion of the unique challenges presented by the disclosure of Scope 3 emissions.

[598] *See, e.g.,* AICPA's Statement on Standards for Attestation Engagements (SSAE) No.22, AT–C Section 210.

[599] *See infra* Section II.H.3 for further discussion of the attestation report requirements, including the difference between a conclusion and an opinion.

[600] *See, e.g.,* AICPA SSAE No. 21, AT–C Sections 205 and 206.

[601] Under commonly used attestation standards, both a reasonable assurance engagement and a limited assurance engagement have the same requirement that the subject matter (*e.g.,* Scope 1 and Scope 2 emissions) of the engagement be appropriate as a precondition for providing assurance. Thus, if the subject matter is appropriate for a limited assurance engagement, it is also appropriate for a reasonable assurance engagement. *See* AICPA SSAE No. 18 (Apr. 2016); and IAASB ISAE 3000 (Revised) (Dec. 2013).

[602] For example, some registrants have voluntarily sought reasonable assurance over certain information, including Scopes 1, 2, and 3 emissions, for which others have voluntarily sought limited assurance. *See, e.g.,* Apple, Inc. Environmental Progress Report (Mar. 2021), at 88–90, available at *https://www.apple.com/environment/pdf/Apple_Environmental_Progress_Report_2021.pdf;* United Parcel Service, Inc. (UPS) FY 2020 GRI Content Index, at 72, available at *https://about.ups.com/content/dam/upsstories/assets/reporting/sustainability-2021/2020_UPS_GRI_Content_Index_081921v2.pdf;* and Guess?, Inc. FY2020–2021 Sustainability Report, at 91, available at *https://static1.squarespace.com/static/609c10ed49db5202181d673f/t/6faf8af82418f5da4778f6f/1627060411937/GUESS+FY20-21+Sustainability+Report.pdf.*

[603] *See supra* note 592 (providing statistics on limited assurance obtained voluntarily in the current market).

[604] The scope of work in a limited assurance engagement is substantially less than a reasonable assurance engagement. The primary difference between the two levels of assurance relates to the nature, timing, and extent of procedures required to obtain sufficient, appropriate evidence to support the limited assurance conclusion or reasonable assurance opinion. Limited assurance engagements primarily include procedures such as inquiries and analytical procedures and do not necessarily include a consideration of whether internal controls have been effectively designed, whereas reasonable assurance engagements require the assurance service provider to consider and obtain an understanding of internal controls. More extensive testing procedures beyond inquiries and analytical procedures, including recalculation and verification of data inputs, are also required in reasonable assurance engagements, such as inspecting source documents that support transactions selected on a sample basis. Driven by these differences, the cost of limited assurance is generally lower than that of reasonable assurance.

[605] *See* letters from CAQ and Energy Infrastructure Council; *supra* note 592 (providing statistics on voluntary assurance obtained by S&P 100 and S&P 500 companies).

emissions, if disclosed? Conversely, should we require accelerated filers and large accelerated filers to obtain assurance covering only Scope 1 emissions disclosure? Should any voluntary assurance obtained by these filers after limited assurance is required be required to follow the same attestation requirements of Item 1505(b)–(d), as proposed?

136. If we required accelerated filers and large accelerated filers to obtain an attestation report covering Scope 3 emissions disclosure, should the requirement be phased-in over time? If so, what time frame? Should we require all Scope 3 emissions disclosure to be subject to assurance or only certain categories of Scope 3 emissions? Would it be possible for accelerated filers and large accelerated filers to obtain an attestation report covering the process or methodology for calculating Scope 3 emissions rather than obtaining an attestation report covering the calculations of Scope 3 emissions? Alternatively, is there another form of verification over Scope 3 disclosure that would be more appropriate than obtaining an attestation report?

137. Should the attestation requirement be limited to accelerated filers and large accelerated filers, as proposed? Alternatively, should the attestation requirement be limited to a subset of accelerated filers and large accelerated filers? If so, what conditions should apply? Should the attestation requirement only apply to well-known seasoned issuers?[606] Should the attestation requirement also apply to other types of registrants? Should we create a new test for determining whether the attestation requirements apply to a registrant that would take into account the resources of the registrant and also apply to initial public offerings? For example, should we create a test similar to the SRC definition,[607] which includes a separate determination for initial registration statements, but using higher public float and annual revenue amounts?

138. Instead of requiring only accelerated filers and large accelerated filers to include an attestation report for Scope 1 and Scope 2 emissions, should the proposed attestation requirements also apply to registrants other than accelerated filers and large accelerated filers? If so, should the requirement apply only after a specified transition period? Should such registrants be required to provide assurance at the same level as accelerated filers and large accelerated filers and over the same scope of GHG emissions disclosure, or should we impose lesser requirements (*e.g.,* only limited assurance and/or assurance over Scope 1 emissions disclosure only)?

139. Should we require accelerated filers and large accelerated filers to initially include attestation reports reflecting attestation engagements at a limited assurance level, eventually increasing to a reasonable assurance level, as proposed? What level of assurance should apply to the proposed GHG emissions disclosure, if any, and when should that level apply? Should we provide a one fiscal year transition period between the GHG emissions disclosure compliance date and when limited assurance would be required for accelerated filers and large accelerated filers, as proposed? Should we provide an additional two fiscal year transition period between when limited assurance is first required and when reasonable assurance is required for accelerated filers and large accelerated filers, as proposed?

140. Should we provide the same transition periods (from the Scopes 1 and 2 emissions disclosure compliance date) for accelerated filers and large accelerated filers, as proposed? Instead, should different transition periods apply to accelerated filers and large accelerated filers? Should we provide transition periods with different lengths than those proposed? Should we require the attestation to be at a reasonable assurance level without having a transition period where only limited assurance is required? Should we instead impose assurance requirements to coincide with reporting compliance periods?

141. Under prevailing attestation standards, ''limited assurance'' and ''reasonable assurance'' are defined terms that we believe are generally understood in the marketplace, both by those seeking and those engaged to provide such assurance. As a result, we have not proposed definitions of those terms. Should we define ''limited assurance'' and ''reasonable assurance'' and, if so, how should we define them? Would providing definitions in this context cause confusion in other attestation engagements not covered by the proposed rules? Are the differences between these types of attestation engagements sufficiently clear without providing definitions?

142. As proposed, there would be no requirement for a registrant to either provide a separate assessment and disclosure of the effectiveness of controls over GHG emissions disclosure by management or obtain an attestation report from a GHG emissions attestation provider specifically covering the effectiveness of controls over GHG emissions disclosure. Should we require accelerated filers and large accelerated filers to provide a separate management assessment and disclosure of the effectiveness of controls over GHG emissions disclosure (separate from the existing requirements with respect to the assessment and effectiveness of DCP)? Should we require management to provide a statement in their annual report on their responsibility for the design and evaluation of controls over GHG emissions disclosure and to disclose their conclusion regarding the effectiveness of such controls? Instead of, or in addition to, such management assessment and statement, should we require the registrant to obtain an attestation report from a GHG emissions attestation provider that covers the effectiveness of such GHG emissions controls as of the date when the accelerated filer or large accelerated filer is required to comply with the reasonable assurance requirement under proposed Item 1505(a)? If so:

(i) Would it be confusing to apply either such requirement in light of the existing DCP requirements that would apply to the proposed GHG emissions disclosure?

(ii) Would a separate management assessment and statement on the effectiveness of controls over GHG emissions provide meaningful disclosure to investors beyond the existing requirement for DCP?

(iii) Should we specify that the separate management assessment and statement must be provided by the accelerated filer's or large accelerated filer's principal executive and principal financial officers, or persons performing similar functions? Should we clarify which members of the accelerated filer or large accelerated filer's management should be involved in performing the underlying assessment?

(iv) What controls framework(s) would the effectiveness of the registrant's controls over GHG emissions disclosure be evaluated against, if any?

(v) For the GHG emissions attestation provider, what requirements should be applied to such GHG emissions disclosure controls attestation requirement? For example, what attestation standards should apply? Should other service provider(s) in addition to or in lieu of the GHG emissions attestation provider be permitted to provide such attestation over the effectiveness of the GHG controls?

(vi) Should we limit such a requirement to accelerated filers and

[606] *See* 17 CFR 230.405 (defining ''well-known seasoned issuer'').

[607] *See, e.g.,* 17 CFR 240.12b–2.

large accelerated filers only or should it apply to other registrants as well?

(vii) What would be the potential benefits and costs of either approach?

(viii) Should we require a certification on the design and evaluation of controls over GHG emissions disclosures by officers serving in the principal executive and principal financial officer roles or persons performing similar functions for an accelerated filer or large accelerated filer? Would a certification requirement have any additional benefits or impose any additional costs when compared to a requirement for management to assess and disclose in a statement in the annual report the effectiveness of controls over GHG emissions?

143. We considered whether to require registrants to include the GHG emissions metrics in the notes or a separate schedule to their financial statements, by amending Regulation S–X instead of Regulation S–K.

(i) Would there be benefits to including this information in a registrant's financial statements? For example, would requiring the GHG emissions disclosure to be included in the financial statements improve the consistency, comparability, reliability, and decision-usefulness of the information for investors? Would it facilitate the integration of GHG metrics and targets into the registrant's financial analysis? Would such placement cause registrants to incur significantly more expense in obtaining an audit of the disclosure? If so, please quantify those additional expenses where possible.

(ii) Should we require a registrant to include the GHG emissions disclosure in its audited financial statements so that the disclosure would be subject to the existing requirements for an independent audit and ICFR? If so, we seek comment on the following aspects of this alternative:

(a) If GHG emissions disclosure is subject to ICFR, or an internal control framework similar to ICFR, would GHG emissions disclosure be more reliable compared to what is currently proposed? What are the benefits or costs?

(b) Should the GHG emissions disclosure be included in a note to the registrant's financial statements (*e.g.,* in the note where the proposed financial statement metrics as discussed above in Section II.F would be included) or in a schedule, or somewhere else? If the GHG emissions disclosure was required in the financial statements, should it be subject to a reasonable assurance audit like the other information in the financial statements? If in a schedule, should the GHG emissions disclosure be disclosed in a schedule similar to those required under Article 12 of Regulation S–X, which would subject the disclosure to audit and ICFR requirements? Should we instead require the metrics to be disclosed as supplemental financial information, similar to the disclosure requirements under FASB ASC Topic 932–235–50–2 for registrants that have significant oil- and gas-producing activities? If so, should such supplemental schedule be subject to ICFR requirements? Instead of requiring the GHG emissions disclosure to be included in a note to the registrant's audited financial statements, should we require a new financial statement for such metrics?

(c) PCAOB auditing standards apply to the audit of a registrant's financial statements. If GHG emissions disclosure is included in a supplemental schedule to the financial statements, should we allow other auditing standards to be applied? If so, which ones? What, if any, additional guidance or revisions to such standards would be needed in order to apply them to the audit of GHG emissions disclosure?

(d) What are the costs and benefits of employing registered public accounting firms to perform audits of GHG emissions disclosure and related attestation of internal controls? Are there potential cost savings in employing registered public accountants that currently perform audits of financial statements and attestation of ICFR to review GHG emissions disclosure and any related internal controls? If we require GHG emissions disclosure to be presented in the financial statements, should we permit entities other than registered public accounting firms to provide assurance of this information, as proposed for the current attestation requirements under Regulation S–K? If not limited to registered public accounting firms, who should be permitted to provide assurance of GHG emissions disclosure? Should we permit environmental consultants, engineering firms, or other types of specialists to provide assurance? What are the costs and benefits of such approach? Would the reliability of the audits and therefore the information disclosed be affected if assurance providers other than registered public accounting firms are permitted to conduct these audits? Please provide supporting data where possible. If we should allow for assurance providers that are not registered public accounting firms, what qualifications and oversight should they have, and what requirements should we impose on them? Should we direct the PCAOB to develop a separate registration process for service providers that are not otherwise registered? What expertise, independence and quality control standards should apply?

(e) What would be the other potential benefits and costs of such an approach?

2. GHG Emissions Attestation Provider Requirements

The proposed rules would require the GHG emissions attestation report required by proposed Item 1505(a) for accelerated filers and large accelerated filers to be prepared and signed by a GHG emissions attestation provider.[608] The proposed rules would define a GHG emissions attestation provider to mean a person or a firm that has all of the following characteristics:

- Is an expert in GHG emissions by virtue of having significant experience in measuring, analyzing, reporting, or attesting to GHG emissions. Significant experience means having sufficient competence and capabilities necessary to:
  - o perform engagements in accordance with professional standards and applicable legal and regulatory requirements; and
  - o enable the service provider to issue reports that are appropriate under the circumstances.[609]
- Is independent with respect to the registrant, and any of its affiliates,[610] for whom it is providing the attestation report, during the attestation and professional engagement period.[611]

The proposed expertise requirement is intended to help ensure that the service provider preparing the attestation report has sufficient competence and capabilities necessary to execute the attestation engagement. In this regard, if the service provider is a firm, we would expect that it have policies and procedures designed to provide it with reasonable assurance that the personnel selected to conduct the GHG emissions attestation engagement have significant experience with respect to both attestation engagements and GHG disclosure. This would mean that the service provider has the qualifications necessary for fulfillment of the responsibilities that it would be called on to assume, including the appropriate engagement of

[608] *See* proposed 17 CFR 229.1505(b).

[609] *See* proposed 17 CFR 229.1505(b)(1).

[610] ''Affiliates,'' for purposes of proposed 17 CFR 229.1505 has the meaning provided in 17 CFR 210.2–01, except references to ''audit'' are deemed to be references to the attestation services provided pursuant to this section. *See* proposed 17 CFR 229.1505(b)(2)(iii).

[611] *See* proposed 17 CFR 229.1505(b)(2) and 229.1505(b)(2)(iv) (defining the term ''attestation and professional engagement period'').

specialists, if needed.[612] The proposed expertise requirement would apply to the person or the firm signing the GHG emissions attestation report.[613]

The second proposed requirement is modeled on the Commission's qualifications for accountants under 17 CFR 210.2–01 (Rule 2–01 of Regulation S–X), which are designed to ensure that auditors are independent of their audit clients. Similar to how assurance provided by independent public accountants improves the reliability of financial statements and disclosures and is a critical component of our capital markets, assurance of GHG emissions disclosure by independent service providers should also improve the reliability of such disclosure. Academic studies demonstrate that assurance provided by an independent auditor reduces the risk that an entity provides materially inaccurate information to external parties, including investors, by facilitating the dissemination of transparent and reliable financial information.[614] We expect that GHG emissions disclosure would similarly benefit if assured by an independent service provider. Moreover, the potential conflicts of interest, or even the appearance of such conflicts of interest, between the GHG emissions attestation provider and the registrant could raise doubts for investors about whether they can rely on the attestation service and its report.

Similar to Rule 2–01 of Regulation S–X,[615] the proposed rules would provide that a GHG emissions attestation provider is not independent if during the attestation and professional engagement period such attestation provider is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that such attestation provider is not, capable of exercising objective and impartial judgment on all issues encompassed within the attestation provider's engagement.[616] The proposed definition for the attestation and professional engagement period, which is modeled on Rule 2–01 of Regulation S–X, includes both (1) the period covered by the attestation report and (2) the period of the engagement to attest to the registrant's GHG emissions or to prepare a report filed with the Commission (the ''professional engagement period''). Under the proposed rules, the professional engagement period would begin when the GHG attestation service provider either signs an initial engagement letter (or other agreement to attest to a registrant's GHG emissions) or begins attest procedures, whichever is earlier.[617]

The proposed rules would further state that, in determining whether a GHG emissions attestation provider is independent, the Commission will consider:

- Whether a relationship or the provision of a service creates a mutual or conflicting interest between the attestation provider and the registrant (or any of its affiliates), places the attestation provider in the position of attesting to such attestation provider's own work, results in the attestation provider acting as management or an employee of the registrant (or any of its affiliates), or places the attestation provider in a position of being an advocate for the registrant (or any of its affiliates);[618] and
- all relevant circumstances, including all financial or other relationships between the attestation provider and the registrant (or any of its affiliates), and not just those relating to reports filed with the Commission.[619]

These proposed provisions are modeled on the factors used by the Commission in determining whether an accountant is independent.[620] Similar to Rule 2–01 of Regulation S–X, the proposed provisions should help protect investors by requiring the GHG emissions attestation provider to be independent both in fact and appearance from the registrant, including its affiliates.

Because the GHG emissions attestation provider would be a person whose profession gives authority to the statements made in the attestation report and who is named as having provided an attestation report that is part of the registration statement, the registrant would be required to obtain and include the written consent of the GHG emissions attestation provider pursuant to Securities Act Section 7,[621] the corresponding rule requiring the written consents of such experts,[622] and the Regulation S–K provision requiring the attachment of the written consent of an expert to a Securities Act registration statement or an Exchange Act report that incorporates by reference a written expert report attached to a previously filed Securities Act registration statement.[623] The GHG emissions attestation provider would also be subject to liability under the federal securities laws for the attestation conclusion or, when applicable, opinion provided. Such liability should encourage the attestation service provider to exercise due diligence with respect to its obligations under a limited or reasonable assurance engagement.

Request for Comment

144. Should we require a registrant to obtain a GHG emissions attestation report that is provided by a GHG emissions attestation provider that meets specified requirements, as proposed? Should one of the requirements be that the attestation provider is an expert in GHG emissions, with significant experience in measuring, analyzing, reporting, or attesting to GHG emissions, as proposed? Should we specify that significant experience means having sufficient competence and capabilities

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[612] Independent auditors and accountants are already required to comply with similar quality control and management standards when providing audit and attest services under the PCAOB, AICPA, or IAASB standards. *See, e.g.,* PCAOB, Quality Control (QC) Standards Section 20 *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* and Section 40 *The Personnel Management Element of a Firm's System of Quality Control—Competencies Required by a Practitioner-in-Charge of an Attest Engagement,* available at *https://pcaobus.org/oversight/standards/qc-standards;* AICPA, QC Section 10, *A Firm's System of Quality Control,* available at *https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest//qc-00010.pdf;* and IAASB, International Standard on Quality Management 1, *Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements,* available at *https://www.ifac.org/system/files/publications/files/IAASB-Quality-Management-ISQM-1-Quality-Management-for-Firms.pdf.*

[613] We have adopted similar expertise requirements in the past to determine eligibility to prepare a mining technical report. Although also relating to technical, specialized disclosures, the mining technical report requirements differ in that such an engagement is not an assurance engagement. *See Modernization of Property Disclosures for Mining Registrants,* Release No. 33–10570 (Oct. 31, 2018), [83 FR 66344 (Dec. 26, 2018)].

[614] *See* Mark Defond & Jieying Zhang, *A Review of Archival Auditing Research,* 58 J. Acct. & Econ., 275 (2014); *Qualifications of Accountants,* Release No. 33–10876 (Oct. 16, 2020) [85 FR 80508 (Dec. 11, 2020)], at 80508 (''The Commission has long recognized that an audit by an objective, impartial, and skilled professional contributes to both investor protection and investor confidence''). *See also* Statement of Paul Munter, Acting Chief Accountant, *The Importance of High Quality Independent Audits and Effective Audit Committee Oversight to High Quality Financial Reporting to Investors* (Oct. 26, 2021).

[615] *See* 17 CFR 210.2–01(b).

[616] *See* proposed 17 CFR 229.1505(b)(2)(i).

[617] *See* proposed 17 CFR 229.1505(b)(2)(iv).

[618] *See* proposed 17 CFR 229.1505(b)(2)(ii)(A).

[619] *See* proposed 17 CFR 229.1505(b)(2)(ii)(B).

[620] *See* 17 CFR 210.2–01. For the avoidance of doubt, we note that if the independent accountant who audits the registrant's consolidated financial statements is also engaged to perform the GHG emissions attestation for the same filing, the fees associated with the GHG emissions attestation engagement would be considered ''Audit-Related Fees'' for purposes of Item 9(e) of 17 CFR 240.14a-101, Item 14 of Form 10–K, Item 16C of Form 20–F, or any similar requirements.

[621] 15 U.S.C. 77g.

[622] *See* 17 CFR 230.436.

[623] *See* 17 CFR 229.601(b)(23).

necessary to: (a) Perform engagements in accordance with professional standards and applicable legal and regulatory requirements and (b) enable the service provider to issue reports that are appropriate under the circumstances, as proposed? Should we instead require that the GHG emissions attestation provider have a specified number of years of the requisite type of experience, such as 1, 3, 5, or more years? Should we specify that a GHG emissions attestation provider meets the expertise requirements if it is a member in good standing of a specified accreditation body that provides oversight to service providers that apply attestation standards? If so, which accreditation body or bodies should we consider (*e.g.,* AICPA)? Are there any other requirements for the attestation provider that we should specify? Instead, should we require a GHG emissions attestation provider to be a PCAOB-registered audit firm?

145. Is additional guidance needed with respect to the proposed expertise requirement? Should we instead include prescriptive requirements related to the qualifications and characteristics of an expert under the proposed rules? For example, should we include a provision that requires a GHG emissions attestation provider that is a firm to have established policies and procedures designed to provide it with reasonable assurance that the personnel selected to provide the GHG attestation service have the qualifications necessary for fulfillment of the responsibilities that the GHG emissions attestation provider will be called on to assume, including the appropriate engagement of specialists, if needed?

146. Should we require the GHG emissions attestation provider to be independent with respect to the registrant, and any of its affiliates, for whom it is providing the attestation report, as proposed? Should we specify that a GHG emissions attestation provider is not independent if such attestation provider is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that such attestation provider is not, capable of exercising objective and impartial judgment on all issues encompassed within the attestation provider's engagement, as proposed? The proposed provision is based on a similar provision regarding the qualification of an accountant to be an independent auditor under Rule 2–01 of Regulation S–X. Is Rule 2–01 an appropriate model for determining the independence of a GHG emissions attestation provider? Is being independent from a registrant and its affiliates an appropriate qualification for a GHG emissions attestation provider?

147. Should we specify that the factors the Commission would consider in determining whether a GHG emissions attestation provider is independent include whether a relationship or the provision of a service creates a mutual or conflicting interest between the attestation provider and the registrant, including its affiliates, places the attestation provider in the position of attesting to such attestation provider's own work, results in the attestation provider acting as management or an employee of the registrant, including its affiliates, or places the attestation provider in a position of being an advocate for the registrant and its affiliates, as proposed? Should we specify that the Commission also will consider all relevant circumstances, including all financial and other relationships between the attestation provider and the registrant, including its affiliates, and not just those relating to reports filed with the Commission, as proposed?

148. Should we adopt all of the proposed factors for determining the independence of a GHG emissions attestation provider, or are there factors we should omit? Are there any additional factors that we should specify that the Commission will consider when determining the independence of a GHG emissions attestation provider? For example, should we include any non-exclusive specifications of circumstances that would be inconsistent with the independence requirements, similar to those provided in 17 CFR 210.2–01(c) (Rule 2–01(c) of Regulation S–X)?

149. Should the definition of ''affiliates'' be modeled on Rule 2–01, as proposed, or should we use a different definition? Would defining the term differently than proposed cause confusion because the rest of the proposed independence requirement is modeled on Rule 2–01? Many accountants are likely familiar with the proposed definition given their required compliance with Rule 2–01, would non-accountants understand how to comply with and apply this concept?

150. Should the term ''attestation and professional engagement period'' be defined in the proposed manner? If not, how should ''attestation and professional engagement period'' be defined? Alternatively, should the Commission specify a different time period during which an attestation provider must meet the proposed independence requirements?

151. Should we include disclosure requirements when there is a change in, or disagreement with, the registrant's GHG emissions attestation provider that are similar to the disclosure requirements in Item 4.01 of Form 8–K and 17 CFR 229.304 (Item 304 of Regulation S–K)?

152. Accountants are already required to comply with the relevant quality control and management standards when providing audit and attest services under the PCAOB, AICPA, or IAASB standards. These quality control and management standards would apply to accountants providing GHG attestation services pursuant to those standards as well. Should we require the GHG emissions attestation provider to comply with additional minimum quality control requirements (*e.g.,* acceptance and continuance of engagements, engagement performance, professional code of conduct, and ethical requirements) to provide greater consistency over the quality of service provided by GHG emissions attestation providers who do not (or cannot) use the PCAOB, AICPA, or IAASB attestation standards? If so, what should the minimum requirements be?

153. As proposed, the GHG emissions attestation provider would be a person whose profession gives authority to statements made in the attestation report and who is named as having provided an attestation report that is part of the registration statement, and therefore the registrant would be required to obtain and include the written consent of the GHG emissions provider pursuant to Securities Act Section 7 and related Commission rules. This would subject the GHG emissions attestation provider to potential liability under Section 11 of the Securities Act. Would the possibility of Section 11 liability deter qualified persons from serving as GHG emissions attestation providers? Should we include a provision similar to 17 CFR 230.436(c), or amend that rule, to provide that a report on GHG emissions at the limited assurance level by a GHG emissions attestation provider that has reviewed such information is not considered part of a registration statement prepared or certified by a person whose profession gives authority to a statement made by him or a report prepared or certified by such person within the meaning of Section 7 and 11 of the Act?

3. GHG Emissions Attestation Engagement and Report Requirements

The proposed rules would require the attestation report required by proposed Item 1505(a) for accelerated filers and large accelerated filers to be included in the separately-captioned ''Climate-Related Disclosure'' section in the relevant filing and provided pursuant to standards that are publicly available at no cost and are established by a body or group that has followed due process procedures, including the broad distribution of the framework for public comment.[624] The requirement that the standards be established by a body or group that has followed due process procedures would be similar to the requirements for determining a suitable, recognized control framework for use in management's evaluation of an issuer's ICFR.[625] In both cases, a specific framework is not prescribed but minimum requirements for what constitutes a suitable framework are provided. This approach would help to ensure that the standards upon which the attestation engagement and report are based are the result of a transparent, public, and reasoned process. This requirement should also help to protect investors who may rely on the attestation report by limiting the standards to those that have been sufficiently developed. Rather than prescribe a particular attestation standard, the proposed approach recognizes that more than one suitable attestation standard exists and that others may develop in the future.

In our view, the attestation standards, for example, of the PCAOB,[626] AICPA,[627] and IAASB [628] would meet this due process requirement. In addition, all of these attestation standards are publicly available at no cost to investors who desire to review them. We believe that open access is an important consideration when determining the suitability of attestation standards for application to GHG emissions disclosure because it would enable investors to evaluate the report against the requirements of the selected attestation standard. By highlighting these standards, we do not mean to imply that other standards currently used in voluntary reporting would not be suitable for use under the proposed rules. Our proposal intends to set minimum standards while acknowledging the current voluntary practices of registrants. As noted below, we seek comment on whether other standards currently used in the voluntary climate-related assurance market or that are otherwise under development would meet the proposed due process requirement and also be suitable for application to GHG emissions under the Commission's proposed rules.

The proposed rules would not include any requirement for a registrant to obtain an attestation report covering the effectiveness of internal control over GHG emissions disclosure, and therefore such a report would not be required even when the GHG emissions attestation engagement is performed at a reasonable assurance level. Given the current evolving state of GHG emissions reporting and assurance, we believe that existing DCP obligations, and the proposed requirement that accelerated filers and large accelerated filers initially obtain at least limited assurance of such disclosure, are appropriate first steps toward enhancing the reliability of GHG emissions disclosure. We also note that, under prevailing attestation standards for limited assurance engagements, the testing of and attestation over internal controls are not required.[629] With respect to the eventual reasonable assurance engagements, while there are requirements under prevailing attestation standards to consider and obtain an understanding of internal controls, there is no required attestation of the effectiveness of internal controls such as that included in Section 404(b) of the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley Act).[630]

We recognize that the attestation standards that a GHG emissions attestation provider may use would have specific requirements for the form and content of attestation reports. The proposed rules would require a GHG emissions attestation provider to follow the specific requirements regarding form and content of the reports set forth by the attestation standard (or standards) used by such attestation provider.[631] Nevertheless, in order to provide some standardization and comparability of GHG emissions attestation reports, the proposed rules would impose minimum requirements for the GHG emissions attestation report.[632] In particular, such minimum report requirements would provide investors with consistent and comparable information about the GHG emissions attestation engagement and report obtained by the registrant when the engagement is conducted by a GHG emissions attestation provider using an attestation standard that may be less widely used or that has less robust report requirements than more prevalent standards.

The proposed minimum attestation engagement and report requirements are primarily derived from the AICPA's attestation standards (*e.g.,* SSAE No. 18), which are commonly used by accountants who currently provide GHG attestation engagement services as well as other non-GHG-related attestation engagement services, and are largely similar to the report requirements under PCAOB AT–101 and IAASB ISAE 3410. Many of the following proposed minimum attestation report requirements are also elements of an accountant's report when attesting to internal control over financial reporting, of an accountant's report on audited financial statements (which is conducted at a reasonable assurance level), or of a review report on interim financial statements (which is conducted at a limited assurance level). We explain below each of the proposed minimum components of a GHG emissions attestation report. These are all common elements of current assurance reports and are also similar to elements of other expert reports and legal opinions provided in Commission filings and other transactions.

As proposed, the GHG emissions attestation report would be required to include an identification or description of the subject matter or assertion on which the attestation provider is

[624] *See* proposed 17 CFR 229.1505(a)(2) and (c).

[625] *See* 17 CFR 240.13a–15(c) and 240.15d–15(c) (stating that the ''framework on which management's evaluation of the issuer's internal control over financial reporting is based must be a suitable, recognized control framework that is established by a group or group that has followed due-process procedures, including the broad distribution of the framework for public comment'').

[626] *See* PCAOB AT Section 101, Attest Engagements, available at *https://pcaobus.org/oversight/standards/attestation-standards/details/AT101.*

[627] *See* AICPA SSAE No. 18 (general attestation standard), available at *https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/ssae-no-18.pdf;* SSAE No. 22, Review Engagements (limited assurance standard, effective for reports dated on or after June 15, 2022), available at *https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/ssae-22.pdf;* and SSAE No. 21, Direct Examination Engagements (reasonable assurance standard, effective for reports dated on or after June 15, 2022 and will amend SSAE No. 18), available at *https://us.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/ssae-21.pdf.*

[628] *See* IAASB ISAE 3000 (Revised), Assurance Engagements Other than Audits or Reviews of Historical Financial Information, available at *https://www.ifac.org/system/files/publications/files/ISAE%203000%20Revised%20-%20for%20IAASB.pdf. See also* IAASB ISAE 3410, Assurance Engagements on Greenhouse Gas Statements, available at *https://www.ifac.org/system/files/publications/files/Basis%20for%20Conclusions%20-%20ISAE%203410%20Assurance%20Engagements%20on%20Greenhouse%20Gas%20Statements-final_0.pdf.*

[629] *See, e.g.,* AICPA SSAE No. 22, AT–C § 210.A16.

[630] *See* 15 U.S.C. 7262(b) (requiring a registered public accounting firm that prepares or issues an audit report for certain issuers to attest to, and report on, the assessment made by the management of the issuer with respect to internal controls).

[631] *See* proposed 17 CFR 229.1505(c).

[632] *See* proposed 17 CFR 229.1505(c)(1) through (13).

reporting.[633] For example, the attestation report would identify the subject matter as Scope 1 and Scope 2 emissions disclosure. If a registrant voluntarily sought attestation of additional items of disclosure, such as GHG intensity metrics or Scope 3 emissions, the attestation provider would be required to identify those additional items as well in the attestation report. If a registrant has made an assertion about the measurement or evaluation of the subject matter to the attestation provider,[634] the attestation report must include such assertion. For example, the attestation report might refer to the registrant's assertion that the Scope 1 and Scope 2 emissions disclosure included within the filing has been presented in accordance with Item 1504 of Regulation S–K. These proposed minimum requirements would elicit information that is fundamental to understanding the attestation report and would clarify the scope of the attestation report when the scope does not align with the scope of the registrant's GHG emissions disclosure (*e.g.,* when Scope 3 emissions disclosure is included in the filing but not covered by the attestation report).

The proposed rules would also require the GHG emissions attestation report to include the point in time or period of time to which the measurement or evaluation of the subject matter or assertion relates.[635] Therefore, the attestation provider would be required to identify the time period to which the Scopes 1 and 2 emissions disclosure (or other additional disclosure) relates, which would be the registrant's most recently completed fiscal year or some other 12-month period if permitted under the applicable climate-related disclosure rules [636] as well as any relevant historical period disclosure included within the filing. This proposed requirement seeks to avoid any confusion investors may have about which period or periods of the climate-related disclosures included within the filing are subject to the attestation.

The proposed rules would also require the attestation report to identify the criteria against which the subject matter was measured or evaluated.[637] For an attestation report solely covering Scopes 1 and 2 emissions disclosure, the identified criteria would include the requirements in proposed Item 1504 of Regulation S–K and, in particular, Item 1504(a), which includes presentation requirements such as disaggregation by each constituent greenhouse gas. The identified criteria would also include Item 1504(b) and the applicable instructions in Item 1504(e) regarding methodology, organizational boundary, and operational boundary. In other words, this minimum requirement would require an attestation provider to refer to the requirements with which the registrant must comply when making the disclosure that is subject to the attestation. Without the frame of reference provided by the identified criteria, the conclusion or opinion included in the report may be open to individual interpretation and misunderstanding by investors.

Prevailing attestation standards require the criteria against which the subject matter is measured or evaluated to be ''suitable.'' In the context of the proposed rules, suitable criteria would, when followed, result in reasonably consistent measurement or evaluation of the registrant's disclosure that is within the scope of the engagement. Characteristics of suitable criteria include relevance, objectivity, measurability, and completeness.[638] We believe that proposed Item 1504 of Regulation S–K would satisfy the suitable criteria requirements of the prevailing attestation standards because the proposed requirements set forth relevant, objective standards that call for measurable and complete disclosure of GHG emissions that would allow for a consistent evaluation of the registrant's disclosure.

The GHG emissions attestation report would further be required to include a statement that identifies the level of assurance provided and describes the nature of the attestation engagement.[639] For example, under the proposed rule, an attestation report providing limited assurance would need to include not only a statement that limited assurance is the provided level of assurance, but also would need to describe the scope of work performed in a limited assurance engagement, which typically would indicate that the procedures performed vary in nature, timing, and extent compared to a reasonable assurance engagement. This proposed minimum requirement would help investors understand the level of assurance provided.

The proposed rules would require the attestation report to include a statement that identifies the attestation standard (or standards) used.[640] As previously discussed, the standard used must be publicly available at no cost and have been established by a body or group that has followed due process procedures, including the broad distribution of the framework for public comment.[641] This minimum report requirement would allow investors to easily identify the attestation standard that the engagement is executed against, which is particularly important because the proposed rules do not prescribe a particular attestation standard. Understanding the attestation standard used would allow investors to better understand the attestation performed by evaluating the report against the attestation standard's requirements and would facilitate comparability across the attestation reports of different registrants.

The attestation report would also be required to include a statement that describes the registrant's responsibility to report on the subject matter or assertion being reported on in order to make it clear to investors who is ultimately responsible for the disclosure.[642] At a minimum, this proposed provision would require a statement that the registrant is responsible for the subject matter, or its assertion on the subject matter. This proposed requirement, like all of the minimum requirements, has corollaries outside of the GHG emissions context. For example, an independent auditor's audit report on a registrant's financial statements is required to include a statement that the registrant's management is responsible for the financial statements that are being audited.[643]

The proposed rules would further require the attestation report to include a statement that describes the attestation provider's responsibilities in connection with the preparation of the attestation report.[644] This is consistent with existing requirements in reports such as those issued by the independent auditor on the audited financial statements or a review report on the interim financial statements. For example, with respect to

[633] *See* proposed 17 CFR 229.1505(c)(1).

[634] *See, e.g.,* AICPA SSAE No. 22, AT–C § 210.45(c); AICPA SSAE No. 21, AT–C § 205.63(c).

[635] *See* proposed 17 CFR 229.1505(c)(1).

[636] As previously mentioned, we are soliciting comment regarding whether the GHG emissions should be reported as of fiscal year-end or some other 12-month period. *See supra* Section II.G.1.

[637] *See* proposed 17 CFR 229.1505(c)(2).

[638] *See, e.g.,* AICPA SSAE No. 18, AT–C § 105.A16 and .A42; AICPA SSAE No. 21, AT–C § 105.A16 and .A44. In addition to relevance and completeness, the characteristics of suitable criteria under ISAE 3000.A23 include reliability, neutrality and understandability. Despite the differences in the characteristics listed, the underlying concepts and objectives are consistent.

[639] *See* proposed 17 CFR 229.1505(c)(3).

[640] *See* proposed 17 CFR 229.1505(c)(4).

[641] *See* proposed 17 CFR 229.1505(a)(2).

[642] *See* proposed 17 CFR 229.1505(c)(5).

[643] *See, e.g.,* PCAOB AS 3101, par. 9(a).

[644] *See* proposed 17 CFR 229.1505(c)(6).

a limited assurance engagement, under prevailing attestation standards, the report would typically include a statement that the attestation provider's responsibilities include expressing a conclusion on the subject matter or the assertion based on the attestation provider's review.[645] Similarly, for a reasonable assurance engagement, the report would typically include a statement that the attestation provider's responsibilities include expressing an opinion on the subject matter or assertion, based on the attestation provider's examination.[646]

The proposed rules would also require the attestation report to include a statement that the attestation provider is independent, as required by proposed 17 CFR 229.1505(a).[647] Because independence from the registrant, including its affiliates, would be a necessary qualification for the GHG emissions attestation provider,[648] the attestation report would be required to include the attestation provider's confirmation of his or her compliance with the proposed independence requirement.

The proposed rules would further require the attestation report, for a limited assurance engagement, to include a description of the work performed as a basis for the attestation provider's conclusion.[649] This proposed provision is intended to enhance the transparency of the GHG emissions attestation report for investors by eliciting disclosure about the procedures undertaken by the attestation provider in its limited assurance engagement, such as inquiries and analytical procedures. This information would allow investors to assess and understand the extent of procedures performed to support the conclusion reached by the attestation provider, which could also facilitate an investor's comparison of different attestation reports provided under the same or different attestation standards.

The GHG emissions attestation report would also be required to include a statement that describes any significant inherent limitations associated with the measurement or evaluation of the subject matter (at a minimum, Scopes 1 and 2 emissions) against the criteria (*i.e.,* the applicable requirements in proposed Item 1504).[650] Such a statement is a common characteristic of attestation reports, including the independent auditor's report on internal control over financial reporting. This proposed provision is intended to elicit disclosure about the estimation uncertainties inherent in the quantification of GHG emissions, driven by reasons such as the state of the science, methodology, and assumptions used in the measurement and reporting processes. For example, an attestation provider might include in its report a statement about measurement uncertainty resulting from accuracy and precision of GHG emission conversion factors.

The proposed rules would require the GHG emissions attestation report to include the attestation provider's conclusion or opinion, as applicable, based on the attestation standard(s) used.[651] For a limited assurance engagement, under prevailing attestation standards, the conclusion would typically state whether the provider is aware of any material modifications that should be made to the subject matter in order for the disclosure to be in accordance with (or based on) the requirements specified in Item 1504, or for the registrant's assertion about such subject matter to be fairly stated.[652] For a reasonable assurance engagement, the attestation provider would typically provide an opinion on whether the subject matter is in accordance with (or based on) the requirements specified in Item 1504 in all material respects, or that the registrant's assertion about its subject matter is fairly stated, in all material respects.[653]

Finally, the proposed rules would require the GHG emissions attestation report to include the signature of the attestation provider (whether by an individual or a person signing on behalf of the attestation provider's firm),[654] the city and state where the attestation report has been issued,[655] and the date of the report.[656] These are all common elements of current assurance and expert reports, and each of these proposed provisions would help to identify and confirm the validity of the GHG emissions attestation provider.

Request for Comment

154. Should we require the attestation engagement and related attestation report to be provided pursuant to standards that are publicly available at no cost and are established by a body or group that has followed due process procedures, including the broad distribution of the framework for public comment, as proposed? Is the requirement of ''due process procedures, including the broad distribution of the framework for public comment'' sufficiently clear? Would the attestation standards of the PCAOB, AICPA, and IAASB meet this due process requirement? Are there other standards currently used in the voluntary climate-related assurance market or otherwise in development that would meet the due process and publicly availability requirements? For example, would verification standards commonly used by non-accountants currently, such as ISO 14064–3 and the AccountAbility's AA1000 Series of Standards, meet the proposed requirements? Are there standards currently used in the voluntary climate-related assurance market or otherwise under development that would be appropriate for use under the Commission's climate-related disclosure rules although they may not strictly meet the proposed public comment requirement? If so, please explain whether those standards have other characteristics that would serve to protect investors?

155. Should we require that the attestation standards used be publicly available at no cost to investors, as proposed? Should we permit the use of attestation standards, even if not publicly available at no cost, provided that registrants provide access to those standards at the request of their investors?

156. Should we require the GHG emissions attestation report to meet certain minimum requirements in addition to any form and content requirements set forth by the attestation standard or standards used by the GHG emissions attestation provider, as proposed? Should we instead require that the attestation report solely meet whatever requirements are established by the attestation standard or standards used?

157. Should we adopt each of the proposed minimum requirements? Are there any proposed requirements that we should omit or add to the proposed list of minimum GHG emissions attestation report requirements?

158. Regarding the proposed provision requiring the identification of the criteria against which the subject matter was measured or evaluated, would reference to proposed Item 1504(a), Item 1504(b), and Item 1504(e)'s instructions concerning the

[645] *See, e.g.,* AICPA SSAE No.22, AT–C sec. 210.45(f).

[646] *See, e.g.,* AICPA SSAE No. 21, AT–C sec. 205.63(f) and sec. 206.12(e)(ii).

[647] *See* proposed 17 CFR 229.1505(c)(7).

[648] *See supra* Section II.H.2.

[649] *See* proposed 17 CFR 229.1505(c)(8).

[650] *See* proposed 17 CFR 229.1505(c)(9).

[651] *See* proposed 17 CFR 229.1505(c)(10).

[652] *See, e.g.,* AICPA SSAE No. 22, AT–C sec. 210.45(l).

[653] *See, e.g.,* AICPA SSAE No. 21 AT–C sec. 205.63(k) and sec. 206.12(j).

[654] *See* proposed 17 CFR 229.1505(c)(11).

[655] *See* proposed 17 CFR 229.1505(c)(12).

[656] *See* proposed 17 CFR 229.1505(c)(13).

presentation, methodology, including underlying assumptions, and organizational and operational boundaries applicable to the determination of Scopes 1 and 2 emissions meet the ''suitable criteria'' requirement under prevailing attestation standards (*e.g.,* AICPA SSAE No. 18, AT–C 105.A16)?

159. If we require or permit a registrant to use the GHG Protocol as the methodology for determining GHG emissions, would the provisions of the GHG Protocol qualify as ''suitable criteria'' against which the Scope 1 and Scope 2 emissions disclosure should be evaluated?

4. Additional Disclosure by the Registrant

In addition to the minimum attestation report requirements described above, which reflect the contents of attestation reports under prevailing attestation standards, we are proposing to require disclosure by the registrant of certain additional matters related to the attestation of a registrant's GHG emissions.[657] These disclosures are not typically included in an attestation report, and would not be included in the GHG emissions attestation report under the proposed rules. Instead, the registrant would be required to provide these disclosures in the separately captioned ''Climate-Related Disclosure'' section, where the GHG emissions disclosure would be provided pursuant to the proposed rules.[658]

These proposed additional disclosures should assist investors in evaluating the qualifications of the GHG emissions attestation provider selected by the registrant, particularly in light of the broad spectrum of attestation providers that would be permitted to provide an attestation report under the proposed rules.[659]

We considered requiring the proposed disclosures to be provided in the attestation report but are not proposing to do so because we are concerned such an approach may create confusion by conflicting with prevalent attestation standards. Furthermore, in light of the variety of attestation service providers the registrant is permitted to engage, requiring the registrant to provide such disclosures may allow the registrant to better provide its investors with relevant information about the qualifications of the service provider that the registrant engaged for the GHG emissions attestation.

[657] *See* proposed 17 CFR 229.1505(d).

[658] *See id.*

[659] *See supra* Section II.H.2.

With respect to the Scope 1 and Scope 2 emissions attestation required pursuant to proposed Item 1505(a) for accelerated filers and large accelerated filers,[660] the registrant would be required to disclose in the filing, based on relevant information obtained from any GHG emissions attestation provider:

- Whether the attestation provider has a license from any licensing or accreditation body to provide assurance, and if so, the identity of the licensing or accreditation body, and whether the attestation provider is a member in good standing of that licensing or accreditation body;[661]
- Whether the GHG emissions attestation engagement is subject to any oversight inspection program, and if so, which program (or programs);[662] and
- Whether the attestation provider is subject to record-keeping requirements with respect to the work performed for the GHG emissions attestation engagement and, if so, identify the record-keeping requirements and the duration of those requirements.[663]

The first two above items of disclosure would help investors better understand the qualifications of the GHG emissions attestation provider, which in turn could help them assess the reliability of the attestation results. An example of a license from a licensing or accreditation body to provide assurance would be a Certified Public Accountant license issued by a state board of accountancy (*e.g.,* the California Board of Accountancy), while an example of oversight programs would include the AICPA peer review program, among others. The proposed disclosure requirement about any record-keeping requirements to which the attestation provider is subject would help enhance the transparency of the attestation process by providing investors with information about the business practices of the attestation provider that has been retained by the registrant.[664]

Request for Comment

160. Should we require certain items of disclosure related to the attestation of a registrant's GHG emissions to be provided by the registrant in its filing that includes the attestation report (where the GHG emissions and other climate-related disclosures are presented), based on relevant information obtained from the GHG emissions attestation provider, as proposed? Should these additional items of disclosure instead be included in the attestation report?

161. Should we require the registrant to disclose whether the attestation provider has a license from any licensing or accreditation body to provide assurance, and if so, the identity of the licensing or accreditation body, and whether the attestation provider is a member in good standing of that licensing or accreditation body, as proposed? In lieu of disclosure, should we require a GHG emissions attestation provider to be licensed to provide assurance by specified licensing or accreditation bodies? If so, which licensing or accreditation bodies should we specify?

162. Should we require a registrant to disclose whether the GHG emissions attestation engagement is subject to any oversight inspection program, and if so, which program (or programs), as proposed? Should we instead require the registrant to disclose whether the attestation engagement is subject to certain specified oversight programs? If so, which oversight programs should we specify?

163. Should we require a registrant to disclose whether the attestation provider is subject to record-keeping requirements with respect to the work performed for the GHG emissions attestation engagement and, if so, identify the record-keeping requirements and duration of those requirements, as proposed? In lieu of disclosure, should we specify that the record-keeping requirements of a GHG emissions attestation provider must be of a certain minimum duration, such as three, five, or seven years, or some other period? Should we specify that the record-keeping requirements must include certain reasonable procedures and, if so, what procedures?

5. Disclosure of Voluntary Attestation

Because GHG emissions reporting and assurance landscapes are both relatively new and evolving as described earlier, at this time, we are proposing to require a registrant, other than a large accelerated filer or an accelerated filer that is required to include a GHG emissions attestation report pursuant to proposed Item 1505(a), to disclose within the separately captioned ''Climate-Related Disclosure'' section in

[660] If an accelerated filer or a large accelerated filer voluntarily obtains assurance beyond what would be required by proposed Item 1505(a) and uses a different service provider for such assurance, it would also be required to provide the information required by proposed Item 1505(d) for such service provider.

[661] *See* proposed 17 CFR 229.1505(d)(1).

[662] *See* proposed 17 CFR 229.1505(d)(2).

[663] *See* proposed 17 CFR 229.1505(d)(3).

[664] For example, the AICPA imposes a minimum five-year documentation retention program for an audit. *See* AU–C 230.17. Although document retention is less prescriptive for attestation engagements, many attestation providers adhere to the five-year period in practice.

the filing the following information if the registrant's GHG emissions disclosures were subject to third-party attestation or verification:

(i) Identify the provider of such assurance or verification;[665]

(ii) Describe the assurance or verification standard used;[666]

(iii) Describe the level and scope of assurance or verification provided;[667]

(iv) Briefly describe the results of the assurance or verification;[668]

(v) Disclose whether the third-party service provider has any other business relationships with or has provided any other professional services to the registrant that may lead to an impairment of the service provider's independence with respect to the registrant;[669] and

(vi) Disclose any oversight inspection program to which the service provider is subject (*e.g.,* the AICPA's peer review program).[670]

Taken together, these proposed disclosure items should help investors understand the nature and reliability of the attestation or verification provided and help them assess whether the voluntary assurance or verification has enhanced the reliability of the GHG emissions disclosure. We are limiting the proposed assurance disclosure requirement to a registrant's GHG emissions disclosure because registrants are more likely to obtain assurance voluntarily for this disclosure item than for other climate-related disclosures.[671] The proposed approach should mitigate the compliance burden of the proposed GHG emissions disclosure rules, taking into consideration the proportionate compliance costs that may impact accelerated and large accelerated filers versus other types of filers, while providing transparency for investors about the level and reliability of the assurance or verification, if any, provided on the GHG emissions disclosures.

Request for Comment

164. Should we require a registrant that is not required to include a GHG emissions attestation report pursuant to proposed Item 1505(a) to disclose within the separately captioned ''Climate-Related Disclosure'' section in the filing the following information, if the registrant's GHG emissions disclosure was subject to third-party attestation or verification, as proposed:

(i) Identify the provider of such assurance or verification;

(ii) Disclose the assurance or verification standard used;

(iii) Describe the level and scope of assurance or verification provided;

(iv) Briefly describe the results of the assurance or verification;

(v) Disclose whether the third-party service provider has any other business relationships with or has provided any other professional services to the registrant that may lead to an impairment of the service provider's independence with respect to the registrant; and

(vi) Disclose any oversight inspection program to which the service provider is subject (*e.g.,* the AICPA's peer review program), each as proposed?

Are there other disclosure items that we should require if a registrant has obtained voluntary assurance or verification of the climate-related disclosures? Are there any of the proposed disclosure items that we should omit? Should we specify parameters or include guidance on when the services provided by a third-party would be considered ''assurance'' or ''verification'' and thus require disclosure pursuant to the proposed rules? Should a registrant be required to furnish a copy of or provide a link to the assurance or verification report so that it is readily accessible by an investor?

165. Instead of requiring a registrant to disclose whether the third-party service provider has any other business relationships with or has provided any other professional services to the registrant that may lead to an impairment of the service provider's independence with respect to the registrant as proposed, should we require the third-party service provider to be independent, according to the standard proposed under Item 1505(b) for accelerated filers and large accelerated filers that are required to include a GHG emissions attestation report pursuant to proposed Item 1505(a)? If not, should we provide guidance as to what constitutes an impairment of a service provider's independence with respect to the registrant? Would this result in decision-useful information to an investor? Should we instead require a registrant to disclose whether the third-party service provider would be considered independent under some other independence requirement?

166. As proposed, a registrant would be required to disclose any oversight inspection program to which the service provider is subject, such as the PCAOB's inspection program or the AICPA's peer review program. Are there other oversight programs that we should provide as examples? Would such disclosure provide decision-useful information to an investor? Is it clear what ''any oversight inspection program'' would include?

167. As proposed, a registrant would not be required to disclose the voluntary assurance or verification fees associated with the GHG disclosures. Should we require GHG disclosure assurance or verification fees to be disclosed? Would such disclosure be decision-useful to investors making voting or investment decisions?

I. Targets and Goals Disclosure

If a registrant has set any climate-related targets or goals, then the proposed rules would require the registrant to provide certain information about those targets or goals.[672] Those goals or targets might, for example, relate to the reduction of GHG emissions, or address energy usage,[673] water usage, conservation or ecosystem restoration. A registrant might also set goals with regard to revenues from low-carbon products in line with anticipated regulatory requirements, market constraints, or other goals established by a climate-related treaty, law, regulation, policy, or organization. The proposed disclosure requirements could help investors better understand the scope of a registrant's climate-related targets or goals, including those related to GHG emissions, and assist in assessing progress towards achieving those targets or goals.

Many commenters recommended that we require registrants to provide detailed information about their climate-related targets and goals, including action plans and timelines for achieving such targets as GHG emissions reductions and performance data measured against those targets.[674] This information could be important for investors in light of the fact that, according to one publication, two-thirds of S&P 500 companies had set a carbon

[665] *See* proposed 17 CFR 229.1505(e)(1).

[666] *See* proposed 17 CFR 229.1505(e)(2).

[667] *See* proposed 17 CFR 229.1505(e)(3).

[668] *See* proposed 17 CFR 229.1505(e)(4).

[669] *See* proposed 17 CFR 229.1505(e)(5).

[670] *See* proposed 17 CFR 229.1505(e)(6).

[671] *See, e.g.,* letters from BNP Paribas; Eni SpA; ERM CVS; and Walmart. *See also* CAQ, *S&P 500 and ESG Reporting.*

[672] *See* proposed 17 CFR 229.1506(a)(1).

[673] For example, numerous companies have pledged to achieve 100% of the electricity used in their global operations from renewable sources by 2050. *See* RE100, What are the requirements to become a RE100 member?, *available at https://www.there100.org/technical-guidance.*

[674] *See, e.g.,* letters from Americans for Financial Reform Education Fund and Public Citizen; Center for Law and Social Policy; Domini Impact Investments; Dynamhex, Inc.; FAIRR Initiative; Generation Investment Management; Hannon Armstrong; HP, Inc.; Interfaith Center on Corporate Responsibility; NYC Office of Comptroller; Pre-Distribution Initiative; Regenerative Crisis Response Committee; and WK Associates.

reduction target by the end of 2020.[675] Despite the numerous commitments to reduce GHG emissions, according to several sources, many companies do not provide their investors with sufficient information to understand how the companies intend to achieve those commitments or the progress made regarding them.[676] The proposed disclosure requirements are intended to elicit enhanced information about climate-related targets and goals so that investors can better evaluate these points.

If a registrant has set climate-related targets or goals, the proposed rules would require it to disclose them, including, as applicable, a description of:

• The scope of activities and emissions included in the target;

• The unit of measurement, including whether the target is absolute or intensity based;

• The defined time horizon by which the target is intended to be achieved, and whether the time horizon is consistent with one or more goals established by a climate-related treaty, law, regulation, policy, or organization;

• The defined baseline time period and baseline emissions against which progress will be tracked with a consistent base year set for multiple targets;

• Any interim targets set by the registrant; and

• How the registrant intends to meet its climate-related targets or goals.[677]

This information would help investors understand a registrant's particular target or goal and a particular timeline for that target or goal, how the target or goal is to be measured, and how progress against the target or goal is to be tracked. For example, a registrant might disclose that it plans to cut its Scopes 1 and 2 emissions by 50 percent by 2030.[678] The registrant might also disclose a target to reduce its Scope 3 emissions by 50 percent by 2035. In addition, the registrant might also set a goal of achieving net zero greenhouse gas emissions across its operations by 2050, in keeping with the goals of the Paris Agreement.

Under the proposed rules, the registrant would be required to disclose the baseline year for multiple targets.[679] Requiring disclosure of defined baseline time periods and baseline emissions against which progress will be tracked, with a consistent base year for multiple targets, could help investors compare the progress made towards each target. The registrant would also be required to disclose the unit of measurement, including whether the target is expressed in absolute terms or is intensity-based. If the registrant has set intervening targets (*e.g.,* reducing its Scope 3 emissions by 35 percent by 2030), the registrant would be required to disclose these targets.[680] Each of the proposed disclosure requirements is intended to provide investors with additional insight into the scope and specifics of a registrant's climate-related targets or goals.

The proposed rules would further require a registrant to discuss how it intends to meet its climate-related targets or goals.[681] This information should enable investors to better understand the potential impacts on a registrant associated with pursuing its climate-related targets or goals. For example, for a target or goal regarding net GHG emissions reduction, the discussion could include a strategy to increase energy efficiency, transition to lower carbon products, purchase carbon offsets or RECs, or engage in carbon removal and carbon storage.[682] For a registrant operating in a water-stressed area, with the goal of reducing its freshwater needs, the discussion could include a strategy to increase the water efficiency of its operations, such as by recycling wastewater or, if in agriculture, engaging in bioengineering techniques to make crops more resilient and less water dependent. Information about how a registrant intends to achieve its climate-related target or goal could provide investors with a better understanding of the potential costs to mitigate a potential climate-related risk, such as a manufacturer's reduction of GHG emissions through implementation of a relatively high cost solution such as carbon capture and storage technology.[683]

The proposed rules would also require a registrant to disclose relevant data to indicate whether it is making progress toward achieving the target or goal and how such progress has been achieved.[684] A registrant would be required to update this disclosure each fiscal year by describing the actions taken during the year to achieve its targets or goals.[685] This proposed disclosure could help investors assess how well a registrant is managing its identified climate-related risks.

Some companies might establish climate-related goals or targets without yet knowing how they will achieve those goals. They might plan to develop their strategies over time, particularly as new technologies become available that might facilitate their achievement of their goals. The fact that a company has set a goal or target does not mean that it has a specific plan for how it will achieve those goals. What is important is that investors be informed of a registrant's plans and progress wherever it is in the process of developing and implementing its plan.

If the registrant has used carbon offsets or RECs in its plan to achieve climate-related targets or goals, it would be required to disclose the amount of carbon reduction represented by the offsets or the amount of generated renewable energy represented by the RECS, the source of the offsets or RECs, a description and location of the underlying projects, any registries or other authentication of the offsets or RECs, and the cost of the offsets or RECs.[686] For example, a carbon offset might pertain to an underlying project to reduce GHG emissions, increase the storage of carbon, or enhance GHG removals from the atmosphere. Information regarding the source, value, underlying projects, and authentication of the offsets or RECs could help investors assess the offsets or RECs and the effectiveness of the registrant's plan to achieve its climate-related targets or goals. Such information could also help investors understand changes in the use or viability of the carbon offsets or RECs as part of achieving a registrant's climate-related targets or goals that are caused by changes in regulation or markets. A reasonable investor could well assess differently the effectiveness and value to a registrant of the use of carbon offsets where the underlying projects resulted in authenticated reductions in GHG emissions compared to the use of offsets where the underlying projects resulted in the avoidance, but not the reduction, in GHG emissions or otherwise lacked verification. As some commenters have indicated, mandated detailed disclosure about the nature of a purchased carbon

[675] *See supra* note 66 (referencing The Wall Street Journal (Nov. 5, 2021)).

[676] *See, e.g.,* Jocelyn Timperley, The Guardian, *The truth behind corporate climate pledges* (July 26, 2021); Peter Eavis and Clifford Krauss, The New York Times, *What's Really Behind Corporate Promises on Climate Change?* (May 12, 2021); and Alice C. Hill and Jennifer Nash, The Hill, *The truth behind companies' 'net zero' climate commitments* (Apr. 9, 2021).

[677] *See* proposed 17 CFR 229.1506(b)(1) through (6).

[678] *See* proposed 17 CFR 229.1506(b)(3).

[679] *See* proposed 17 CFR 229.1506(b)(4).

[680] *See* proposed 17 CFR 229.1506(b)(5).

[681] *See* proposed 17 CFR 229.1506(b)(6).

[682] *See* proposed 17 CFR 229.1506(b)(6).

[683] *See* proposed 17 CFR 229.1502.

[684] *See* proposed 17 CFR 229.1506(c).

[685] *See id.*

[686] *See* proposed 17 CFR 229.1506(d).

offset could also help to mitigate instances of greenwashing.[687]

Proposed 17 CFR 229.1505(a)(2) (Item 1505(a)(2)) would state that a registrant may provide the disclosures required by the section when discussing climate-related impacts on its strategy, business model, and outlook (in response to proposed Item 1502) or when discussing its transition plan as part of its risk management disclosure (in response to proposed Item 1503). If so, it need not repeat the disclosure in response to the proposed targets and goals section but should cross-refer to the section where the information has been provided.

A registrant's disclosure of its climate-related targets or goals should not be construed to be promises or guarantees. To the extent that information regarding a registrant's climate-related targets or goals would constitute forward-looking statements, which we would expect, for example, with respect to how a registrant intends to achieve its climate-related targets or goals and expected progress regarding those targets and goals, the PSLRA safe harbors would apply to such statements, assuming all other statutory requirements for those safe harbors are satisfied.

Request for Comment

168. Should we require a registrant to disclose whether it has set any targets related to the reduction of GHG emissions, as proposed? Should we also require a registrant to disclose whether it has set any other climate-related target or goal, *e.g.,* regarding energy usage, water usage, conservation or ecosystem restoration, or revenues from low-carbon products, in line with anticipated regulatory requirements, market constraints, or other goals, as proposed? Are there any other climate-related targets or goals that we should specify and, if so, which targets or goals? Is it clear when disclosure under this proposed item would be triggered, or do we need to provide additional guidance? Would our proposal discourage registrants from setting such targets or goals?

169. Should we require a registrant, when disclosing its targets or goals, to disclose:

- The scope of activities and emissions included in the target;
- The unit of measurement, including whether the target is absolute or intensity based;
- The defined time horizon by which the target is intended to be achieved, and whether the time horizon is consistent with one or more goals established by a climate-related treaty, law, regulation, or organization;
- The defined baseline time period and baseline emissions against which progress will be tracked with a consistent base year set for multiple targets;
- Any intervening targets set by the registrant; and
- How it intends to meet its targets or goals, each as proposed?

Are there any other items of information about a registrant's climate-related targets or goals that we should require to be disclosed, in addition to or instead of these proposed items? Are there any proposed items regarding such targets or goals that we should exclude from the required disclosure? If a registrant has set multiple targets or goals, should it be permitted to establish different base years for those targets or goals?

170. Should we require a registrant to discuss how it intends to meet its climate-related targets or goals, as proposed? Should we provide examples of potential items of discussion about a target or goal regarding GHG emissions reduction, such as a strategy to increase energy efficiency, a transition to lower carbon products, purchasing carbon offsets or RECs, or engaging in carbon removal and carbon storage, as proposed? Should we provide additional examples of items of discussion about climate-related targets or goals and, if so, what items should we add? Should we remove any of the proposed examples of items of discussion?

171. Should we require a registrant, when disclosing its targets or goals, to disclose any data that indicates whether the registrant is making progress towards meeting the target and how such progress has been achieved, as proposed?

172. Should we require that the disclosure be provided in any particular format, such as charts? Would certain formats help investors and others better assess these disclosures in the context of assessing the registrant's business and financial condition? What additional or other requirements would help in this regard?

173. If a registrant has used carbon offsets or RECs, should we require the registrant to disclose the amount of carbon reduction represented by the offsets or the amount of generated renewable energy represented by the RECS, the source of the offsets or RECs, the nature and location of the underlying projects, any registries or other authentication of the offsets or RECs, and the cost of the offsets or RECs, as proposed? Are there other items of information about carbon offsets or RECs that we should specifically require to be disclosed when a registrant describes its targets or goals and the related use of offsets or RECs? Are there proposed items of information that we should exclude from the required disclosure about offsets and RECs?

174. Should we apply the PSLRA statutory safe harbors as they currently exist to forward-looking statements involving climate-related targets and goals, or other climate-related forward-looking information? Should we instead create a separate safe harbor for forward-looking climate-related information, including targets and goals? Should we adopt an exception to the PSLRA statutory safe harbors that would extend the safe harbors to climate-related forward-looking disclosures made in an initial public offering registration statement?

J. Registrants Subject to the Climate-Related Disclosure Rules and Affected Forms

The proposed climate-related disclosure rules would apply to a registrant with Exchange Act reporting obligations pursuant to Exchange Act Section 13(a)[688] or Section 15(d)[689] and

[687] *See, e.g.,* letter from Dimensional Fund Advisors.

[688] 15 U.S.C. 78m(a).

[689] 15 U.S.C. 78o(d).

companies filing a Securities Act or Exchange Act registration statement. Specifically, we are proposing to require a registrant to include climate-related disclosure in Securities Act or Exchange Act registration statements (Securities Act Forms S–1, F–1, S–3, F–3, S–4, F–4, and S–11, and Exchange Act Forms 10 and 20–F)[690] and Exchange Act annual reports (Forms 10–K and 20–F), including the proposed financial statement metrics.[691] Similar to the treatment of other important business and financial information, the proposed rules would also require registrants to disclose any material change to the climate-related disclosure provided in a registration statement or annual report in its Form 10–Q (or, in certain circumstances, Form 6–K for a registrant that is a foreign private issuer that does not report on domestic forms).[692]

The proposed rules would amend Form 20–F and the Securities Act forms that a foreign private issuer may use to register the offer and sale of securities under the Securities Act to require the same climate-related disclosures as proposed for a domestic registrant.[693] Because climate-related risks potentially impact both domestic and foreign private issuers, regardless of the registrant's jurisdiction of origin or organization, requiring that foreign private issuers provide this disclosure would be important to achieving our goal of more consistent, reliable, and comparable information across registrants. Moreover, we note that Form 20–F imposes substantially similar disclosure requirements as those required for Form 10–K filers on matters, such as risk factors and MD&A, that are similar and relevant to the proposed climate-related disclosures.[694]

We are not proposing generally to exempt SRCs, EGCs,[695] or registrants that are foreign private issuers from the entire scope of the proposed climate-related disclosure rules because we agree with commenters who stated that, because of their broad impact across industries and jurisdictions, climate-related risks may pose a significant risk to the operations and financial condition of domestic and foreign issuers, both large and small.[696] While we are not proposing to exempt SRCs from the full scope of the proposed climate-related disclosure rules, we are proposing to exempt SRCs from the proposed Scope 3 emissions disclosure requirement.[697] We also are proposing to provide a longer transition period for SRCs to comply with the proposed rules than we are proposing for other registrants.[698] The proposed accommodations for Scope 3 emissions disclosures could mitigate the proposed rules' compliance burden for smaller registrants that, when compared to larger registrants with more resources, may be less able to afford the fixed costs associated with the reporting of GHG emissions. In addition, the extended compliance period would give SRCs additional time to allocate the resources necessary to compile and prepare their climate-related disclosures.

Request for Comment

175. Should the proposed climate-related disclosures be required in Exchange Act reports and registration statements, as proposed? Should we exempt SRCs from all of the proposed climate-related disclosure rules instead of exempting them solely from Scope 3 emissions disclosure requirements, as proposed? Should we exempt SRCs from certain other proposed climate-related disclosure requirements and, if so, which requirements? For example, in addition to the proposed exemption from Scope 3 emissions disclosure, should we exempt SRCs from the proposed requirement to disclose Scopes 1 and 2 emissions? Are there certain types of other registrants, such as EGCs or business development companies (''BDCs''),[699] that should be excluded from all or some of the proposed climate-related disclosure rules?

176. Should we require foreign private issuers that report on Form 20–

[690] Form 20–F is the Exchange Act form used by a foreign private issuer for its annual report or to register a class of securities under Section 12 of the Exchange Act. The proposed rules would amend Part I of Form 20–F to require a foreign private issuer to provide the climate-related disclosures pursuant to the proposed rules either when registering a class of securities under the Exchange Act or when filing its Exchange Act annual report. A foreign private issuer would also be required to comply with the proposed rules when filing a Securities Act registration statement on Form F–1. Because Form F–1 requires a registrant to include the disclosures required by Part I of Form 20–F, the proposed amendment to Form 20–F would render unnecessary a formal amendment to Form F–1. We are similarly not formally amending Forms S–3 and F–3 because the climate-related disclosure would be included in a registrant's Form 10–K or 20–F annual report that is incorporated by reference into those Securities Act registration statements.

[691] *See* Form 20–F, General Instruction B(d) (stating that Regulation S–X applies to the presentation of financial information in the form). Although Item 17 and 18 of Form 20–F, and the forms that refer to Form 20–F (including Forms F–1 and F–3) permit a foreign private issuer to file financial statements prepared in accordance with IFRS as issued by the IASB, the proposed Article 14 disclosure would nevertheless be required (similar to disclosure required by Article 12 of Regulation S–X). *See Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to U.S. GAAP,* Rel. No. 33–8879 (Dec. 21, 2007) [73 FR 986 (Jan. 4, 2008)], 999, n.136 (stating that ''Regulation S–X will continue to apply to the filings of all foreign private issuers, including those who file financial statements prepared using IFRS as issued by the IASB,'' but providing that such issuers ''will comply with IASB requirements for form and content within the financial statements, rather than with the specific presentation and disclosure provisions in Articles 4, 5, 6, 7, 9, and 10 of Regulation S–X'').

[692] Form 6–K is the form furnished by a foreign private issuer with an Exchange Act reporting obligation if the issuer: (i) Makes or is required to make the information public pursuant to the law of the jurisdiction of its domicile or in which it is incorporated or organized, or (ii) files or is required to file the information with a stock exchange on which its securities are traded and which was made public by that exchange, or (iii) distributes or is required to distribute the information to its security holders. *See* General Instruction B to Form 6–K. That instruction currently list certain types of information that are required to be furnished pursuant to subparagraphs (i), (ii), and (iii), above. While we are proposing to amend Form 6–K to add climate-related disclosure to the list of the types of information to be provided on Form 6–K, a foreign private issuer would not be required to provide the climate-related disclosure if such disclosure is not required to be furnished pursuant to subparagraphs (i), (ii), or (iii) of General Instruction B.

[693] *See* proposed Item 3.E to Form 20–F.

[694] For similar reasons, we believe that requiring the proposed climate disclosures on Forms F–1, F–3, and F–4 is appropriate because those forms either require the disclosure pursuant to certain parts of Form 20–F (Forms F–1 and F–4) and certain items, such as risk factors, under Regulation S–K, or permit the incorporation by reference of Form 20–F (Forms F–3 and F–4) and therefore require disclosure similar to the domestic forms.

[695] An emerging growth company (''EGC'') is a registrant that had total annual gross revenues of less than $1.07 billion during its most recently completed fiscal year and has not met the specified conditions for no longer being considered an EGC. *See* 17 CFR 230.405; 17 CFR 240.12b–2; 15 U.S.C. 77b(a)(19); 15 U.S.C. 78c(a)(80); and *Inflation Adjustments and Other Technical Amendments under Titles I and II of the JOBS Act,* Release No. 33–10332 (Mar. 31, 2017) [82 FR 17545 (Apr. 12, 2017)].

[696] *See, e.g.,* letters from Rob Bonta, California Attorney General *et al.;* Ceres *et al.;* and Natural Resources Defense Council.

[697] *See* proposed 17 CFR 229.1504(c)(3). In this regard we note that participants in the Commission-hosted 2021 Small Business Forum recommended that the Commission provide exemptions or scaled requirements for small and medium-sized companies in connection with any new ESG disclosure requirements adopted by the Commission. *See* Report on the 40th Annual Small Business Forum (May 2021), available at *https://www.sec.gov/files/2021_OASB_Annual_Forum_Report_FINAL_508.pdf. See also* Office of the Advocate for Small Business Capital Formation, *Annual Report for Fiscal Year 2021* (supporting ''efforts to continue tailoring the disclosure and reporting framework to the complexity and size of operations of companies, either by scaling obligations or delaying compliance for the smallest of the public companies, particularly as it pertains to potential new or expanded disclosure requirements'').

[698] *See infra* Section II.M.

[699] A BDC is a closed-end investment company that has a class of its equity securities registered under, or has filed a registration statement pursuant to, Section 12 of the Exchange Act, and elects to be regulated as a business development company. *See* Section 54 of the Investment Company Act, 15 U.S.C. 80a–53. Like other Section 12 registrants, BDCs are required to file Exchange Act annual reports.

F to provide the same climate-related disclosures as Form 10–K filers, as proposed? Should we require climate-related disclosures in the registration statements available for foreign private issuers, as proposed? If not, how should the climate-related disclosures provided by foreign private issuer registrants differ from the disclosures provided by domestic registrants?

177. Should we require a registrant to disclose any material changes to the climate-related disclosure provided in its registration statement or annual report in its Form 10–Q or Form 6–K, as proposed? Are there any changes that should be required to be reported on Form 8–K?

178. Should we require the climate-related disclosure in the forms specified above? Is the application of the proposed rules to the forms sufficiently clear, or should we include additional clarifying amendments? For example, would the application of proposed Article 14 to Forms 20–F, F–1 and F–3 be sufficiently clear when a registrant prepares its financial statements pursuant to IFRS as issued by the International Accounting Standards Board (''IASB'') without reconciliation to U.S. generally accepted accounting principles (''U.S. GAAP''), or should we add a related instruction to those forms?

179. Are there certain registration statements or annual reports that should be excluded from the scope of the proposed climate-related disclosure rules? For example, should we exclude Securities Act registration statements filed in connection with a registrant's initial public offering? Would such an accommodation help address concerns about the burdens of transitioning to public company status? We have not proposed to require climate-related disclosures in registration statements on Form S–8 or annual reports on Form 11–K. Should we require such disclosures?

180. Should we require climate-related disclosure in Forms S–4 and F–4, as proposed? Should we provide transitional relief for recently acquired companies? For example, should we provide that a registrant would not be required to provide the proposed climate-related disclosures for a company that is a target of a proposed acquisition under Form S–4 or F–4 until the fiscal year following the year of the acquisition if the target company is not an Exchange Act reporting company and is not the subject of foreign climate-related disclosure requirements that are substantially similar to the Commission's proposed requirements? Should such transitional relief in this instance be for a longer period than one year and, if so, for how long should such transitional relief extend?

181. We have not proposed to amend Form 40–F, the Exchange Act form used by a Canadian issuer eligible to report under the Multijurisdictional Disclosure System (''MJDS'') to register securities or to file its annual report under the Exchange Act, to include the proposed climate-related disclosure requirements. Should we require a Form 40–F issuer to comply with the Commission's proposed climate-related disclosure requirements? Should we permit a MJDS issuer to comply with Canadian climate-related disclosure requirements instead of the proposed rules if they meet certain conditions or provide certain additional disclosures and, if so, which conditions or disclosures?

182. The proposed rules would not apply to asset-backed issuers. The Commission and staff are continuing to evaluate climate-related disclosures with respect to asset-backed securities. Should we require asset-backed issuers to provide some or all of the disclosures under proposed Subpart 1500 of Regulation S–K? If so, which of the proposed disclosures should apply to asset-backed issuers? Are other types of climate disclosure better suited to asset-backed issuers? How can climate disclosure best be tailored to various asset classes?

183. Should we adopt an alternative reporting provision that would permit a registrant that is a foreign private issuer and subject to the climate-related disclosure requirements of an alternative reporting regime that has been deemed by the Commission to be substantially similar to the requirements of proposed Subpart 1500 of Regulation S–K and Article 14 of Regulation S–X to satisfy its disclosure obligations under those provisions by complying with the reporting requirements of the alternative reporting regime (''alternative reporting provision'')? If so, should we require the submission of an application for recognition of an alternative reporting regime as having substantially similar requirements for purposes of alternative reporting regarding climate-related disclosures? Should we permit companies, governments, industry groups, or climate-related associations to file such an application? Should we require the applicant to follow certain procedures, such as those set forth in 17 CFR 240.0–13?

184. If we adopt an alternative reporting provision, should we specify certain minimum standards that the alternative reporting regime must meet in order to be recognized and, if so, what standards? For example, should we specify that an alternative reporting regime must require the disclosure of a foreign private issuer's Scopes 1 and 2 emissions and related targets, the proposed financial statement metrics, as well as disclosures pursuant to the TCFD's recommendations regarding governance, strategy, and risk management disclosure? Should we specify that the alternative reporting regime must require the disclosure of Scope 3 emissions and, if so, should we deem the alternative reporting regime to be substantially similar even if its Scope 3 emissions requirements become effective after the Commission's phase in period for Scope 3 emissions disclosure requirements? Should we specify that the alternative reporting regime must require the disclosure of scenario analysis if a registrant uses scenario analysis in formulating its strategy regarding climate-related risks? Are there certain climate-related disclosure requirements that have been adopted or are in the process of being adopted in other jurisdictions that we should consider to be substantially similar to the Commission's rules for purposes of an alternative reporting provision? If so, which requirements should we consider?

185. If we adopt an alternative reporting provision, should it be a mutual recognition system, so that, as a condition of our recognition of a particular jurisdiction as an alternative reporting regime, that jurisdiction must recognize the Commission's climate-related disclosure rules as an alternative reporting system that a registrant dual-listed in the United States and the other jurisdiction may use to fulfill the foreign jurisdiction's climate-related disclosure rules?

186. If we adopt an alternative reporting provision, should we require a registrant filing the alternative climate-related disclosure to make certain changes that we deem necessary as a condition to alternative reporting? For example, should we require a registrant to comply with XBRL tagging requirements as a condition to filing alternative climate-related disclosure? Are there other specific conditions that we should impose on disclosure under an alternative climate reporting provision?

187. If we adopt an alternative reporting provision, should we require a registrant using that system to:

- State in the filing that it is relying on this alternative reporting provision;
- Identify the alternative reporting regime for which the climate-related disclosure was prepared;

• Identify the exhibit number of the filing where the alternative disclosure can be found; and

• File a fair and accurate English translation of the alternative climate-related disclosure if in a foreign language?

Would these requirements enhance the accessibility of the alternative disclosures? Are there other requirements that we should impose to enhance the transparency of the alternative climate-related disclosure?

188. If we adopt an alternative reporting provision, should we permit a registrant to follow the submission deadline of the approved alternative reporting regime even if that deadline differs from the deadline for reporting under our rules? If so, what conditions, if any, should apply to permit the use of such alternative deadline? For example, should the registrant be required to provide adequate notice, before the due date of the Commission filing in which the alternative disclosure is required to be included? Should such notice indicate the registrant's intent to file the alternative disclosure using the alternative jurisdiction's deadline? If so, what would constitute adequate notice? For example, should the deadline for filing the notice be three, five, or ten business days before the Commission filing deadline? Should we permit a registrant to provide such notice through an appropriate submission to the Commission's EDGAR system? Should we permit a registrant to indicate in its Form 20–F or other report that it will file the alternative disclosure at a later date if permitted to do so by the alternative reporting regime? In that case, should we permit the registrant to file the alternative disclosure on a Form 6–K or 8–K? Should we instead require a registrant to submit the notice via a form that we would create for such purpose? Should there be any consequences if a registrant fails to file a timely notice or fails to file the alternative disclosure by the alternative regime's due date? For example, should we preclude such a registrant from relying on the alternative reporting provision for the following fiscal year?

189. An International Sustainability Standards Board (ISSB) has recently been created, which is expected to issue global sustainability standards, including climate-related disclosure standards.[700] If we adopt an alternative reporting provision, should that provision be structured to encompass reports made pursuant to criteria developed by a global sustainability standards body, such as the ISSB? If so, should such alternative reporting be limited to foreign private issuers, or should we extend this option to all registrants? What conditions, if any, should we place on a registrant's use of alternative reporting provisions based on the ISSB or a similar body?

K. Structured Data Requirement

The proposed rules would require a registrant to tag the proposed climate-related disclosures in a structured, machine-readable data language.[701] Specifically, the proposed rules would require a registrant to tag climate-related disclosures in Inline eXtensible Business Reporting Language (''Inline XBRL'') in accordance with 17 CFR 232.405 (Rule 405 of Regulation S–T) and the EDGAR Filer Manual. The proposed requirements would include block text tagging and detail tagging of narrative and quantitative disclosures provided pursuant to Subpart 1500 of Regulation S–K and Article 14 of Regulation S–X.[702]

In 2009, the Commission adopted rules requiring operating companies to submit the information from the financial statements (including footnotes and schedules thereto) included in certain registration statements and periodic and current reports in a structured, machine-readable data language using eXtensible Business Reporting Language (''XBRL'').[703] In 2018, the Commission adopted modifications to these requirements by requiring issuers to use Inline XBRL, which is both machine-readable and human-readable, to reduce the time and effort associated with preparing XBRL filings and improve the quality and usability of XBRL data for investors.[704] In 2020, the Commission adopted Inline XBRL requirements for business development companies that will be effective no later than February 2023.[705]

Requiring Inline XBRL tagging of the proposed climate-related disclosures would benefit investors by making the disclosures more readily available and easily accessible to investors, market participants, and other users for aggregation, comparison, filtering, and other analysis, as compared to requiring a non-machine readable data language such as ASCII or HTML. This would enable automated extraction and analysis of climate-related disclosures, allowing investors and other market participants to more efficiently perform large-scale analysis and comparison of climate-related disclosures across companies and time periods. At the same time, we do not expect the incremental compliance burden associated with tagging the additional information to be unduly burdensome, because issuers subject to the proposed requirements are or in the near future will be subject to similar Inline XBRL requirements in other Commission filings.[706]

Request for Comment

190. Should we require registrants to tag the climate-related disclosures, including block text tagging and detail tagging of narrative and quantitative disclosures required by Subpart 1500 of Regulation S–K and Article 14 of Regulation S–X in Inline XBRL, as proposed? Should we permit custom tags for the climate-related disclosures?

191. Should we modify the scope of the proposed climate-related disclosures required to be tagged? For example, should we only require tagging of the quantitative climate-related metrics?

192. Are there any third-party taxonomies the Commission should

[700] *See supra* note 92.

[701] *See* proposed 17 CFR 229.1507.

[702] For the proposed Subpart 1500 disclosures, this tagging requirement would be implemented by including a cross-reference to Rule 405 of Regulation S–T in proposed Item 1507 of Regulation S–K, and by revising Rule 405(b) of Regulation S–T to include the proposed climate-related disclosures required by Subpart 1500 of Regulation S–K. The proposed Article 14 of Regulation S–X disclosures would be subject to existing requirements in Rule 405(b) to tag information in financial statements (including footnotes). Pursuant to Rule 301 of Regulation S–T the EDGAR Filer Manual is incorporated by reference into the Commission's rules. In conjunction with the EDGAR Filer Manual, Regulation S–T governs the electronic submission of documents filed with the Commission. Rule 405 of Regulation S–T specifically governs the scope and manner of disclosure tagging requirements for operating companies and investment companies, including the requirement in Rule 405(a)(3) to use Inline XBRL as the specific structured data language to use for tagging the disclosures.

[703] *Interactive Data to Improve Financial Reporting,* Release No. 33–9002 (Jan. 30, 2009) [74 FR 6776 (Feb. 10, 2009)] (''2009 Financial Statement Information Adopting Release'') (requiring submission of an Interactive Data File to the Commission in exhibits to such reports); *see also* Release No. 33–9002A (Apr. 1, 2009) [74 FR 15666 (Apr. 7, 2009)].

[704] *Inline XBRL Filing of Tagged Data,* Release No. 33–10514 (June 28, 2018) [83 FR 40846, 40847 (Aug. 16, 2018)]. Inline XBRL allows filers to embed XBRL data directly into an HTML document, eliminating the need to tag a copy of the information in a separate XBRL exhibit. *Id.* at 40851.

[705] *Securities Offering Reform for Closed-End Investment Companies,* Release No. 33–10771 (Apr. 8, 2020) [85 FR 33290 (June 1, 2020) at 33318].

[706] *See supra* notes 704 and 705. Inline XBRL requirements for business development companies will take effect beginning Aug. 1, 2022 (for seasoned issuers) and Feb. 1, 2023 (for all other issuers). *See id.* If the proposed Inline XBRL requirements are adopted in the interim, they will not apply to business development companies prior to the aforementioned effectiveness dates.

look to in connection with the proposed tagging requirements?

193. Should we require issuers to use a different structured data language to tag climate-related disclosures? If so, what structured data language should we require? Should we leave the structured data language undefined?

L. Treatment for Purposes of Securities Act and Exchange Act

We are proposing to treat the proposed required climate-related disclosures as "filed" and therefore subject to potential liability under Exchange Act Section 18,[707] except for disclosures furnished on Form 6–K. The proposed filed climate-related disclosures would also be subject to potential Section 11 liability [708] if included in or incorporated by reference into a Securities Act registration statement. This treatment would apply both to the disclosures in response to proposed subpart 1500 of Regulation S–K and to proposed Article 14 of Regulation S–X.

Form 6–K disclosures would not be treated as "filed" because the form, by its own terms, states that "information and documents furnished in this report shall not be deemed to be "filed" for the purposes of Section 18 of the Act or otherwise subject to the liabilities of that section." [709] The treatment of disclosures on Form 6–K as furnished is a long-standing part of our foreign private issuer disclosure system.[710]

Commenters expressed differing views on whether we should treat Commission-mandated climate-related disclosures as filed or furnished. Many commenters recommended that we treat such climate-related disclosures as filed.[711] Some of these commenters stated that we should treat climate-related disclosures like financial disclosures and require them to be filed together with the rest of the Commission filing.[712] Other commenters indicated that the treatment of climate-related disclosures as filed would help ensure that investors have confidence in the accuracy and completeness of such disclosures because of the liability associated with filed documents.[713]

Other commenters recommended that we treat climate-related disclosures as furnished.[714] Some of these commenters stated that the Commission's treatment of such disclosures as filed could act as a disincentive to providing "broader" disclosure and would incentivize some issuers "to disclose in the manner most limited to meet the specific requirement and avoid more robust explanation." [715] Other commenters stated that the treatment of climate-related disclosures as furnished would be appropriate because, in their view, much of that disclosure is based on projections and aspirational statements ill-suited to the application of a stricter liability standard.[716]

We agree with those commenters who indicated that the treatment of climate-related disclosures as filed could help promote the accuracy and reliability of such disclosures for the benefit of investors.[717] In this regard, we believe these disclosures should be subject to the same liability as other important business or financial information that the registrant includes in its registration statements and periodic reports. While we acknowledge commenters who stated that the methodology underlying climate data continues to evolve,[718] we intend to provide registrants with an ample transition period to prepare to provide such disclosure.[719] Further, much of the disclosure proposed to be required reflects discussion of a company's own climate risk assessment and strategy, which is not dependent on external sources of information. In addition, we have provided guidance and proposed rules on the applicability of safe harbors to certain disclosures under the proposed rules. For these reasons, we believe it would be appropriate for the proposed disclosures to be filed rather than furnished, except with respect to the proposed disclosure we are requiring on Form 6–K.

Request for Comment

194. Should we treat the climate-related disclosures required by proposed subpart 1500 of Regulation S–K and proposed Article 14 of Regulation S–X as filed for purposes of potential liability under the Securities Act and Exchange Act, except for the climate disclosures on Form 6–K, as proposed? Should we instead treat the climate-related disclosures required by both proposed subpart 1500 of Regulation S–K and proposed Article 14 of Regulation S–X as furnished? Are there reasons why the proposed climate-related disclosures should not be subject to Section 18 liability?

195. Should we only treat the climate-related disclosures required by proposed subpart 1500 of Regulation S–K as filed? Should we only treat the climate-related disclosures required by proposed Article 14 of Regulation S–X as filed? Is there some other subset of climate-related disclosures that should be treated as furnished rather than filed? For example, should we only treat as filed disclosures related to a registrant's Scopes 1 and 2 emissions, and treat a registrant's Scope 3 emissions as furnished?

196. Should we treat the climate disclosures on Form 6–K as filed?

M. Compliance Date

We recognize that many registrants may require time to establish the necessary systems, controls, and procedures to comply with the proposed climate-related disclosure requirements. In addition, some commenters recommended that the Commission not adopt a "one size fits all" approach when promulgating climate-related disclosure rules because such an approach would disproportionately impact smaller registrants.[720] In order to provide registrants, especially smaller registrants, with additional time to prepare for the proposed climate-related disclosures, we are proposing phased-in dates for complying with proposed subpart 1500 of Regulation S–K and Article 14 of Regulation S–X, which would provide additional time for certain smaller registrants. The table

[707] 15 U.S.C. 78r.

[708] 15 U.S.C. 77k.

[709] Form 6–K, General Instruction B.

[710] *See* Release No. 34–8069 (Apr. 28, 1967), [32 FR 7853 (May 30, 1967)]. Form 6–K's treatment as furnished for purposes of Section 18 has existed since the Commission adopted the form.

[711] *See, e.g.,* letters from Baillie Gifford; Rob Bonta, California Attorney General *et al.*; Calvert Research and Management; Carolyn Kohoot; Center for American Progress; Ceres *et al.*; Certified B Corporations; Clean Yield Asset Management; Climate Risk Disclosure Lab; Consumer Federation of America; Environmental Bankers Association; Friends of the Earth, Amazon Watch, and Rainforest Action Network; Garcia Hamilton & Associates (June 11, 2021); Grant Thornton; Sarah Ladin; Miller/Howard Investments; Natural Resources Defense Council; New York State Society of Certified Public Accountants; Nia Impact Capital; Teachers Insurance and Annuity Association of America; ValueEdge Advisors (July 5, 2021); and Vert Asset Management.

[712] *See, e.g.,* letters from Rob Bonta, California Attorney General *et al.*; Calvert Research and Management; and Ceres *et al.*

[713] *See, e.g.,* letters from Consumer Federation of America; and Natural Resources Defense Council.

[714] *See, e.g.,* letters from American Petroleum Institute; Associated General Contractors of America; Bank Policy Institute; Business Roundtable; Chamber of Commerce; Chevron; Cisco; ConocoPhilips; Dell Technologies; Dow; FedEx Corporation (June 11, 2021); Investment Company Institute; NACCO Industries, Inc. (June 11, 2021); KPMG, LLP; National Association of Manufacturers; National Investor Relations Institute; National Mining Association; Society for Corporate Governance; and United Airlines Holdings, Inc.

[715] Letter from American Petroleum Institute; *see also* letters from Chamber of Commerce; and National Association of Manufacturers.

[716] *See, e.g.,* letters from National Mining Association; and United Airlines Holdings.

[717] *See supra* note 713.

[718] *See, e.g.,* letter from National Association of Manufacturers.

[719] *See infra* Section II.M.

[720] *See supra* note 556.

below summarizes the proposed phase-ins for the compliance date. The table assumes, for illustrative purposes, that the proposed rules will be adopted with an effective date in December 2022, and that the registrant has a December 31st fiscal year-end.

Registrant type	Disclosure compliance date		Financial statement metrics audit compliance date
	All proposed disclosures, including GHG emissions metrics: Scope 1, Scope 2, and associated intensity metric, but excluding Scope 3.	GHG emissions metrics: Scope 3 and associated intensity metric.	
Large Accelerated Filer	Fiscal year 2023 (filed in 2024)	Fiscal year 2024 (filed in 2025)	Same as disclosure compliance date.
Accelerated Filer and Non-Accelerated Filer.	Fiscal year 2024 (filed in 2025)	Fiscal year 2025 (filed in 2026).	
SRC	Fiscal year 2025 (filed in 2026)	Exempted.	

The proposed compliance dates in the table above would apply to both annual reports and registration statements. For example, if a non-accelerated filer with a December 31st fiscal year-end filed a registration statement that was not required to include audited financial statements for fiscal year 2024 (*e.g.,* the registration statement was filed in 2023 or 2024), it would not be required to comply with the proposed climate disclosure rules in that registration statement.

A registrant with a different fiscal year-end date that results in its fiscal year 2023 commencing before the effective date of the rules would not be required to comply with subpart 1500 of Regulation S–K and Article 14 of Regulation S–X until the following fiscal year. For example, a large accelerated filer with a March 31st fiscal year-end date would not be required to comply with the proposed climate disclosure rules until its Form 10–K for fiscal year 2024, filed in June, 2024. This would provide large accelerated filers, who would have the earliest compliance date of all categories of filers, with what we believe is a reasonable amount of time to comply with the rules.

We believe that initially applying the disclosure requirements to the more limited pool of large accelerated filers would be appropriate, because many large accelerated filers are already collecting and disclosing climate-related information, have already devoted resources to these efforts, and have some levels of controls and processes in place for such disclosure.[721] In comparison, registrants that are not large accelerated filers may need more time to develop the systems, controls, and processes necessary to comply with the proposed rules, and may face proportionately higher costs. Accordingly, we propose to provide them additional time to comply.

We also recognize that obtaining the data necessary to calculate a registrant's Scope 3 emissions might prove challenging since much of the data is likely to be under the control of third parties. In order to provide sufficient time for registrants to make the necessary arrangements to begin gathering and assessing such data, we are proposing an additional one-year phase-in period for the Scope 3 emissions disclosure requirements. As previously mentioned, we also are proposing an exemption for SRCs from the proposed Scope 3 emissions disclosure provision.[722]

The proposed mandatory compliance periods are intended to provide registrants with ample time to prepare to provide the proposed disclosures. Registrants would, however, be able to provide the disclosures at any time after the effective date of the rules.

Request for Comment

197. Should we provide different compliance dates for large accelerated filers, accelerated filers, non-accelerated filers, or SRCs, as proposed? Should any of the proposed compliance dates in the table above be earlier or later? Should any of the compliance dates be earlier so that, for example, a registrant would be required to comply with the Commission's climate-related disclosure rules for the fiscal year in which the rules become effective?

198. Should we provide a compliance date for the proposed Scope 3 emissions disclosure requirements that is one year later than for the other disclosure requirements, as proposed? Should the compliance dates for the Scope 3 emissions disclosure requirements be earlier or later? Should the compliance date for the Scope 3 emissions disclosure requirements depend upon whether the registrant is a large accelerated filer, accelerated filer, or non-accelerated filer?

199. Should we provide different compliance dates for registrants that do not have a December 31st fiscal year-end?

200. Should we include rules or guidance addressing less common situations, such as, but not limited to, reverse mergers, recapitalizations, other acquisition transactions, or if a registrant's SRC (or EGC) status changes as a result of such situations?

201. Are there other phase-ins or exemptions regarding any or all of the proposed rules that we should provide?

III. General Request for Comments

We request and encourage any interested person to submit comments on any aspect of the proposed amendments, other matters that might have an impact on the proposed amendments, and any suggestions for additional changes. With respect to any comments, we note that they are of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments and by alternatives to our proposals where appropriate.

IV. Economic Analysis

We are mindful of the economic effects that may result from the proposed rules, including the benefits, costs, and the effects on efficiency, competition, and capital formation.[723]

[721] *See, e.g.,* letters from Adobe; Apple; BNP Paribas; bp; Chevron; Eni SpA; and Walmart.

[722] *See supra* Section II.G.3.

[723] Section 2(b) of the Securities Act, 15 U.S.C. 77b(b), and Section 3(f) of the Exchange Act, 17 U.S.C. 78c(f), require the Commission, when engaging in rulemaking where it is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. Further, Section 23(a)(2) of the Exchange Act, 17 U.S.C. 78w(a)(2), requires the Commission, when making rules under the Exchange Act, to consider the impact that the

This section analyzes the expected economic effects of the proposed rules relative to the current baseline, which consists of the regulatory framework of disclosure requirements in existence today, the current disclosure practices of registrants, and the use of such disclosures by investors and other market participants.

We anticipate the proposed rules will give rise to several benefits by strengthening investor protection, improving market efficiency, and facilitating capital formation. The primary benefit is that investors would have access to more consistent, comparable, and reliable disclosures with respect to registrants' climate-related risks, which is expected to enable investors to make more informed investment or voting decisions.[724] By providing access to this information through SEC filings for all public issuers, this enhanced disclosure could mitigate the challenges that investors currently confront in assessing the nature and extent of the climate-related risks faced by registrants and their impact on registrants' business operations and financial condition. In this way, the proposed rules may reduce information asymmetry both among investors, which can reduce adverse selection problems and improve stock liquidity,[725] and between investors and firms, which can reduce investors' uncertainty about estimated future cash flows, thus lowering the risk premium they demand and therefore registrant's cost of capital. The proposed rules could also mitigate certain agency problems between the firm's shareholders and management, thus strengthening investor protection.[726] Further, by enabling climate-related information to be more fully incorporated into asset prices, the proposed rules would allow climate-related risks to be borne by those who are most willing and able to bear them, thereby strengthening financial system resilience. Taken together, the proposed rules are expected to contribute to the efficient allocation of capital, capital formation, competition, and the maintenance of fair and orderly markets.[727]

We are also mindful of the costs that would be imposed by the proposed rules. Registrants would face increased compliance burdens in meeting the new disclosure requirements. In some cases, these additional compliance burdens could be significant while in others relatively small if companies already provide information similar to that required by our rules. Other potential costs include increased litigation risk and the potential disclosure of proprietary information about firms' operations and/or production processes.[728]

A. Baseline and Affected Parties

This section describes the current regulatory and economic landscape with respect to climate-related disclosures. It discusses the parties likely to be affected by the proposed rules, current trends in registrants' voluntary reporting on climate risks, related assurance practices, and existing mandatory disclosure rules under state and other Federal laws. These factors form the baseline against which we estimate the likely economic effects of the proposed rules.

1. Affected Parties

The proposed disclosure requirements would apply to Forms S–1, F–1, S–3, F–3, S–4, F–4, S–11, 6–K, 10, 10–Q, 10–K, and 20–F. Thus, the parties that are likely affected by the proposed rules include registrants subject to the disclosure requirements imposed by these forms, as well as investors and other market participants that use the information in these filings (*e.g.* financial analysts, investment advisors, asset managers, etc.).

The proposed rules may affect both domestic registrants and foreign private issuers (FPIs).[729] We estimate that during calendar year 2020, excluding registered investment companies, there were approximately 6,220 registrants that filed on domestic forms[730] and approximately 740 FPIs that filed on Forms 20–F. Among the registrants that filed on domestic forms, approximately 31 percent were large accelerated filers, 11 percent were accelerated filers, and 58 percent were non-accelerated filers. In addition, we estimate that approximately 50 percent of these domestic registrants were smaller reporting companies (SRCs) and 22 percent were emerging growth companies (EGCs).

2. Current Regulatory Framework

A number of the Commission's existing disclosure requirements may elicit disclosure about climate-related risks; however, many of these requirements are principles-based in nature and thus the nature and extent of the information provided depends to an extent on the judgment of management. As discussed above, in 2010, the Commission published interpretive guidance on existing disclosure requirements as they pertain to business or legal developments related to climate change.[731] The 2010 Guidance emphasized that if climate-related factors have a material impact on a firm's financial condition, disclosure may be required under current Item 101 (Description of Business), Item 103 (Legal Proceedings), Item 105 (Risk Factors), or Item 303 (MD&A) of Regulation S–K. While these provisions may elicit some useful climate-related disclosure, these provisions have not resulted in the consistent and comparable information about climate-related risks that many investors have stated that they need in order to make informed investment or voting decisions.[732]

3. Existing State and Federal Laws

There are also state and other Federal laws that require certain climate-related disclosures or reporting. For instance,

rules would have on competition, and prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the Exchange Act.

[724] *See infra* Section IV.C.1.

[725] *Id.*

[726] *Id.*

[727] *See infra* Section IV.D.

[728] *See infra* Section IV.C.2

[729] FPIs refer to the subset of all FPIs that file annual reports on Form 20–F, excluding MJDS filers using form 40–F.The number of domestic registrants and FPIs affected by the final amendments is estimated as the number of unique companies, identified by Central Index Key (CIK), that filed a Form 10–K, Form 20–F, or an amendment thereto, or both a Form 10–Q and a Form S–1, S–3, S–4, or S–11 with the Commission during calendar year 2020, excluding asset-backed securities issuers. For purposes of this economic analysis, these estimates do not include registrants that only filed a Securities Act registration statement during calendar year 2020, or only filed a Form 10–Q not preceded by a Securities Act registration statement (in order to avoid including entities such as certain co-issuers of debt securities). We believe that most registrants that have filed a Securities Act registration statement or a Form 10–Q not preceded by a Securities Act registration statement, other than such co-issuers, would be captured by this estimate. The estimates for the percentages of SRCs, EGCs, accelerated filers, large accelerated filers, and non-accelerated filers are based on data obtained by Commission staff using a computer program that analyzes SEC filings, with supplemental data from Ives Group Audit Analytics and manual review of filings by staff.

[730] This number includes approximately 20 FPIs that filed on domestic forms in 2020 and approximately 90 BDCs.

[731] *See Commission Guidance Regarding Disclosure Related to Climate Change,* Release No. 33–9106 (Feb. 2, 2010) [75 FR 6290 (Feb, 8, 2010)] (''2010 Climate Change Guidance''), *available at https://www.sec.gov/rules/interp/2010/33-9106.pdf* (The guidance did not create new legal requirements nor modify existing ones. Instead, it highlighted climate-related topics that registrants should consider in seeking to meet their existing disclosure obligations (*e.g.,* the impact of legislation, regulation, international accords, indirect consequences, physical risks, etc.) and in what section they should be discussed (*e.g.,* risk factors, MD&A, etc.)). *See* also discussion in Section I.A.

[732] *See* Section I.B.

there are requirements for mandatory climate risk disclosure within the insurance industry. As of 2021, 14 states [733] and the District of Columbia require any domestic insurers that write more than $100 million in annual net written premium [734] to disclose their climate-related risk assessment and strategy via the NAIC Climate Risk Disclosure Survey.[735] Survey question topics include climate risk governance, climate risk management, modeling and analytics, stakeholder engagement, and greenhouse gas management. In fiscal year 2020, there were 66 publicly traded insurance companies that may be required to provide disclosure pursuant to these state law provisions and that also would be subject to the proposed rules.

There also exist Federal- and state-level reporting requirements related to greenhouse gas (GHG) emissions. Federal GHG reporting requirements consist of the U.S. Environmental Protection Agency's (EPA) 2009 Mandatory Reporting of Greenhouse Gases Rule.[736] This rule requires large direct emitters and suppliers of fossil fuels to report their emissions to the EPA.[737] Specifically, the rule requires each facility that directly emits more than 25,000 metric tons of CO_2e per year to report these direct emissions. Additionally, facilities that supply certain products that would result in over 25,000 metric tons of CO_2e if those products were released, combusted, or oxidized must similarly report these ''supplied'' emissions.[738] The resulting emissions data are then made public through their website.

Due to the nature of the EPA's reporting requirements, their emissions data does not allow a clean disaggregation across the different scopes of emissions for a given registrant. The EPA requires reporting of facility-level direct emissions, which can contribute to a registrant's Scope 1 emissions (but can typically be considered a subset, to the extent that the registrant has other non-reporting facilities), and facility-level supplied emissions, which can contribute to a registrant's Scope 3 emissions (but can also be very different from it).[739] Gases required to be reported by the EPA include all those referenced by the GHG Protocol and included within the proposed definition of ''greenhouse gases.'' [740] The EPA estimates that the required reporting under their rule covers 85–90% of all GHG emissions from over 8,000 facilities in the United States.[741]

In addition, at least 17 states have specific GHG emissions reporting requirements.[742] States' rules vary with respect to reporting thresholds and emissions calculation methodologies, but most tend to focus on direct emissions (*i.e.,* Scope 1), with certain exceptions. For example, New York requires the reporting of direct emissions from any owner or operator of a facility that directly emits or has the potential to emit 100 tons per year or more of GHGs, and 100,000 tons per year or more of carbon dioxide equivalent (CO_2e).[743] Colorado excludes oil and gas that is exported out of state, but includes both imported and exported electricity when calculating the state's emissions inventory.[744] California requires annual reporting of GHG emissions by industrial sources that emit more than 10,000 metric tons of CO_2e, transportation and natural gas fuel suppliers, and electricity importers.[745] As a result of these federal and state-level emissions reporting requirements, some registrants affected by the proposed rules may already have in place certain processes and systems to measure and disclose their emissions.

4. International Disclosure Requirements

Issuers with operations abroad may also be subject to those jurisdictions' disclosure requirements. Many jurisdictions' current and/or proposed requirements are based on the TCFD's framework for climate-related financial reporting.[746] In 2015, the Financial Stability Board (FSB) established the TCFD, an industry-led task force charged with developing a framework for assessing and disclosing climate-related financial risk. In 2017, the TCFD published disclosure recommendations that provide a framework to evaluate climate-related risks and opportunities through an assessment of their projected short-, medium-, and long-term financial impact on an issuer. The framework establishes eleven disclosure topics related to four pillars that reflect how companies operate: Governance, strategy, risk management, and metrics and targets.[747] The TCFD forms the framework for the recently published climate prototype standard that the IFRS Foundation is considering as a potential model for standards by the IFRS Foundation's International Sustainability Standards Board (ISSB). As of September 2021, the TCFD

[733] The 14 states are California, Connecticut, Delaware, Maine, Maryland, Massachusetts, Minnesota, New Mexico, New York, Oregon, Pennsylvania, Rhode Island, Vermont, and Washington.

[734] Net written premium is defined as the premiums written by an insurance company, minus premiums paid to reinsurance companies, plus any reinsurance assumed.

[735] *See* NAIC, *Assessments of and Insights from NAIC Climate Risk Disclosure Data* (Nov. 2020), *available at https://content.naic.org/article/news_release_naic_assesses_provides_insight_insurer_climate_risk_disclosure_survey_data.htm.*

[736] *See* 40 CFR part 98 (2022); see also EPA, *EPA Fact Sheet: Greenhouse Gases Reporting Program Implementation* (2013), *available at https://www.epa.gov/sites/default/files/2014-09/documents/ghgrp-overview-factsheet.pdf.*

[737] According to the EPA, ''direct emitters'' are facilities that combust fuels or otherwise put GHGs into the atmosphere directly from their facility. An example of this is a power plant that burns coal or natural gas and emits carbon dioxide directly into the atmosphere. The EPA estimates that the GHGRP data reported by direct emitters covers about half of total U.S. emissions. ''Suppliers'' are those entities that supply products into the economy which if combusted, released or oxidized emit greenhouse gases into the atmosphere. These fuels and industrial gases are not emitted from the supplier facility but instead distributed throughout the country and used. An example of this is gasoline, which is sold in the U.S. and primarily burned in cars throughout the country. The majority of GHG emissions associated with the transportation, residential and commercial sectors are accounted for by these suppliers.

[738] The EPA's emissions data does not include emissions from agriculture, land use, or direct emissions from sources that have annual emissions of less than 25,000 metric tons of CO_2e.

[739] On this latest point, in particular, facility-level supplied emissions cannot necessarily be characterized as a portion of the registrant's Scope 3 emission as the boundaries of the entity required to report under the EPA reporting regime (the facility) are different from the boundaries of the entity required to report under our proposed rules (the registrant).

[740] The EPA requires emissions reporting only for domestic facilities, while the proposed rule would not be limited to U.S. facilities and includes indirect emissions. The EPA also requires some gases (*e.g.* fluorinated ethers, perfluoropolyether) that are considered optional under the GHG Protocol and that are not included within the proposed definition of ''greenhouse gases.''

[741] *See supra* note 736.

[742] *See* NCSL, *Greenhouse Gas Emissions Reduction Targets and Market-Based Policies* (2021), *available at https://www.ncsl.org/research/energy/greenhouse-gas-emissions-reduction-targets-and-market-based-policies.aspx.* The 17 states with GHG reporting requirements are Hawaii, Washington, Oregon, California, Nevada, Colorado, Minnesota, Iowa, Virginia, Pennsylvania, New York, New Jersey, Maryland, Connecticut, Massachusetts, Vermont, and Maine.

[743] *See* Air Compliance and Emissions (ACE) Reporting, *available at https://www.dec.ny.gov/chemical/54266.html.*

[744] *See* M. Sakas, Colorado Greenhouse Gas Producers Are Now Required To Report Emissions Data To The State, *Colorado Public Radio News* (2020), *available at https://www.cpr.org/2020/05/22/colorado-greenhouse-gas-producers-are-now-required-to-report-emissions-data-to-the-state.*

[745] *See* Cal. Air Res. Bd., *Mandatory Greenhouse Gas Reporting 2020 Emissions Year Frequently Asked Questions* (Nov. 4, 2021), *available at https://www.arb.ca.gov/cc/reporting/ghg-rep/reported-data/2020mrrfaqs.pdf?_ga=2.110314373.182173320.1638196601-1516874544.1627053872.*

[746] *See* Section I.D.

[747] *See* TCFD, *Overview* (Mar. 2021) (''TCFD_Booklet_FNL_Digital_March-2020''), *available at https://assets.bbhub.io/company/sites/60/2020/10/TCFD_Booklet_FNL_Digital_March-2020.pdf.*

reported that eight jurisdictions have implemented formal TCFD-aligned disclosure requirements for domestic issuers: Brazil, the European Union, Hong Kong, Japan, New Zealand, Singapore, Switzerland, and the United Kingdom.[748] In these jurisdictions, disclosures are already being provided by in-scope issuers or are expected to start between 2022 and 2025. Plans to expand the scope of current requirements have also been announced in several countries, including the United Kingdom,[749] the European Union,[750] and Japan.[751] In addition, several other jurisdictions have proposed TCFD-aligned disclosure requirements, issued policies or guidance in line with the TCFD recommendations, or otherwise indicated support for the TCFD recommendations, including Australia, Canada,[752] Denmark, France, Ireland, Italy, Malaysia, Norway, Russia and South Korea.[753] Insofar as issuers have operations abroad, they would already be subject to these mandatory disclosure requirements, policies and guidance.

5. Current Market Practices

a. Climate-Related Disclosures in SEC Filings

The Commission's staff reviewed 6,644 annual reports (Forms 10–K, 40–F, and 20–F) submitted from June 27, 2019 until December 31, 2020 to determine how many contain any of the following keywords: ''climate change'', ''climate risk'', or ''global warming''. The presence of any of the keywords in any part of the annual report is indicative of some form of climate-related disclosure.[754] Table 1 (presented as a graph in Figure 1) shows that 33% of all annual reports contain some disclosure related to climate change, with a greater proportion coming from foreign registrants (the corresponding percentages for Forms 20–F and 40–F are 39% and 73%, respectively). Table 2 (presented as a graph in Figure 2) provides a breakdown by accelerated filer status. Among large accelerated filers, 49% of filings discussed climate change, while the figures for accelerated filers and non-accelerated filers are 29% and 17%, respectively. Table 3 (presented as a graph in Figure 3), which provides a breakdown by industry groups, shows that the industries with the highest percentage of annual reports containing climate-related disclosure include maritime transportation, electric services, oil and gas, steel manufacturing, and rail transportation, among others.

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TABLE 1—FILINGS WITH CLIMATE-RELATED KEYWORDS BY FORM TYPE

Form	Has keyword	All filings	Percent
10–K	1,785	5,791	31
20–F	286	729	39
40–F	91	124	73
Total	2,162	6,644	33

This table presents the analysis of annual filings submitted to the Commission between June 27, 2019, and Dec. 31, 2020. For each form type, the table indicates how many contain any of the climate-related keywords, which include ''climate change,'' ''climate risk,'' and ''global warming.''

[748] *See* TCFD, *2021 Status Report* (Oct. 2021), *available at https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Status_Report.pdf.*

[749] For example, the United Kingdom's Financial Conduct Authority (FCA) issued a policy statement in 2021 expanding its TCFD-aligned disclosure requirements to standard issuers and formally incorporating references to the TCFD's Oct. 2021 guidance on metrics, targets and transition plans and updated implementation annex. This policy will apply for accounting periods beginning on or after Jan. 1, 2022. The FCA requirements are currently on a comply-or-explain basis; the FCA has announced that it plans to consult on making these requirements mandatory alongside future proposals adapting the rules to any future ISSB climate standard, once issued. *See* FCA, *PS21/23: Enhancing Climate-Related Disclosures by Standard Listed Companies* (Dec. 2021), available at *https://www.fca.org.uk/publication/policy/ps21-23.pdf.* In addition, the United Kingdom has adopted TCFD-aligned disclosure requirements for asset managers and certain asset owners, effective Jan. 1, 2022, with certain phase-ins. *See* FCA, *PS21/24: Enhancing Climate-Related Disclosures by Asset Managers, Life Insurers and FCA-Regulated Pension Providers* (Dec. 2021), *available at https://www.fca.org.uk/publication/policy/ps21-24.pdf.*

[750] In the European Union, the European Commission (EC) adopted a proposal for a Corporate Sustainability Reporting Directive (CSRD), which would revise existing company reporting rules and aim to provide more comparable and consistent information to investors. The CSRD proposal enlarges the scope of the reporting requirements and would cover nearly 50,000 companies in the European Union. The CSRD proposal acknowledges the importance of the IFRS' efforts to establish the ISSB and seeks compatibility with the TCFD recommendations, along with other international frameworks. The EC aims to have the new CSRD reporting requirements in place for reporting year 2023. *See Proposal for Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting,* COM (2021) 189 final (Apr. 21, 2021), *available at https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC018.* Additionally, the EC is progressing work on reporting standards for meeting the proposed CSRD requirement. The European Financial Reporting Advisory Group (''EFRAG'') published a climate standard prototype in Sept. 2021 that is based on the TCFD framework. *See* EFRAG, *Climate Standard Working Paper,* (Sept. 8, 2021), *available at https://www.efrag.org/News/Project-527/EFRAG-PTF-ESRS-welcomes-Climate-standard-prototype-working-paper?AspxAutoDetectCookieSupport=1.*

[751] Japan's Financial Services Agency (FSA) is planning to make it mandatory for large companies to make climate-related disclosures aligned with the TCFD framework from as early as Apr. 2022. In addition, climate disclosures have been part of Japan's corporate governance code since June 2021; however, the code is not legally binding and the disclosures were introduced on a 'comply-or-explain' basis. In Apr. 2022, the Tokyo Stock Exchange (TSE) will be replacing its First and Second sections, the ''Mothers'' market for startups and the tech-focused JASDAQ, with three new segments: Prime, Standard and Growth. According to Nikkei, companies listed on the Prime market will be required to comply with disclosure requirements aligned with the TCFD recommendations starting in Apr. 2022. *See* Japan's FSA to Mandate Climate Disclosures from Apr. 2022, (Oct. 2021), *available at https://www.esginvestor.net/japans-fsa-to-mandate-climate-disclosures-from-april-2022/.*

[752] The Canadian Securities Administrators (CSA) is considering proposed climate-related disclosure requirements largely consistent with the TCFD recommendations, with a few exceptions. The proposed requirements would elicit disclosure by issuers related to the four pillars of the TCFD recommendations (Governance, Strategy, Risk management, and Metrics and targets). The CSA anticipates that the proposed requirements would come into force in 2022 and would be phased in over one and three year periods. *See* Consultation: Climate-Related Disclosure Update and CSA and Request for Comment, *available at https://www.osc.ca/sites/default/files/2021-10/csa_20211018_51-107_disclosure-update.pdf.*

[753] *See TCFD 2021 Status Report, available at https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Status_Report.pdf.*

[754] One limitation of using this keyword search is that it is unable to discern the extent or quality of climate-related disclosures, nor can it determine specific sub-topics within climate-related disclosures. For these reasons, the analysis was supplemented by natural language processing (NLP) analysis, as described later in this section.

Figure 1. Filings with Climate-related Keywords by Form Type

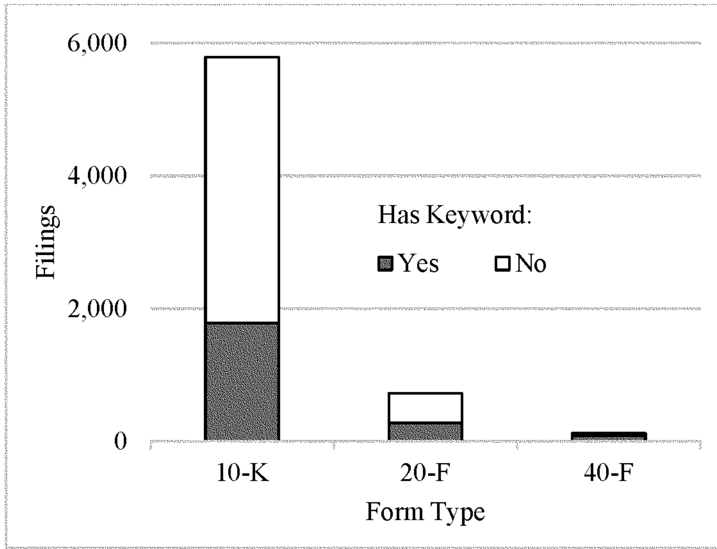


TABLE 2—FILINGS WITH CLIMATE-RELATED KEYWORDS BY ACCELERATED FILER STATUS

Filer status	Has keyword	All filings	Percent
LAF	1,117	2,280	49
AF	371	1,290	29
NAF	465	2,754	17
Other	209	320	65
Total	2,162	6,644	33

This table presents the analysis of annual filings submitted to the Commission between June 27, 2019, and Dec. 31, 2020. Filer status consists of large accelerated filers (LAF), accelerated filers (AF), and non-accelerated filers (NAF). For each filer status, the table indicates how many contain any of the climate-related keywords, which include "climate change," "climate risk," and "global warming."

Figure 2. Filings with Climate-related Keywords by Accelerated Filer Status

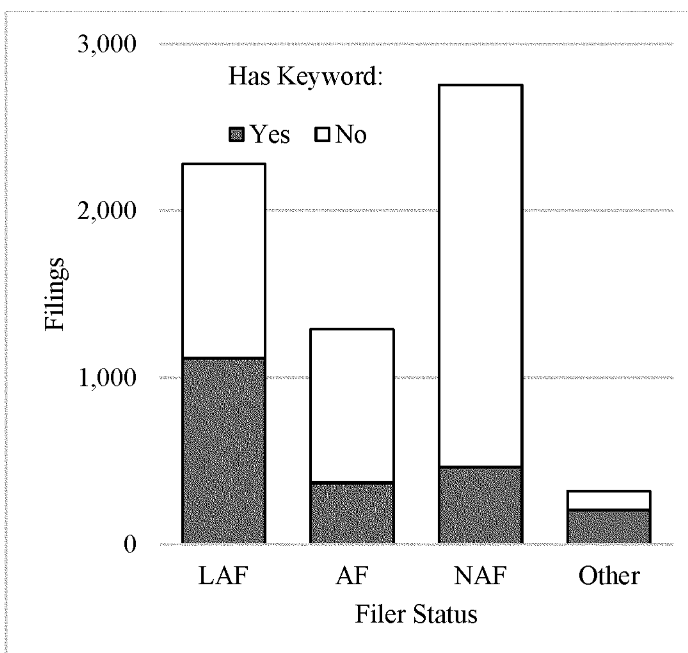
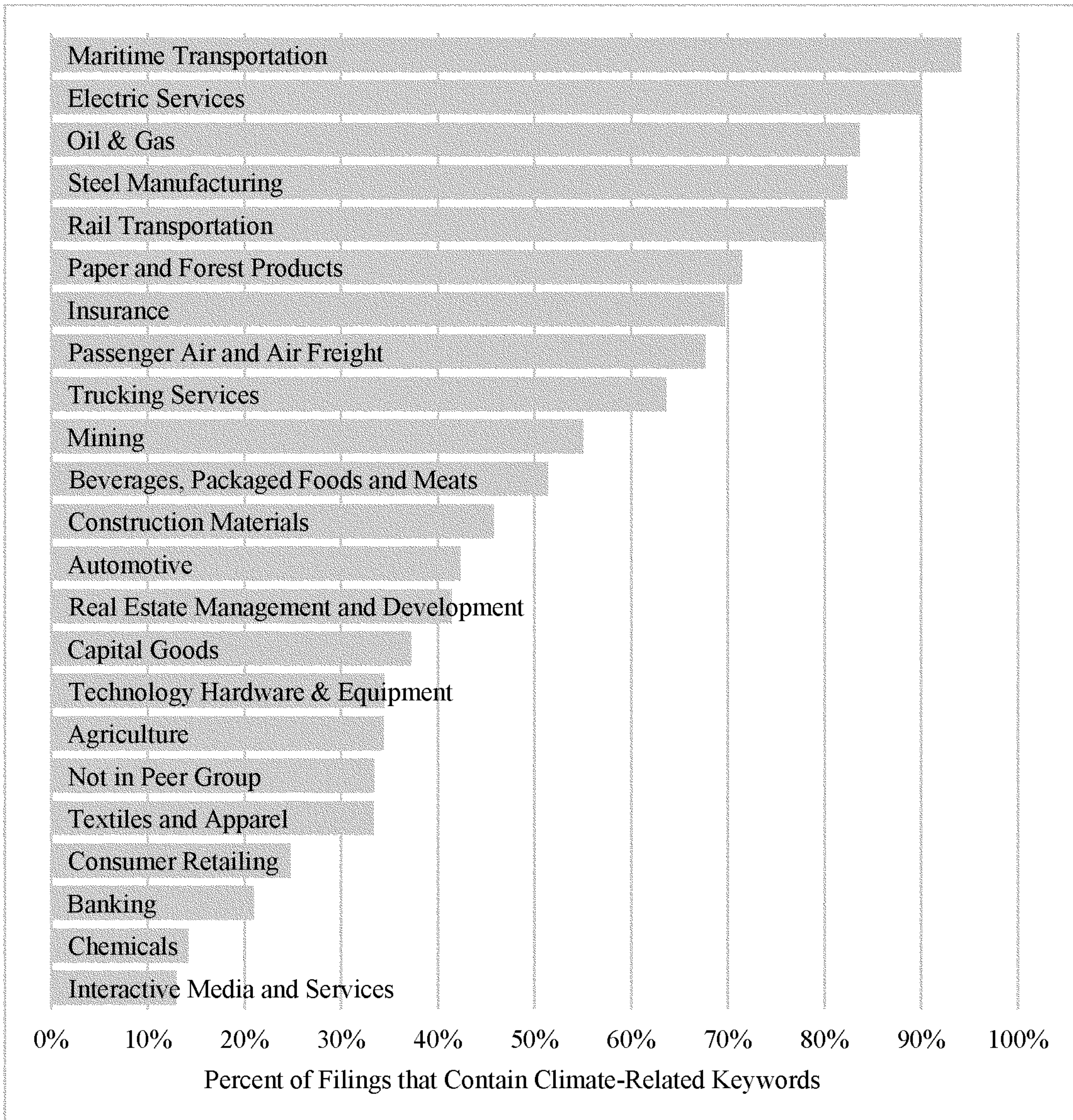


TABLE 3—FILINGS WITH CLIMATE-RELATED KEYWORDS BY INDUSTRY

Industry	Has keyword	All filings	Percent
Maritime Transportation	64	68	94
Electric Services	154	171	90
Oil and Gas	169	202	84
Steel Manufacturing	14	17	82
Rail Transportation	8	10	80
Paper and Forest Products	20	28	71
Insurance	46	66	70
Passenger Air and Air Freight	23	34	68
Trucking Services	14	22	64
Mining	109	198	55
Beverages, Packaged Foods and Meats	56	109	51
Construction Materials	54	118	46
Automotive	11	26	42
Real Estate Management and Development	274	661	41
Capital Goods	41	110	37
Technology Hardware & Equipment	61	177	34
Agriculture	11	32	34
Textiles and Apparel	12	36	33
Not in Peer Group	478	1,431	33
Consumer Retailing	138	558	25
Banking	158	754	21
Chemicals	131	922	14
Interactive Media and Services	116	894	13
Total	2,162	6,644	33

This table presents the analysis of annual filings submitted to the Commission between June 27, 2019, and Dec. 31, 2020. For each industry, the table indicates how many contain any of the climate-related keywords, which include “climate change,” “climate risk,” and “global warming.”

Figure 3. Filings with Climate-related Keywords by Industry

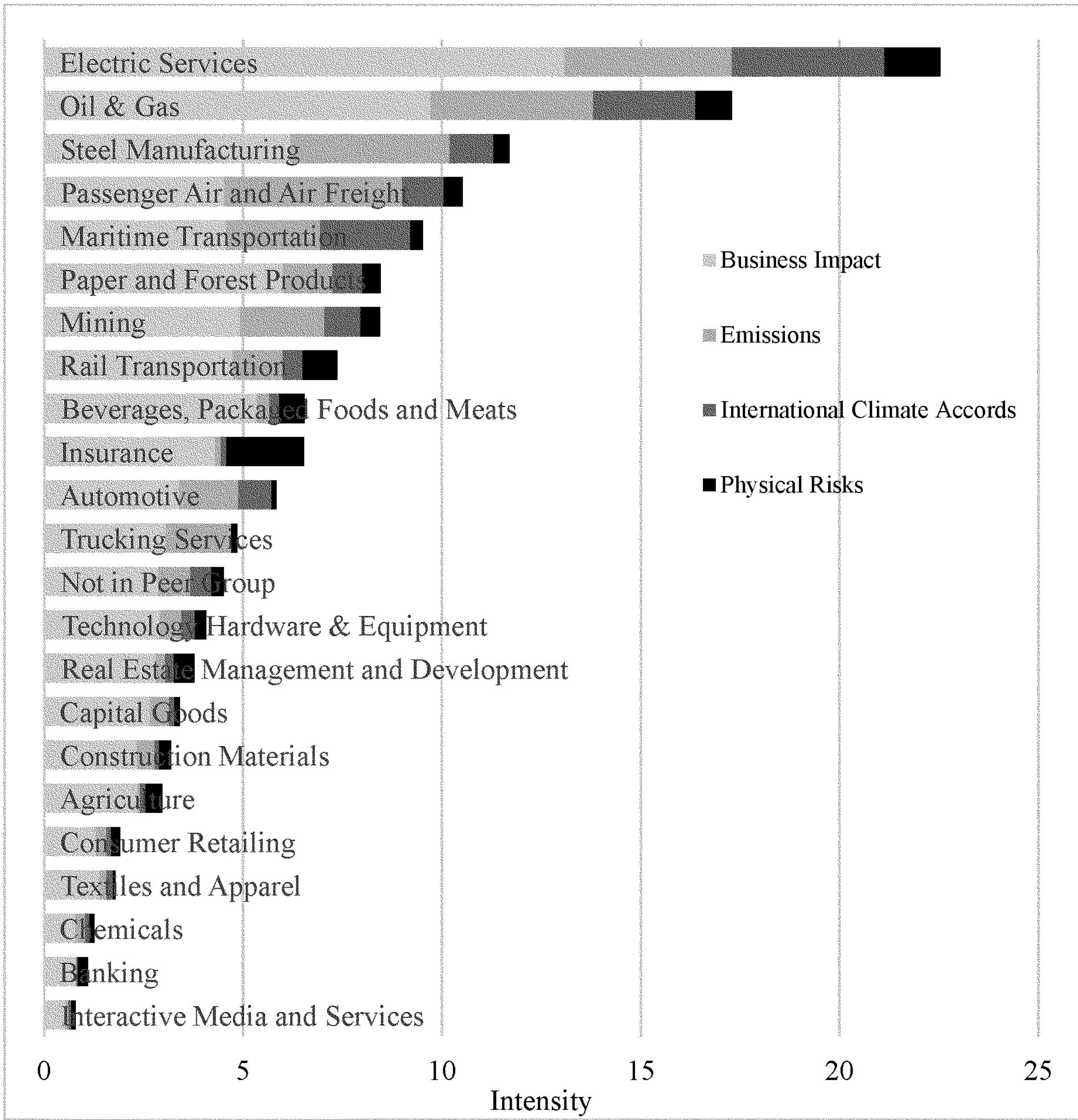


Using the same sample of annual reports, additional analysis was conducted by Commission's staff using natural language processing (NLP), which can provide insight on the semantic meaning of individual sentences within registrants' climate-related disclosures and classify them into topics (*i.e.* clusters).[755] The NLP analysis suggests that climate-related disclosures can be broadly organized into four topics: Business impact, emissions, international climate accords, and physical risks. The analysis finds significant heterogeneity, both within the quantity and content, of climate-related disclosures across industries, as shown in Figures 4 and 5. Figure 4 presents the intensity of disclosure for domestic filings. The intensity refers to sentences per firm, which is calculated by taking the aggregate number of sentences in an industry and dividing it by the total number of firms within the industry (including those that do not discuss climate change at all). Thus, the intensity represents a more comparable estimate across industries.

Figure 4 shows that firms in the following industries have the most ample climate-related discussion, on average: Electric services, oil and gas, steel manufacturing, passenger air and air freight, and maritime transportation. The majority of the discussion is on business impact, followed by emissions, international climate accords, and physical risks. Figure 5 presents the corresponding information for foreign filings (Forms 40–F and 20–F). Overall, the analysis indicates that the majority of the disclosure is focused on transition risks, with comparatively fewer mentions of physical risk.

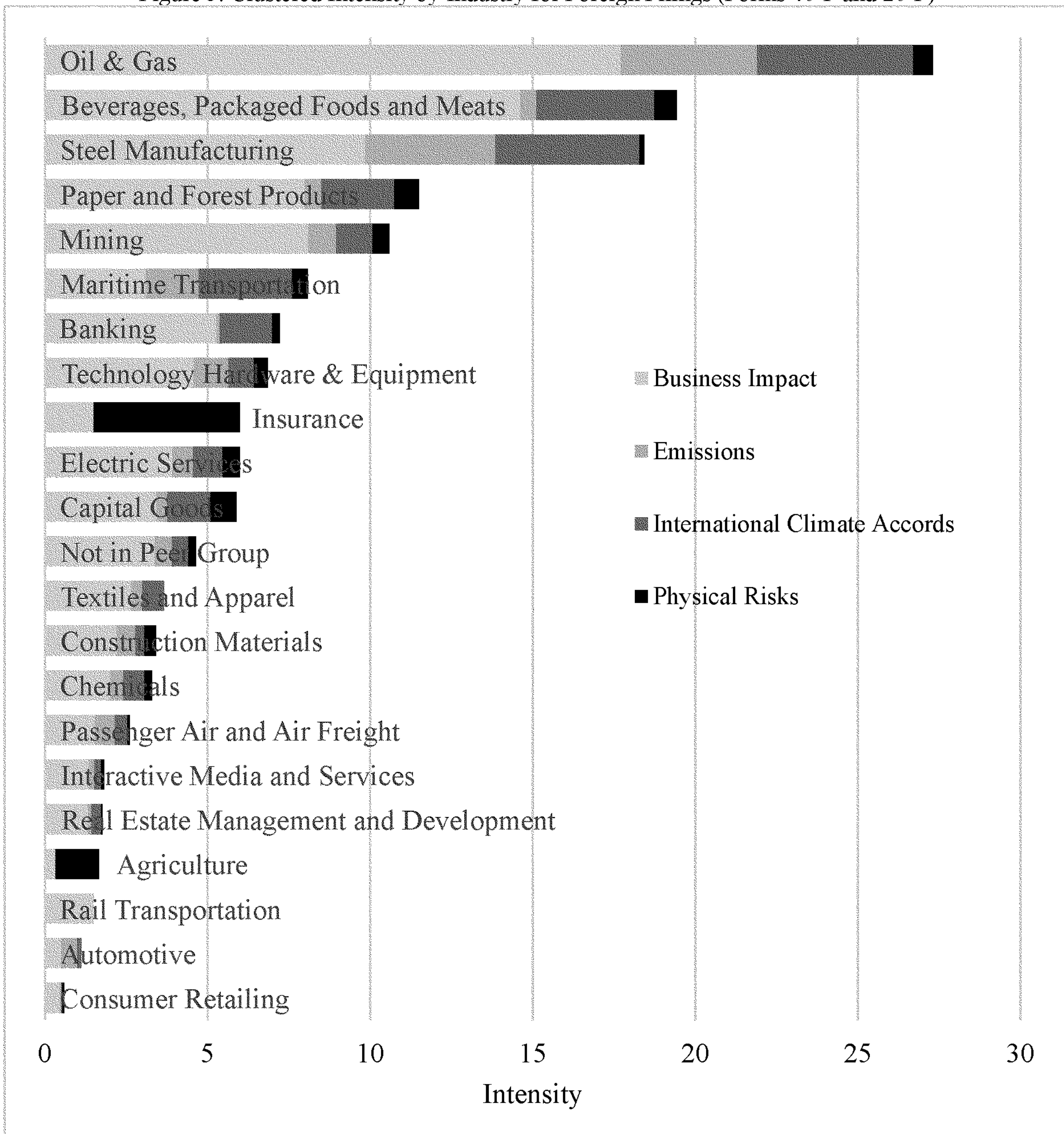
[755] The specific NLP method used in this analysis is word embedding, which utilizes Google's publicly available, pre-trained word vectors that are then applied to the text of climate-related disclosures within regulatory filings. While this NLP analysis can be used to identify the general topic and the extent of disclosures, it is limited in its ability to discern the quality or decision-usefulness of disclosures from investors' perspective.

Figure 4. Clustered Intensity by Industry for Forms 10-K



This figure presents the analysis of Form 10-K annual filings submitted to the Commission between June 27, 2019, and Dec. 31, 2020. Natural language processing (NLP) is used to analyze sentences contained within the annual filings and classify them into four broad topics (i.e. clusters): business impact, emissions, international climate accords, and physical risks. Intensity refers to sentences per firm, which is calculated by taking the aggregate number of sentences in an industry and dividing it by the total number of firms within the industry

Figure 5. Clustered Intensity by Industry for Foreign Filings (Forms 40-F and 20-F)



This figure presents the analysis of Forms 40-F and 20-F annual filings submitted to the Commission between June 27, 2019, and Dec. 31, 2020. Natural language processing (NLP) is used to analyze sentences contained within the annual filings and classify them into four broad topics (i.e. clusters): business impact, emissions, international climate accords, and physical risks. Intensity refers to sentences per firm, which is calculated by taking the aggregate number of sentences in an industry and dividing it by the total number of firms within the industry.

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The staff's findings are consistent with academic studies that have looked at the extent of climate-related disclosures by SEC registrants. Bolstad et al. (2020) systematically reviewed Form 10–K filings from Russell 3000 firms over the last 12 years and found that the majority of climate-related disclosure is focused on transition risks as opposed to physical risks.[756] They further report that while 35% of Russell 3000 firms provided climate-related information in 2009, this figure grew to 60% in 2020,[757] representing a significant increase. They also found that the extent of disclosure for a given report has increased. In 2009, firms mentioned climate risks 8.4 times on average in their Form 10–K. This figure grew to 19.1 times in 2020.

[756] *See* P. Bolstad, S. Frank, E. Gesick, and D. Victor, Flying Blind: What Do Investors Really Know About Climate Change Risks in the U.S. Equity and Municipal Debt Markets, *Hutchins Center Working Paper* 67 (2020).

[757] *Id.* The methodology uses a series of keywords to determine whether a company provides climate-related disclosures. Some keywords may occur in non-climate contexts, with the authors noting that the statistics are biased.

b. Additional Trends in Climate-Related Disclosures

While Commission staff reviewed certain firms' sustainability reports for climate-related disclosures, they did not conduct a systematic review of a large, representative sample of sustainability reports. However, as discussed below, a number of industry and advocacy groups have examined the scope of voluntary ESG reporting, including climate-related disclosures and their findings could be relevant to an assessment of the proposed rules' impact.

The U.S. Chamber of Commerce's Center for Capital Markets Competitiveness (CCMC), in collaboration with several other organizations, conducted a survey (''CCMC Survey'') on a sample of U.S. public companies—436 companies across 17 industries that range from small to large in terms of market capitalization.[758] According to the survey, over half of the companies (52%) are currently publishing a corporate social responsibility (CSR), sustainability, ESG or similar report whose content commonly includes information regarding climate-related risks. The most frequently discussed topics there are energy (74%), emissions (70%), environmental policy (69%), water (59%), climate mitigation strategy (57%), and supplier environmental policies (35%). Among the registrants that report climate-related information to the public, the majority disclose such information via external reports or company websites rather than regulatory filings. Similar to the Commission staff review, the CCMC Survey finds that about a third (34%) of the respondents disclose climate change, greenhouse gas emissions, or energy sourcing in their SEC filings information on risks. Among these firms, 82% disclose such information in Risk Factors, 26% in the MD&A, 19% in the Description of Business, and 4% in Legal Proceedings.

The Governance & Accountability Institute[759] (''G&A'') analyzed sustainability reports by the companies belonging to the Russell 1000 Index and found that in 2020, 70% published sustainability reports—up from 65% in 2019 and 60% in 2018.[760]

Other sources confirm that, at least within samples of larger firms, a sizeable portion already measure and disclose their emissions, though not necessarily through their regulatory filings. The CDP[761] reports that out of the 524 U.S. companies in their Climate High Impact Sample,[762] 402 disclosed through the CDP system in 2021, up from 379 in 2020, and 364 in 2019. Out of the sample of reviewed companies, 22.1% (89 out of 402 companies) reported Scope 3 emissions in 2021. This reflects an increase from the previous two years, during which 18% (67 out of 379 companies) reported such information in 2020, and 17% (62 out of 364 companies) in 2019.[763] One commenter stated that there is significant variation in disclosure rates of GHG emissions across various industries.[764] The commenter, using a sample of the 1,100 U.S. companies included within the Sustainalytics dataset, reports that the disclosure rate of material Scopes 1, 2, and 3 emissions is 59.5%.[765] Furthermore, the International Platform on Sustainable Finance found that among the U.S. listed firms present in the Refinitiv dataset, 10.8% disclosed Scope 1 emissions in 2019, representing 55.4% of U.S. market capitalization.[766] To the extent that registrants' current climate-related disclosures overlap with the proposed rules, registrants may face lower incremental compliance costs, as discussed in further detail below.[767]

c. Use of Third-Party Frameworks

Some companies follow existing third-party reporting frameworks when developing climate-related disclosures for SEC filings or to be included in CSR, sustainability, ESG, or similar reports. For instance, the CCMC Survey finds that 59% of respondents follow one or more such frameworks. Among these respondents, 44% use the SASB,[768] 31% use the GRI,[769] 29% use the TCFD,[770] and 24% use the CDP.[771] Similar statistics on the usage of different reporting frameworks are also provided by other studies. The G&A report[772] finds that 53% of the Russel 1000 reporters either mention or align with SASB,[773] 52% utilized GRI reporting standards,[774] 30% either

[758] *See* Climate Change & ESG Reporting from the Public Company Perspective (2021), *available at https://www.centerforcapitalmarkets.com/wp-content/uploads/2021/08/CCMC_ESG_Report_v4.pdf.*

[759] Governance & Accountability Institute Inc. (''G&A, Inc.'') is a consulting and research organization providing services to publicly traded and privately owned companies to help enhance their public environmental, social and governance (ESG) and sustainability profiles.

[760] *See* G & A Inc., Sustainability Reporting in Focus (2021), *available at https://www.ga-institute.com/research/ga-research-collection/sustainability-reporting-trends/2021-sustainability-reporting-in-focus.html.*

[761] CDP operates a global disclosure system that enables companies, cities, states and regions to measure and manage their environmental risks, opportunities and impacts. Despite not being a framework like GRI, SASB and TCFD, CDP's questionnaires gather both qualitative and quantitative information from across governance, strategy, risk, impact and performance. To aid comparability and ensure comprehensiveness, CDP includes sector-specific questions and data points. In 2018, CDP aligned its climate change questionnaire with the TCFD.

[762] The CDP Climate High Impact sample identifies companies deemed high impact based on two main considerations—market cap and GHG emissions.

[763] *See* Letter from CDP North America (Dec. 13, 2021).

[764] *See* Letter from Aron Szapiro, Head of Policy Research, Morningstar (June 9, 2021).

[765] *Id.* The comment letter does not disaggregate the disclosure rate across the different scopes of emissions.

[766] *See State and Trends of ESG Disclosure Policy Measures Across IPSF Jurisdictions, Brazil, and the US,* International Platform on Sustainable Finance (2021) (The disclosure rates are calculated using data from Refinitiv), *available at https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/211104-ipsf-esg-disclosure-report_en.pdf.*

[767] *See* Section IV.C.2.3.

[768] The SASB standards are designed for communication by companies to investors about how sustainability issues impact long-term enterprise value. SASB standards guide the disclosure of financially material sustainability information by companies to their investors. SASB standards, which are available for 77 industries, identify the subset of ESG issues most relevant to financial performance in each industry. The SASB standards can be both complementary with the core elements of the TCFD recommendations, as well as used by organizations to operationalize them. *See https://www.sasb.org/about/sasb-and-other-esg-frameworks/.*

[769] The GRI standards outline both how and what to report regarding the material economic, social and environmental impacts of an organization on sustainable development. For 33 potentially material sustainability topics, the GRI standards contain disclosure requirements. Three series of GRI standards support the reporting process: The GRI Topic Standards, each dedicated to a particular topic and listing disclosures relevant to that topic; the GRI Sector Standards, which are applicable to specific sectors; and the GRI Universal Standards, which apply to all organizations. The GRI Standards can be used in sustainability reports, as well as in annual or integrated reports that are oriented at a broad range of stakeholders. *See https://www.globalreporting.org/standards/.*

[770] The TCFD recommended disclosures cover four core elements: Governance, Strategy, Risk Management and Metrics and Targets. Each element has two or three specific disclosures (as shown in Table 4) to be made in the organization's mainstream report (*i.e.* annual financial filings). These are meant to generate comparable, consistent and reliable information on climate-related risks. The TCFD provides both general, and in some cases, sector-specific guidance for each disclosure, while simultaneously framing the context for disclosure, and offering suggestions on what and how to disclose in the mainstream report. *See https://www.fsb-tcfd.org/recommendations/.*

[771] *See supra* note 761.

[772] *See* supra note 760.

[773] Of the Russell 1000 reporting companies, 39% indicate that they are in alignment with SASB standards, while the other 14% simply mention the standards.

[774] Of those reporters utilizing the GRI standards, G&A finds that a small portion (5%) utilizes the ''Comprehensive'' level of reporting, the majority (64%) chose to report in accordance with the ''Core'' option, while the remaining portion (31%)

mention or align with TCFD recommendations,[775] and 40% responded to the CDP Climate Change questionnaire. The law firm White & Case also conducted an in-depth review of website sustainability disclosures by 80 small- and mid-cap firms across five different industries and found comparable numbers.[776]

While these various frameworks are distinct, they overlap in their alignment with the TCFD. In particular, the CDP questionnaire fully incorporates the TCFD framework and thus exhibits full alignment.[777] The Corporate Reporting Dialogue[778] also provides a detailed assessment of the various frameworks' degrees of alignment with each TCFD disclosure item, ranging from maximum to minimum alignment as follows: Full, Reasonable, Moderate, Very Limited, and None. They report that the GRI exhibits ''Reasonable'' alignment, while the SASB generally exhibits ''Moderate'' or ''Reasonable'' alignment with the majority of the TCFD disclosure items. Thus, companies that report following the CDP, SASB, or GRI frameworks are, to varying degrees, already producing disclosures that are in line with parts of the TCFD. However, because each framework takes different approaches (*e.g.* intended audience, reporting channel) and because certain differences exist in the scope and definitions of certain elements, investors may find it difficult to compare disclosures under each framework. Table 4 reports the rate of disclosure for each TCFD disclosure element for a sample of 659 U.S. companies in 2020/21.

TABLE 4—DISCLOSURE RATE OF TCFD ELEMENTS AMONG U.S. FIRMS[779]

TCFD disclosure element	Rate of disclosure (%)
Governance:	
(a) Describe the board's oversight of climate-related risks and opportunities	17
(b) Describe management's role in assessing and managing climate-related risks and opportunities	10
Strategy:	
(a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term	45
(b) Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning	34
(c) Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2 °C or lower scenario	5
Risk Management:	
(a) Describe the organization's processes for identifying and assessing climate-related risks	15
(b) Describe the organization's processes for managing climate-related risks	17
(c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management	16
Metrics and Targets:	
(a) Describe the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process	21
(b) Disclose Scope 1, Scope 2, and, if appropriate, Scope 3 greenhouse gas (GHG) emissions, and the related risks	19
(c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets	25

d. Climate-Related Targets, Goals, and Transition Plan Disclosures

Carbon reduction targets or goals have become an increasing focus for both companies and countries.[780] For example, 191 countries, including the United States and European Union, have signed the Paris Climate Agreement. The agreement aims to strengthen the global response to the threat of climate change by keeping a rise in global temperatures to well below 2 °Celsius above pre-industrial levels this century, as well as pursue efforts to limit the temperature increase even further to 1.5° degrees Celsius.[781] As of 2020, according to one source, about two-thirds of S&P 500 companies have established a target for carbon emissions—a number that has nearly doubled over the past decade.[782] Approximately one-fifth of these companies have science-based targets in-line with a 1.5 degree Celsius limit

utilizes ''GRI-Referenced'' reports, which are not fully in accordance with the GRI standards. GRI-Referenced reports contain the GRI Content Index and reference certain disclosures.

[775] Of the Russell 1000 reporting companies, 17% indicate that they are in alignment with the TCFD recommendations, while the other 13% simply mention the recommendations.

[776] *See* White & Case and the Society for Corporate Governance: A Survey and In-Depth Review of Sustainability Disclosures by Small- and Mid-Cap Companies, *available at https://www.whitecase.com/publications/article/survey-and-depth-review-sustainability-disclosures-small-and-mid-cap-companies* (Among the firms reviewed, 41 firms (51%) provided some form of voluntary sustainability disclosure on their websites. Further, only nine of those 41 firms indicated the reporting standards with which they aligned their reporting, with the majority of the nine companies not following any one set of standards completely. Additionally, six firms followed the GRI, while three firms stated that they follow both the TCFD and SASB).

[777] *See* How CDP is Aligned to the TCFD (2018), *available at https://www.cdp.net/en/guidance/how-cdp-is-aligned-to-the-tcfd.*

[778] The Corporate Reporting Dialogue is a platform, convened by the Value Reporting Foundation, to promote greater coherence, consistency and comparability between corporate reporting frameworks, standards and related requirement. *See Driving Alignment in Climate-related Reporting, Corporate Reporting Dialogue* (2019), *available at https://www.integratedreporting.org/wp-content/uploads/2019/09/CRD_BAP_Report_2019.pdf.*

[779] *See* Moody's Analytics, *TCFD-Aligned Reporting by Major U.S. and European Corporations,* (2022), *available at https://www.moodysanalytics.com/articles/pa/2022/tcfd_aligned_reporting_by_major_us_and_european_corporations.* To arrive at these statistics, Moody's conducted an artificial intelligence (AI) based review of all public filings, including financial filings, annual reports, integrated reports, sustainability reports, and other publicly available reports that were associated with companies' annual reporting on sustainability. Non-public disclosures, such as CDP reports, were not included in the analysis.

[780] *See* Commitments to Net Zero Double in Less Than a Year, United Nations Climate Change (Sept. 21, 2020), *available at https://unfccc.int/news/commitments-to-net-zero-double-in-less-than-a-year.*

[781] *See* Section I.

[782] *See, e.g.,* J. Eaglesham, Climate Promises by Businesses Face New Scrutiny, *The Wall Street Journal* (2021), *available at www.wsj.com/articles/climate-promises-by-businesses-face-new-scrutiny-11636104600.*

on global warming.[783] In addition, a growing number of companies or organizations have signed on to the Climate Pledge, which indicates a commitment to achieve net-zero emissions by 2040.[784] The trend in companies disclosing other climate-related targets (*e.g.* water usage) has also been increasing over time.[785]

Despite the increasing prevalence in stated targets and goals, monitoring which firms are taking steps to implement them is difficult given the lack of required recurring standardized metrics for progress. Absent such a monitoring device, investors have insufficient information to gauge the credibility of the targets. Moreover, without knowing the specific strategy that registrants intend on adopting in pursuit of their targets, investors are unable to determine how the targets will impact the company's financial position (*e.g.,* a company that plans to only purchase offsets may face different risks and costs over time than a company that invests in renewable energy or carbon capture technology).[786]

Consistent with this need for an oversight or monitoring mechanism, research suggests that the prevalence of ''green bonds'' and positive cumulative abnormal stock returns surrounding their announcements may arise, at least in part, because they help signal credible value-enhancing targets in the absence of mandatory standardized public disclosures.[787] These findings suggest a demand for such an oversight or monitoring mechanism for targets and goals among investors that would facilitate their understanding of registrants' stated climate-related targets and progress and the impact on the registrant's business.

e. Third-Party Assurance of Climate-Related Disclosures

Among the companies that provide climate-related disclosures, a considerable portion include some form of third-party assurance for these disclosures. The G&A study [788] finds that 35% of Russell 1000 index firms, which are virtually all large accelerated filers, obtained third-party assurance for their sustainability reports in 2020, up from 24% in the year prior. The rate of assurance is concentrated among the larger half of the sample firms (*i.e.,* the S&P 500 firms). Among the firms that obtained assurance, however, only 3% obtained assurance for the entire report. The remaining firms were evenly split between obtaining assurance on specified sections only and GHG emissions only. Regarding the level of assurance, the overwhelming majority (90%) obtained limited assurance while only 7% obtained reasonable assurance. Regarding service providers, 14% of firms received assurance from an accounting firm, 31% from small consultancy/boutique firms, and 55% from engineering firms. Because these statistics are limited to Russell 1000 firms, corresponding figures for the full sample of U.S. registrants may be lower to the extent that the practice of obtaining third-party assurance is concentrated in large firms.[789]

B. Broad Economic Considerations

1. Investors' Demand for Climate Information

Investors have expressed a need for information on climate-related risks as they relate to companies' operations and financial condition.[790] The results of multiple recent surveys indicate that climate risks are among the most important priorities for a broad set of large asset managers.[791] PWC reported in their Annual Global CEO Survey that in 2016, only 39% of asset and wealth management CEOs reported that they were concerned about the threats posed by physical risks brought about climate change, whereas this figure increased to 70% in 2021.[792]

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[783] *See* memorandum, dated Nov. 30, 2021, concerning staff meeting with representatives of Persefoni. This statistic is compiled by Persefoni using information from the Science Based Targets Initiative. This and the other staff memoranda referenced below are available at *https://www.sec.gov/comments/s7-10-22/s71022.htm.*

[784] As of Jan. 25, 2022, The Climate Pledge has acquired 217 signatories. *See* The Climate Pledge, *available at https://www.theclimatepledge.com/us/en/Signatories.*

[785] For example, the percentage of both global and U.S. companies with water reduction targets grew by 4% in 2019 on a year-over-year basis. This represented 28% of major global companies (*i.e.* those listed on the S&P Global 1200 index) and 27% of major (*i.e.* those listed in the S&P 500 index)) U.S. companies publicly disclosing these targets. *See* State of Green Business 2021, *available at https://www.spglobal.com/marketintelligence/en/news-insights/research/state-of-green-business-2021.*

[786] *See* S. Lu, *The Green Bonding Hypothesis: How do Green Bonds Enhance the Credibility of Environmental Commitments?* (2021), *available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3898909.*

[787] *See* C. Flammer, Corporate Green Bonds, *Journal of Financial Economics,* 499–516 (2021). (Green bonds may only be a partial solution to achieving credible targets given that they have implications beyond commitment.)

[788] *See supra* note 760.

[789] Other studies also report evidence of third-party assurance among smaller samples of companies analyzed. For example, according to a recent study by the International Federation of Accountants, in 2019, 99 out of the 100 largest U.S. firms by market capitalization provided some form of sustainability disclosure, which may contain climate-related information among other sustainability-related topics. Seventy of those firms obtained some level of third-party assurance, with the vast majority being ''limited assurance'' according to the study. Of the 70 firms that obtained assurance, the study reports that 54 obtained ''limited assurance,'' eight obtained ''reasonable assurance,'' five obtained ''moderate assurance,'' and three did not disclose any assurance. Of the 81 unique assurance reports examined in the study, nine were found to be issued by an auditing firm, while 72 were issued by another service provider. *See* International Federation of Accountants (''IFAC''), The State of Play in Sustainability Assurance (2021), *available at https://www.ifac.org/knowledge-gateway/contributing-global-economy/publications/state-play-sustainability-assurance.* Among the sample of 436 companies included in the CCMC Survey, 28% disclosed that they engaged a third party to provide some form of assurance regarding their climate-related disclosure (the frequency of these disclosures was 52% among the 436 companies in the sample). *See supra* note 758.

[790] *See* 2021 Global Investor Statement to Governments on the Climate Crisis (2021) (this statement has been signed by 733 investors collectively managing over US$52 trillion in assets), *available at https://theinvestoragenda.org/wp-content/uploads/2021/09/2021-Global-Investor-Statement-to-Governments-on-the-Climate-Crisis.pdf; See also* Alexander Karsner, *Testimony Before the House Financial Services Subcommittee on National Security,* International Development and Monetary Policy (Sept. 11, 2019), *available at https://financialservices.house.gov/uploadedfiles/hhrg-116-ba10-wstate-karsnera-20190911.pdf.* A recent report examined how climate change could affect 22 different sectors of the U.S. economy and found that if global temperatures rose 2.8 °C from pre-industrial levels by 2100, climate change could cost $396 billion each year. If temperatures increased by 4.5 °C, the yearly costs would reach $520 billion. *See* Jeremy Martinich and Allison Crimmins, *Climate Damages and Adaptation Potential Across Diverse Sectors of the United States,* Nature Climate Change 9, 397–404 (2019); *available at https://www.nature.com/articles/s41558-019-0444-6.* Similarly, the Swiss Re Institute estimated how global warming could affect 48 countries—representing 90% of the world economy—and found that the decrease in GDP in North America could range from −3.1% if Paris Agreement targets are met (a well-below 2 °C increase), to −9.5% if no mitigating actions are taken (3.2 °C increase); *See* The Economics of Climate Change: No Action Not an Option, *available at https://www.swissre.com/dam/jcr:e73ee7c3-7f83-4c17-a2b8-8ef23a8d3312/swiss-re-institute-expertise-publication-economics-of-climate-change.pdf.*

[791] *See, e.g.,* Emirhan Ilhan, Climate Risk Disclosure and Institutional Investors, *Swiss Fin. Inst. Research Paper Series* (Working Paper No. 19–66), (last revised Jan. 7, 2020), *available at https://ssrn.com/abstract=3437178* (noting that a survey of 439 large institutional investors shows that 79% of respondents believe that climate risk reporting is as important as traditional financial reporting, and almost one-third consider it to be more important); *See also Macquaire Asset Management 2021 ESG Survey Report* (2021), *available at https://www.mirafunds.com/assets/mira/our-approach/sustainability/mam-esg-survey/mam-2021-esg-survey-report.pdf* (noting that in a survey of 180 global institutional real assets investors, including asset managers, banks, consultants and investment advisors, foundations and endowments, insurance companies, and pension funds, who combined represent more than $21 trillion of assets under management, more than half of responding investors selected climate change as their primary ESG concern).

[792] *See* PWC, *The Economic Realities of ESG* (Oct. 28, 2021), *available at https://www.pwc.com/gx/en/*

Investors' demand for climate-related information may also be related to the transition risks that companies face (*e.g.* changes in future regulation, shifts in investor, consumer, counterparty preferences or other market conditions, and other technological challenges or innovations). For example, the United States' commitment to the Paris Agreement may have contributed to investors' demand for information on registrants' emissions and exposure to potential transition risk, as well as whether they have in place emissions targets with credible pathways of achievement.[793] The 2021 Institutional Investors Survey solicited the views of 42 global institutional investors managing over $29 trillion in assets (more than a quarter of global assets under management (AUM)) and found that climate risk remains the number one investor engagement priority. A significant majority (85%) of surveyed investors cite climate risk as the leading issue driving their engagements with companies. These institutional investors also indicated that they consider climate risk to be material to their investment portfolios and are demanding robust and quantifiable disclosure around its impacts and the plan to transition to net zero.[794]

State Street Global Advisors (SSGA) and Blackrock, two of the world's largest investment managers, recently announced the focus areas for their asset stewardship program for 2022, with climate change at the top of their priority list. One of the key expectations set by SSGA this year is a requirement for companies to provide disclosures aligned with TCFD recommendations, including reporting on board oversight on climate-related risks and opportunities, Scope 1 and 2 GHG emissions, and targets for emissions reduction.[795] Similarly, Blackrock expects to continue encouraging companies to demonstrate that their plans are resilient under likely decarbonization pathways, and to ask that companies disclose a net zero-aligned business plan that is consistent with their business model to demonstrate how their targets are consistent with the long-term economic interests of their shareholders.[796]

Investors, including large institutional investors, have also formed initiatives aimed in part at improving corporate disclosures on climate-related risks. These initiatives include the Climate Disclosure Project, Climate Action 100+,[797] the Global Investor Coalition on Climate Change (''GIC''),[798] the Institutional Investors Group on Climate Change (''IIGCC''),[799] and the Transition Pathway Initiative (''TPI''),[800] with many of these groups seeing increasing membership in recent years.[801] In addition to stated demand, revealed preferences from investment decisions and asset price responses to ESG-related news and climate change risk suggest substantive demand for information on climate-related risks.[802] Investors have also demonstrated their interest in climate-related issues through an increase in climate-related shareholder proposals[803] and increased flows into mutual funds with environmental goals in their investment mandates.[804]

2. Impediments to Voluntary Climate-Related Disclosures

a. General Impediments to Voluntary Climate-Related Disclosures

In practice, however, investors' demand for climate-related information is often met by inconsistent and incomplete disclosures due to the considerable variation in the coverage, specificity, location, and reliability of information related to climate risk. Multiple third-party reporting frameworks and data providers have emerged over the years; however, these resources lack mechanisms to ensure compliance and can contribute to reporting fragmentation.[805] Due to deficiencies in current climate-reporting practices, investor demand for comparable and reliable information does not appear to have been met.[806] As a result, investors may face difficulties locating and assessing climate-related information when making their investment or voting decisions.[807]

services/audit-assurance/corporate-reporting/esg-investor-survey.html.

[793] *See* Section IV.A.5.d.

[794] *See* Morrow and Sodali, Institutional Investor Survey (2021), *available at https://higherlogicdownload.s3.amazonaws.com/GOVERNANCEPROFESSIONALS/a8892c7c-6297-4149-b9fc-378577d0b150/UploadedImages/Institutional_Investor_Survey_2021.pdf.*

[795] *See https://www.esgtoday.com/state-street-to-require-companies-to-provide-tcfd-aligned-climate-disclosures/.*

[796] *See* BlackRock Investment Stewardship (BIS), *Policies Updated Summary* (2022), *https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-engprinciples-global-summary.pdf.*

[797] Climate Action 100+ is composed of 615 global investors across 33 markets with more than US$60 trillion in AUM. *See* Climate Action 100+, *available at https://www.climateaction100.org/about/.*

[798] As of Apr. 2018, GIC was signed by 409 investors representing more than U.S. $24 trillion in AUM, *available at https://climateinitiativesplatform.org/index.php/Global_Investor_Coalition_on_Climate_Change_(GIC).*

[799] IIGCC has more than 330 members, mainly pension funds and asset managers, across 22 countries, with over $33 trillion in AUM. *See* The Institutional Investors Group on Climate Change, *available at https://www.iigcc.org/.*

[800] The TPI is supported globally by 108 investors with more than $29 trillion combined AUM. *See* Transition Pathway Initiative, *available at https://www.transitionpathwayinitiative.org/.*

[801] For example, Climate Action 100+ launched in 2017 with 225 investors with more than USD $26.3 trillion AUM to engage with 100+ of the world's highest emitting companies to reduce material climate risks. In 2021, Climate Action 100+ has grown to 615 investors, $60 trillion in assets, engaging with 167 companies that represent 80%+ of global industrial emissions.

[802] *See* P. Krüger, *Corporate Goodness and Shareholder Wealth,* 115(2) Journal of Financial Economics 304–329 (2015); G. Capelle-Blancard, A. Petit, *Every Little Helps? ESG News and Stock Market Reaction,* Journal of Business Ethics 157, 543–565 (2019); and G. Serafeim and A. Yoon, *Which Corporate ESG News Does the Market React To?* (Forthcoming) Financial Analysts Journal (2021) (for evidence of stock market responses to ESG news). *See also* A. Bernstein, M. Gustafson, and R. Lewis, *Disaster on the Horizon: The Price Effect of Sea Level Rise,* 134.2 Journal of Financial Economics 253–300 (2019) A. Bernstein, S. Billings, M. Gustafson, and R. Lewis, *Partisan Residential Sorting on Climate Change Risk* (Forthcoming), Journal of Financial Economics (2021); M. Baldauf, L. Garlappi, and C. Yannelis, *Does Climate Change Affect Real Estate Prices? Only If You Believe In It,* 33 (3) Review of Financial Studies 1256–1295 (2020) (for evidence of responses of investor demand in equilibrium prices and investment choice (based on heterogeneous preferences and beliefs) in real estate markets).

[803] A recent 2021 proxy season review by the Harvard Law School found that shareholder climate-related proposals have increased for the second consecutive year. The authors also note that, in 2021, environmental proposals were withdrawn at a meaningfully higher rate relative to the prior year. This is an indication of stronger commitments from companies to take actions towards the specified environmental goals, or at the very least provide the related disclosures. Many companies may prefer engaging with a proponent rather than taking the proposal to a vote. *See* 2021 Proxy Season Review: Shareholder Proposals on Environmental Matters, *available at https://corpgov.law.harvard.edu/2021/08/11/2021-proxy-season-review-shareholder-proposals-on-environmental-matters/.*

[804] *See* S.M. Hartzmark and A.B. Sussman, *Do Investors Value Sustainability? A Natural Experiment Examining Ranking and Fund Flows,* 74 (6) The Journal of Finance 2789–2837 (2019). Data from fund tracker Morningstar Inc. compiled by Goldman Sachs Group Inc. shows that, since the start of 2019, a net $473 billion has flowed into stock mutual and exchange-traded funds with environmental goals as part of their mandates, compared to a net $103 billion going into all other stock funds. *See* Scott Patterson and Amrith Ramkumar, *Green Finance Goes Mainstream, Lining Up Trillions Behind Global Energy Transition,* Wall Street Journal (May 22, 2021), *available at https://www.wsj.com/articles/green-finance-goes-mainstream-lining-up-trillions-behind-global-energy-transition-11621656039?mod=article_inline.*

[805] *See* Section IV.B.2.b.

[806] *See* IOSCO, *Report on Sustainability-Related Registrant Disclosures* (2021), *available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD678.pdf.*

[807] *See* GAO, Climate-Related Risks (2018) *available at https://www.gao.gov/assets/gao-18-188.pdf* (reporting that ''investors may find it difficult to navigate through the filings to identify, compare, and analyze the climate-related disclosures across filings'').

Below we describe some key market failures with regard to disclosure, for example (1) disclosures are not costless; (2), there are agency problems; [808] (3) managers may inaccurately present information; and (4) investor responses may be unpredictable and non-unfirm.[809] In addition, there may be other problems, *e.g.* a lack of consistency, that may indicate Commission action.

(1) Disclosures Are Not Costless

In practice, firms can still approach full disclosure voluntarily if there are costs to disclosure, as long as these costs are relatively low.[810] This is not the case, however, if individual firms' private benefits of disclosure are also small, yet those same disclosures provide positive informational externalities. For example, disclosures by one registrant may provide investors with useful information via inference with respect to peer firms. Consistent with this theory, research in the accounting literature has documented that earnings announcements by one firm can provide predictive signals about the earnings of other firms in the same industry.[811] In these cases, disclosures can benefit investors in the aggregate (though not necessarily investors of a specific firm) by allowing them to make comparisons across firms, which can aid in their capital allocation decisions.

This illustrates how, theoretically, in the absence of mandated disclosure requirements, registrants fully internalize the costs of disclosure but not the benefits, which may lead them to rationally under-disclose relative to what is optimal from the investors' perspective.[812] As a result, a tension can exist between investors (in the aggregate) and managers, where investors prefer more disclosure and managers prefer less. In such instances, there may be scope for regulation to substantially increase information provision since absent regulation, investors are not able to fully ascertain the risks and opportunities that firms face.

(2) Agency Problems

In order for voluntary disclosure to result in the complete revelation of all relevant private information, there would need to be no agency problems (*i.e.,* no conflicts of interest between managers and shareholders) such that managers' sole objective with respect to such disclosures would be to maximize shareholder information and, ultimately, shareholder value. However, if managers have other objectives and incentives for making voluntary disclosures (*i.e.,* there exist agency problems), then the voluntary disclosures may not result in the same complete information.[813] Moreover, when agency problems exist, investors can no longer be sure if the absence of disclosure under a voluntary regime reflects good or bad news for the firm, given that some managers may have self-serving incentives. For example, managers may have career concerns which could incentivize them to withhold disclosing information they expect to be favorably received until it is useful to balance out bad news. In contrast, when the disclosure requirements are mandatory, the relevant, complete information should be disclosed regardless of managers' objectives or incentives, and investors would accordingly have more confidence in the completeness of the resulting disclosures. For these reasons, the benefits of a mandatory reporting regime may be more pronounced in settings in which disclosure-related conflicts of interests exist between managers and shareholders.

(3) Misrepresentation by Managers

If investors are unable to verify that managerial disclosures are complete and truthful (*e.g.,* if investors have difficulty in determining the extent of managers' selective disclosure of metrics or methods of computation, exaggeration, obfuscation, outright misreporting, etc.), then voluntary disclosures may not be fully revealing. For example, managers may be able to engage in misleading reporting (*i.e.,* they can apply a favorable bias to their disclosures), but they incur a cost that increases with the magnitude of the misreporting.[814] Under these circumstances, theoretical research suggests that, in equilibrium, they may not accurately report their private information. This is because investors would not be able to distinguish truthful disclosures from those that are misleading (*i.e.,* favorably biased). In this setting, all managers would then have an incentive to misreport by providing disclosures with a favorable bias, the extent of which depends on the cost of misreporting. Furthermore, because misreporting comes at a cost, this would violate the assumption of costless disclosure, which can exacerbate the issue of incomplete disclosures.[815]

If, on the other hand, misreporting has no costs for managers, then this results in what is referred to as a cheap talk equilibrium.[816] In this setting, any misalignment of incentives between managers and investors could again result in a situation in which not all relevant private information is fully revealed. While this could be driven by agency problems stemming from managerial self-interest, it also occurs when investors have heterogeneous preferences that cause differing incentives or if managers are concerned with strategic disclosures that may be viewed by not only investors, but also competitors, regulators, and customers.

In this case, a mandatory reporting regime would be beneficial to investors to the extent that voluntary disclosures are unverifiable and possibly misleading. These include situations where managers obfuscate certain information in their disclosures, convey information in a complex or difficult manner, or conceal the discretionary choices with respect to what was reported.

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[808] Agency problems are those conflicts of interest between shareholders (*i.e.,* the principals) and managers (*i.e.,* the agents) of a firm.

[809] *See* Beyer, Cohen, Lys, and Walther, *The Financial Reporting Environment: Review of The recent Literature,* J. Acct. Econ. 296–343 (2010) for a more technical and detailed discussion of these and other additional assumptions.

[810] *See* for example R.E. Verrecchia, *Discretionary Disclosure,* 5 Journal of Accounting and Economics 365–380 (1983).

[811] *See* Robert Freeman and Senyo Tse, *An Earnings Prediction Approach to Examining Intercompany Information Transfers,* 15(4) J. Acct. Econ. 509–523 (1992).

[812] It is worth noting that in some cases, undertaking costly signals can allow agents to credibly signal their type to investors. In these cases, costly disclosures can lead to a separating equilibrium where it may otherwise not exist. *See* D. Kreps and J. Sobel, 2(1) *Signaling,* Handbook of Game Theory with Economic Applications, 849–867 (1994); J. Riley, *Silver Signals: Twenty-Five Years of Screening and Signaling,* 39(1) Journal of Economic Literature 432–478, (2001).

[813] *See* E. Einhorn. *Voluntary Disclosure Under Uncertainty About the Reporting Objective,* 43 Journal of Accounting and Economics 245–274 (2007).

[814] *See* E. Einhorn, and A. Ziv, *Biased Voluntary Disclosure,* Review of Accounting Studies 420–442 (2012) (Biases in reporting can be any number of costs in these models. These include not only inefficient actual investments associated with the cost of distorted reporting, but also the risk of litigation, reputation erosion, and/or future flexibility in reporting.).

[815] If misrepresentation becomes sufficiently costly, then there may be no managers who find it advantageous to misrepresent, despite any potential benefits. In this case, purposeful misrepresentation would not occur, thereby fulfilling one of the assumptions of the standard full revelation argument. Clear guidelines for disclosure and imposed costs upon the discovery of misrepresentation are important mechanisms for enforcing and promoting the transmission of information to investors.

[816] *See* V. Crawford, J. Sobel, *Strategic Information Transformation,* 50 Econometrica 1431–1451 (1982).

(4) Uncertain Investor Responses

Another condition necessary for voluntary reporting to be fully revealing is that managers must be certain of investor responses to disclosures. However, if investors have heterogeneous prior beliefs, such that managers cannot determine whether investors will consider a given disclosure good or bad news, then not all managers will choose to disclose, resulting in certain private information remaining undisclosed.[817] Similarly, if there are varying levels of sophistication among investors in their ability to understand disclosures, then again, some managers may be uncertain about how reports may be interpreted, leading them to abstain from some disclosures.[818] In this respect, mandatory disclosure is more likely to benefit investors in settings where the types of disclosures are complex or divisive, such that managers may not be certain how they will be perceived by investors with differing prior beliefs and/or sophistication.

b. Climate-Specific Factors That Exacerbate Impediments to Voluntary Disclosure

In the context of climate-related disclosure, these impediments may be made worse due to agency problems arising from the potentially long-term nature of certain climate-related risks and other issues related to the complexity and uncertainty of climate-related factors. We explore each of these impediments in further detail.

Impediments to climate-related disclosures may be exacerbated due to agency problems related to potential conflicts between short-term profitability and long-term climate risk horizons. Physical and transition risks can materialize over time horizons ranging from the immediate future to several decades.[819] Likewise, shareholders may have interests in maximizing their investment returns over both the short- and long-term. Agency problems can worsen to the extent that the investment horizons of a firm's shareholders and its management are misaligned.[820] If management prioritizes short-term results [821] due to pressures to perform along certain metrics,[822] management may fail to assess and provide relevant disclosures on certain climate-related risks,[823] particularly those that are medium- or long-term in nature.[824] Stock-based management compensation has the potential to mitigate this issue, provided that the stock price reflects the value of the company in the long-run. However, under the current regime, certain climate-related risks may be unobservable or obfuscated, and hence not fully reflected into stock prices, giving short-term-focused managers an incentive to initiate or continue projects exposed to these risks to maximize their compensation at the expense of long-term shareholder value.

Impediments to voluntary climate-related disclosures can also be exacerbated due to the uncertainty and complexity of climate-related risks and the multidimensional nature of the information being disclosed. First, this uncertainty and complexity may lead to misrepresentation of disclosures, which, as discussed previously, violates a condition for the full revelation of material information in a voluntary reporting environment. The complexity of these risks has led to many types of methodologies, metrics, and statements that can be provided to communicate potential economic impacts and risks.[825] This multitude of choices to represent such risks may therefore allow managers substantial discretion to selectively choose metrics that appear favorable. If this managerial discretion is more difficult to be verified by investors, managers may face lower costs for their misreporting. Moreover, the complex and multidimensional nature of certain climate-related risks may further impede investors' abilities to detect misreporting. This could lead to a cheap-talk equilibrium, which, as previously discussed, could lead to climate-related information remaining undisclosed.

The uncertainty and complexity of climate-related risks may also be an impediment to voluntary disclosure if managers are less able to anticipate how investors may respond to such disclosures. As noted above, predictable investor responses to disclosures is one of the key assumptions necessary for the full revelation of material information in a voluntary reporting environment.[826] Uncertainty in responses means mandatory disclosures have the potential to improve information provision to investors. The challenge in anticipating investor responses to climate-related disclosure may stem, in part, from the fact that the impact of these risks on registrants' financial outcomes and operations can vary significantly. This challenge may be compounded by the uncertainty surrounding the future path of climate change and the evolving nature of the science and methodologies measuring their economic impacts.[827] The uncertainty and complexity of climate-related risks are likely to cause substantial heterogeneity with respect to investors' interpretation of related disclosures and their understanding of firms' exposures to such risks, resulting in heterogeneous and unpredictable

[817] *See* J. Suijs, *Voluntary Disclosure Of Information When Firms Are Uncertain Of Investor Response,* 43 Journal of Accounting and Economics 391–410 (2007).

[818] *See* R.A. Dye, *Investor Sophistication and Voluntary Disclosures,* 3 Review of Accounting Studies 261–287 (1998).

[819] Longer horizons, for example, tend to involve changes in chronic physical risks—sea-level rise, drought, etc. Shorter-term horizons may, instead, be relevant for any increase in acute physical risks such as hurricanes, wildfires, and heatwaves. *See* ING Climate Risk Report 2020, *available at https://www.ing.com/MediaEditPage/ING-Climate-Risk-report-2020.htm.*

[820] A stream of literature examines the association of climate-related disclosures with corporate governance structures and managerial characteristics. *See, e.g.,* M. Kılıç and C. Kuzey, *The Effect of Corporate Governance on Carbon Emission Disclosures: Evidence from Turkey,* 11–1 International Journal of Climate Change Strategies and Management 35–53 (2019). *See also* S. Yunus, E.T. Evangeline, and S. Abhayawansa, *Determinants of Carbon Management Strategy Adoption: Evidence from Australia's Top 200 Publicly Listed Firms,* 31–2 Managerial Auditing Journal 156–179 (2016).

[821] Henry M. Paulson Jr., *Short-Termism and the Threat From Climate Change,* Perspectives on the Long Term: Building a Stronger Foundation for Tomorrow (Apr. 2015), *available at https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/short-termism-and-the-threat-from-climate-change.*

[822] Factors including corporate executive compensation and attention to quarterly earnings and reporting are thought to contribute to excessive focus on short-term goals. *See, e.g., Short-Termism Revisited, available at https://corpgov.law.harvard.edu/2020/10/11/short-termism-revisited/.*

[823] *See How to Take the Long-Term View in a Short-Term World,* Moral Money (Financial Times), (Feb. 25, 2021), *available at https://www.ft.com/content/5bc1580d-911e-4fe3-b5b5-d8040f060fe1.*

[824] *See* Richard Mahony and Diane Gargiulo, *The State of Climate Risk Disclosure: A Survey of U.S. Companies* (2019) (A recent survey conducted on the members of the Society for Corporate Governance (SCG) about the state of U.S. climate risk disclosures revealed that tying executive compensation to progress on climate goals is beginning to emerge among some companies, but it is far from a common practice. Only 6% of respondents said their board linked compensation to climate objectives.), *available at https://www.dfinsolutions.com/sites/default/files/documents/2019-10/TCFD_II_Climate_Disclosure_V10_revisedFINAL.pdf.*

[825] *See, e.g.,* TCFD, *Recommendations of the Task Force on Climate-Related Financial Disclosures,* at 16 (June 2017), *available at https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf.*

[826] In other words, this assumes that all investors uniformly interpret (and react to) managers' disclosures or their absence and that investors' interpretation and reaction is known to managers. *See, e.g.,* A. Beyer, D.A. Cohen, T.Z. Lys, and B.R. Walther, *The Financial Reporting Environment: Review of the Recent Literature,* 50 (2) Journal of Accounting and Economics 296–343 (2010).

[827] *See, e.g.,* TCFD, *Recommendations of the Task Force on Climate-Related Financial Disclosures,* at 16 (June 2017), *available at https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf.*

investor responses. In this circumstance, managers may prefer to withhold applicable disclosures.[828]

Due to these impediments, companies may not report (or may report only limited amounts of) relevant climate-related information, and hence, the stock price that investors observe may not reflect the companies' true exposures to physical and transition risks.[829] Even when companies assess and disclose climate-related risks, reporting fragmentation can present substantial obstacles to investors in processing this information.[830] This is because disclosures currently vary considerably in terms of coverage, location, and presentation across companies, making it difficult for investors to navigate through different information sources and filings to identify, compare, and analyze climate-related information.[831] Moreover, these disclosures are often vague and boilerplate, creating further challenges for investors.[832] While it may seem that more information is always better, when the incentives of investors and managers diverge, evidence suggests such amorphous statements could reduce the quality of communication both in theory[833] and in practice.[834]

The current regulatory regime leaves substantial uncertainty around the type of climate-related information that should be disclosed and how it should be presented. Multiple third-party climate reporting frameworks have emerged to try to fill this reporting gap.[835] Due to the voluntary nature of third-party frameworks, however, companies often disclose some but not all components, and the components that are disclosed may not be the same across companies.[836] The location, format, and granularity of the information provided may also vary, although the substance may be similar. This has resulted in considerable heterogeneity in firms' existing disclosure practices.[837] The wide range of reporting practices and frameworks makes it difficult to assess how much material climate-related information firms currently are disclosing and may leave opportunities for companies to omit unfavorable information.[838] Some studies point to the potential for substantial underreporting of material climate-related information within the current voluntary reporting regime.[839]

The proposed rules aim to address these market failures by requiring more specificity around the way registrants disclose climate-related risks and their impacts on business activities and operations in the short, medium, and long-term. By requiring comprehensive and standardized climate-related disclosures along several dimensions, including disclosure on governance, business strategy, risk management, financial statement metrics, GHG emissions, and targets and goals, the proposed rules would provide investors with climate-related information that is more comparable, consistent, and reliable and presented in a centralized location.

C. Benefits and Costs

Below we discuss the anticipated economic effects that may result from the proposed rules. Where possible, we have attempted to quantify these economic effects, including the benefits and costs. In many cases, however, we are unable to reliably quantify these potential benefits and costs. For example, existing empirical evidence does not allow us to reliably estimate how enhancements in climate-related disclosure affect information processing by investors or firm monitoring. Nevertheless, there is a large body of studies examining the effects of corporate disclosure in general, as well as a subset focusing on sustainability-related disclosures (*e.g.* ESG- or CSR-related disclosures).[840] We draw on existing empirical evidence and theoretical arguments from these studies to the extent they are applicable to disclosures on climate-related information specifically.

Similarly, we qualitatively describe the factors that may affect disclosure costs but we are unable to accurately quantify these costs. Costs related to preparing climate-related disclosures are generally private information known only to the issuing firm, hence such data are not readily available to the Commission. There is also likely considerable variation in these costs depending on a given firm's size, industry, complexity of operations, and other characteristics, which makes comprehensive estimates difficult to obtain.

We encourage commenters to provide us with relevant data or empirical evidence related to the costs of preparing climate-related disclosures and, more generally, to provide us with

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[828] *See, e.g.,* M.J. Fishman and K.M. Hagerty, *Mandatory versus Voluntary Disclosure in Markets With Informed and Uninformed Customers,* 19 (1) Journal of Law, Economics, & Organization 45–63 (2003); P. Bond and Y. Zeng, *Silence Is Safest: Information Disclosure When the Audience's Preferences Are Uncertain* (forthcoming), Journal, of Financial Economics (2021); D. Butler, and D. Read, *Unravelling Theory: Strategic (Non-) Disclosure of Online Ratings,* 12 Games 73 (2021).

[829] *See* J.A. Bingler, M. Kraus, and M. Leippold, *Cheap Talk and Cherry-Picking: What Climate Bert Has to Say on Corporate Climate Risk Disclosures* (2021) *available at, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3796152.*

[830] Carbon Disclosure Project (''CDP''), *Pitfalls of Climate-Related Disclosures* (2020), *available at* Pitfalls-of-Climate-Related-Disclosure.pdf (*rackcdn.com*).

[831] *See* SASB, *The State Of Disclosure: An Analysis of the Effectiveness of Sustainability Disclosure in SEC Filings,* (2017), *available at https://www.sasb.org/knowledge-hub/state-of-disclosure-2017/.*

[832] The SASB reports that about 50% of SEC registrants provide generic or boilerplate sustainability information in their regulatory filings.

[833] *See* Vincent P. Crawford and Joel Sobel, *Strategic Information Transmission,* Econometrica: Journal of the Econometric Society 1431–1451 (1982).

[834] *See, e.g.,* Robert Forsythe, Russell Lundholm and Thomas Rietz, *Cheap Talk, Fraud, and Adverse Selection In Financial Markets: Some Experimental Evidence,* 12 (3) The Review of Financial Studies 481–518 (July 1999), *available at https://doi.org/10.1093/revfin/12.3.0481.*

[835] The TCFD, the SASB, the GRI, the Principles for Responsible Investment, the PCAF, and the CDP (among others), have all developed standards and systems that aim to help firms and investors identify, measure, and communicate climate-related information and incorporate that information into their business practices. Multiple frameworks have emerged, in part, because each seeks to provide different information or fulfill different functions when it comes to disclosing information related to climate-related risks or other ESG factors that may be important to investors.

[836] *See* Climate Risk Disclosures & Practices, *available at https://climatedisclosurelab.duke.edu/wp-content/uploads/2020/10/Climate-Risk-Disclosures-and-Practices.pdf.*

[837] *See* Section IV.A.5. A recent survey of members of the Society for Corporate Governance (SCG) regarding the state of U.S. climate risk disclosures revealed that companies are using many of the existing frameworks to present emissions, environmental data, and other information on ESG issues. Many of the respondents indicated that their companies are now reporting using CDP, GRI, SASB and other standards, with corporate registrants expressing a desire for greater clarity regarding how to make adequate climate disclosures. The survey results indicate that many companies are grappling with how best to provide useful information to investors regarding complex and interrelated risks. *See* Richard Mahony and Diane Gargiulo, *The State of Climate Risk Disclosure: A Survey of U.S. Companies* (2019), *available at https://www.dfinsolutions.com/sites/default/files/documents/2019-10/TCFD_II_Climate_Disclosure_V10_revisedFINAL.pdf.*

[838] *See* Lee Reiners and Charlie Wowk, *Climate-Risk-Disclosures-and-Practices* (2021), *available at https://climatedisclosurelab.duke.edu/wp-content/uploads/2020/10/Climate-Risk-Disclosures-and-Practices.pdf.*

[839] A past study using ESG disclosure data in Bloomberg on US-listed firms, found that, on average, from 2007 to 2015, firms provided only about 18% (median: 13%) of the prescribed SASB disclosure items (which serve as benchmark for financially material disclosures). *See* J. Grewal, C. Hauptmann and G. Serafeim, *Material Sustainability Information and Stock Price Informativeness,* Journal of Business Ethics (Forthcoming) (2020), *available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2966144.*

[840] *See* H.B. Christensen, L. Hail, and C. Leuz, *Mandatory CSR and Sustainability Reporting: Economic Analysis and Literature Review,* Review of Accounting Studies 1–73 (2021).

any type of data that would allow us to quantitatively assess the costs and benefits of the proposed rules.

1. Benefits

The primary benefit of the proposed rules is that investors would have access to more comparable, consistent, and reliable disclosures with respect to registrants' climate-related risks. As discussed in the previous sections, investors currently face obstacles in accessing comparable, consistent, and reliable climate-related information due to a combination of registrants not disclosing this information at all, or registrants disclosing this information but with varying degrees of coverage and specificity and in varying formats and locations, including company websites, standalone reports, and SEC filings.

Investors are expected to benefit from the required disclosures given that material climate-related information would be provided to the market more consistently across registrants of different sizes and filer status, whether domestic or foreign issuers, and regardless of industry. Investors are also expected to benefit from the more consistent content of the disclosures. Specifically, the proposed rules would enhance comparability by requiring registrants to provide disclosures on a common set of qualitative and quantitative climate-related disclosure topics in their filings.

In addition to the standardized content, investors are expected to benefit from a common location of the disclosures in regulatory filings. The proposed rules would require registrants to place all relevant climate-related disclosures in Securities Act or Exchange Act registration statements and Exchange Act annual reports in a separately captioned ''Climate-Related Disclosure'' section, or alternatively, to incorporate by reference from another section, such as Risk Factors, Description of Business, or MD&A. By mandating that standardized climate-related information be disclosed, and requiring it to be placed in a centralized location within regulatory filings, the proposed rules could reduce investors' search costs and improve their information-processing efficiency. These factors can also lead to positive information externalities—as more firms disclose how measures of climate risk affect their business operations, investors would gain a better understanding of how those same climate risks may affect other similar firms.[841]

Furthermore, by requiring this information to be *filed* with the Commission as opposed to posted on company websites or *furnished* as exhibits to regulatory filings, the proposed rules are expected to improve the reliability of information provided to investors moving forward.[842] Several commenters indicated that the treatment of climate-related disclosures as filed would help improve investor confidence in the accuracy and completeness of such disclosures.[843] Recent academic work provides evidence of firms' engagement in obfuscation and other misleading efforts (so-called ''greenwashing'')[844] to manipulate the set of information available on corporate websites and sustainability reports with the goal of attaining higher ESG ratings, which are relied upon, in particular, by unsophisticated investors for the value of institutional certification.[845] Direct disclosures may also reduce reliance on these ESG ratings, which are not necessarily standardized nor fully transparent with respect to their methodologies. In fact, several studies found low correlations of classifications across ESG providers.[846] Additionally, a study suggested that models and metrics used by ESG providers for appropriately classifying funds are not always transparent and consistent across ESG providers.[847]

As discussed in Section IV.B.1, surveys of institutional investors indicate that climate risk is one of the most prominent issues driving their investment decisions and engagements with companies. Evidence from the stock market response appears consistent with this, with increased mandatory ESG disclosure being associated with aggregate stock price movement.[848] Such stock price effects tend to display cross-sectional heterogeneity with, for example, firms disclosing large GHG emissions experiencing price declines.[849] Similar effects have also been observed in derivatives markets.[850] Investor responses in real estate markets potentially affected by physical risks,[851] as well as revealed preferences from flows into mutual funds with environmental goals in their investment mandates,[852] provide further evidence of investors' interest in disclosures pertaining climate risks. Taken together, the mandatory and standardized nature of the proposed climate-related disclosures could benefit investors by improving their ability to assess these risks and their impact on registrants' financial condition and operations, thereby allowing investors to make better-informed investment decisions and enhancing investor protection.

[841] One study documents how investors can use information from one firm to make inferences of other similar firms in the context of earnings announcements. *See* supra note 812.

[842] By proposing to treat the proposed required climate-related disclosures as ''filed,'' we are therefore subjecting them to potential liability under Exchange Act Section 18, except for disclosures made on Form 6–K. The proposed filed climate-related disclosures would also be subject to potential Section 11 liability if included in or incorporated by reference into a Securities Act registration statement. *See* Section II.C.4 (discussions within).

[843] *See* Section II.H.k.

[844] A review of several academic papers reveal that there is no universally accepted definition of ''greenwashing.'' Though the term ''greenwashing'' is often used in industry discussions regarding ESG, the Commission does not define ''greenwashing'' in this proposal, rules, or form amendments. Greenwashing is typically described as the set of activities conducted by firms or funds to falsely convey to investors that their investment products or practices are aligned with environmental or other ESG principles.

[845] *See* Ruoke Yang, *What Do We Learn From Ratings About Corporate Social Responsibility?,* R&R Journal of Financial Intermediation (2021), *available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3165783.*

[846] Florian Berg, Julian Kölbel, Roberto Rigobon, *Aggregate Confusion: The Divergence of ESG Ratings,* MIT Sloan School (Working Paper 5822–19) (May 17, 2020), *available at https://ssrn.com/abstract=3438533* or *http://dx.doi.org/10.2139/ssrn.3438533.* Authors found that the correlations between six different ESG ratings are on average 0.54, and range from 0.38 to 0.71, while the correlations between credit ratings were 0.99. *See also* OECD, *OECD Business and Finance Outlook 2020,* Sustainable and Resilient Finance (Sept. 29, 2020), *available at https://www.oecd.org/daf/oecd-business-and-finance-outlook-26172577.htm.* OECD analyzed different rating providers, such as Bloomberg, MSCI and Refinitiv and found wide differences in the ESG ratings assigned, with an average correlation of 0.4. When OECD analysis then compared ESG ratings with the issuer credit rating by major providers, it found that credit scores for selected issuers vary much less. *See also* International Monetary Fund, Global Financial Stability Report (Oct. 2019), *available at https://www.imf.org/en/Publications/GFSR/Issues/2019/10/01/global-financial-stability-report-october-2019.* It found that only 37% of Lipper ethical funds also carry a sustainable designation by Bloomberg.

[847] *See* OECD Business and Finance Outlook 2020, *Sustainable and Resilient Finance* (Sept. 29, 2020); H. Friedman, M. Heinle, and I. Luneva, *A Theoretical Framework for Environmental and Social Impact Reporting* (Working Paper) (2021).

[848] *See* J. Grewal, E.J. Riedl, and G. Serafeim, *Market Reaction to Mandatory Nonfinancial Disclosure,* 65 (7) Management Science 3061–3084 (2019).

[849] *See* V. Jouvenot and P. Kruger, *Mandatory Corporate Carbon Disclosure: Evidence from a Natural Experiment* (Working Paper) (2021); P. Bolton and M. Kacperzcyk, *Signaling through Carbon Disclosure* (Working Paper) (2020).

[850] E. Ilhan, Z. Sautner, G. Vilkov, *Carbon Tail Risk,* 34 (3) Review of Financial Studies 1540–1571 (2021).

[851] *See supra* note 802.

[852] *See supra* note 804.

Improving and standardizing climate disclosures also could mitigate adverse selection problems that may arise in the presence of asymmetric information [853] by making more accurate and standardized information available to the general public.[854] Improved disclosure could make it easier for investors to process information more effectively and improve the estimation of firm's future cash flows, leading to more accurate firm valuation.[855] In particular, the enhanced disclosures may yield further benefits for the disclosures of financial firms. Because financial firms can have significant exposures to climate-related risks through their portfolio companies, any enhancements in the portfolio companies' disclosures can subsequently be leveraged by these financial firms in assessing the risks to their portfolios and to the firm as a whole.[856]

Another benefit of the proposed rules is that it could allow firm's shareholders to better monitor management's decisions and mitigate certain agency problems stemming from management's discretionary choices with respect to climate disclosure. Agency problems could occur when management act opportunistically in their own self-interest at the expense of shareholders by disclosing only certain climate-related information at their discretion. As previously discussed in Section IV.B.2.b, management may be motivated to selectively disclose only climate-related information,[857] while omitting harder to verify risks.[858] In the context of climate-related risks, agency issues may be exacerbated by the potential conflicts between short-term profitability and long-term climate risk horizons [859] and the misalignment of interests and incentives between long-term shareholders and management,[860] whereby the latter may unduly focus on short-term results [861] given pressures to demonstrate performance.[862] Under the current regime, many climate-related risks may be unobservable or obfuscated, giving short-term-focused managers an incentive to initiate projects exposed to these risks without properly informing investors.

Agency problems might be exacerbated by registrants' use of boilerplate language or selective disclosure (*i.e.,* ''cherry picking''),[863] which might reduce transparency and impair investors' ability to effectively monitor firm management. The lack of a standardized disclosure framework could make it easier for registrants to forego the use of certain metrics or scopes and omit information that might otherwise indicate shortcomings.[864] Previous studies have found that more detailed reporting can mitigate agency problems as it facilitates the scrutiny and discipline of firm management, allowing investors to monitor firms' operations more closely and thus evaluate whether managers have acted in the best interests of shareholders.[865] By requiring registrants to provide comprehensive and detailed climate-related information to investors, the proposed rules are expected to reduce the likelihood of unreliable or boilerplate disclosures. This can enable investors to better monitor firm's management, reducing agency problems and ultimately strengthening investor protection. In the following sections, we discuss how specific aspects of the proposed rules could contribute to the aforementioned benefits.

The proposed rules would mandate more detailed and comprehensive disclosure with respect to climate-related risks. More consistent, comparable, and reliable disclosures could lead to capital market benefits in the form of improved liquidity, lower costs of capital, and higher asset prices

[853] Asymmetric information occurs when one party to an economic transaction possesses greater material knowledge than the other party. Adverse selection occurs when the more knowledgeable party only chooses to transact in settings that, based on their private information, is advantageous for them. Less informed parties aware of their informational disadvantage might be less inclined to transact at all for fear of being taken advantage of. *See* George Akerlof, *The Market for 'Lemons, Quality Uncertainty and the Market Mechanism,* 84 (3) Quarterly Journal of Economics 488–500 (1970).

[854] *See* R.E. Verrecchia, Essays on Disclosure, 32 *Journal of Accounting and Economics* 1–3, 97–180 (2001).

[855] *See* R. Lambert, C. Leuz, and R.E. Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital,* 45 (2) Journal of Accounting Research 385–420 (2007).

[856] In 2021, the CDP coordinated with 168 financial institutions, with a combined AUM of $17 trillion USD, to engage over 1,300 companies to request climate-related information, among other topics. *See* CDP Non-Disclosure Campaign: 2021 Results, *available at https://cdn.cdp.net/cdp-production/cms/reports/documents/000/006/069/original/CDP_2021_Non-Disclosure_Campaign_Report_10_01_22_%281%29.pdf?1642510694.*

[857] *See supra* note 830 (A recent study, for example, shows that absent mandatory requirements from regulators, voluntary disclosures following third-party frameworks are generally of poor quality and that firms making these disclosures cherry-pick to report primarily non-material climate risk information.).

[858] *See* World Economic Forum, *How to Set Up Effective Climate Governance on Corporate Boards: Guiding Principles and Questions* (2019), *available at https://www3.weforum.org/docs/WEF_Creating_effective_climate_governance_on_corporate_boards.pdf.* In addition, there are a number of academic studies examining the association of climate-related disclosures with corporate governance structures and managerial characteristics. *See, e.g.,* M. Kılıç and C. Kuzey, *The Effect of Corporate Governance on Carbon Emission Disclosures: Evidence from Turkey,* 11–1 International Journal of Climate Change Strategies and Management 35–53 (2019); S. Yunus, E.T. Evangeline, and S. Abhayawansa, *Determinants of Carbon Management Strategy Adoption: Evidence from Australia's Top 200 Publicly Listed Firms,* 31–2 Managerial Auditing Journal 156–179 (2016); Caroline Flammer, Michael W. Toffel, and Kala Viswanathan, *Shareholder Activism and Firms' Voluntary Disclosure of Climate Change Risks,* 42–10 Strategic Management Journal 1850–1879 (Oct. 2021).

[859] Physical and transition climate risks can materialize over time horizons ranging from the immediate future to several decades. Long horizons, for example, tend to involve changes in chronic physical risks—(sea-level rise, drought, etc.). Shorter-term horizons may, instead, be relevant for increase in acute physical risks such as hurricanes, wildfires, and heatwaves. *See* ING Climate Risk Report 2020, *available at https://www.ing.com/2021-Climate-Report.htm.*

[860] A report by the Environmental Audit Committee of the UK House of Commons on Greening Finance, issued in June 2018, found that short-termism is a pervasive problem in corporate decision making and leaves business ill-equipped to consider and incorporate long term risks, such as climate change and sustainability. *See* Envtl. Audi Comm., House of Commons, U.K. Parliament, *Greening Finance: Embedding Sustainability in Financial Decision Making* (June 6, 2018), *available at https://publications.parliament.uk/pa/cm201719/cmselect/cmenvaud/1063/106302.htm.*

[861] *See* Henry M. Paulson Jr., *Short-Termism and the Threat From Climate Change, Perspectives on the Long Term: Building a Stronger Foundation for Tomorrow* (Apr. 2015), *available at https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/short-termism-and-the-threat-from-climate-change.*

[862] Factors including corporate executive compensation and attention to quarterly earnings and reporting are thought to contribute to excessive focus on short-term goals. *See, e.g., https://corpgov.law.harvard.edu/2020/10/11/short-termism-revisited.*

[863] *See supra* note 806; see also Morningstar, *Corporate Sustainability Disclosures* (2021), *available at https://www.morningstar.com/en-uk/lp/corporate-sustainability-disclosures.* (''Companies will disclose the good and hide the bad while disclosure remains voluntary.'').

[864] *See* JE Fisch, *Making Sustainability Disclosure Sustainable,* 107 Georgetown Law Journal 923–966 (2019). *See* Climate Risk Disclosures & Practices: Highlighting the Need for a Standardized Regulatory Disclosure Framework to Weather the Impacts of Climate Change on Financial Markets, (2020), *available at https://climatedisclosurelab.duke.edu/wp-content/uploads/2020/10/Climate-Risk-Disclosures-and-Practices.pdf.*

[865] *See* C. Kanodia and D. Lee, *Investment and Disclosures: The Disciplinary Role of Performance Reports,* 36(1) Journal of Accounting Research 33–55 (1998); P. Healy, and K. Palepu, *Information Asymmetry, Corporate Disclosure, and the Capital Markets: A Review of the Empirical Disclosure Literature,* 31 (1–3) Journal of Accounting and Economics 405–440 (2001); Huang Pinghsun and Yan Zhang, *Does Enhanced Disclosure Really Reduce Agency Costs? Evidence from the Diversion of Corporate Resources,* 87(1) The Accounting Review, 199–229 (2012); R.M. Bushman and A.J. Smith, *Financial Accounting Information and Corporate Governance,* 32 (1–3) Journal of Accounting and Economics 237–333 (2001); R. Lambert, C. Leuz, and R.E. Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital,* 45 (2) Journal of Accounting Research 385–420 (2007).

(or firm valuations).[866] These benefits would stem from reductions in information asymmetries brought about by the required disclosure of climate-related information, both among investors and between firms and their investors. In the first case, less information asymmetry among investors could mitigate adverse selection problems by reducing the informational advantage of informed traders. This is likely to improve stock liquidity which, in turn, can attract more investors, thereby reducing the cost of capital. In the second case, less information asymmetry between firms and their investors could allow investors to better estimate future cash flows, which could reduce investors' uncertainty, as well as the risk premium they demand, thus lowering the costs of capital for registrants. Economic theory illustrates how, all else equal, a drop in the cost of capital leads to a boost in equity valuation, which can further benefit investors.

a. Disclosure Regarding Climate-Related Risks and Their Impacts on Strategy, Business Model, and Outlook

The proposed rules would require registrants to identify their climate-related risks that are reasonably likely to have a material impact on the registrant's business or consolidated financial statements over the short, medium, and long-term and describe the actual and potential impacts of those risks on its strategy, business model, and outlook. Registrants would specifically be required to disclose impacts on, or any resulting significant changes made to, their: (i) Business operations, including the types and locations of its operations; (ii) products or services; (iii) supply chain or value chain; (iv) activities to mitigate or adapt to climate-related risks; and (v) expenditures for research and development.

If, as part of its net emissions reduction strategy, a registrant uses carbon offsets or RECs, the proposed rules would require it to disclose specific information around the role that carbon offsets or RECs play in the registrant's climate-related business strategy. If a registrant uses an internal carbon price, the proposed rules would require it to disclose information around the boundaries for measurement of overall CO_2e, the price per metric ton of CO_2e, as well as how the total price is estimated to change over time, if applicable. Similarly, to the extent that the registrant uses analytical tools such as scenario analysis, the proposed rules would require a description of those analytical tools, including the assumptions and methods used.

The specific disclosures required by the proposed rules are expected to improve investors' understanding of what the registrant considers to be the relevant short-, medium-, and long-term climate-related risks that are reasonably likely to have a material impact on its business, taking into consideration the useful life of the organization's assets or infrastructure and the fact that climate-related risks may manifest themselves over the medium and longer terms. Compared to the baseline, investors would be better able to identify and assess how climate-related risks may affect a registrant's businesses, strategy, and financial planning in several areas, including products and services, supply chain and/or value chain, adaptation and mitigation activities, investment in research and development, operations (including types of operations and location of facilities), acquisitions or divestments, and access to capital. Investors would gain insight into how climate-related risks may serve as an input to the registrant's financial planning process and the time period(s) used for this process.

For example, investors may gain better insights into the registrant's estimated costs of any operational changes expected to be implemented to achieve emission reduction targets. Alternatively, investors may gain valuable information on how certain climate events may impact the registrant's property, workforce, or its production schedule across the different physical sites where the registrant conducts business. Adverse climate-related events may impact the useful lives and/or valuation reserves of balance sheet assets. For example, sea level increases and other climate related patterns may adversely impact the estimated useful lives of coastal facilities. Similarly, more extreme weather patterns may adversely impact agricultural regions and the value of related equipment and lands. This information is expected to be useful for investors in assessing how climate-related risks are managed, and whether and how these risks may affect a registrant's financial condition and results of operations. The required disclosure around the role that carbon offsets or RECs play in the registrant's climate-related business strategy could help investors better understand that strategy, including how resilient it is to changes in costs or the availability or value of offsets or RECs over the short, medium and long-term. The required disclosures around internal carbon price, when used by a registrant, could provide investors with more standardized and detailed information regarding how the registrant developed a particular business strategy and help investors assess whether a registrant's internal carbon pricing practice is reasonable and whether its overall evaluation and planning regarding climate-related factors is sound. The required disclosure around the assumptions and methods used by a registrant when employing analytical tools or conducting scenario analysis can improve investors' assessment of the resiliency of a registrant's strategy and business model in light of foreseeable climate-related risks and improve investors' ability to compare said resiliency among registrants.

The proposed requirement to identify material climate-related risks over the short-, medium-, and long-term could also help mitigate agency problems deriving from the potential misalignment of planning horizons between the firm's shareholders and its managers. The information required to be disclosed about the firm's business operations, products or services, supply or value chain, activities to mitigate or adapt to climate-related risks, and expenditure for research and development could allow investors to assess how climate-related issues may impact the registrant's financial performance (*e.g.,* revenues, costs) and financial condition (*e.g.,* assets, liabilities). These disclosures should allow investors to gain valuable insights on how resources are being used by management to mitigate climate-related risks and to facilitate investors' evaluation of whether managers are taking appropriate steps to address such risks.

b. Governance Disclosure

The proposed rules would require a registrant to disclose information concerning the board's oversight of climate-related risks as well as management's role in assessing and managing those risks. The proposed rules would require a registrant to disclose whether any member of its board of directors has expertise in climate-related matters and the processes and frequency by which the board discusses climate-related factors. When describing management's role in assessing and managing climate-related factors, a registrant would be required to disclose whether certain management positions are responsible for assessing and managing climate-related factors and the processes by which the responsible managers are informed

[866] *See* Section IV.D for more information on capital market benefits.

about and manage climate-related factors.

The disclosures required by the proposed rules should enable investors to better understand how the firm is informed about climate-related factors and how frequently the firm considers such factors as part of its business strategy, risk management, and financial oversight. Investors would be expected to gain better information around whether the organization has assigned climate-related responsibilities to management-level positions or committees and, if so, whether those responsibilities include assessing and/or managing climate-related risks. As a result, investors may be better able to understand and evaluate the processes by which management is informed about and monitors climate-related risks. For example, investors may be better positioned to assess whether and how the firm's board and management consider climate-related risks when reviewing and guiding business strategy and major plans of action, when setting and monitoring implementation of risk management policies and performance objectives, and when reviewing and approving annual budgets.

With detailed information about climate expertise among the registrant's directors, investors could more effectively evaluate the firm's governance practices related to the identification and management of climate-related risks. In particular, investors may be able to exercise closer oversight of management's actions as they assess implementation of risk management policies and performance objectives, review and approve annual budgets, and oversee major capital expenditures, acquisitions, and divestitures.

c. Risk Management Disclosure

The proposed rules would require registrants to describe their processes for identifying, assessing, and managing climate-related risks. This includes disclosure on how registrants assess materiality, whether they consider likely future regulatory actions, how they prioritize, mitigate, or adapt to climate-related risks, and overall how climate-related factors are integrated into the registrants' risk management systems or processes. Registrants would also be required to provide detailed descriptions on any transition plans,[867] as applicable, including relevant targets and metrics, how physical and transition risks are managed, and actions taken and progress made toward the plan's targets or goals.[868]

The disclosures required by the proposed disclosures could inform investors regarding how proactive and diligent registrants may be with respect to climate-related risks. Investors can use this information to acquire a more detailed understanding of how resilient registrants' risk management systems may be towards climate-related risks, which could contribute to better-informed investment or voting decisions. These disclosures could allow investors to better monitor and assess whether registrants have in place adequate risk management systems and whether they are aligned with investor preferences.

Conversely, investors may be better able to detect whether certain registrants' risk management systems would fail to account for certain types of climate factors such as change in consumer preferences, adjustments of business models, and technological challenges or innovations, which may have implications on companies' operations and financial conditions. These disclosures may also allow investors to assess whether registrants are evaluating these risks over specific time horizons, which may be particularly relevant in cases in which management may be more concerned with short-term performance while neglecting longer term risks. Accordingly, this provision could help address agency problems related to the misalignment of planning horizons.

d. Financial Statement Metrics

The proposed rules would require registrants to disclose certain disaggregated climate-related metrics in its financial statements under the following categories: (i) Financial impact metrics; (ii) financial expenditure metrics; and (iii) financial assumptions. The proposed rules would require a registrant to disclose the impact of climate-related events (severe weather events and other natural conditions and physical risks identified by the registrant) and transition activities (including transition risks identified by the registrant) on its consolidated financial statements, if the disclosure threshold is met. For each type of metric, the provisions would require the registrant to disclose contextual information to enable the reader to understand how it derived the metric, including a description of significant inputs and assumptions used to calculate the specified metrics, thus providing the necessary transparency for facilitating investors' understanding and peer comparisons. To avoid potential confusion and to maintain consistency with the rest of the financial statements, the proposed financial statement metrics would be required to be calculated using financial information that is consistent with the scope of the rest of the registrant's consolidated financial statements included in the filing. The proposed rules would specify the basis of calculation for the climate-related financial statement metrics and clarify how to apply these accounting principles when calculating the climate-related financial statement metrics.

With respect to financial impact metrics, the proposed rules would require a registrant to disclose the impacts arising from climate-related events, including physical risks identified by the registrant and severe weather events and natural conditions, such as flooding, drought, wildfires, extreme temperatures, and sea level rise. In addition to physical risks, registrants also would be required to disclose the financial impact of transition activities (including transition risks identified by the registrant), such as efforts to reduce GHG emissions or otherwise mitigate exposure to transition risks on any relevant line items in the registrant's consolidated financial statements. The proposed rule would require registrants to reflect the impact of the climate-related events or transition activities on each line item of the registrant's consolidated financial statements (*e.g.,* line items of the consolidated income statement, balance sheet, or cash flow statement) unless the aggregate impact of the events and transition activities is less than one percent of the total line item. By exempting such line item reporting when the aggregate impact of the events is less than one percent, the proposed rule would reduce overall costs for firms associated with disclosures for instances where the impact is likely to be quite small, while providing assurance to investors that more significant impacts are reflected in line item reporting.[869]

We expect that the proposed financial statement metrics impact would provide additional transparency into the nature

[867] Transition plans would be defined as a registrant's strategy and implementation plan to reduce climate-related physical and transition risks and increase climate-related opportunities, including by reducing its own emissions. If the registrant has made a public commitment to reduce its GHG emissions by a certain date, it must disclose such date and its plan to achieve its public commitment.

[868] *See* Section IV.C.1.f for a more detailed discussion of the potential benefits of targets and goals disclosure.

[869] The choice of a one percent threshold is consistent with what the Commission currently uses in other contexts for disclosure of certain items within the financial statements and without (*e.g.,* §§ 210.5–03.1(a), 210.12–13, and 229.404(d)).

of a registrant's business and the significance of many of the climate-related risks and impacts on its overall financial condition. Such disclosures are expected to provide investors with valuable insights into potential changes to, among others, revenue or costs from disruptions to business operations or supply chains; impairment charges and changes to the carrying amount of assets due to the assets being exposed to physical risks; revenue or cost due to new emissions pricing or regulations resulting in the loss of a sales contract and; operating, investing, or financing cash flow from changes in upstream costs, such as transportation of raw materials. Separately reporting the financial statement impacts from the specified climate-related events and transition activities could improve comparability of both the registrant's year-to-year disclosure and between the disclosures of different registrants. Because the risks presented by the climate-related events and transition activities may be correlated across different registrants and across time, future climate-related risks could manifest in such a way that a large subset of registrants are affected, making them potentially a non-diversifiable risk. In this case, separate financial impact disclosures could inform investors of their exposure to these risks not just for a single registrant, but across all the registrants in their portfolios. Such disclosures could be beneficial as they would be informative of both individual registrant exposures to climate-related risks, and the level of climate-related risks in the aggregate, thus allowing investors to more effectively evaluate and manage the risk of their entire portfolio. Moreover, to the extent that registrants are not aware of climate-related risks in the aggregate, these disclosures would allow for a greater understanding of the climate-related risks they face, providing them the opportunity *to make more informed investment decisions taking into account such risks.*

With respect to financial expenditure metrics, the proposed rules would require a registrant to disclose the positive and negative impacts associated with the same climate-related events and transition activities as the proposed financial impact metrics. The expenditure metrics would require a registrant to separately aggregate amounts of expenditure expensed and capitalized costs incurred during the fiscal years presented. For each of those categories, a registrant would be required to disclose separately the amount incurred during the fiscal years presented toward positive and negative impacts associated with the specified climate-related events and to mitigate exposure to transition risks. The expenditure metrics would also be subject to the same disclosure threshold as the financial impact metrics, which should promote consistency and clarity.

Together, these disclosures are expected to provide investors with information about the total expenditure toward or capitalized costs incurred for specified climate-related events. As such, they are expected to increase the resilience of assets or operations, retire or shorten the estimated useful lives of impacted assets, relocate assets or operations at risk, or otherwise reduce the future impact of severe weather events and other natural conditions on business operations. The proposed rules also would provide investors with information about the amount of expenditure expensed or capitalized costs incurred for climate-related transition activities related, among others, to research and development of new technologies, purchase of assets, infrastructure, or products that are intended to reduce GHG emissions, increase energy efficiency, or improve other resource efficiency.

With respect to financial assumptions, the proposed rules would require registrants to disclose whether the estimates and assumptions used to produce the consolidated financial statements were impacted by risks and uncertainties associated with, or known impacts from, severe weather events and other natural conditions, such as flooding, drought, wildfires, extreme temperatures, and sea level rise. If so, the registrant would be required to provide a qualitative description of how such events have impacted the development of the estimates and assumptions used to prepare such financial statements. Similarly, if the estimates and assumptions were impacted by potential transition risks, the registrant would be required to provide a qualitative description of how the development of the estimates and assumptions were impacted by such a transition. We expect that the proposed disclosures would provide transparency to investors on the impact of climate-related events and transition activities on the estimates and assumptions used by the registrant to prepare the financial statements and allow investors to evaluate the reasonableness of the registrant's estimates and assumptions.

Prior evidence shows that existing climate-related disclosures often contain boilerplate language or are ''cherry-picked'' to present information that is favorable to the company.[870] Accordingly, registrants under the current regulatory regime may choose to provide only brief, qualitative descriptions of certain climate-related factors while omitting concrete, quantitative information on how climate-related factors can impact individual financial statement line items. The proposed rule may mitigate these types of agency problems by requiring registrants to disclose specific, quantitative metrics according to standardized scopes and methodologies, thereby helping investors processing information more effectively.

The proposed financial metrics would be part of the financial statements and thus audited by an independent public accounting firm in accordance with existing Commission rules and PCAOB auditing standards.[871] Subjecting these climate-related disclosures to reasonable assurance pursuant to an audit would require the auditor to assess the risk of material misstatement related to the estimates and judgments, including through evaluation of the method of measurement and reasonableness of the assumptions used, and to understand management's risk management processes, including the accuracy of the proposed disclosure, thereby alleviating possible concerns about the data's reliability and comparability, and improving investor confidence in such disclosure.[872] Academic research finds that assurance procedures can increase the relevance and reliability of disclosures, particularly for those involving significant estimation uncertainties. [873]

e. GHG Emissions Metrics

The proposed rules would require all registrants to disclose Scope 1 and Scope 2 GHG emissions. Given the

[870] *See supra* note 830 and 806.

[871] Such audits could increase the probability of discovering and penalizing any misrepresentation. Since this would increase the expected costs of engaging in misrepresentation, as discussed in Section IV.B.2, this would also be likely to increase the odds of accurate revelation of material information.

[872] *See* Section II.F.5.

[873] *See* M. DeFond and J.A. Zhang, *A Review of Archival Auditing Research,* 58(2–3) *Journal of Accounting and Economics* 275–326 (2014); V.K. Krishnan, *The Association Between Big 6 Auditor Industry Expertise and the Asymmetric Timeliness of Earnings* 20 *Journal of Accounting, Auditing and Finance* 209–228 (2005); W. Kinney and R. Martin, *Does Auditing Reduce Bias in Financial Reporting? A Review of Audit-Related Adjustment Studies,* 13 Auditing: A Journal of Practice & Theory 149–156 (1994); K.B. Behn, J.H. Choi, and T. Kang, (2008), *Audit Quality and Properties of Analyst Earnings Forecasts* 83 The Accounting Review 327–349 (2008). Some commenters expressed similar views. *See, e.g.,* Comment Letters from CAQ, Ceres; Impax Asset Management; San Francisco Employees' Retirement System; and UNEP–FI.

possibility of a transition to a lower-carbon economy, investors and other market participants may be concerned about registrants that have high GHG emissions since these registrants may be more exposed to certain transition risks, such as regulations that restrict emissions or the potential impacts of changing consumer preferences or market conditions. Should a transition to a low-carbon economy gain momentum, registrants with higher amounts of Scope 1 and 2 emissions may be more likely to face sharp declines in cash flows, either from greater costs of emissions or the need to scale back on high-emitting activities, among other reasons, as compared to firms with lower amounts of such emissions.

Understanding the extent of this potential exposure to transition risks could help investors in assessing their risk exposures with respect to the companies in which they invest. Greater consistency in emissions disclosures can further benefit investors as it can facilitate comparisons between the registrants and their peers and assist in understanding the overall risk of their portfolios. As described below, emissions disclosures would also help inform investors about the extent to which a company has been or is following through with its disclosed strategies and transition plans. As further discussed in Section IV.D, we expect this provision to lower uncertainty for investors, thereby reducing the cost of capital. This may make it easier to raise equity and debt, or to obtain loan financing.

Besides the direct risk to cash flows through cost of emissions or the need to scale back on high-emitting activities, such a transition could also cause a registrant's assets to suffer from unanticipated or premature write-downs, devaluations, and/or adverse adjustments in reserves. The proposed Scope 1 and 2 emission disclosures would allow investors to identify registrants whose assets may be more likely to become obsolete or non-performing or lose economic value ahead of their anticipated useful life due to a potential transition to a lower-carbon economy, and more generally allow investors to discern whether certain investments are unlikely to earn the anticipated economic return due to such transition. The proposed disclosures would also allow investors to more closely monitor whether a firm's management is properly accounting for the impairment of such stranded assets to ensure that they are recorded on the balance sheet as a loss of profit and are not carried at more than their recoverable amount. Given the significant possibility that Scope 1 and 2 emissions will affect the valuation of the registrant through impacts on earnings, cost of capital, investor demand, or potentially some other channel, investor protection would be enhanced by requiring disclosure of this information.

Moreover, by specifying that the information should be provided by all registrants, investors would benefit from having access to a more comprehensive set of emissions data against which to measure a registrant's progress in meeting any stated emissions goals or otherwise managing its climate-related risks, as a part of assessing the registrant's overall business and financial condition. In the absence of the proposed rules, some registrants may choose to selectively omit quantitative emissions metrics. The resulting state of disclosures is less meaningful and less transparent, making it significantly more difficult for investors to assess the degree of risk in individual firms, to compare across firms, and to value securities.

As discussed in Section IV.A, some registrants currently report emissions via the EPA's 2009 mandatory Greenhouse Gas Reporting Program.[874] However, the nature of the reporting requirements and the resulting data is more suited to the purpose of building a national inventory of GHG emissions, not of assessing emissions-related risks to individual registrants. Specifically, direct emitters must report their emissions at the facility-level (not registrant-level) and suppliers of certain products must report their ''supplied emissions,'' conditional on these emissions exceeding a specified threshold.[875] In addition, as previously discussed, the EPA emissions data does not allow a clean disaggregation across the different scopes of emissions for a given registrant.[876] From the point of view of an investor seeking greater information regarding a registrant, the EPA's emissions data may be difficult for investors to use, because the data are made public by facility and not by company. While each facility is matched to its parent company, this company may not be the entity registered with the SEC and thus of interest to investors. Taken together, the EPA emissions data is not well suited to enabling investors to fully assess the degree to which each registrant is exposed to transition risks.

[874] *See* Section IV.A.3.

[875] *See* supra note 737.

[876] *See* Section IV.A.3.

The proposed rules would result in more comprehensive and tailored emissions information by requiring disclosure of Scope 1, Scope 2, and in some cases Scope 3 emissions by registrants in SEC filings. Prior evidence has shown that when information that is already publicly available elsewhere is included within SEC filings, the public becomes more aware of the information.[877] While there are numerous differences with regard to EPA reporting, this evidence suggests that even were these differences not to exist, and the only change were to be inclusion in SEC filings, there would nonetheless be an advantage in improving consistency and reliability and decreasing search costs.

The proposed rules would also provide informational benefits beyond the voluntary disclosure of emissions in sustainability reports. While currently disclosed information reflects investor demand, the overall information disclosed to the market may be biased due to its voluntary nature, in that companies that have more favorable data (*e.g.,* lower emissions) may be more likely to make these voluntary disclosures. Requiring all registrants to provide consistent disclosures, as proposed, would reduce the bias that can result from a voluntary regime. Moreover, as discussed above, locating the information in SEC filings may make it more accessible to investors and contribute to greater consistency and reliability.

Specific provisions are designed to facilitate comparability across registrants and industries. For example, requiring the disclosure of GHG intensity in terms of metric tons of CO_2e per unit of total revenue and per unit of production would allow investors to directly assess the efficiency of the registrant's operations and compare across different industries and firms of varying size. Increased standardization in the reporting of these metrics may allow investors to assess more effectively a registrant's transition risk against that of its competitors. As another example, the proposed rules would require a registrant to set the organizational boundaries for its GHG emissions disclosure using the same scope of entities, operations, assets, and other holdings within its business organization structure as those included in its consolidated financial statements. Requiring a consistent approach would

[877] *See* H.B. Christensen, E. Floyd, L.Y. Liu, and M Maffett, *The Real Effects of Mandated Information on Social Responsibility in Financial Reports: Evidence from Mine-Safety Records,* 64 (2–3) Journal of Accounting and Economics 284–304 (2017).

avoid potential investor confusion about the reporting scope used in the financial statements and enhance comparability across registrants,[878] helping investors in assessing a registrant's transition risk against that of its competitors.

The proposal would also require non-SRC registrants to disclose Scope 3 emissions if material or if the registrant has a target or goal related to Scope 3.[879] In addition, specified registrants would also be required to disclose the methodology used to compute emissions, the breakdown of the different GHGs, as well as upstream and downstream activities, and data quality.[880] Scope 3 emissions GHG emissions can represent the majority of the carbon footprint for many companies, in some cases as high as 85% to 95%.[881] For example, according to Morgan Stanley Capital International (MSCI), the Scope 3 emissions of the integrated oil and gas industry are more than six times the level of its Scope 1 and 2 emissions.[882] Companies may have indirect control over their Scope 3 emissions through choices they make, for example in selecting suppliers, designing products, or sourcing inputs more efficiently. Nevertheless, the majority of companies do not typically report this information. As of July 10, 2020, for example, within the sample of companies belonging to the MSCI ACWI Investable Market Index (IMI),[883] the total Scope 3 average intensity was almost three times greater than the combined Scope 1 and 2 intensity. Yet, only 18% of constituents of the MSCI ACWI IMI reported Scope 3 emissions, with even lower reporting percentages when looking at the individual Scope 3 categories.[884]

The reporting of Scope 3 emissions for these registrants would provide additional benefits for investors. Scope 3 emissions information may be material in a number of situations to help investors gain a more complete picture of the transition risks to which a registrant may be exposed. Relative to registrants with substantial Scope 1 and 2 emissions, future regulations that restrict emissions may impact registrants with high Scope 3 emissions differently. In certain industries, a transition to lower-emission products or processes may already be underway, triggered by existing policies, a shift in consumer preferences, technological changes, or other market forces.

Registrants with significant Scope 3 emissions may be more likely to face disruptions not only in their cash flows, but also in their business models or value chains to the extent that these registrants are compelled to make changes in their products, suppliers, distributors, or other commercial partners.[885] Moreover, if consumer demand changes to favor less carbon intensive products, companies with high Scope 3 emissions may see a marked reduction in demand for their products, and companies that are not aware of these risks could be less profitable relative to those that understand these risks and are prepared to mitigate them. Alternatively, companies that can source inputs that involve less GHG emissions could achieve potential cost savings and those that could produce products that generate less GHG emissions by the end user could potentially enjoy higher demand. Some registrants may plan to shift their activities to capitalize on these changes and thus may need to allocate capital to invest in lower emissions equipment or to create new types of products. Investors would need information about the registrants' full GHG emissions footprint and intensity to determine and compare how exposed a registrant is to the financial risks associated with a transition to lower-carbon economy.

Over the last few years, a number of studies have shown that firms try to reduce their local carbon footprints by outsourcing their carbon emissions to suppliers in states or countries with weaker environmental policies.[886] These studies provide evidence of the substitutional relationship between direct and outsourced GHG emissions. Recent studies have also analyzed the substitution effects between Scope 1 and Scope 3 GHG emission activities of U.S. firms. The findings show that the relative share of Scope 1 emissions out of a firm's total emissions tend to fall at the expense of the rising proportion of its supplier-generated Scope 3 emissions and that a firm's imports further augment the substitutional relationship between its Scope 1 and Scope 3 emissions.[887] In addition to the outsourcing incentives related to regulatory arbitrage, the authors of these studies posit that firms may also be outsourcing emissions abroad to exploit investors' current difficulties in assessing the firm's carbon emissions through imports along the upstream supply chain. By requiring the disclosure of Scope 3 GHG emissions, the proposed rules would make it more difficult for non-SRC registrants to avoid investors' scrutiny by outsourcing all or part of their activities abroad.

Finally, as described in Section IV.A5.d, many companies have set emissions targets, and it is not always clear whether these targets pertain to Scope 3 emissions or not. As explained in Section IV.C.1.g, registrants would be required to disclose whether the targets pertain to Scope 3 emissions, and as described above, if they do, they would need to report such emissions. Without reporting of Scope 3 emissions amounts and categories, investors would not have the information they need to understand the scale and scope of actions the company may need to take to fulfill its commitment, and thus the overall financial implications of a registrant's targets. For example, a registrant's disclosure of its Scope 3

[878] Unlike the GHG Protocol, which currently provides different options for setting organizational boundaries, the proposed rules would require that the scope of consolidation and reporting be consistent for financial data and GHG emissions data.

[879] The proposed rules include a safe harbor for Scope 3 emissions disclosure from certain forms of liability under the federal securities laws.

[880] In calculating Scope 3 emissions, registrants have the flexibility to choose a methodology they deem fit, however, the specific methodology must be disclosed. Estimates or ranges are permitted. Emissions reporting must be presented as CO_2e as well as disaggregated into the different types of GHGs.

[881] *See* Eric Rosenbaum, Climate experts are worried about the toughest carbon emissions for companies to capture (Aug. 18, 2021) *available at https://www.cnbc.com/2021/08/18/apple-amazon-exxon-and-the-toughest-carbon-emissions-to-capture.html#:~:text=Scope%203%20carbon%20emissions%2C%20or,as%2085%25%20to%2095%25.*

[882] *See also* MSCI, *Emissions: Seeing the Full Picture* (Sept. 17, 2020), *available at https://www.msci.com/www/blog-posts/scope-3-carbon-emissions-seeing/02092372761.*

[883] The MSCI ACWI Investable Market Index (IMI) captures large, mid and small cap representation across 23 Developed Markets and 25 Emerging Markets countries, covering approximately 99% of the global equity investment opportunity set.

[884] *Ibid.*

[885] Scope 3 upstream and downstream emissions represents a substantial portion of global GHG emissions. For example, according to a recent report, Scope 3 downstream emissions that happen after a product or service leaves a company's control/ownership represented about 49% of global GHG emissions in 2019. Capital goods (87%), banks (81%) and retailing (80%) were among the industries with the highest percentage of Scope 3 downstream emissions relative to their total emissions. These downstream emissions can come from a variety of sources. For example, capital goods activities include emissions from raw material manufacturing and transport. Banks emit few GHGs to run their operations—but finance the emissions of other companies through loans and investments. *See* State of Green Business 2021, *available at https://www.spglobal.com/marketintelligence/en/news-insights/research/state-of-green-business-2021.*

[886] *See, e.g.* I Ben-David, Y. Jang, S. Kleimeier, and M. Viehs, *Exporting Pollution: Where Do Multinational Firms Emit CO_2?* 36 (107) Economic Policy 377–437 (2021); X. Li and Y.M. Zhou, *Offshoring Pollution While Offshoring Production?* 38 Strategic Management Journal 2310–2329 (2017).

[887] *See* R. Dai, R. Duan, H. Liang, and L. Ng, *Outsourcing Climate Change* (SSRN Working Paper) (2021), *available here https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3765485.*

emissions, together with the proposed financial statement metrics, could allow investors to assess the potential (additional) investments the registrant may need to make to meet a certain goal. Moreover, as described further below, reporting of Scope 3 emissions gives a quantitative metric for investors to track, thus reducing opportunities for misleading claims on the part of the registrant.

Because the value of a firm's equity is largely derived from expected future cash flows, disclosure of Scope 1, 2, and 3 emissions can help investors incorporate risks associated with such future cash flows into asset values today. Indeed, the academic literature indicates that equity is a long-term asset, meaning that even risks related to regulatory changes in the distant future could be priced today.[888] Thus, for many registrants, reasonable investors may view GHG emissions as necessary to assess the registrants' exposure to climate-related risks, particularly transition risks, and whether they have developed strategies to reduce their carbon footprint in the face of potential regulatory, policy, and market constraints. This may be particularly important in light of the investor demand documented in IV.B.1 and the potential price impact, as discussed in IV.D.

f. Assurance of GHG Scopes 1 and 2 Emissions Disclosures for Large Accelerated Filers and Accelerated Filers

The proposed rules would require registrants that are large accelerated filers and accelerated filers to provide an attestation report for the registrant's Scope 1 and 2 GHG emissions disclosures. Large accelerated filers constitute approximately 31% of the universe of registrants that filed annual reports during calendar year 2020 (1,950 out of 6,220), but account for 93.6% of market cap within the same universe. Accelerated filers constitute approximately 10% of the universe of registrants that filed annual reports during calendar year 2020 (645 out of 6,220) and account for 0.9% of market cap within the same universe.

The proposed rules provide specific transition periods for obtaining attestation reports. Large accelerated filers would be required to provide Scopes 1 and 2 emissions disclosures in the fiscal year immediately following rule adoption. Next, they would be required to obtain limited assurance over these disclosures in fiscal years 2 and 3 after adoption. They would then be required to obtain reasonable assurance over these disclosures in fiscal year 4 after adoption and going forward. Accelerated filers would follow the same timeline but with a delay of one fiscal year. Specifically, accelerated filers would be required to provide Scopes 1 and 2 emissions disclosures in fiscal year 2 after adoption. Next, they would be required to obtain limited assurance over these disclosures fiscal years 3 and 4 after adoption. They would then be required to obtain reasonable assurance over these disclosures in fiscal year 5 after adoption and going forward.

The proposed transition periods for assurance over large accelerated filers' and accelerated filers' Scopes 1 and 2 GHG emission disclosures are intended to provide these registrants time to familiarize themselves with the GHG emissions disclosure requirements, develop the relevant DCP, and provide the market with an opportunity to develop enough expertise to satisfy the increased demand for GHG emission assurance services. We expect that during the proposed transition periods, the market for assurance services would further mature with respect to institutional knowledge, procedural efficiency, and overall competition, thus lowering costs for registrants and improving the quality of service. Although Scope 3 GHG emissions can constitute a large portion of a registrant's total emission, the proposed rules would exclude Scope 3 GHG emission disclosures from the attestation requirement due to the unique challenges associated with their measurement, which is based on data sources not owned by the registrant,[889] as well as the potential higher costs associated with their verification.

Section IV.A.5.e above discusses survey evidence on the frequency with which firms obtain assurance in sustainability reports. This evidence suggests that a significant fraction of large companies already obtain some form, albeit limited, of assurance. Practices appear to be fragmented with respect to the levels of assurance provided, the assurance standards used, the types of service providers, and the scope of disclosures covered by the assurance. One consequence of such fragmentation has been a lack of clarity about the nature of assurance provided, which can lead to confusion for investors when assessing the quality of disclosures. Moreover, as noted above, the voluntary nature of the reporting could result in biased or incomplete data. The fact, however, that a significant proportion of large companies already obtain some form of assurance over this information is indicative of investors' and companies' need for such disclosures to be reliable.

The importance of assurance for climate-related information also is highlighted by the International Federation of Accountants, which recently published its Vision for High-Quality Sustainability Assurance.[890] As discussed earlier, contrary to other quantitative information that is provided outside of the financial statements, and which is typically derived from the same books and records that are used to generate a registrant's audited financial statements, GHG emissions disclosures are not developed from information that is included in the registrant's books and records.[891] Accordingly, such quantitative disclosure is not be subject to audit procedures as part of the audit of the financial statements in the same filing. Because of this, the proposed requirement of a third-party attestation report may be particularly beneficial to verify the reliability of such quantitative information and enhance its accuracy. In general, subjecting climate-related disclosures to assurance would require the assurance provider to assess the risk of material misstatements related to the estimates and judgments, including through evaluation of the method of measurement and reasonableness of the assumptions used, and an understanding of management's risk management processes, including the risks identified and the actions taken to address those risks.[892] Moreover, by specifying minimum standards for the assurance provided with respect to GHG Scope 1 and 2 emissions disclosures, we expect the proposed rules to promote accuracy and consistency in the reporting of this information, while also providing investors with a baseline level

[888] *See* J. van Binsbergen, *Duration-Based Stock Valuation: Reassessing Stock Market Performance and Volatility* (2021), *available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3611428;* D. Greenwald, M. Leombroni, H. Lustig, and S. van Nieuwerburgh, *Financial and Total Wealth Inequality with Declining Interest Rates* (2021), *available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3789220.* Both of these papers find that the Macauley duration of equity, the weighted average length of time which investors will receive the cash flows from the asset, is in excess of 35 years as of 2019. This indicates that changes in cash flows in the distant future can impact equity prices today.

[889] *See* Section II.G.3.

[890] *See* IFAC Charts the Way Forward for Assurance of Sustainability Information (Dec. 6, 2021), *available at https://www.ifac.org/news-events/2021-12/ifac-charts-way-forward-assurance-sustainability-information.*

[891] *See* Section II.H.1 for more information.

[892] *See* PCAOB, AS 2110 Identifying and Assessing Risks of Material Misstatement (2010).

of reliability against which to evaluate the disclosures.[893]

Academic research finds that assurance procedures can increase the relevance and reliability of disclosures,[894] particularly for those involving significant estimation uncertainties. While most of this academic evidence focuses on the effects of reasonable assurance procedures, we cannot preclude the possibility that such findings may have implications for limited assurance as well. Experimental evidence has found that both limited and reasonable assurance can increase perceived reliability of sustainability reports, but those same studies do not find a statistically significant difference between limited and reasonable assurance.[895] Obtaining assurance for sustainability reports, which as noted above is typically limited assurance, has also been associated with firms with lower costs of capital, increased analyst coverage, and decreased analyst forecast errors and forecast dispersion.[896]

The proposed rules would require the attestation report to identify the criteria against which the subject matter was measured or evaluated, the level of assurance provided, the nature of the engagement, and the attestation standard used. In particular, the proposed rules would require the attestation report to include a description of the work performed as a basis for the attestation provider's conclusion and for that conclusion to be provided pursuant to standards that are established by a body or group that has followed due process procedures, including the broad distribution of the framework for public comment. We expect this provision would help ensure that the standards upon which the attestation report is based were the result of a transparent and reasoned process. In this way, the requirement should help to protect investors who may rely on the attestation report by limiting the standards used to those that are appropriate for the subject matter and purpose. Further, we expect this provision to enhance the transparency of the GHG emissions attestation report for investors by providing them with additional information about the general procedures undertaken by the attestation provider. For example, under the proposed rules, an attestation report providing limited assurance would need to state that the procedures performed vary in nature and timing from, and are less extensive than, a reasonable assurance engagement, thus helping investors understand the level of assurance provided.

The GHG emissions attestation report would also be required to include a statement that describes any significant limitations associated with the measurement or evaluation of the subject matter against the criteria. The provision would require disclosure about the estimation uncertainties inherent in the quantification of GHG emissions, driven by reasons such as the state of the science and assumptions used in the measurement and reporting processes. By eliciting disclosure with respect to the procedures undertaken by the attestation provider, such as inquiries and analytical procedures, and the methodology used in the attestation process, the proposed provision would enhance the transparency of the GHG emissions attestation quality, thus allowing investors to gain a better understanding of the emission related information. This could help investors process emission related information more effectively. More informed investment decisions by investors also may benefit registrants by lowering their cost of capital.

The proposed rules would also require registrants to disclose whether the attestation provider has a license from any licensing or accreditation body to provide assurance and whether the GHG emissions attestation engagement is subject to any oversight inspection program and record-keeping requirements with respect to the work performed for the GHG emissions attestation. These requirements are expected to benefit investors by helping them to better understand the qualifications of the GHG emissions attestation provider, which in turn would allow them to make better informed decisions about the reliability of such information.

Finally, the proposed rules would require that the GHG emissions attestation report be prepared and signed by a provider that is an expert in GHG emissions and independent with respect to the registrant, and any of its affiliates, for whom it is providing the attestation report. These qualification and independence requirements should help ensure that the attestation provider is capable of exercising informed, objective and impartial judgment. Academic research has found that the independence of assurance providers can be important in certain settings for disclosure quality.[897] Academic research has also found that equity prices respond to analyst forecast even after management has released the exact same information, highlighting more generally the perceived value of external evaluations of firm disclosures and resulting investor confidence in the related disclosures.[898]

g. Targets and Goals Disclosure

The proposed rules would require a registrant to disclose whether it has set any climate-related targets or goals and, if so, how it intends to meet those targets and goals. Such climate-related targets or goals might relate to the reduction of GHG emissions or address energy usage, water usage, conservation or ecosystem restoration. Associated disclosure would include the scope of activities and emissions included in the target, the unit of measurement, and the defined time horizon. Additionally, disclosures include the baseline emissions for measuring progress, any interim targets, how it intends to meet these targets or goals, and data showing any progress toward achieving these targets, including how that progress was

[893] *See* K. Hodge, K., N. Subramaniam, J. Stewart, *Assurance of Sustainability Reports: Impact on Report Users' Confidence and Perceptions of Information Credibility,* (19) *Australian Accounting Review* 178–194 (2009), *available at https://doi.org/10.1111/j.1835-2561.2009.00056.x*.

[894] *See* supra note 874.

[895] *See, e.g.,* K. Hodge, K., N. Subramaniam, and J. Stewart, *Assurance of Sustainability Reports: Impact on Report Users' Confidence and Perceptions of Information Credibility,* 19 Australian Accounting Review 178–194 (2009), *available at https://doi.org/10.1111/j.1835-2561.2009.00056.x;* Mark Sheldon, *User Perceptions of CSR Disclosure Credibility with Reasonable, Limited and Hybrid Assurances* (Dissertation) (2016) *available at https://vtechworks.lib.vt.edu/bitstream/handle/10919/65158/Sheldon_MD_D_2016.pdf.* This absence of evidence, however, is not necessarily evidence of absence. It is possible that reasonable assurance can have benefits over limited assurance that are not easily identifiable.

[896] *See* R.J. Casey and J.H. Grenier, Understanding and contributing to the enigma of corporate social responsibility (CSR) assurance in the United States, 34(1) Auditing: A Journal of Practice & Theory 97, 97–130 (2015). The authors also find that the lower costs of capital are in excess of estimated assurance costs (*i.e.,* 5% to 10% of total audit fees) for the majority of companies. We acknowledge, however, that the benefits cited in this study may be overstated to the extent that they reflect a selection bias. Specifically, companies that anticipate a net loss due to assurance would choose to forgo obtaining such assurance, thereby removing themselves from the treatment group. This potential limitation in interpreting such findings is also supported by evidence of systematic differences in companies voluntarily reporting higher assurance levels. *See* C.H. Cho, G. Michelon, D.M. Patten, and R.W. Roberts, *CSR report assurance in the USA: An empirical investigation of determinants and effects,* 5(2) Sustainability Accounting, Management and Policy Journal 130, 130–148 (2014), *available at https://doi.org/10.1108/SAMPJ-01-2014-0003.*

[897] *See* N. Tepalagul, and L. Lin, Auditor Independence And Audit Quality: A Literature Review, 30(1) Journal of Accounting, Auditing & Finance 101–121 (2015) (for a more detailed discussion on academic evidence on independence in auditing).

[898] *See* Marco Grotteria, and Roberto Gomez Cram, *Do Financial Investors Underreact To Voluntary Corporate Disclosure?* (Working Paper) (2022).

achieved, and details about any carbon offsets of RECs that have been used.

For example, in 2019 Amazon and Global Optimism co-founded The Climate Pledge, a commitment to net zero carbon by 2040. Since then, a growing list of major companies and organizations have signed on to the Climate Pledge, which indicates a commitment to the following three principles: (i) Measure and report greenhouse gas emissions on a regular basis; (ii) Implement decarbonization strategies in line with the Paris Agreement; (iii) Neutralize any remaining emissions with additional offsets to achieve net zero annual carbon emissions by 2040.[899] The proposed rules would help to make such commitments more transparent by requiring disclosure on the unit of measurement, time horizon, and baseline for measuring progress, including how that progress was achieved (*e.g.,* through efficiency improvements, renewable energy adoption, materials reductions, and other carbon emission elimination strategies).

Such standardized reporting as a form of an oversight or monitoring mechanism might be critical in overcoming agency problems in the presence of asymmetric information. Investment in achieving targets could be value-enhancing in the long-run, but reduce cash flow in the short-run. Companies may decide that it is an optimal strategy to bear the costs up front of shifting its operations to those that have fewer emissions or upgrading their equipment, rather than bearing the risk that these costs will be borne in an unpredictable and possibly disorderly way in the future. In the absence of a means to credibly convey that efforts to achieve these long-term targets are being undertaken diligently, however, investors might be unable to observe which registrants are actually following through on such actions. For example, if registrants are incurring costs in the short-run to undertake investments to reduce Scope 1, 2, and 3 emissions, reducing short-run profitability, but are unable to convey to investors that they are meaningfully following through on achieving potential long-term value-enhancing strategies, there could be a disincentive for investors to invest in the firm, thus undermining its value in the long-run. This has been put forth as one potential explanation for some private sector attempts at addressing these problems, such as green bonds, which commit firms to recurring, more standardized disclosure requirements for progress in achieving stated targets and goals.[900] The proposed rules would provide enhanced transparency about targets and goals so that investors can identify registrants with credible goals and track their progress over time. This can not only reduce incentives for misleading goal disclosures, but can also allow investors to recognize goals that generate long-term value despite short run costs, which can attract capital and increase firm value.

As explained above, the pursuit of targets could have a material impact, either in the short-term or long-term, on a registrant's operations or financial condition.[901] At this time, however, there is little consistency with respect to the extent of disclosure and the relevant details concerning such climate-related targets and goals. This can result in insufficient information for investors' monitoring or decision-making needs. The proposed disclosure could provide more comparable, consistent, and reliable metrics of any climate-related targets or goals. It would require a registrant to clearly define baselines for targets, the scope of activities and emissions covered by the target, the unit of measurement, the defined time horizon, and how progress is made towards the targets. For example, the disclosure would require the registrant to state whether or not the targets pertain to Scope 3 emissions. If targets do include Scope 3 emissions, disclosure of Scope 3 emission sources and amounts would be required so that investors would understand the scale and scope of changes the company would need to undertake, and thus the full financial impact of meeting the target.[902] Such disclosures would also enable investors to monitor progress firm management has made and plans to make towards achieving climate-related targets or goals, assess the credibility of its goal, and evaluate the effectiveness of the company's investments to achieve its goals. As described above, this required disclosure could make targets more credible and serves as an oversight or monitoring mechanism.

h. Structured Data Requirement

Under the proposed rules, the new climate-related disclosures would be tagged in the Inline XBRL structured data language. The provision requiring Inline XBRL tagging of climate-related disclosures would benefit investors by making those disclosures more readily available for aggregation, comparison, filtering, and other enhanced analytical methods.[903] These benefits are expected to reduce search costs and substantially improve investors' information-processing efficiency.[904] XBRL requirements for public company financial statement disclosures have been observed to reduce information-processing costs, thereby decreasing information asymmetry and increasing transparency by incorporating more company-specific information into the financial markets.[905] In addition, the proposed Inline XBRL requirement for the climate-related disclosures may further limit agency problems, as XBRL requirements for financial statement tagging have been observed to facilitate external monitoring of firms through the aforementioned reduction of information processing costs.[906]

[899] As of Jan. 25, 2022, The Climate Pledge has acquired 217 signatories. *See The Climate Pledge, available at https://www.theclimatepledge.com/us/en/Signatories.*

[900] *See* S. Lu, *The Green Bonding Hypothesis: How do Green Bonds Enhance the Credibility of Environmental Commitments?* (2021), *available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3898909.*

[901] *See* supra Sections II.G.1.b. and III C.1.e.

[902] *See id.*

[903] For example, structuring climate-related disclosures would enable more advanced analyses than those described in the aforementioned Commission staff review that used keyword searches and NLP. *See supra* IV.A.5.a.

[904] The findings on XBRL cited in the following paragraphs are not necessarily focused on climate-related disclosures and metrics, but we expect the findings to be generally applicable and to result in similar benefits for investors.

[905] *See, e.g.,* Y. Cong, J. Hao, and L. Zou, *The Impact of XBRL Reporting on Market Efficiency,* 28 J. Info. Sys. 181 (2014) (finding support for the hypothesis that ''XBRL reporting facilitates the generation and infusion of idiosyncratic information into the market and thus improves market efficiency''); Y. Huang, J.T. Parwada, Y.G. Shan, and, J. Yang, *Insider Profitability and Public Information: Evidence From the XBRL Mandate* (Working Paper) (2019) (finding XBRL adoption levels the informational playing field between insiders and non-insiders); J. Efendi, J.D. Park, and C. Subramaniam, *Does the XBRL Reporting Format Provide Incremental Information Value? A Study Using XBRL Disclosures During the Voluntary Filing Program,* 52 Abacus 259 (2016) (finding XBRL filings have larger relative informational value than HTML filings); J. Birt, K. Muthusamy, and P. Bir, XBRL and the Qualitative Characteristics of Useful Financial Information, 30 Account. Res. J. 107 (2017) (finding ''financial information presented with XBRL tagging is significantly more relevant, understandable and comparable to non-professional investors''); S.F. Cahan, S. Chang, W.Z. Siqueira, and K. Tam, *The Roles of XBRL and Processed XBRL in 10–K Readability,* J. Bus. Fin. Account. (2021) (finding Form 10–K file size reduces readability before XBRL's adoption since 2012, but increases readability after XBRL adoption, indicating ''more XBRL data improves users' understanding of the financial statements'').

[906] *See, e.g.,* P.A. Griffin, H.A. Hong, J.B. Kim, and J.H. Lim, *The SEC's XBRL Mandate and Credit Risk: Evidence on a Link between Credit Default Swap Pricing and XBRL Disclosure,* 2014 American Accounting Association Annual Meeting (2014) (attributing the negative association between XBRL information and credit default swap spreads to ''(i) a reduction in firm default risk from better outside monitoring and (ii) an increase in the quality of information about firm default risk from lower

Investors with access to XBRL analysis software may directly benefit from the availability of the climate-related disclosures in Inline XBRL, whereas other investors may indirectly benefit from the processing of Inline XBRL disclosures by asset managers and by information intermediaries such as financial analysts.[907] In that regard, XBRL requirements for public company financial statement disclosures have been observed to increase the number of companies followed by analysts, decrease analyst forecast dispersion, and, in some cases, improve analyst forecast accuracy.[908] Should similar impacts on the analysts' informational environment arise from climate-related disclosure tagging requirements, this would likely benefit retail investors, who have generally been observed to rely on analysts' interpretation of financial disclosures rather than directly analyzing those disclosures themselves.[909]

2. Costs

Below we discuss the anticipated direct and indirect costs of the proposed rules. Direct costs would include compliance burdens for registrants in their efforts to meet the new disclosure requirements. These direct costs could potentially be significant; however, the incremental costs would be lower to the extent that registrants already provide the required disclosures. Indirect costs may include heightened litigation risk and the potential disclosure of proprietary information.[910] We proceed by discussing these various costs.

a. Direct Costs

The primary direct costs that the proposed rules would impose on registrants are compliance costs. To the extent that they are not already gathering the information required to be disclosed under the proposed rules, registrants may need to re-allocate in-house personnel, hire additional staff, and/or secure third-party consultancy services. Registrants may also need to conduct climate-related risk assessments, collect information or data, measure emissions (or, with respect to Scope 3 emissions, gather data from relevant upstream and downstream entities), integrate new software or reporting systems, seek legal counsel, and obtain assurance on applicable disclosures (*i.e.,* Scopes 1 and 2 emissions). In addition, even if a registrant already gathers and reports the required information, some or all of this information may be in locations outside of SEC filings (such as sustainability reports posted on company websites or emissions data reported to the EPA). These registrants may face lower incremental costs by virtue of already having the necessary processes and systems in place to generate such disclosures; however they may still incur some additional costs associated with preparing this information for inclusion in SEC filings.

(1) General Cost Estimates

In this section, we review sources that provide insight into the magnitude of the potential costs associated with the proposed rules. With some exceptions discussed in further detail, these sources provide information at the level of general costs for climate disclosures. We acknowledge that these sources are limited in scope or representativeness and thus may not directly reflect registrants' compliance costs. For instance, some third-party sources may present cost estimates that do not include all items required under the proposed rules (*e.g.,* assurance costs), or else they may aggregate the costs of multiple items (including those not required under the proposed rules) into a single cost figure. However, these sources may serve as useful references to the extent that they overlap with specific disclosure elements required in the proposed rules. For example, third-party cost estimates of preparing TCFD reports or completing the CDP questionnaire can offer a rough approximation of potential compliance costs due to their similarity with the proposed rules. Below, we request further data to assist us in estimating potential costs.

As discussed in Section V, for purposes of the Paperwork Reduction Act of 1995 (''PRA''),[911] we estimate the annual costs over the first six years of compliance with the proposed rules.[912] For non-SRC registrants, the costs in the first year of compliance are estimated to be $640,000 ($180,000 for internal costs and $460,000 for outside professional costs), while annual costs in subsequent years are estimated to be $530,000 ($150,000 for internal costs and $380,000 for outside professional costs). For SRC registrants, the costs in the first year of compliance are estimated to be $490,000 ($140,000 for internal costs and $350,000 for outside professional costs), while annual costs in subsequent years are estimated to be $420,000 ($120,000 for internal costs and $300,000 for outside professional costs). These costs are expected to decrease over time for various reasons, including increased institutional knowledge,

information cost''); J.Z. Chen, H.A. Hong, J.B. Kim, and J.W. Ryou, Information Processing Costs and Corporate Tax Avoidance: Evidence from the SEC's XBRL Mandate, 40 (2) J. Account Pub. Pol. (2021) (finding XBRL reporting decreases likelihood of firm tax avoidance, because ''XBRL reporting reduces the cost of IRS monitoring in terms of information processing, which dampens managerial incentives to engage in tax avoidance behavior'').

[907] Additional information intermediaries that have used XBRL disclosures may include financial media, data aggregators and academic researchers. *See, e.g.,* N. Trentmann, *Companies Adjust Earnings for Covid–19 Costs, but Are They Still a One-Time Expense?* The Wall Street Journal (2020), *available at https://www.wsj.com/articles/companies-adjust-earnings-for-covid-19-costs-but-are-they-still-a-one-time-expense-11600939813* (citing XBRL research software provider Calcbench as data source); *Bloomberg Lists BSE XBRL Data, XBRL.org* (2018), *available at https://www.xbrl.org/news/bloomberg-lists-bse-xbrl-data/*; R. Hoitash, and U. Hoitash, *Measuring Accounting Reporting Complexity with XBRL,* 93 Account. Rev. 259–287 (2018). *See 2019 Pension Review First Take: Flat to Down,* Goldman Sachs Asset Management (2020) (an example of asset manager use of XBRL data), *available at https://www.gsam.com/content/dam/gsam/pdfs/common/en/public/articles/2020/2019_Pension_First_Take.pdf?sa=n&rd=n* (citing XBRL research software provider Idaciti as a data source).

[908] *See, e.g.,* A.J. Felo, J.W. Kim, and J. Lim, Can XBRL *Detailed Tagging of Footnotes Improve Financial Analysts' Information Environment?,* 28 Int'l J. Account. Info. Sys. 45 (2018); Y. Huang, Y.G. Shan, and J.W. Yang., *Information Processing Costs and Stock Price Informativeness: Evidence from the XBRL Mandate,* 46 Aust. J. Mgmt., 110–131 (2020) (finding ''a significant increase of analyst forecast accuracy post-XBRL''*);* M. Kirk, J. Vincent, and D. Williams, *From Print to Practice: XBRL Extension Use and Analyst Forecast Properties* (Working Paper 2016) (finding ''the general trend in forecast accuracy post-XBRL adoption is positive''); C. Liu, T. Wang, and L.J. Yao, *XBRL's Impact on Analyst Forecast Behavior: An Empirical Study,* 33 J. Account. Pub. Pol. 69–82 (2014) (finding ''mandatory XBRL adoption has led to a significant improvement in both the quantity and quality of information, as measured by analyst following and forecast accuracy''). *But see* S.L. Lambert, K. Krieger, and N. Mauck, *Analysts' Forecasts Timeliness and Accuracy Post-XBRL,* 27 Int'l. J. Account. Info. Mgmt. 151–188 (2019) (finding significant increases in frequency and speed of analyst forecast announcements, but no significant increase in analyst forecast accuracy post-XBRL).

[909] *See, e.g., A.* Lawrence, J. Ryans, and E. Sun, *Investor Demand for Sell-Side Research,* 92 Account. Rev. 123–149 (2017) (finding the ''average retail investor appears to rely on analysts to interpret financial reporting information rather than read the actual filing''); D. Bradley, J. Clarke, S. Lee, and C. Ornthanalai, *Are Analysts' Recommendations Informative? Intraday Evidence on the Impact of Time Stamp Delays,* 69 J. Finance 645–673 (2014) (concluding ''analyst recommendation revisions are the most important and influential information disclosure channel examined'').

[910] For example, these costs may include the revelation of trade secrets, the disclosure of profitable customers and markets, or the exposure of operating weakness to competing firms, unions, regulators, investors, customers or suppliers. These costs are commonly referred to as ''proprietary costs.''

[911] See Paperwork Reduction Act, Public Law 104–13, 109 Stat 163 (1995) (codified at 44 U.S.C. 3501 *et seq.*). *See infra* Section V.

[912] The following estimates are applicable to registrants filing form 10–K that have no existing climate-related disclosure processes or expertise. All estimates are rounded to the nearest $5,000.

operational efficiency, and competition within the market for relevant services.

One commenter provided cost estimates for their services in assisting client companies prepare TCFD-aligned disclosures.[913] For companies that have no prior experience in GHG analysis or climate-related disclosures, the commenter estimates initial costs to range from $150,000 to $200,000 to prepare TCFD-aligned disclosures.[914] Companies that have already calculated their carbon footprints and only need assistance with TCFD reporting may expect costs of $50,000 to $200,000, with the average cost of approximately $100,000. Ongoing costs for their services are expected to be zero conditional upon the TCFD requirements remaining unchanged,[915] however the reporting company may still incur internal costs in preparing these disclosures on an annual basis.

Another source presents survey results of climate-related disclosure costs for three unnamed companies, which consist of a European-based multinational large-cap financial institution, a US-based large-cap industrial manufacturing company, and a US-based mid-cap waste management company.[916] The survey reports that each firm has ''already established robust in-house climate disclosure systems that can easily be leveraged to comply with any new disclosure rule,'' as evidenced by their concurrent reporting under multiple climate disclosure frameworks (*e.g.,* TCFD, CDP, SASB, GRI, etc.). The respondents indicate that anticipated incremental costs of a mandatory climate disclosure rule are therefore expected to be minimal.[917] All respondents disclose Scopes 1, 2, and 3 emissions, while none of them obtain third-party assurance for their climate-related disclosures.

The mid-cap waste management company estimates that the cost of producing their first TCFD report was less than $10,000. The company's reported annual costs consist of employee costs ($12,600) [918] and third-party costs ($60,000 to $160,000).[919] However, the reported annual costs may be less applicable to potential compliance costs as they combine additional costs associated with several other activities not necessarily required in the proposed rules, including its adherence to multiple climate disclosure frameworks (*e.g.,* TCFD, GRI, SASB, and CDP) and designing its annual sustainability report and associated web page.[920] Overall, the company reports that its total costs related to producing climate-related disclosures across these multiple frameworks are less than 5% of its total SEC compliance-related costs.

The large-cap industrial manufacturing company reports that the costs of preparing its first CDP questionnaire was no more than $50,000. Additionally, the combined costs of producing its first TCFD, SASB, and GRI disclosures were between $200,000 and $350,000. Reported annual costs include internal costs (between $200,000 and $350,000) [921] and the cost for auditors and consultants ($400,000).[922] These cost estimates, however, may overestimate potential compliance costs to the extent that they include disclosure items or activities not required in the proposed rules. The company reports that their annual costs of producing its voluntary climate-related disclosures are less than 0.1% of their revenues.

The multinational financial institution reports that the cost of producing its first TCFD report, SASB report, and CDP questionnaire were each less than $100,000 given that such information overlaps with what the company already discloses under the EU's Prospectus Regulation (Regulation (EU) 2017/1129). The company estimates annual costs ranging from $250,000 and $500,000 to produce these disclosures, but as before, this range may combine the costs of activities that are not required in the proposed rules.[923] Similar to the industrial manufacturing company, this company also notes that the annual costs of producing its voluntary climate-related disclosures are less than 0.1% of their revenues.

Some commenters also provided estimates of climate-related disclosure costs for individual firms. One commenter provided a breakdown of such costs for seven unnamed large cap firms across six different industries.[924] Headcount requirements ranged from two to 20 full-time equivalent employees. One large-cap firm in the energy industry reported that its TCFD reporting process involved 40 employees and six months of nearly full-time participation by 20 core team members. Employee hours spent on climate reporting ranged from 7,500 to 10,000 annually. Fees for external advisory services ranged from $50,000 to $1.35 million annually, which generally included legal counsel and consulting services related to environmental engineering, emissions, climate science, modeling, or sustainability reporting. Another commenter, a Fortune 500 energy infrastructure firm, reported that it employs a full-time, management level director that spends about 25% of his time developing sustainability reports and other ESG initiatives. This commenter also reported that it pays a third-party consulting firm more than

[913] *See* memorandum, dated Feb. 4, 2022, concerning staff meeting with representatives of S&P Global.

[914] This cost range pertains to clients' use of the commenter's ''TCFD Suite'', which consists of the following modules: Benchmarking/gap assessment, management interviews, physical risk assessment, and various transition risk assessments, including policy risk analysis, market risk assessment, technology risk assessment, and reputation risk assessment. This cost range excludes the cost of additional services, such as target-setting ($20,000 to $30,000) and calculating GHG footprints ($75,000 to $125,000 for Scopes 1, 2, and 3), the latter of which is discussed in further detail in the following subsection.

[915] The commenter reports that should the TCFD requirements change based on new science, projections, and business changes, costs of the TCFD Suite in future years may range from $125,000 to $175,000.

[916] *See* L. Reiners and K. Torrent, *The Cost of Climate Disclosure: Three Case Studies on the Cost of Voluntary Climate-Related Disclosure,* Climate Risk Disclosure Lab (2021), *available at https://climatedisclosurelab.duke.edu/wp-content/uploads/2021/12/The-Cost-of-Climate-Disclosure.pdf.*

[917] Incremental costs would be minimal to the extent that the mandatory disclosure rule overlaps with their current reporting practices. The respondents acknowledge that actual incremental costs would depend on the contents of the final rule.

[918] The company allocates three employees to produce climate-related disclosures. Two employees in Legal and Compliance devote a combined 80 hours per year on this task, while one employee in Management and Administration devotes two hours per year.

[919] The company reports that approximately one-third of these third-party costs is associated with designing the annual sustainability report and associated web page, while the remaining two-thirds is associated with report writing and consulting work on the voluntary frameworks.

[920] These annual costs reflect a larger scope of climate-related disclosures (*e.g.,* multiple frameworks, sustainability report, etc.) relative to the initial cost, which is specific to TCFD reporting only. Nevertheless, because these estimates aggregate the costs of reporting under the TCFD in addition to other climate disclosure framework, these estimates can serve as an upper bound of what annual costs may be specific to TCFD reporting only.

[921] Internal costs include the cost of approximately 20 employees working part-time on climate-related disclosures from Nov. until Mar. and one full-time consultant.

[922] Auditors review data quality and data collection procedures, while consultants help prepare substantive disclosures, advise on adherence to the voluntary climate disclosure frameworks, and prepare web updates.

[923] The company notes that the bulk of its annual costs comes from producing chapter 7 of its Universal Registration Document, issued under the EU's Prospectus Regulation (Regulation (EU) 2017/1129). Chapter 7 pertains to the extra-financial performance statement of the consolidated firm.

[924] *See* Letter from Society for Corporate Governance (June 11, 2021).

$250,000 annually to assist in its ESG and sustainability report process.[925]

The UK's Department for Business, Energy & Industrial Strategy, as part of its Green Finance Strategy, has released a final stage impact assessment (the ''UK impact assessment'') of their proposed rules that would also require certain TCFD-aligned disclosures from firms and asset managers listed on UK financial markets.[926] The UK impact assessment provides a breakdown of estimated average compliance costs per affected entity. Under the assumption that affected entities have no pre-existing climate-related disclosure practices or expertise, the UK impact assessment estimates that first-year one-time costs would include familiarization costs ($17,300[927] plus $2,600 per subsidiary, as applicable) and legal review ($4,400). They also estimate recurring annual governance disclosure costs ($12,500), strategy disclosure costs ($17,900[928]), risk management disclosure costs ($14,900), metrics and targets disclosure costs ($104,400 in the first year and $80,500 in subsequent years[929]), internal audit costs ($30,300), and signposting costs ($100).[930] For companies with subsidiaries, the costs of collecting information from subsidiaries and processing this information are expected to be $4,300 for the parent company and $1,700 for each subsidiary. In total, the study estimates that a company with no pre-existing climate-related disclosure practices or expertise could incur costs of $201,800 in the first year and $177,900 in subsequent years, plus additional costs due to subsidiaries, as applicable. This cost estimation methodology is conditional upon assumptions regarding the number of required staff, the rank or title of the staff, and the required labor hours, which are then matched with local wage data to estimate final costs.

It is important to note that all of these cost estimates are conditional on specific assumptions and can vary significantly depending on firm characteristics, such as firm size, industry, business model, the complexity of the firm's corporate structure, starting level of internal expertise, etc. In addition, we note that, in certain cases, these cost estimates may represent a registrant's optimal response to investor demand, and thus may exceed the minimum cost necessary to fulfill mandatory reporting of climate-related risks. We are accordingly requesting comments regarding compliance costs, including cost data that can be used to generate more accurate, granular, and reliable cost estimates that are more representative of the full set of affected registrants.

(2) Cost Estimates Specific to Emissions

In this section, we review the available evidence, which provides some insight into the scope of the compliance costs associated with reporting GHG emissions. We are cognizant of the type of costs that registrants will incur to report GHG emissions, *e.g.* resources, systems, design and implementation of DCP, external consulting services. In light of the limited information available, however, we are unable to fully and accurately quantify these costs. Accordingly, we are requesting comments regarding cost data for GHG emissions reporting.

One commenter reports that their services in calculating client companies' GHG footprints (Scopes 1, 2, and 3 emissions) would initially cost $75,000 to $125,000 if the client company has no prior experience in this area.[931] Ongoing costs amount to approximately $40,000 assuming no material changes in Scope 3 emissions (*i.e.,* assess Scopes 1 and 2 only). If there are material changes to Scope 3 emissions, ongoing costs would range from $75,000 to $125,000 (*i.e.,* assess Scopes 1, 2, and 3).

Another commenter, a climate management and accounting platform, provided cost estimates of the measurement and reporting of emissions. This commenter's estimates are disaggregated across scopes of emissions as well as ''low maturity'' vs ''high maturity'' companies with respect to emissions reporting. Low maturity companies are defined as those that have no formal understanding of GHG emission calculations and have no related policies or programs in place. Accordingly, these companies have not organized or collected any data for such a calculation. High maturity companies are defined as those that have the aforementioned understanding, policies, programs, and data. Therefore, high maturity companies are expected to face lower incremental costs. The commenter estimates that the average first-year startup cost of assessing Scopes 1 and 2 emissions amount to $45,000 and $25,000 for companies of low and high maturity, respectively. Including the assessment of Scope 3 emissions would increase the costs by $80,000 and $25,000 for companies of low and high maturity, respectively. The commenter indicated that it expects these costs to decrease over time as software solutions simplify the process and reduce the burden on companies.

Additional cost estimates are provided by another commenter, which is an organization that assists companies, communities, and other organizations in accurately assessing emissions data across all scopes of emissions.[932] According to their pricing structure, initial one-time costs amount to $10,000, which includes identifying data input needs, developing the design and organization of user interfaces, establishing software and IT systems, and reporting emissions from prior years to the extent that historic data is available. Ongoing costs, which includes a subscription fee and data management fee, amount to $12,000 plus $1,200 per building that is covered

[925] *See* Letter from Williams Companies, Inc. (June 12, 2021).

[926] *See* U.K. Dep't for Bus., Energy, & Indus. Strategy, *Mandating Climate-Related Financial Disclosures by Publicly Quoted Companies, Large Private Companies and Limited Liability Partnerships (LLPs),* Final Stage Impact Assessment (Oct. 1, 2021), *available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1029317/climate-related-financial-disclosure-consultation-final-stage-impact-assessment.pdf* (The UK's climate-related disclosure rules would apply to Relevant Public Interest Entities (PIEs), including Premium and Standard Listed Companies with over 500 employees, UK registered companies with securities admitted to AiM with more than 500 employees, Limited Liability Partnership (LLPs) within the threshold of the ''500 test,'' and UK registered companies which are not included in the categories above and are within the threshold of the ''500 test.'').

[927] In the final stage impact assessment, the cost estimate provided for familiarization costs assumes that scenario analysis is required. Because the proposed rules do not require scenario analysis, this number references familiarization costs provided in the *initial* impact assessment, which assumes no scenario analysis. *See* U.K. Dep't for Bus., Energy, & Indus. Strategy, *Mandating Climate-Related Financial Disclosures by Publicly Quoted Companies, Large Private Companies and Limited Liability Partnerships (LLPs),* Consultation Impact Assessment (Jan. 29, 2021), *available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/972423/impact-assessment.pdf.*

[928] This number excludes the cost of scenario analysis since this is not required under the proposed rules.

[929] We note that these numbers do not include the costs of measuring and reporting Scope 3 emissions since this is not required under the UK proposed rules.

[930] These numbers have been converted from GBP based on the 2021 average exchange rate of $1.3757 USD/GBP, rounded to the nearest $100. We note that the impact assessment also provides estimates of incremental costs associated with each subsidiary; however, these costs are not included in the estimates cited above for the sake of brevity. Signposting costs refer to the ''additional annual cost to those in scope to upload the required reporting documentation and signposting to this documentation within their annual report.''

[931] *See supra* note 783. Legal and audit fees are not included in these cost estimates.

[932] *See* memorandum, dated Jan. 21, 2022, concerning staff meeting with representatives of Ledger8760, available at *https://www.sec.gov/comments/s7-10-22/s71022.htm.*

in the calculation of emissions. Another organization that offers similar services, among others, indicates that their fees for GHG accounting for Scopes 1, 2, and 3 can range from $11,800 to $118,300.[933] Their fees for applying the PCAF method on investment and lending portfolios range from $11,800 to $35,500. They note that the assessment process take approximately 1–3 months depending on the complexity and availability of data.

The EPA has also sought to quantify the costs of measuring and reporting emissions in accordance with the mandatory Greenhouse Gas Reporting Program, which generally requires facility-level reporting of emissions from large emitters and from large suppliers of certain products (*e.g.,* entities that produce gasoline that will eventually be consumed downstream by the end-user).[934] The EPA estimated that the rule would impose small expected costs on the facilities under its purview. The EPA estimated that, for most sectors, the costs represent at most 0.1% of sales.[935] For small entities,[936] the EPA estimated that the costs are on average less than 0.5% of sales. While the EPA's emissions reporting requirements, as discussed above, may elicit some of the information required under our proposed rules, given that the requirements are different, the actual compliance costs would differ accordingly.

A survey conducted by PCAF provides some estimates of the costs of assessing financed emissions.[937] Financed emissions, which can be one component of Scope 3 emissions for certain financial institutions, can be described as the emissions generated by companies in which a financial institution invests or to which it otherwise has exposure. The PCAF survey of 18 unnamed financial institutions[938] found that typical staff time ranged between 50 and 100 days and the costs for contracting external support was less than $20,000 for the majority of respondents. These estimates may provide some sense of the costs that may be incurred by those financial institutions that would be required to report Scope 3 emissions under the proposed rules.

(3) Cost Estimates of Assurance for Scopes 1 and 2 Emissions Disclosures

Registrants that are accelerated filers and large accelerated filers will incur additional costs in obtaining assurance of Scopes 1 and 2 emissions disclosures. The Commission estimates these costs starting with data on these filers' median audit fees in fiscal year 2020, which is $989,566 and $2,781,962 for accelerated filers and large accelerated filers, respectively.[939] Next, an academic study suggests that assurance costs for sustainability reports (which serve as a common location for climate-related information, in addition to other non-financial topics) may range from 5% to 10% of total audit fees.[940] We take the minimum, median, and maximum percentages (5%, 7.5%, and 10%, respectively) and apply further adjustments based on (i) emissions disclosures typically compromising only a portion of CSR reports, (ii) the potential fee premium related to attestation report included in SEC filings, and (iii) the average pricing difference between limited and reasonable assurance. For limited assurance, we estimate that accelerated filers will incur costs ranging from $30,000 to $60,000 (with a median of $45,000), while large accelerated filers will incur costs ranging from $75,000 to $145,000 (with a median of $110,000). For reasonable assurance, we estimate that accelerated filers will incur costs ranging from $50,000 to $100,000 (with a median of $75,000), while large accelerated filers will incur costs ranging from $115,000 to $235,000 (with a median of $175,000).

On the one hand, these estimates may underestimate actual costs as they are based on relative costs of assurance for financial statements, and assurance on emissions may differ in important ways. On the other hand, the costs may be lower in the future to the extent that the market for assurance services matures with respect to institutional knowledge, procedural efficiency, and overall competition. We request additional data that may assist in accurately assessing the costs of obtaining assurance over emissions disclosures.

(4) Factors That Affect Direct Costs

Incremental compliance costs may be relatively lower for registrants that already meet some of the disclosure and tagging requirements. For instance, registrants that are currently subject to the EPA's Greenhouse Gas Reporting Program would face lower incremental costs in reporting certain scopes of emissions relative to a firm that has no emissions measurement systems in place.[941] Similarly, registrants that already provide extensive qualitative disclosures on climate-related risks, which tend to be large accelerated filers and registrants in high emission industries,[942] may face lower incremental costs in meeting certain disclosure requirements. As discussed in Section IV.A.5.a, the Commission's staff reviewed 6,644 recent annual reports (Forms 10–K, 40–F, and 20–F) and found that 33% of them contained disclosures related to climate change, the majority of which discussed information related to business impact, emissions, international climate accords, and physical risks. Registrants with operations in foreign jurisdictions[943] where disclosure requirements are based on the TCFD's framework for climate-related financial reporting, would also face lower incremental costs.[944] Moreover, costs may also be mitigated by the proposed transition period, which would allow firms to more gradually transition to the new reporting regime.

Several industry reports also document how a sizeable portion of U.S.

[933] *See* memorandum, dated Jan. 14, 2022, concerning staff meeting with representatives of South Pole. These numbers have been converted from EUR based on the 2021 average exchange rate of $1.183 USD/EUR, rounded to the nearest $100.

[934] *See* Section IV.A.3 for more information on the EPA mandatory Greenhouse Gas Reporting Program.

[935] *See* EPA, *Regulatory Impact Analysis for the Mandatory Reporting of Greenhouse Gas Emissions* (Sept. 2009), *available at https://www.epa.gov/sites/default/files/2015-07/documents/regulatoryimpact analysisghg.pdf.* The EPA notes that several facility types do not currently report emissions (or the existence of such disclosure practices cannot be confirmed), therefore the cost estimates for these facility types reflect full start-up costs to meet the reporting requirements.

[936] The EPA defines a small entity as (1) a small business, as defined by SBA's regulations at 13 CFR part 121.201; (2) a small governmental jurisdiction that is a government of a city, county, town, school district, or special district with a population of less than 50,000; or (3) a small organization that is any not-for-profit enterprise that is independently owned and operated and is not dominant in its field.

[937] *See* Letter from PCAF (Dec. 21, 2021).

[938] The 18 survey respondents consist of 2 insurance companies, 13 banks (commercial, investment, or development), 1 asset owner, and 2 asset managers. Respondents' asset size ranges from less than a $1bn USD to $500bn USD. The average assets covered by this disclosure activity was approximately $5–20bn USD.

[939] Data on audit fees is from Audit Analytics, which provides all fee data disclosed by SEC registrants in electronic filings since Jan. 1, 2000.

[940] *See* R.J. Casey and J.H. Grenier, *Understanding and Contributing to the Enigma of Corporate Social Responsibility (CSR) Assurance in the United States,* 97 Auditing: A Journal of Practice & Theory 130 (2015).

[941] *See* Section IV.C.1.e for more information on how the proposed rules compare to the EPA's emissions reporting requirements.

[942] *See* Section IV.A.5.a.

[943] E.g., Morningstar reports that over 35% of S&P 500 revenues came from foreign markets, while this percentage is around 20% for the revenues coming from companies belonging to the Russell 2000 index. See, *https://www.morningstar.com/articles/918437/your-us-equity-fund-is-more-global-than-you-think.*

[944] See Section IV.A.4 for a discussion on International Disclosure Requirements.

companies report climate-related information under one or more third-party frameworks that are either fully or partially aligned with the TCFD disclosure elements. For example, the CCMC survey (G&A study) reports that among their sample of U.S. public companies, 44% (53%) use the SASB, 31% (52%) use the GRI, 29% (30%) use the TCFD, and 24% (40%) use the CDP. Moody's analytics provides a detailed view for a sample of 659 U.S. companies of the existing disclosure rate across the different TCFD disclosure elements that range from a high of 45% disclosure rate for Risks and Opportunities—Strategy (a), to a low of 5% for Risks and Opportunities—Strategy (c) (see Table 4). Since the proposed rules are broadly consistent with the TCFD framework, we would expect lower incremental compliance costs for registrants that provide most or all disclosures according to the TCFD or related frameworks, including the CDP, which has fully integrated the TCFD disclosure elements into its disclosure questionnaire, and other frameworks and/or standards partly aligned with the TCFD recommendations.

Similarly, registrants in the insurance industry may also face lower incremental costs due to their existing disclosure practices. As discussed in Section IV.A.3, a large subset of insurance firms are required to disclose their climate-related risk assessment and strategy via the NAIC Climate Risk Disclosure Survey. A comment by a state insurance commissioner stated that because this survey overlaps extensively with the TCFD recommendations, these firms should be able to easily switch to reporting via the TCFD disclosure framework.[945] This is because the proposed rules are broadly consistent with the TCFD. We expect that registrants in the insurance industry may be able to adapt more easily to providing disclosure under these rules.

Section IV.A.5.e reports survey evidence on the frequency with which firms obtain assurance in sustainability reports. This evidence suggests that a significant fraction of large companies already obtain some form, albeit limited, of assurance. To the extent that large accelerated filers and accelerated filers already voluntarily obtain some form of assurance over their GHG emissions, these registrants would face lower incremental costs associated with complying with the proposed rules' assurance requirements. These registrants tend to bear proportionately lower compliance costs than smaller issuers due to the fixed cost components of such compliance.[946] Additionally, as the market for assurance matures, the Commission staff expects these costs to decrease over time.

Incremental costs may be higher for smaller firms considering that they are less likely to have climate-related disclosure systems and processes already in place.[947] If smaller firms were to face higher proportional fixed costs in meeting the disclosure requirements, this may potentially put them at a competitive disadvantage to larger firms.[948] Conversely, incremental costs for smaller firms may be lower to the extent that they have less complexity with respect to their assets and operations, which may allow them to assess climate-risk exposures or measure emissions at lower cost.

With respect to the Inline XBRL tagging requirements, various preparation solutions have been developed and used by operating companies to fulfill their structuring requirements, and some evidence suggests that, for smaller companies, XBRL compliance costs have decreased over time.[949] The incremental compliance costs associated with Inline XBRL tagging of climate-related disclosures would also be mitigated by the fact that filers that would be subject to the proposed requirements would also be subject to other Inline XBRL requirements for other disclosures in Commission filings, including financial statement and cover page disclosures in certain periodic reports and registration statements.[950] As such, the proposal would not impose Inline XBRL compliance requirements on filers that would otherwise not be subject to such requirements, and filers may be able to leverage existing Inline XBRL preparation processes and/or expertise in complying with the proposed climate-related disclosure tagging requirements.

We expect that the number of registrants committed to preparing climate-related disclosures will increase in the future, independently from our proposed rules. As discussed in Section IV.B.1, a sizeable and growing portion of global investors consider climate change as the leading issue driving their engagements with companies and is demanding robust disclosure around its impacts and the plan to mitigate climate-related risks. Consistent with this increasing demand for climate-related information, recent trends showed an uptick in climate-related disclosures, particularly within samples of larger firms, though not necessarily through their regulatory filings.[951] Furthermore, the market for related services (*e.g.,* GHG accounting services, auditors, and other consultants, etc.) may become more competitive, driving down costs. To the extent that these trends continue in the future, we would expect that the incremental costs for complying with the proposed rules would become lower for an increasing number of firms.

b. Indirect Costs

In addition to the direct costs of preparing climate-related disclosures, the proposed rules could also lead to indirect costs. For example, the proposed rules may result in additional litigation risk since the proposed climate-related disclosures may be new

[945] *See* Letter from Mike Kreidler, Office of the Insurance Commissioner, State of Washington (June 14, 2021).

[946] For example, during fiscal year 2020, median audit fees as percentage of revenue for large accelerated filers and accelerated filers was 0.16%, while the corresponding figure for non-accelerated filers was 1.1%.

[947] *See supra* note 760. *See also* discussion of the Commission staff's review using climate-related keyword searches in Section IV.A.5.a.

[948] Because higher proportional fixed costs for smaller firms may be particularly acute with respect to assessing Scope 3 emissions, the proposed rules exempt SRCs from providing Scope 3 emissions disclosures. Since SRCs are a small fraction of the market, the overall benefit to investors would not be as large as for non-SRCs, while avoiding high fixed costs that could put them at a potential competitive disadvantage.

[949] An AICPA survey of 1,032 reporting companies with $75 million or less in market capitalization in 2018 found an average cost of $5,850 per year, a median cost of $2,500 per year, and a maximum cost of $51,500 per year for fully outsourced XBRL creation and filing, representing a 45% decline in average cost and a 69% decline in median cost since 2014. *See* M. Cohn, *AICPA Sees 45% Drop in XBRL Costs for Small Companies, Accounting Today* (Aug. 15, 2018) (stating that a 2018 NASDAQ survey of 151 listed registrants found an average XBRL compliance cost of $20,000 per quarter, a median XBRL compliance cost of $7,500 per quarter, and a maximum, XBRL compliance cost of $350,000 per quarter in XBRL costs per quarter), *available at https://www.accountingtoday.com/news/aicpa-sees-45-drop-in-xbrl-costs-for-small-reporting-companies (retrieved from Factiva database). See also* Letter from Nasdaq, Inc., Mar. 21, 2019 to the Request for Comment on Earnings Releases and Quarterly Reports; Release No. 33–10588 (Dec. 18, 2018) 83 FR 65601 (Dec. 21, 2018).

[950] *See* 17 CFR 229.601(b)(101); 17 CFR 232.405 (for requirements related to tagging financial statements (including footnotes and schedules) in Inline XBRL). *See* also 17 CFR 229.601(b)(104); 17 CFR 232.406 for requirements related to tagging cover page disclosures in Inline XBRL. Beginning in 2024, filers of most fee-bearing forms will also be required to structure filing fee information in Inline XBRL, although the Commission will provide an optional web tool that will allow filers to provide those tagged disclosures without the use of Inline XBRL compliance services or software. *See* 17 CFR 229.601(b)(108) and 17 CFR 232.408; Filing Fee Disclosure and Payment Methods Modernization, Release No. 33–10997 (Oct. 13, 2021), 86 FR 70166 (Dec. 9, 2021).

[951] *See* Section IV.A.5.

and unfamiliar to many registrants.[952] The proposed rules would significantly expand the type and amount of information registrants are required to provide about climate-related risks. Registrants unfamiliar preparing these disclosures may face significant uncertainty and novel compliance challenges. To the extent this leads to inadvertent non-compliance, registrants may face additional exposure to litigation or enforcement action.

However, certain factors may mitigate this concern. First, existing and proposed safe harbors [953] would provide protection from liability for certain statements by registrants, including projections regarding future impacts of climate-related risks on a registrant's consolidated financial statements and climate-related targets and goals. Second, the proposed rules would include phase-in periods after the effective date to provide registrants with sufficient time to become familiar with and meet the proposed disclosure requirements.[954]

Another potential indirect cost is the possibility that certain provisions of the proposed rules may force registrants to disclose proprietary information.[955] Under the proposed rules, registrants would be required to disclose a wide range of climate-related information, including potential impacts on its business operations or production processes, types and locations of its operations, products or services, supply chain and/or value chain. Registrants would be further required to disclose whether they have emissions-related targets and metrics or an internal carbon price, and if they do, what they are. To the extent that a registrant's business model or strategy relies on the confidentiality of such information, the required disclosures may put the registrant at a competitive disadvantage.

c. Other Cost Considerations

Although the proposed rules may impose significant compliance costs, we expect these costs to decrease over time, both from firm-specific and market-wide contexts. From the firm-specific context, registrant disclosing climate-related information for the first time is likely to incur initial fixed costs to develop and implement the necessary processes and controls.[956] Once the firm invests in the institutional knowledge and systems to prepare the disclosures, the procedural efficiency of these processes and controls should subsequently improve, leading to lower costs in following years.[957]

Establishing a framework for standardized climate-related disclosures could also reduce uncertainty for registrants over the specific content to disclose and could mitigate disclosure burdens to the extent that it reduces information requests from third parties. Before registrants can take any tangible steps toward preparing climate-related disclosures, they must first determine which specific climate-related discussions, metrics, and analyses are most appropriate to disclose—a process that, under the current regime, can involve significant uncertainty. Furthermore, the uncertain, complex, and multidimensional nature unique to climate-related risks, combined with the unpredictability of investor responses to such disclosures,[958] can also make it costly for management to determine the risks which meet the materiality threshold.

By implementing a standardized climate disclosure framework, the proposed rules could potentially reduce the burden that registrants may face in the environment of diverging voluntary frameworks and help clarify for registrants what they should disclose, where and when to make their disclosures, and what structure or methodology to use.[959] While a more principles-based approach would provide additional flexibility for registrants, it also may impose certain costs if they are unsure of what climate-related measures are needed to satisfy legal requirements. Such an approach could entail additional judgment on the part of management, or result in registrants erring on the side of caution in complex matters such as climate-related disclosures. This could ultimately translate into spending more resources to determine appropriate compliance with the Commission's applicable reporting standards. The proposed rules should provide legal certainty around climate-related disclosure and therefore mitigate the compliance burdens associated with the existing regulatory framework.

Furthermore, some registrants currently receive multiple, diverse requests for climate-related information from different parties, such as investors, asset managers, and data service providers. Responding to such third-party request can be costly and inefficient [960] and may put significant and sometimes competing demands on registrants.[961] A standardized climate disclosure framework could potentially reduce information requests from third parties to the extent that such requests overlap with the disclosures required under the proposed rules. We acknowledge, however, that registrants that currently use third-party frameworks to disclose climate-related information may incur certain costs of switching from their existing practice to our proposed disclosure framework.

From a market-wide context, mandated climate disclosures may heighten demand for certain data or third-party services related to preparing the required disclosures, including assistance with the reporting of emissions data. In the short term, there could be a potential increase in the prices of such services to extent that the initial growth in demand exceeds the supply. In the long term, however, this heightened demand is expected to spur competition, innovation, and other economies of scale that could over time lower associated costs for such services and data and improve their availability. Moreover, the aggregate accumulation of institutional knowledge may lead to a broad convergence of disclosure-related best practices, which could further reduce the costs of the proposed disclosures.

Overall, the market effects deriving from competition and innovation could enhance the efficiency and availability of relevant data and services, thereby

[952] *See supra* note 841.

[953] As previously noted, registrants would be able to use the existing safe harbors for forward-looking statements that were added to the Securities Act and Exchange Act pursuant to the PSLRA assuming all conditions of those safe harbor provisions are met. *See supra* note 219.

[954] Compliance would be required in a registrant's fiscal year ending no earlier than two years after the effective date of any adopted rules. An additional one year phase-in would be provided for registrants that are not large accelerated filers, while complying with Scope 3 emissions reporting would also be provided with an additional one year phase-in.

[955] Proprietary costs are generally relevant for reporting that involves information about a firms' business operations or production processes and disclosures that are specific, detailed and process-oriented. *See, e.g.,* C. Leuz, A. Triantis, and T.Y. Wang, *Why Do Firms Go Dark? Causes and Economic Consequences of Voluntary SEC Deregistrations,* 45(2) Journal of Accounting and Economics 181–208 (2008); D.A. Bens, P. G. Berger, and S.J. Monahan, *Discretionary Disclosure in Financial Reporting: An Examination Comparing Internal Firm Data to Externally Reported Segment Data,* 86 (2) The Accounting Review 417–449 (2011).

[956] *See* Letter from Financial Executives International's (FEI) Committee on Corporate Reporting (CCR) (June 10, 2021).

[957] The assumption that first year's costs are greater than subsequent years' is consistent with the cost estimation models of the EPA's Greenhouse Gas Reporting Program and the UK's proposal of mandatory TCFD-aligned disclosure.

[958] *See* Section IV.B.2.a.(4).

[959] *See supra* note 806.

[960] *Id.*

[961] TCFD, *Status Report: Task Force on Climate-related Financial Disclosures,* (June 2019), *available at https://www.fsb-tcfd.org/wp-content/uploads/2019/06/2019-TCFD-Status-Report-FINAL-053119.pdf.*

lowering costs. These positive externalities from standard reporting practices can provide additional market-wide cost savings to the extent that they reduce duplicative effort in the production and acquisition of information.[962]

D. Anticipated Effects on Efficiency, Competition, and Capital Formation

1. Efficiency

As discussed in Section IV.B.2, the complexity, uncertainty, and long-term nature of climate risks make it unlikely that voluntary disclosure of such risks would be fully revealing. Therefore, as detailed in Section IV.C.1, mandating that climate-related disclosures be presented in a comparable and consistent manner and in a machine-readable language (Inline XBRL) is likely to enhance the information environment for investors. In doing so, the proposed rules are expected to improve market efficiency and price discovery by enabling climate-related information to be more fully incorporated into asset prices. Improved efficiency could inform the flow of capital and allow climate-related risks to be borne by those who are most willing and able to bear them.[963]

These expected improvements in market efficiency are broadly consistent with empirical research. If climate-related information is relevant for asset prices, and therefore market efficiency, then the effective disclosure of climate-related information would be expected to cause differential asset price/financing cost responses across firms and settings. Empirical evidence is largely consistent with this expectation. Academic studies have found evidence that among firms that voluntarily report emissions via the CDP questionnaire, those with higher emissions (relative to their size and industry peers) pay higher loan spreads.[964] A recent report from Lazard Ltd. also found a significant relationship between carbon dioxide emissions and a company's price-to-earnings ratio.[965] Even in settings with mandatory disclosure, evidence is consistent with abnormally positive stock returns on announcement date for low-emitters and negative returns for high-emitters.[966]

While the disclosure of climate-related information can improve market efficiency, investor response to such disclosures can vary depending on specific circumstances, thereby highlighting the limitations of the aforementioned studies.[967] For example, if increased disclosure causes investors to realize that their portfolios are more exposed to climate risk than previously known, valuations may fall and costs of capital may increase as investors reallocate capital to balance this risk. Further, aggregate pricing effects could also be due to a better understanding of future regulatory risks firms face.[968] Studies find, however, that cumulative abnormal stock returns around the announcement date are negatively correlated with firms' mandatorily disclosed emission levels. This consistent with mandatory reporting of climate-related information improving price discovery and market efficiency.

Empirical research has also documented evidence of market inefficiencies with respect to climate-related risks. For example, one study finds that stock prices of food companies (*i.e.* food processing and agricultural companies) may exhibit mispricing with respect to drought exposure.[969] The study documents that drought-exposed firms report reduced future profitability, indicating that drought exposure is a financial risk. In an efficient market, this risk should result in trading activity that decreases the current stock price and increases the expected return (to compensate investors for bearing this risk). The study, however, finds that drought-exposed firms deliver *lower* future returns relative to firms with less exposure, suggesting that the market initially under-reacts to drought exposure. In other words, the market may fail to sufficiently incorporate the risk of drought exposure into the current stock price, resulting in investors holding mispriced assets and bearing risk for which they are not appropriately compensated. Another study finds, through similar reasoning, that stock prices may exhibit mispricing with respect to temperature changes induced by climate change.[970] According to survey evidence of global institutional investors, respondents believe that equity valuations do not fully reflect climate-related risks.[971] Mandatory disclosures may help address these inefficiencies as it would provide investors with the information necessary to better incorporate climate-related risks into asset prices.

These capital market benefits can be further strengthened by the requirement to tag the climate-related disclosures in Inline XBRL, as XBRL requirements have been observed to reduce informational advantages of informed traders, increase stock liquidity, and reduce cost of capital.[972] These benefits

[962] *See supra* note 841.

[963] A recent study by McKinsey found that 85% of investors either agreed or strongly agreed that ''more standardization of sustainability reporting'' would help them allocate capital more effectively, and 83% either agreed or strongly agreed that it would help them manage risk more effectively. *See* Sara Bernow et al., *More Than Values: The Value-Based Sustainability Reporting That Investors Want,* McKinsey & Company (Aug. 7, 2019), *available at https://www.mckinsey.com/~/media/McKinsey/Business%20Functions/Sustainability/Our%20Insights/More%20than%20values%20The%20value%20based%20sustainability%20reporting%20that%20investors%20want/More%20than%20values-VF.pdf.*

[964] *See* S. Kleimeier, and M. Viehs, Carbon Disclosure, Emission Levels, and the Cost of Debt, Emission Levels, and the Cost of Debt, SSRN (2018), *available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2719665.*

[965] *See* Lazard Climate Center (2021), *available at https://www.lazard.com/media/451920/lazard-climate-center-presentation-december-2021.pdf.* The report examined more than 16,000 companies from 2016 through 2020 and found that investors are actively and directly pricing some transition risk into valuations, however the effects vary significantly across different types of GHGs, market cap, and sectors. Large cap companies (≤$50 billion) experience greater valuation discounts, while big emitters, such as energy companies, showed the starkest correlation. On average, a 10% decrease in a large U.S. energy company's emissions corresponded with a 3.9% increase in its price-to-earnings ratio.

[966] *See supra* note 850 (Jouvenout and Kruger, 2021).

[967] *Id. See also* J. Grewal, E.J. Riedl, and G. Serafeim, Market Reaction to Mandatory Nonfinancial Disclosure, 65 (7) *Management Science* 3061–3084 (2019); *See supra* note 850 (Bolton and Kacperczyk, 2020). The first paper in particular finds a negative aggregate stock market response to the passage of a mandatory ESG disclosure rules in the EU. These results, however, should be interpreted with caution. For one, the empirical design is based on matching, but there are reasons to believe that the treatment and control groups differ along important dimensions. Further, there is no event study plot, and results are not shown for cumulative abnormal returns after controlling for common risk factors like the Fama-French 3-factor model. It is therefore difficult to discern whether the passage of the disclosure rules is actually driving the aggregate market response.

[968] For example, the passage of disclosure rules may signal more stringent enforcement of emissions rules going forward, leading to an increase in the risk of regulation. Therefore, it is difficult to disentangle the pure effect of disclosure rules on stock performance and the cost of capital.

[969] *See* H. Hong, F.W. Li, J. Xu. *Climate Risks And Market Efficiency,* 208.1 Journal of Econometrics 265–28 (2019).

[970] *See, e.g.,* K. Alok, W. Xin, C. Zhang, *Climate Sensitivity And Predictable Returns, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3331872.*

[971] *See* P. Krueger, Z. Sautner, L.T. Starks, *The Importance of Climate Risks for Institutional Investors,* 33(3) The Review of Financial Studies, 1067–1111 (2020).

[972] *See, e.g.,* N. Bhattacharya, Y.J. Cho, J.B. Kim, *Leveling the Playing Field Between Large and Small Institutions: Evidence from the SEC's XBRL Mandate,* 93(5) The Accounting Review 51–71 (2018); B. Li, Z. Liu, W. Qiang, and B. Zhang, *The Impact of XBRL Adoption on Local Bias: Evidence from Mandated U.S. Filers,* 39(6) Journal of Accounting and Public Policy (2020); W. Sassi, H. Ben Othman, and K. Hussainey, *The Impact of Mandatory Adoption of XBRL on Firm's Stock Liquidity: A Cross-Country Study,* 19(2) Journal of Financial Reporting and Accounting 299–324

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may also have valuation implications. The discounted cash flow model illustrates how, all else equal, a drop in the cost of capital leads to a boost in equity valuation, which can further benefit investors.

There are also important efficiency implications in relation to systemic risks.[973] The increasing frequency and severity of climate events can potentially lead to destabilizing losses for insurance companies,[974] banks,[975] and other financial intermediaries with direct and indirect exposures to different affected industries and assets. Some commentators state that, in addition to physical risks, the financial system could be destabilized also by potentially rapid and unexpected losses to carbon-intensive assets caused by a disorderly transition to a low-carbon economy or a shift in the market's perception of climate risks.[976] With insufficient and inconsistent disclosures, asset prices may not fully reflect climate-related risks. Consequently, market participants may inadvertently accumulate large exposures to such risks, leaving them vulnerable to considerable unexpected and potentially sudden losses.[977]

In the face of such losses, financial intermediaries may be forced to sell off assets at fire-sale prices to generate enough cash to pay claims or to otherwise meet the time-sensitive cash demands of creditors and counterparties. This fire-sale dynamic could push down asset prices as well as the value of firms holding similar assets due to mark-to-market losses, potentially increasing risk premia and correlations across asset classes.[978] Stress from large, complex, and interconnected financial institutions, or correlated stress across smaller market participants, could be transmitted and propagate through the financial system,[979] causing disruptions in the provision of financial services.[980] A more efficient allocation of capital brought about the disclosure required by the proposed rules could reduce the probability and magnitude of disorderly price corrections or dislocations, thereby strengthening financial system resilience.[981]

2. Competition

The provisions included in the proposed rules are expected to increase comparability among registrants by demanding climate-related information in a consistent manner and with machine-readable data language (Inline XBRL). More standardized climate reporting could improve competition among registrants as it could reduce their costs for both producing such information due to enhanced efficiencies of scale across the economy and the cost for acquiring and processing said information by investors.

As discussed in Section IV.C.2, positive externalities from standard reporting practices can provide market-wide cost savings to registrants in the long-term, to the extent that they reduce duplicative effort in registrants' production and acquisition of information (*e.g.* certain data or third-party services related to preparing the required disclosures, including the reporting of emissions data, may become cheaper in the long run as the heightened demand spur competition, innovation, and other economies of scale). These cost savings could be particularly helpful for smaller registrants, or those that are capital constrained, which otherwise may not be able to provide the same amount, or level of detail, of climate-related disclosures as registrants with greater resources.

More standardized reporting should also reduce investors' costs for acquiring and processing climate-related information by facilitating investors' analysis of a registrant's disclosure and assessing its climate-related risks against those of its competitors. The placement of climate-related information in SEC filings with machine-readable data language (Inline XBRL), rather than external reports or company websites, should also make it easier for investors to find and compare this information.

Overall, we expect that by standardizing reporting practices, the proposed rules would level the playing field among firms, making it easier for investors to assess the climate-related risks of a registrant against those of its competitors. The effects of peer benchmarking can contribute to increased competition for companies in search for capital both across and within industries, whereby firms can be more easily assessed and compared by investors against alternative options.

Failure to implement the proposed rules could lead to an informational gap between U.S. registrants and companies

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(2021); C. Ra and H. Lee, *XBRL Adoption, Information Asymmetry, Cost of Capital, and Reporting Lags,* 10 IBusiness, 93–118 (2018); S.C. Lai, Y.S. Lin, Y.H. Lin, and H.W. Huang, XBRL *Adoption and Cost of Debt,* International Journal of Accounting & Information Management (2015); Y. Cong, J. Hao, and L. Zou, *The Impact of XBRL Reporting on Market Efficiency,* 28(2) Journal of Information Systems 181–207 (2014).

[973] Systemic risk refers to the risk of a breakdown of an entire system, rather than simply the failure of individual parts. In a financial context, systematic risk denotes the risk of a cascading failure in the financial sector, caused by linkages within the financial system, resulting in a severe economic downturn.

[974] *See Facts + Statistics: Global Catastrophes,* Insurance Information Institute, *available at https://www.iii.org/fact-statistic/facts-statistics-global-catastrophes.*

[975] The Office of the Comptroller of the Currency (OCC) recently requested feedback on draft principles designed to support the identification and management of climate-related financial risks at OCC-regulated institutions with more than $100 billion in total consolidated assets. *See Principles for Climate-Related Financial Risk Management for Large Banks,* Office of the Comptroller of the Currency (2021), *available at https://occ.gov/news-issuances/news-releases/2021/nr-occ-2021-138.html?source=email.*

[976] Gregg Gelzinis and Graham Steele, *Climate Change Threatens the Stability of the Financial System,* Center for American Progress (Nov. 21, 2019, 12:01 a.m.), *available at https://www.americanprogress.org/issues/economy/reports/2019/11/21/477190/climate-change-threatens-stability-financial-system.*

[977] *See The Availability Of Data with Which to Monitor and Assess Climate-Related Risks to Financial Stability,* The Financial Stability Board (''FSB'') (July 7, 2021) (stating that the availability of data with which to monitor and assess climate-related risks to financial stability), *available at https://www.fsb.org/2021/07/the-availability-of-data-with-which-to-monitor-and-assess-climate-related-risks-to-financial-stability/.*

[978] *The Implications of Climate Change for Financial Stability,* FSB, *available at https://www.iii.org/fact-statistic/facts-statistics-global-catastrophes* (2021).

[979] Physical risks can have immediate and direct effects on asset values, but they also present long-term indirect risks. By damaging assets that serve as collateral for loans or that underpin other investments, reducing property values, increasing insurance premiums or decreasing insurance coverage, diminishing agricultural capacity, and causing labor forces to migrate, the physical consequences of climate change could have profound and long term effects on financial markets more generally. *See* Jonathan Woetzel et al., *Climate Risk and Response: Physical Hazards and Socioeconomic Impacts,* McKinsey Global Institute (Jan. 2020), *available at https://www.mckinsey.com/business-functions/sustainability/our-insights/climate-risk-and-response-physical-hazards-and-socioeconomic-impacts.*

[980] A recent report by an advisory committee to the Commodity Futures Trading Commission (CFTC) concluded that ''climate change poses a major risk to the stability of the U.S. financial system and to its ability to sustain the American economy.'' See Report of the Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission, Managing Climate Risk in the U.S. Financial System (2020). The Office of the Comptroller of the Currency (OCC) has identified the effects of climate change and the transition to a low carbon economy as presenting emerging risks to banks and the financial system. *See, e.g.,* Semiannual Risk Perspective, 2–4 (Fall 2021), *available at https://www.occ.treas.gov/publications-and-resources/publications/semiannual-risk-perspective/files/pub-semiannual-risk-perspective-fall-2021.pdf.*

[981] *See The Availability Of Data with Which to Monitor and Assess Climate-Related Risks to Financial Stability,* (July 7, 2021) (stating that the availability of data with which to monitor and assess climate-related risks to financial stability), *available at https://www.fsb.org/2021/07/the-availability-of-data-with-which-to-monitor-and-assess-climate-related-risks-to-financial-stability/.*

operating in foreign jurisdictions which require climate-related disclosures. For example, such a gap may increase investors' uncertainty when assessing climate-related risks of U.S. registrants vis-à-vis foreign competitors and place U.S. registrants at a competitive disadvantage, with the potential to deter investments and hence increase U.S. registrants' cost of capital. This informational gap may also pose obstacles to U.S. companies transacting with counterparts and businesses in their supply-chain operating in foreign jurisdictions which require Scope 3 emission disclosures. According to Morningstar, more than 35% of S&P 500 firms' total revenues came from foreign markets, while this percentage is around 20% for the revenues of Russell 2000 firms.[982] Lack of standardized disclosures around Scope 1 and 2 GHG emission by U.S. companies, which may in part be due to the aforementioned impediments to voluntary disclosure,[983] may obstruct foreign counterparts from accurately assessing their Scope 3 GHG emissions, thus putting U.S. registrants at a competitive disadvantage over other foreign companies which may be publicly disclosing such information.

3. Capital Formation

More consistent, comparable, and reliable disclosures could lead to capital-market benefits in the form of improved liquidity, lower costs of capital, and higher asset prices (or firm valuations).[984] Enhanced disclosures (*e.g.,* accurate GHG emissions disclosures) can reduce the time necessary for processing registrant's relevant information, thus increasing efficiency for registrants in their access to capital and allowing the market to more efficiently assess its cost. These benefits would stem from reductions in information asymmetries brought about by the required disclosure of climate-related information. More comparable, consistent, and reliable climate-related disclosures could reduce information asymmetries, both among investors and between firms and their investors.

In the first case, less information asymmetry among investors could mitigate adverse selection problems by reducing the informational advantage of informed traders.[985] This is likely to improve stock liquidity (*i.e.,* narrower bid-ask spreads), which could attract more investors and reduce the cost of capital. In the second case, less information asymmetry between firms and their investors could allow investors to better estimate future cash flows, which could reduce investors' uncertainty, as well as the risk premium they demand, thus lowering the costs of capital.[986]

Recent studies provide some supporting empirical evidence of these effects within the context of ESG- or climate-related disclosure. These studies have found that, when firms voluntarily provide material sustainability disclosures, they also experience improvements in liquidity (*e.g.* smaller bid-ask spreads).[987] In addition, firms that choose to disclose emissions have lower costs of equity and loan spreads.[988] While firms' decisions about whether and when to disclose emissions data may be correlated with other factors as well asset prices/financing costs, this would be consistent with such disclosures reducing the costs of capital for firms (to the extent that some of these effects are driven by the disclosures themselves).

E. Other Economic Effects

The proposed rules may have some effects on firm behavior. Prior empirical evidence supports the notion that, in response to mandatory ESG-related disclosure rules, firms tend to report actions that appear more ''favorable'' with respect to the corresponding disclosures. These decisions would be made by a firm's management with the goal of maximizing firm value in response to the new disclosure mandate. To the extent that these actions reduce firms' exposures to physical and transition risks, this could lower the return that investors require for investing in these firms, hence facilitating capital formation. This could reduce volatility of stock returns due to enhanced resiliency against such risks.

Empirical evidence shows that mandatory reporting of GHG emissions results in reduced aggregate reported emissions among affected firms.[989] Academic research shows that mandatory ESG-related disclosure often contributes, not only to increased monitoring by investors or other stakeholders, but also to enhanced peer benchmarking by firms as they can more easily compare themselves with their competitors.[990] These changes may reflect market responses by companies and investors to the newly disclosed information. Accordingly, registrants may change their behavior in response to the proposed disclosure requirements by reducing exposures to certain physical or transition risks. However, this could also come with the potential cost of lower productivity, profitability, or market share in the short-term.

Registrants might respond to the proposed disclosures by devoting more resources to climate-related governance and risk management in an effort to address indirect effects on their business arising from the disclosures. For example, the proposed rules require disclosure of members of the board or management that have prior climate expertise. Some registrants may respond by giving more weight to climate expertise when searching for directors, which may lead them to deviate from the board composition that would have been in place absent the proposed rules. Similarly, the proposed rules would require disclosure on how climate-related risks can impact registrants' consolidated financial statements, among others. Registrants may respond by taking measures to minimize

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982 See, *https://www.morningstar.com/articles/918437/your-us-equity-fund-is-more-global-than-you-think.*

983 *See* Section IV.B.2.

984 *See* D.W. Diamond and R.E. Verrecchia, Disclosure, Liquidity, and the Cost of Capital, 46 *J. Fin.*1325 (1991) (this study finds that revealing public information to reduce information asymmetry can reduce a firm's cost of capital through increased liquidity); See also C. Leuz and R.E. Verrecchia, The Economic Consequences of Increased Disclosure, 38 *J. Acct. Res.* 91 (2000). Several studies provide both theoretical and empirical evidence of the link between information asymmetry and cost of capital. *See, e.g.,* T.E. Copeland and D. Galai, *Information Effects on the Bid-Ask Spread,* 38 J. Fin. 1457 (1983) (proposing a theory of information effects on the bid-ask spread); D. Easley and M. O'Hara, *Information and the Cost of Capital,* 59 J. Fin. 1553 (2004) (This study shows that differences in the composition of information between public and private information affect the cost of capital, with investors demanding a higher return to hold stocks with greater private information.).

985 *See* R.E. Verrecchia, *Essays on Disclosure,* 32(1–3) Journal of Accounting and Economics 97–180 (2001).

986 *See supra* note 841*; See also* D.W. Diamond and R.E. Verrecchia, *Disclosure, Liquidity, and the Cost of Capital,* 46(4) The Journal of Finance 1325–1359 (1991).

987 *See* J. Grewal, C. Hauptmann, and G. Serafeim, *Material Sustainability Information and Stock Price Informativeness,* Journal of Business Ethics 1–32 (2020); M.E. Barth, S.F. Cahan, L. Chen, and E.R. Venter, *Integrated Report Quality: Share Price Informativeness and Proprietary Costs,* Socially Responsible Investment eJournal (2021).

988 *See* D.S. Dhaliwal et al., *Voluntary Nonfinancial Disclosure and the Cost of Equity Capital: The Initiation of Corporate Social Responsibility Reporting,* 86.1 The Accounting Review 59–100 (2011; S. Kleimeier, and M. Viehs, *Carbon Disclosure, Emission Levels, and the Cost of Debt, Emission Levels, and the Cost of Debt* (2018); E.M. Matsumura, R. Prakash, and S.C. Vera-Munoz. *Climate Risk Materiality and Firm Risk, available at* SSRN 2983977 (2020).

989 *See* B. Downar, J. Ernstberger, S. Reichelstein, S. Schwenen, and A. Zaklan, *The Impact of Carbon Disclosure Mandates on Emissions and Financial Operating Performance,* Review of Accounting Studies 1–39 (2021); S. Tomar, *Greenhouse Gas Disclosure and Emissions Benchmarking* (Working Paper) (2021), *available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3448904; See supra* note 850 (Jouvenout and Kruger, 2021).

990 *See supra* note 841.

negative impacts in order to put forth more favorable metrics. For example, registrants may move assets or operations away from geographic areas with higher physical risk exposures or may seek to decrease GHG emissions.

The provision on GHG Emissions would also require scope 1, 2, and 3 (if material or the registrant has a set a target or goal for scope 3) emission disclosures. These emission disclosures may induce firms to use peer benchmarking to decide whether to investigate and reevaluate their energy usage [991] or otherwise reduce emissions based on anticipated market reactions to the disclosed information. This process may provide certain registrants with incentives to search for alternative energy sources or find different suppliers, which could increase costs. Conversely, it could also prompt certain firms to reduce nonessential activities and improve operational efficiency, which could lead to lower operating costs.

The provision requiring assurance of GHG Scopes 1 and 2 emissions disclosures would only apply to accelerated filers. Non-accelerated filers would, instead, be required only to state whether any of their GHG emissions disclosures were subject to third-party assurance, and if so, at what level. By asking all registrants, including non-accelerated filers, to disclose climate-related information within SEC filings, however, the proposed rules may motivate more non-accelerated filers to voluntarily seek assurance over these types of disclosures, than if the same information had been disclosed on companies' websites or sustainability reports. Certain non-accelerated filers may also voluntarily decide to attain assurance over their GHG emission disclosures in order to enhance their reliability and prevent these disclosures from being perceived by investors as less reliable compared to those provided by accelerated filers.

As another example, the proposed rules would require the disclosure of the location (via ZIP code) of firm assets or operations, which could allow investors to assess firms' exposures to physical risk at a more granular level. This may allow investors to more easily diversify these geographic-driven risks or expose themselves to such risks, if they choose to, more deliberately. This may cause some firms to relocate assets or operations to geographical areas less exposed to physical risks and/or give preferences to such areas for future business activity. It may also cause some firms with higher geographic exposures to physical risks to alter overall operational risk and strategies.

The proposed rules might also affect the networks firms choose to operate in. For example, a firm may choose to change some suppliers or disengage with certain clients due to the effect that they may have on the firm's Scope 3 emissions. This may be particularly relevant for certain financial institutions that are impacted by their portfolio firms' emissions or climate-related risks. These financial institutions may be less willing to extend credit to firms for which it is difficult to measure climate risk exposure information, potentially increasing the cost of capital for these firms.

However, there are certain factors that may mitigate this effect. First, the proposed rules establish a phase-in period, which is intended to give financial institutions and their prospective borrowers sufficient time to prepare the required disclosures. Second, analytical tools, data, and related methodologies (such as those related to measuring/reporting GHG emissions) are developing rapidly and increasing in availability. Finally, frameworks like the PCAF to measure financed emissions would allow financial institutions to compute proxies for the emissions of their clients in a systematic and comparable manner even in the absence of actual emissions data.

The proposed rules could also cause some firms to pursue avoidance strategies. The provision on Targets and Goals would require a registrant to disclose whether it has set any climate-related targets or goals and the specific plans in place to achieve those objectives and metrics to monitor progress. This may disincentivize certain firms from making such commitments and providing the associated disclosures in SEC filings. Risk of litigation or enforcement actions, could result in registrants being more cautious in their decision to set climate-related targets. Other firms, however, may find the existence of mandatory disclosures around climate-related targets and goals to be beneficial for signaling credible value-enhancing commitments to investors. More credible and standardized disclosures on climate-related targets and goals could make registrants' communication more effective and facilitate investors' understanding of related progress, hence providing additional incentives for making such commitments.

More generally, if compliance costs with the proposed rules are high, this could influence the marginal firm's decision to exit public markets or refrain from going public in the first place in order to circumvent the disclosure requirements. Firms may choose this strategy if they believe the potential compliance costs from the proposed rules outweigh the benefits of being registered public company. Uptake of this avoidance strategy may widen the transparency gap between public and private firms, negatively affecting capital markets' information efficiency, and potentially reduce the size of the stock market. However, it is unlikely that a significant number of firms would pursue this avoidance strategy given that it would come with significant disadvantages, such as higher costs of capital, limited access to capital markets, and limits to their growth potential. Moreover, recent trends in private markets indicate that industry's top leaders are working toward a standard set of metrics for tracking their portfolio companies' ESG progress. The pressure on private companies to disclose information on climate-related risks is rapidly escalating within the private industry, hence diminishing the potential incentive for registrants to go private in order to avoid climate-related disclosure requirements. For example, since its launch in September 2021, the ESG Data Convergence Project, which seeks to standardize ESG metrics and provide a mechanism for comparative reporting for the private market industry, has announced a milestone commitment of over 100 leading general partners and limited partners to its partnership representing $8.7 trillion USD in AUM and over 1,400 underlying portfolio companies across the globe. The initial data for the project includes, among others, greenhouse gas emissions and renewable energy metrics.[992]

F. Reasonable Alternatives

1. Requirements Limited to Only Certain Classes of Filers

One alternative would be to require the proposed disclosures only from larger registrants, such as large accelerated filers or non-SRCs. While the proposed rules already provide certain exemptions for SRCs (*e.g.,* Scope 3 emissions disclosures and assurance requirements), this alternative would exempt smaller registrants from the entirety of the proposed rules. The main benefit of this alternative is that it

[991] *See supra* note 841.

[992] *See* Carlyle, Private Equity Industry's First-Ever ESG Data Convergence Project Announces Milestone Commitment of Over 100 LPs and GPs (Jan. 28, 2022), *available at https://www.carlyle.com/media-room/news-release-archive/private-equity-industrys-first-ever-esg-data-convergence-project-announces-over-100-lps-gps.*

would avoid imposing potentially significant compliance costs on smaller registrants, which are more likely to be resource-constrained. However, considering that SRCs make up approximately 50% of registrants (and registrants that are not large accelerated filers make up approximately 70%), this alternative would also considerably undermine one of the primary objectives of the proposed rules, which is to achieve consistent, comparable, and reliable disclosures of climate-related information. Furthermore, climate-related risks are impacting or are expected to impact every sector of the economy,[993] further highlighting the need for enhanced disclosures from all registrants. In an effort to arrive at an appropriate balance between these costs and benefits, the proposed rules exempt SRCs from some, but not all, disclosure requirements.

2. Require Scenario Analysis

Another alternative would be to require registrants to conduct scenario analysis and include the related information in their disclosures. Consistent, comparable, and reliable disclosures of scenario analysis could inform investors with respect to the resilience of registrants' business strategies and operations across a range of plausible future climate scenarios. Disclosure of scenario analysis could deliver informational benefits to investors beyond that which would be provided under the proposed rules. It could help investors assess issues that have high uncertainty by evaluating the impact on and the resiliency of the registrant under multiple plausible future scenarios, such as a temperature increase of 1.5°C, 2°C, and 3°C above pre-industrial levels. It could also allow investors to proactively manage risk as they would be better able to assess the range of potential threats and opportunities, evaluate different management actions, and adapt accordingly. Furthermore, since some climate-related risks may only manifest over longer horizons, scenario analysis could assist investors in determining whether registrants have incorporated such risks into their long-term strategy. Investors could subsequently incorporate this information into asset prices, thereby more accurately pricing climate-related risks and contributing to market efficiency.

[993] SASB research shows climate risk is nearly ubiquitous but highly differentiated across 77 industries. *See SASB Publishes Updated Climate Risk Technical Bulletin* (Apr. 13, 2021), available at *https://www.globenewswire.com/news-release/2021/04/13/2208855/0/en/SASB-Publishes-Updated-Climate-Risk-Technical-Bulletin.html.*

Both scenario analysis methodologies and climate science, however, continue to advance and develop, which may pose significant challenges for some registrants. Specifically, the required data may be unavailable or costly to obtain. Furthermore, some registrants may lack the necessary expertise, requiring them to hire external consultants to conduct the analysis. These challenges may pose undue burdens with respect to difficulty and/or costs to some registrants, such as smaller companies and those that otherwise have no prior experience in scenario analysis. For these reasons, the Commission is not proposing to mandate scenario analysis and related disclosure at this time.

3. Require Specific External Protocol for GHG Emissions Disclosure

Another alternative would be to require registrants to follow an external protocol (*e.g.,* GHG protocol) for reporting emissions. Requiring a specific protocol may potentially benefit investors by providing a more consistent and comparable framework in reporting emissions, thus facilitating investors' information processing. However, there also may be certain drawbacks.

First, the organizational boundaries adopted by external protocols may create inconsistencies with the way companies would report information about their GHG emissions vis-à-vis the rest of their financial statements. The GHG Protocol, for example, requires that a company base its organizational boundaries on either an equity share approach or a control approach, which may differ from the way registrants set their scope for the purpose of reporting information in their financial statements. The proposed rules would require a registrant to set the organizational boundaries for its GHG emissions disclosure using the same scope of entities, operations, assets, and other holdings as those included in its consolidated financial statements. Requiring a consistent scope of consolidation and reporting between financial data and GHG emissions data should help avoid potential investor confusion about the reporting scope used in determining a registrant's GHG emissions and the reporting scope used for the financial statement metrics.

Furthermore, requiring companies to follow a specific external protocol might limit flexibility for registrants and thus reduce their ability to report emissions in a manner that is tailored to their specific circumstances. For example, registrants following an existing but different protocol, which nevertheless provides relevant emissions information, would be required to switch protocols, incurring additional cost.

Requiring compliance with a specific protocol could also reduce the scope for innovation in driving the most appropriate forms of disclosure within these overarching guidelines (*e.g.,* the methodologies pertaining to the measurement of GHG emissions, particularly Scope 3 emissions, are still evolving). Additionally, requiring compliance with a specific external protocol as of the date of the adoption of any final rules may become problematic in the future to the extent that the external protocol's methodologies shift or evolve such that the version incorporated by reference into the final rules becomes outdated or inconsistent with improving methodologies. While we expect that many registrants will choose to follow many of the standards and guidance provided by the GHG Protocol when calculating their GHG emissions, not requiring compliance with the GHG Protocol would provide some flexibility to the Commission's climate-related disclosure regime and enable registrants to follow new and potentially less costly methodologies as they emerge.

4. Permit GHG Emissions Disclosures To Be ''Furnished'' Instead of ''Filed''

Another alternative would be to permit Scopes 1, 2, and 3 emissions disclosures to be considered ''furnished'' instead of ''filed,'' which may limit the incremental risk of being held liable under Section 18 of the Exchange Act for these disclosures. This may also benefit some registrants as their Scopes 1 and 2 emissions disclosures would not be automatically incorporated into Securities Act registration statements and thereby not be subject to Section 11 liability. We note that this could have a lower incremental impact on Scope 3 emissions disclosures since Scope 3 emissions disclosures are covered under a proposed safe harbor provision and hence already afforded other liability protections. However, reduced liability in general may lead to the applicable disclosures being perceived as less reliable by investors, which could have adverse effects on registrants' stock liquidity or costs of capital. For these reasons, the Commission is not proposing to permit emissions disclosures to be furnished at this time.

5. Do Not Require Scope 3 Emissions for Registrants With a Target or Goal Related to Scope 3

Another alternative would be to not require Scope 3 emissions disclosures if such emissions are part of a target or goal from any registrant. This would allow certain registrants to avoid the potentially significant costs and difficulties associated with measuring and reporting Scope 3 emissions. This could potentially deprive investors of important information necessary to assess registrants' exposures to certain risks associated with trying to achieve targets or transition plans. Scope 3 emissions can provide investors with a more complete picture of how targets or transition plans might impact risks (*e.g.,* future regulations restricting emissions or changes in market conditions that disfavor high emissions products or services) of the registrant through the value chain. This can be particularly important considering that Scope 3 emissions can make up the vast majority of total emissions for many registrants.[994] Furthermore, some firms can give the appearance of low (direct) emissions by shifting high-emission activities elsewhere in their value chain.[995] Mandatory disclosure of Scope 3 emissions for registrants with a target or goal related to Scope 3 emissions can help prevent such misrepresentation.

6. Exempt EGCs From Scope 3 Emissions Disclosure Requirements

Another alternative would be to retain the exemption for SRCs, as currently proposed, but also extend it to EGCs. EGCs may similarly face resource constraints related to company size or age, hence this alternative would allow EGCs to avoid the costs of Scope 3 emissions measurement and reporting. Given that the designations of SRC and EGC are not mutually exclusive, however, EGCs that are also SRCs would be covered under the exemption as currently proposed. Conversely, EGCs that are *not* SRCs are relatively less resource-constrained since they, by definition, have greater revenues and/or public float, and therefore may be better positioned to provide Scope 3 emissions disclosures.

7. Eliminate Exemption for SRCs From Scope 3 Reporting

Another alternative would be to eliminate the exemption for SRCs. Because SRCs make up approximately half of domestic filers in terms of numbers (though considerably less in terms of market cap), this alternative could address data gaps with respect to Scope 3 emissions, with the potential to benefit all investors. As discussed in Section II.G.3, however, this alternative may pose fixed costs (*e.g.* data gathering and verification), that would fall disproportionately on SRCs. Also, because SRCs are a small fraction of the market, the overall benefit to investors would be limited.

8. Remove Safe Harbor for Scope 3 Emissions Disclosures

The proposed rules provide a safe harbor for Scope 3 emissions disclosures. An alternative would be to remove this safe harbor for Scope 3 emissions disclosures. This alternative would strengthen accountability for Scope 3 emissions disclosures. It also would significantly increase registrants' exposure to litigation over the accuracy of such disclosures. While rigorous liability in many contexts can provide incentives that promote reliable disclosures, an accommodation may be warranted for Scope 3 emissions due to the challenges associated with their measurement and disclosure.[996]

9. Require Large Accelerated Filers and Accelerated Filers To Provide a Management Assessment and To Obtain an Attestation Report Covering the Effectiveness of Controls Over GHG Emissions Disclosures

The proposed rules would require assurance over Scopes 1 and 2 emissions disclosure from large accelerated filers and accelerated filers. In addition to such assurance, we could require these filers to also obtain either a separate assessment by management and disclosure on the effectiveness of controls over GHG emissions disclosures or an attestation report specifically covering the effectiveness of controls over GHG emissions disclosures, or both. Specifically, management could be required to include a statement in the annual report on their responsibility for the design and evaluation of controls over GHG emission disclosures, as well as to disclose their conclusion regarding the effectiveness of controls over GHG emissions disclosures, in addition to the existing DCP evaluation and disclosure. In addition, we could require a GHG emissions attestation provider to obtain reasonable assurance on whether material weaknesses exist regarding management's assessment of the effectiveness of controls over GHG emissions disclosures as of the measurement date. The GHG emissions attestation provider could also be required to issue an attestation report on the effectiveness of controls over GHG emissions disclosures.[997]

By requiring GHG emissions attestation providers to assess not just the disclosures, but also the controls over GHG emissions disclosures (*i.e.,* the underlying mechanisms, rules, and procedures associated with generating such disclosures), this alternative could further strengthen the integrity of the disclosed information. In the context of emissions, GHG emissions attestation providers may evaluate and test the effectiveness of registrants' controls related to the collection, calculation, estimation, and validation of GHG emissions data and disclosure. These processes could strengthen disclosure credibility as they reduce the likelihood of errors or fraud and their ensuing misstatements.[998] Investors would benefit from any resulting improvement in disclosure reliability for reasons discussed in prior sections: It would allow investors to make better-informed investment decisions, allow applicable information to be better incorporated into asset prices, and contribute to a more efficient allocation of capital. Registrants may also benefit via reduced costs of capital and increased stock liquidity.

However, this alternative would also impose additional assurance costs.[999] Given that GHG emissions measurement and disclosure are developing areas, it is unclear what exact controls are or would be in effect, making it difficult to anticipate precisely what such attestation would entail. These uncertainties pose further difficulties in obtaining informative cost estimates and, accordingly, accurate assessments of how burdensome such a requirement would be to registrants. This leaves the

[994] *See supra,* note 888.

[995] *See supra,* note 893.

[996] *See* Section II.G.3

[997] *See* AICPA, AU–C 940, *An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements* (2021), *available at https://www.aicpa.org/content/dam/aicpa/research/standards/auditattest/downloadabledocuments/au-c-00940.pdf.*

[998] Potentially consistent with this, though in a different setting, academic evidence surrounding Section 404 of the Sarbanes-Oxley Act (SOX) finds lower accruals and discretionary accruals for small firms whose 2002 float (prior to when firms could have known and therefore tried to alter their float to avoid the regulation) made them likely to be just above the requirements for compliance, relative to those just below. Iliev, Peter (2010). The effect of SOX Section 404: Cost, earnings quality and stock prices. Journal of Finance, 65, 1163–1196.

[999] Also potentially consistent with this, prior academic studies of Section 404 of SOX find significantly higher auditing fees, negative stock returns, and reduced innovation, though no clear evidence of a decline in investment, for marginally complying small firms near the float requirement threshold. *See* Iliev, Peter (2010). The effect of SOX Section 404: Cost, earnings quality and stock prices. Journal of Finance, 65, 1163–1196; Gao, Huasheng, and Jin Zhang (2019). SOX Section 404 and corporate innovation. Journal of Financial and Quantitative Analysis 54(2): 759–787; Albuquerque, Ana and Julie Lei Zhu (2019). Has Section 404 of the Sarbanes-Oxley Act discouraged corporate investment? New evidence from a natural experiment. Management Science 65(7): 3423–3446.

possibility that the costs could outweigh the incremental benefits given that the proposed rules already require assurance for Scopes 1 and 2 emissions disclosures for applicable registrants. For these reasons, the Commission is not proposing at this time to require an attestation report on the effectiveness of controls over GHG emissions disclosures.

10. Require Reasonable Assurance for Scopes 1 and 2 Emissions Disclosures From All Registrants

Another alternative would be to require reasonable assurance for Scopes 1 and 2 emissions disclosures from all registrants. As described above, requiring assurance can benefit investors in several ways, including enhanced reliability of disclosures, which would allow investors to make better-informed investment decisions

However, because costs increase with the level of assurance, requiring reasonable assurance may be particularly burdensome for affected registrants (*i.e.,* smaller firms) as they would be more likely to incur proportionately higher compliance costs due to the fixed cost components of such compliance, regardless of whether or not there is a transition period before this requirement takes effect. While the benefits of assurance could be approximately proportional to registrant's market value, the costs are not. In an effort to arrive at an appropriate balance between these factors, the proposed rules would require reasonable assurance (after a specified transition period) only from large accelerated filers and accelerated filers because the benefits to investors are more likely to justify the costs for these firms.

11. Require Limited, Not Reasonable, Assurance for Large Accelerated Filers and/or Accelerated Filers and/or Other Filers

Obtaining reasonable assurance generally costs more than obtaining limited assurance. Current market practice appears to favor obtaining limited assurance over sustainability reports, if assurance is obtained at all. Experimental evidence suggests assurance (relative to none) may increase perceived reliability of sustainability reports, but is yet to provide evidence that reasonable assurance increases perceived reliability of sustainability reports relative to limited assurance.[1000] We acknowledge, however, that experimental findings from lab settings may not necessarily reflect the behavior or preferences of experienced investors in actual financial markets. Furthermore, other research often exhibits a selection bias (*i.e.,* companies that voluntarily decide to obtain a higher-than-required level of assurance are systematically different across several dimensions), making it difficult to determine the causal effect of the different levels of assurance.[1001]

One possibility to mitigate the additional costs of reasonable assurance would be to maintain the requirement that large accelerated filers obtain reasonable assurance, but allow accelerated filers to obtain limited assurance without any scaling up to a reasonable assurance. Another possibility would be to require limited assurance, but expand the assurance requirement to a broader scope of registrants including non-accelerated filers and smaller reporting companies. However, these possibilities have the disadvantage of lack of consistency, which could lead to confusion among investors.

12. In Lieu of Requiring Assurance, Require Disclosure About Any Assurance Obtained Over GHG Emissions Disclosures

Another alternative would be to require all registrants to disclose what type of assurance they are receiving, if any, in lieu of requiring assurance. This would potentially allow affected registrants to avoid the costs of obtaining limited assurance and/or reasonable assurance.[1002] Additionally, registrants would have the flexibility to choose any level of assurance (*i.e.,* none, limited, or reasonable assurance) but still be required to disclose their choice for transparency. This alternative, however, may reduce the reliability and comparability of these disclosures relative to the standardized assurance requirements within the proposed rules. In addition, as it does not set any minimum requirements for the assurance, this alternative would not address the fragmentation and selective disclosure issues that characterize the current, voluntary reporting regime.

13. Permit Host Country Disclosure Frameworks

Another alternative would be to permit alternative compliance using host country disclosure frameworks that the Commission deems suitable. Such an alternative would be beneficial for registrants that already comply with another country's disclosure requirements since they could avoid incurring additional costs to comply with the Commission's rules. This flexibility, however, may fail to address or may even exacerbate growing concerns from investors that climate-related disclosures lack comparability and consistency. While it might be individually optimal for a given firm to use their existing host country disclosure frameworks, the potential lack of consistency and comparability of the disclosure between these firms and other registrant might impose costs on investors. Investors might not able to compare across firms using different disclosure presentations, or may have to incur additional costs in order to do so.

14. Alternative Tagging Requirements

With respect to Inline XBRL tagging, one alternative is to change the scope of disclosures required to be tagged. We could, for example, remove the tagging requirements for climate-related disclosures for all or a subset of registrants (such as smaller reporting companies). As another example, we could require only a subset of proposed climate-related disclosures, such as the quantitative climate-related metrics, to be tagged in Inline XBRL. Narrowing the scope of climate-related disclosures to be tagged could provide some incremental cost savings for registrants compared to the proposal, because incrementally less time would be required to select and review the particular tags to apply to the climate-related disclosures.

We expect this incremental cost savings to be low because all affected registrants are or in the near future will be required to tag certain of their disclosures (including both quantitative and qualitative disclosures) in Inline XBRL.[1003] Moreover, narrowing the scope of tagging requirements would

[1000] *See, e.g.,* K. Hodge, K., N. Subramaniam, and J. Stewart, *Assurance of Sustainability Reports: Impact on Report Users' Confidence and Perceptions of Information Credibility,* 19 Australian Accounting Review 178–194 (2009), *available at https://doi.org/10.1111/j.1835-2561.2009.00056.x;* Mark Sheldon, *User Perceptions of CSR Disclosure Credibility with Reasonable, Limited and Hybrid Assurances* (Dissertation) (2016) *available at https://vtechworks.lib.vt.edu/bitstream/handle/10919/65158/Sheldon_MD_D_2016.pdf.*

[1001] *See* C.H. Cho, G. Michelon, D.M. Patten, and R.W. Roberts, *CSR report assurance in the USA: An empirical investigation of determinants and effects,* 5 (2) Sustainability Accounting, Management and Policy Journal 130, 130–148 (2014), *available at https://doi.org/10.1108/SAMPJ-01-2014-0003.*

[1002] *See* Section IV.C.2.(3) for cost estimates of assurance over emissions disclosures.

[1003] Inline XBRL requirements for business development companies will take effect beginning Aug. 1, 2022 (for seasoned issuers) and Feb. 1, 2023 (for all other issuers). If the proposed Inline XBRL requirements are adopted in the interim, they will not apply to business development companies prior to the aforementioned effectiveness dates. *See supra* note 706.

diminish the extent of informational benefits that would accrue to investors by reducing the volume of climate-related information that would become less costly to process and easier to compare across time and registrants. For example, an alternative whereby only quantitative climate-related disclosures would be tagged would inhibit investors from efficiently extracting/searching climate-related disclosures about registrants' governance; strategy, business model, and outlook; risk management; and targets and goals, thus creating the need to manually run searches for these disclosures through entire documents.[1004] Such an alternative would also inhibit the automatic comparison/redlining of these disclosures against prior periods, and the performance of targeted artificial intelligence or machine learning assessments (tonality, sentiment, risk words, etc.) of specific narrative climate-related disclosures outside the financial statements rather than the entire unstructured document.

G. Request for Comment

We request comment on all aspects of our economic analysis, including the potential costs and benefits of the proposed rules and alternatives thereto, and whether the proposed rules, if adopted, would promote efficiency, competition, and capital formation or have an impact on investor protection. In addition, we also seek comment on alternative approaches to the proposed rules and the associated costs and benefits of these approaches. Commenters are requested to provide empirical data, estimation methodologies, and other factual support for their views, in particular, on costs and benefits estimates. Specifically, we seek comment with respect to the following questions:

- Are there any costs and benefits to any entity that are not identified or misidentified in the above analysis?
- Are there any effects on efficiency, competition, and capital formation that are not identified or misidentified in the above analysis?
- Are there any other alternative approaches to improving climate-related disclosure that we should consider? If so, what are they and what would be the associated costs or benefits of these alternative approaches? For example, what would be the costs and benefits of implementing a new, comprehensive system, for reporting and transferring GHG emissions across corporate supply and distribution chains, as described by Kaplan and Ramanna (2021)? [1005]
- Are there any sources of data that could provide a more precise estimation of the potential compliance costs that registrants may incur if the proposed rules are adopted?
- Have we accurately estimated the costs of disclosing Scope 1 and 2 emissions? If not, please provide alternative estimates of these costs.
- Have we accurately estimated the costs of disclosing Scope 3? If not, please provide alternative estimates of these costs.
- Are there any additional sources of information to estimate the costs of complying with the Scopes 1, 2, and 3 GHG emissions disclosure requirements and the costs of obtaining limited and reasonable assurance for these disclosures?
- Would any data sources allow these compliance cost estimates to be apportioned to separate provisions of the proposed rules? Furthermore, how would these cost estimates vary across time horizons? For example, the first year of implementation may come with higher start-up costs while subsequent years may come with lower costs.
- Have we accurately characterized the cost of limited assurance and reasonable assurance over Scopes 1 and 2 emissions? If not, please provide an estimate of these costs. Similarly, is there data that can show how the costs of limited assurance and reasonable assurance differ for large accelerated, accelerated and non-accelerated filers?
- How are the costs of obtaining limited assurance and reasonable assurance likely to change over time (*e.g.,* over the five years following adoption or compliance with a specified level of assurance)? What would be the costs and benefits of providing a longer transition period for obtaining assurance over Scopes 1 and 2 emissions disclosures?

V. Paperwork Reduction Act

A. Summary of the Collections of Information

Certain provisions of our rules and forms that would be affected by the proposed amendments contain ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (''PRA'').[1006] The Commission is submitting the proposal to the Office of Management and Budget (''OMB'') for review in accordance with the PRA.[1007] The hours and costs associated with preparing and filing the forms and reports constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information requirement unless it displays a currently valid OMB control number. Compliance with the information collections is mandatory. Responses to the information collections are not kept confidential and there is no mandatory retention period for the information disclosed. The titles for the affected collections of information are:

- Form S–1 (OMB Control No. 3235–0065);
- Form F–1 (OMB Control No. 3235–0258);
- Form S–4 (OMB Control No. 3235–0324);
- Form F–4 (OMB Control No. 3235–0325);
- Form S–11 (OMB Control No. 3235–0067);
- Form 10 (OMB Control No. 3235–0064);
- Form 10–K (OMB Control No. 3235–0063);
- Form 10–Q (OMB Control No. 3235–0070);
- Form 20–F (OMB Control No. 3235–0288); and
- Form 6–K (OMB Control No. 3235–0116).[1008]

The proposed amendments would require U.S. registrants filing Securities Act registration statements on Forms S–1, S–4, and S–11 to include the climate-related disclosures required under proposed subpart 1500 of Regulation S–K and proposed Article 14 of Regulation S–X. The proposed amendments would also require foreign private issuers to include the proposed climate-related disclosures when filing Securities Act registration statements on Forms F–1 and F–4. The proposed amendments would further require U.S. registrants and foreign private issuers to include

[1004] To illustrate, using a search string such as ''climate change'' or ''greenhouse gas'' to search through the text of all filings from a particular filer population so as to determine the trends in narrative climate-related disclosure among that population over time, could return many narrative disclosures outside of the climate-related disclosures. Examples of this would be a description of pending environmental litigation, existing government regulations and agency names, and broader regulatory risk factors.

[1005] *See* R. Kaplan and K. Ramanna, *How to Fix ESG Reporting* (2021), *available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3900146.*

[1006] *See* 44 U.S.C. 3501 *et seq.*

[1007] 44 U.S.C. 3507(d) and 5 CFR 1320.11.

[1008] The proposed amendments would also indirectly affect Forms S–3 and F–3. Registrants filing Forms S–3 and F–3 are able to incorporate by reference their annual reports filed on Forms 10–K or 20–F. Because the proposed amendments would affect Forms 10–K and 20–F, and are not expected to affect Forms S–3 and F–3 except when Forms 10–K and 20–F are incorporated by reference into those Securities Act forms, we are not separately accounting for the PRA burden related to Forms S–3 and F–3.

the proposed climate-related disclosures in their Exchange Act annual reports filed, respectively, on Forms 10–K and 20–F and in Exchange Act registration statements filed, respectively, on Forms 10 and 20–F. Registrants would be required to include the climate-related information required under proposed subpart 1500 in a part of the registration statement or annual report that is separately captioned as *Climate-Related Disclosure.* Registrants would be required to include the climate information required under Article 14 in a note to the financial statements, which would be subject to audit. Further, as described below, accelerated filers and large accelerated filers would be required to include an attestation report covering their Scopes 1 and 2 emissions disclosure, subject to phase-ins. In addition, U.S. registrants and foreign private issuers would be required to report material changes to the climate information disclosed in their Exchange Act reports on, respectively, Forms 10–Q and 6–K. A description of the proposed amendments, including the need for the climate information and its proposed use, as well as a description of the likely respondents, can be found in Section II above, and a discussion of the economic effects of the proposed amendments can be found in Section IV above.

B. Summary of the Proposed Amendments' Effects on the Collections of Information

Our estimates of the paperwork burden associated with the proposed amendments are based primarily on climate-related reporting cost estimates from six sources: A comment letter from the Society for Corporate Governance (''Society'') that provided some hour and cost estimates for climate reporting by large-cap companies; [1009] a report by the Climate Risk Disclosure Lab at Duke University School of Law's Global Financial Markets Center that presents survey results of climate-related disclosure costs for three unnamed companies; [1010] an impact assessment conducted by the United Kingdom's Department for Business, Energy, and Industrial Strategy for a rule that, similar to the Commission's proposed rules, would require TCFD-aligned disclosures from all listed firms; [1011] two cost estimates from a data analytics firm—one that covered primarily risk assessment and analysis pursuant to the TCFD framework, and the other for calculating GHG emissions; [1012] and cost estimates for GHG emissions measurement and reporting from two climate management firms.[1013]

In response to Acting Chair Lee's request for public input about climate disclosures,[1014] Society submitted the results of a survey it had conducted on a small number of public large-cap companies about the costs of their current climate reporting. According to this commenter, two companies estimated that the number of employee hours spent on climate reporting ranged from 7,500 to 10,000 annually, while a third company estimated the number of annual employee hours spent on climate reporting to be 2,940 hours.[1015] The average annual employee hours spent on climate reporting for these large-cap companies was 6,813 hours.[1016]

The Climate Risk Disclosure Lab's report presents the results of its survey of one European large-cap financial institution, one US large-cap industrial manufacturing company, and one US mid-cap waste management company about their climate-related disclosure costs.[1017] The European financial institution reported annual climate-related disclosure costs ranging from $250,000 to $500,000, which averages to $375,000 annually.[1018] For PRA purposes, we have converted this dollar cost average to 6,818 burden hours using a metric of $55/hour.[1019] The US industrial manufacturing company disclosed annual climate-related disclosure costs for its employees and one full-time consultant ranging from $200,000 to $350,000, which averages to $275,000 annually. We have similarly converted this dollar cost average to 5,000 burden hours.[1020] The US waste management company reported that its employees spent 82 hours annually to produce its climate-related disclosures. The average annual internal burden hours spent on climate reporting for these three companies comes to 3,967 hours.[1021]

The UK Impact Assessment estimated on an ongoing, annual basis the number of hours and costs that it would take in-house personnel [1022] to gather data and prepare and provide disclosure for each of the following TCFD-aligned topics: Governance, strategy, risk management, and metrics and targets.[1023] The impact assessment also estimated on an annual, ongoing basis the number of hours and costs that it would take a parent company's personnel to collect and process climate-related data from its subsidiaries.[1024] The impact assessment further estimated on a one-time basis the number of hours and costs that it would take in-house personnel to become familiar with and review the new climate-related reporting requirements and related guidance.[1025]

[1009] *See* letter from Society for Corporate Governance.

[1010] *See* Climate Risk Disclosure Lab *The Cost of Climate Disclosure: Three Case Studies on the Cost of Voluntary Climate-Related Disclosure* (Dec. 2021), *available at https://climatedisclosurelab.duke.edu/wp-content/uploads/2021/12/The-Cost-of-Climate-Disclosure.pdf.*

[1011] *See* UK Department for Business, Energy, and Industrial Strategy, Final Stage Impact Assessment (Oct. 1, 2021), available at *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1029317/climate-related-financial-disclosure-consultation-final-stage-impact-assessment.pdf; see also* UK Department for Business, Energy, and Industrial Strategy, Initial Impact Assessment (Jan. 29, 2021), available at *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/972423/impact-assessment.pdf* . The scope of the impact assessment included companies listed on the London Stock Exchange with over 500 employees, UK registered companies admitted to AIM with over 500 employees, and certain other companies.

[1012] *See* memorandum, dated Feb. 4, 2022, concerning staff meeting with representatives of S&P Global. This and the other staff memoranda referenced below are available at *https://www-draft.sec.gov/comments/s7-10-22/s71022.htm.*

[1013] *See* memorandum, dated Nov. 30, 2021, concerning staff meeting with representatives of Persefoni; and memorandum, dated Jan. 14, 2022, concerning staff meeting with representatives of South Pole.

[1014] *See supra* Section I.B.

[1015] *See* letter from Society for Corporate Governance. This commenter also stated that fees for external climate advisory services ranged from $50,000 to $1.35 million annually.

[1016] 7,500 hrs. + 10,000 hrs. + 2,940 hrs. = 20,440 hrs.; 20,440/3 = 6,813 hrs.

[1017] *See supra* Section IV.C.2 for a more detailed discussion of these reported costs.

[1018] $250,000 + $500,000 = $750,000. $750,000/2 = $375,000.

[1019] This metric is based on a reported national annual average salary for a climate specialist of $114,463. *See* glassdoor, *How much does a Climate Change Specialist make?* (Dec. 2021), available at *https://www.glassdoor.com/Salaries/climate-change-specialist-salary-SRCH_KO0,25.htm.* $114,463/2080 hrs. = $55/hr. $375,000/$55/hr. = 6,818 hrs. (rounded to nearest dollar).

[1020] $200,000 + $350,000 = $550,000. $550,000/2 = $275,000. $275,000/$55/hr. = 5,000 hrs.

[1021] 6,818 hrs. + 5,000 hrs. + 82 hrs. = 11,900 hrs.; 11,900 hrs./3 = 3,967 hrs.

[1022] Unlike this PRA analysis, which assumes that some of the paperwork burden will be borne by in-house personnel and some by outside professionals, the UK Impact Assessment assumed that all of the work would be done by in-house personnel.

[1023] The UK Impact Assessment's estimated number of hours for each TCFD-aligned disclosure topic per company was: 225 hrs. for governance; 295 hrs. for strategy; 245 hrs. for risk management; and (in Year 1) 2,227 hrs. for metrics and targets, which included one in-house climate-related expert working full-time.

[1024] This estimate was 85 hrs.

[1025] The primary difference between the Initial Impact Assessment and Final Impact Assessment concerned the estimated ''familiarization'' costs. The Final Impact Assessment assumed that the rule would require scenario analysis and added additional hours for in-house personnel to become familiar with scenario analysis methodology.

Continued

The total number of hours that the Impact Assessment estimated it would take a company to comply with the TCFD-aligned disclosure requirements in the first year came to 3,447 hours, of which 977.5 hours pertained to qualitative, TCFD-aligned disclosure and 2,469.5 hours pertained to GHG emissions metrics and targets disclosure.[1026]

We also have considered cost estimates from S&P Global, a data analytics firm that provides ESG consulting services, including climate-related data collection and analysis, among other services. This firm provided one cost estimate for preparing TCFD-aligned disclosures primarily covering physical risk and transition risk assessment and analysis, which, for a company lacking any experience in climate reporting, ranged from $150,000 to $200,000 (an average of $175,000) in the first year of reporting.[1027] For a company with prior experience in GHG emissions reporting but requiring assistance with TCFD-aligned reporting, the firm estimated average costs of $100,000.[1028] This results in an average cost estimate for all companies for TCFD-aligned disclosures, excluding GHG emissions calculation and reporting, of $137,500 in the first year of TCFD-aligned reporting.[1029] For PRA purposes, we have converted this dollar cost average to 2,500 burden hours.[1030]

This data analytics firm provided a separate cost estimate for calculating a company's Scopes 1, 2, and 3 emissions.[1031] For the initial calculation of a company's GHG emissions, including all three scopes, the cost estimate ranged from $75,000 to $125,000 (an average of $100,000).[1032] The firm also estimated that the setting and reporting of GHG emissions targets would on average add an additional $25,000, resulting in an average first-year cost estimate for GHG emissions metrics and targets of $125,000.[1033] For PRA purposes, we have converted this dollar cost average to 2,273 burden hours.[1034] This results in a total incremental burden increase (for both TCFD-aligned disclosures and GHG emissions calculation) in the first year of climate-related reporting of 4,773 burden hours.[1035]

We also considered the cost estimates for GHG emissions measurement and reporting provided by two climate management firms, Persefoni and South Pole. Persefoni estimated that, depending on the maturity of a company's emissions reporting program, a company's average first-year costs for measuring and reporting Scopes 1, 2, and 3 emissions ranged from $50,000 to $125,000, which averages to $87,500, or 1,591 hours.[1036] South Pole estimated annual costs for measuring and reporting Scopes 1, 2 and 3 emissions as ranging from $11,800 to $118,300, which averages to $65,050, or 1,183 hours.[1037]

The UK Impact Assessment estimated that the calculation and reporting of GHG emissions metrics and related targets would take the greatest amount of time, constituting approximately 72 percent of the total incremental burden.[1038] The data analytics firm, however, estimated that GHG emissions metrics and targets would constitute approximately 48 percent of the total incremental burden.[1039] The burden estimates provided by the above-referenced commenter and Climate Lab did not allocate between GHG emissions and non-GHG emissions climate reporting. For purposes of the PRA, we have allocated the burden estimates from the commenter and Climate Lab equally between the qualitative TCFD-aligned disclosure and the GHG emissions metrics and targets disclosure.[1040]

Based on the above sources, we estimate that the proposed qualitative TCFD-aligned disclosures would result in an average incremental burden hour increase of 2,217 hrs. for each affected collection of information for the first year of climate reporting.[1041] We estimate that the proposed GHG emissions metrics and targets disclosure would result in an average incremental burden hour increase of 2,151 hours for each affected collection of information for the first year of reporting.[1042]

In addition to GHG emissions metrics, the proposed rules would require the disclosure of certain climate-related financial statement metrics. Although the TCFD recommends the disclosure of metrics pertaining to the financial impacts of climate-related events and conditions, it is unclear whether the above sources' burden estimates for TCFD-aligned disclosure would include financial statement metrics. Based on staff experience reviewing financial statements, we estimate that preparation of the financial statements to present the proposed financial statement metrics would require 70 additional burden hours per filing. To ensure that our PRA estimates cover the burden associated with the proposed climate-related financial statement metrics, we have included this amount, in addition to the burden estimate for GHG emissions metrics and targets, in the estimated overall PRA burden of the proposed rules.

The proposed rules would require a registrant to present the climate-related financial statement metrics and associated disclosures in a note to its

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Because our proposed rules do not require scenario analysis, we are using the familiarization estimate of the Initial Impact Assessment (323 hrs.) when totaling the estimated hours required to comply with the UK's proposed climate disclosure rules. We have added to the familiarization estimate the number of hours (77 hrs.) that the Final Impact Assessment estimated for the one-time legal review of the new climate disclosure requirements by in-house personnel.

[1026] 400 hrs. (familiarization and review) + 195 hrs. (governance) + 295 hrs. (strategy) + 245 hrs. (risk management) + 2,227 hrs. (metrics and targets) + 85 hrs. (parent co. processing) = 3,447 hrs. For purposes of the PRA, we have allocated approximately half of the hours pertaining to familiarization and review and parent company processing between the qualitative TCFD-aligned disclosure and the GHG emissions metrics and targets disclosure. This results in 977.5 hrs. allocated to the qualitative TCFD-aligned disclosure and 2,469.5 hrs. allocated to the GHG emissions metrics and targets disclosure.

[1027] *See* memorandum concerning staff meeting with representatives of S&P Global. $150,000 + $200,000 = $350,000; $350,000/2 = $175,000.

[1028] *See id.*

[1029] $175,000 + $100,000 = $275,000; $275,000/2 = $137,500.

[1030] $137,500/$55/hr. = 2,500 hrs.

[1031] *See* memorandum concerning staff meeting with representatives of S&P Global. Although the proposed rules would require the disclosure of a registrant's Scope 3 emissions only if they are material, this cost estimate is relevant for determining the upper bound of the proposed rules' estimated PRA burden.

[1032] $75,000 + $125,000 = $200,000; 200,000/2 = $100,000.

[1033] Although the proposed rules would not require a registrant to set GHG emissions targets, they would require certain disclosures if the registrant does set targets. We have therefore included S&P Global's cost estimate for targets for purposes of determining the upper bound of the proposed rules' estimated PRA burden. However, because setting targets would be voluntary under the proposed rules, the estimated PRA burden may overstate the potential burden.

[1034] $125,000/$55/hr. = 2,273 hrs.

[1035] 2,500 hrs. + 2,273 hrs. = 4,773 hrs.

[1036] *See* memorandum concerning staff meeting with representatives of Persefoni. $50,000 + $125,000 = $175,000; $175,000/2 = $87,500; $87,500/$55/hr. = 1,591 hrs.

[1037] *See* memorandum concerning staff meeting with representatives of South Pole. $11,800 + $118,300 = $130,100; $130,100/2 = $65,050; $65,050/$55/hr. = 1,183 hrs.

[1038] *See supra* note 1033 (2,469.5 hrs./3,447 hrs. = 72 percent).

[1039] *See supra* note 1042 (2,273 hrs./4,773 hrs. = 48 percent).

[1040] For the Society for Corporate Governance-derived estimate, this results in 3,406.5 hrs. for each of the qualitative TCFD-aligned disclosure and the GHG emissions metrics and targets disclosure. For the Climate Lab-derived burden estimate, this results in 1,983.5 burden hrs. for each of the qualitative and quantitative disclosures.

[1041] 3,406.5 hrs. (Society) + 1,983.5 hrs. (Climate Lab) + 977.5 hrs. (UK) +2,500 hrs. (S&P Global) = 8,867.5 hrs.; 8,867.5/4 = 2,217 hrs. (rounded to the nearest whole number).

[1042] 3,406.5 hrs. (Society) + 1,983.5 hrs. (Climate Lab) + 2,469.5 hrs. (UK) + 2,273 hrs. (S&P Global) + 1,591 hrs. (Persefoni) + 1,183 hrs. (South Pole) = 12,906.5 hrs.; 12,906.5 hrs./6 = 2,151 hrs.

financial statements, which would be audited. Because the audit of such information would be part of the registrant's overall audit of its financial statements, we expect the incremental audit costs associated with these climate-related financial statement metrics and disclosures to be modest.[1043] We are conservatively estimating that auditing the note pertaining to the climate-related financial statement metrics and associated disclosures would add audit fees of $15,000 to the overall costs associated with the audit of the registrant's financial statements. We derived this estimate by first estimating costs as an average percentage of total audit fees (1.5%)[1044] and then applying that percentage to median audit fees of $690,000,[1045] which results in $10,350. To be conservative, we have increased this amount to $15,000 for estimated audit fees. We believe that this estimate represents the average cost of the incremental efforts that may be incurred, taking into consideration factors such as the scale and complexity of different registrants and the extent of impact by climate-related events (*e.g.,* location of operations, nature of business). This cost also takes into consideration the need to understand and evaluate the registrants' processes and internal controls associated with the reporting of the climate-related financial statement metrics and associated disclosures.

The proposed rules would require a registrant that is a large accelerated filer[1046] or an accelerated filer[1047] to include, in the relevant filing, an attestation report covering the disclosure of its Scope 1 and Scope 2 emissions and to provide certain related disclosures. Following a one-year phase-in period in which no attestation report would be required, for filings made for the second and third fiscal years following the compliance date for the GHG emissions disclosure requirement, large accelerated filers would be required to obtain an attestation report for their Scopes 1 and 2 emissions disclosure, at minimum, at a limited assurance level. We estimate the cost of a limited assurance attestation report covering a large accelerated filer's Scopes 1 and 2 emissions to be $110,000.[1048] Commencing with the fourth fiscal year following the compliance date and thereafter, a large accelerated filer would be required to obtain an attestation report covering its Scopes 1 and 2 emissions disclosure at a reasonable assurance level. We estimate the cost for such a reasonable assurance attestation report to be $175,000.[1049] This results in an initial six-year average[1050] assurance cost for a large accelerated filer's Scopes 1 and 2 emissions of $124,167.[1051]

Following a one-year phase-in period in which no attestation report would be required, for filings made for the second and third fiscal years following the compliance date for the GHG emissions disclosure requirement, accelerated filers would be required to obtain an attestation report for their Scopes 1 and 2 emissions disclosure, at minimum, at a limited assurance level. We estimate the cost of a limited assurance attestation report covering an accelerated filer's Scopes 1 and 2 emissions to be $45,000.[1052] Commencing with the fourth fiscal year following the compliance date and thereafter, an accelerated filer would be required to obtain an attestation report covering its Scopes 1 and 2 emissions disclosure at a reasonable assurance level. We estimate the cost for such a reasonable assurance attestation report to be $75,000.[1053] This results in an initial six-year average assurance cost for an accelerated filer's Scopes 1 and 2 emissions of $52,500.[1054]

The proposed rules would require a registrant that is not required to include a GHG emissions attestation report to state whether any of the registrant's GHG emissions disclosures were subject to third-party attestation or verification. If so, the registrant would be required to identify the provider of assurance or verification and disclose certain additional information, such as the level and scope of assurance or verification provided, among other matters.[1055] The burden and costs for this disclosure are encompassed within the estimated overall internal burden and costs for the proposed GHG emissions disclosure.

The UK Impact Assessment assumed a 25 percent reduction in hour and cost estimates for the work required to comply with the GHG emissions metrics and targets disclosure requirement in Year 2 compared to Year 1 because initial implementation of the metrics and targets framework would not need to be repeated. We believe this assumption is reasonable and have made a similar reduction after the first year of compliance when calculating the four-year average for the estimated paperwork burden hour effect of the proposed rules. We also have assumed a 10 percent reduction in the hour and cost estimates for preparing and providing the disclosures for the other TCFD-aligned topics in Years 2 through 6 compared to Year 1. We believe that this assumption is reasonable because the burden hours and costs associated with becoming familiar with the other TCFD disclosure topics would not need to be repeated.[1056] We believe that the reduction in the compliance burden and costs for the metrics and targets disclosure requirement would be greater

[1043] This belief is based on post-implementation review observations and activities from accounting standards that provided further disaggregation of information and that are analogous to the proposed financial statement metrics requirements, as discussed *supra* Section II.F.2.a (*e.g.,* segment reporting and disaggregation of revenue). *See* FASB's post-implementation review report on FASB Statement No. 131, Disclosures about Segments of an Enterprise and Related Information (Dec. 2012), 11, (''Preparers' incremental costs to implement and comply with Statement 131 generally were not significant and were in line with expectations''), *available at https://www.accountingfoundation.org/cs/Satellite?c=Document_C&cid=1176160621900&pagename=Foundation%2FDocument_C%2FDocumentPage. See also* FASB's Board Meeting Handout, post-implementation review of Topic 606, Revenue with Contracts with Customers Our (July 28, 2021) (While the post-implementation review is still ongoing, most users agreed that the disaggregated [revenue] disclosure is helpful (par. 16) and users noted that although they incurred costs to become familiar with the new standard, update models, or maintain dual models during the transition period, most of those costs were nonrecurring. For users that are generalists or that cover sectors that did not have significant changes to revenue recognition measurement or timing under Topic 606, the costs were not significant. (par. 20), *available at https://www.fasb.org/cs/ContentServer?c=Document_C&cid=1176176976563&d=&pagename=FASB%2FDocument_C%2FDocumentPage.*

[1044] The staff estimated a range of 0.5% to 2.5%, which averages to 1.5%.

[1045] This is based on staff review of Audit Analytics data for 2020.

[1046] Based on staff review of filings made in 2020, large accelerated filers filed approximately 31% of domestic forms and approximately 37% of Form 20–Fs in 2020. For PRA purposes, we have used 37% as a proxy for the percentage of all foreign private issuer forms filed by large accelerated filers in 2020.

[1047] Based on staff review of filings made in 2020, accelerated filers filed approximately 11% of domestic forms and 15% of Form 20–Fs in 2020.

[1048] *See supra* Section IV.C.2.a.3. for the basis of this limited assurance cost estimate.

[1049] *See id.*

[1050] In order to capture three years of the cost of a reasonable assurance attestation report required for accelerated filers and large accelerated filers, which requirement does not commence until the fourth fiscal year following the proposed rules' compliance date, we have used a six-year average when calculating the estimated paperwork burden effects of the proposed rules.

[1051] 0 + $110,000 + $110,000 + $175,000 + $175,000 + $175,000 = $745,000; $745,000/6 = $124,167.

[1052] *See supra* Section IV.C.2.a.3. for the basis of this limited assurance cost estimate.

[1053] *See id.*

[1054] 0 + $45,000 + $45,000 + $75,000 + $75,000 + $75,000 = $315,000; $315,000/6 = $52,500.

[1055] *See* proposed 17 CFR 229.1505(e).

[1056] S&P Global estimated a similar reduction in costs in subsequent years, the magnitude of which depends on the extent of material changes to the TCFD-aligned disclosure and the GHG emissions metrics.

than the reduction for the other TCFD-aligned disclosure topics because the initial work to implement a climate data collection and reporting framework to comply with the metrics and targets requirement would be greater than the initial framework required for the other disclosure requirements.

SRCs, which comprise 50 percent of domestic filers, and 45 percent of total affected registrants,[1057] would bear a lesser compliance burden because those registrants would not be subject to the proposed disclosure requirement pertaining to Scope 3 emissions, which, of the three types of GHG emissions, poses the greatest challenge to calculate and report. We accordingly estimate that the increase in the PRA burden pertaining to the GHG emissions requirement for SRCs filing on domestic forms would be approximately 50% less than the increased burden for the GHG emissions requirement for non-SRC registrants.[1058] Smaller foreign private issuers that file on the foreign private issuer forms would not be eligible for this adjustment because those foreign private issuers are excluded from the definition of, and therefore cannot be, SRCs.[1059]

In addition to requiring the annual climate disclosures, the proposed rules would require a registrant to disclose any material change to its climate-related disclosures reported in its annual Exchange Act annual report (Form 10–K or 20–F) on a Form 10–Q (if a domestic filer) or a Form 6–K (if a foreign private issuer filer). We would not expect a registrant to report such a material change until its second year of compliance, at the earliest. Based on the staff's assessment of the amount of time it would take to determine that there has been a material change in the previously reported climate disclosure, particularly concerning its GHG emissions metrics, and to prepare disclosures regarding the material change, if any, we estimate a burden hour increase of 40 hours per form, or an initial six-year average of 33 hours per form.[1060]

The following table summarizes the estimated paperwork burden effects of the proposed amendments for non-SRC and SRC registrants associated with the affected collections of information.

[1057] In 2020, there were 6,220 domestic filers + 740 foreign private issuer (fpi) filers = 6,960 affected filers. 3,110 domestic filers + 740 fpi filers = 3,850 non-SRC filers. 3,850/6,960 = 55%. 3,110 filers were SRCs in 2020. 3,110/6,960 = 45%. *See supra* Section IV.B.

[1058] This is generally consistent with some of the cost estimates obtained for calculating and reporting Scopes 1, 2, and 3 emissions. For example, Persefoni indicated that the annual GHG emissions costs for a company having experience calculating and reporting GHG emissions would double if it included Scope 3 emissions after calculating Scopes 1 and 2 emissions. *See supra* note 1020. In addition, S&P Global indicated that a company's annual ongoing reporting costs of Scopes 1 and 2 emissions would, at a minimum, increase from $40,000 to $75,000 if it included Scope 3 emissions. *See supra* note 1019.

[1059] *See, e.g.,* Instruction 2 to the definition of smaller reporting company under 17 CFR 230.405.

[1060] 0 + (40 hrs. × 5) = 200 hrs.; 200 hrs./6 = 33 hrs. (rounded to nearest whole number).

PRA TABLE 1—ESTIMATED PAPERWORK BURDEN EFFECTS OF THE PROPOSED AMENDMENTS FOR NON-SRC AND SRC REGISTRANTS[1]

Collections of information	Proposed disclosure item	Estimated PRA burden hour effect for non-SRC registrants (year 1) (hrs)	Estimated PRA burden hour effect for SRC registrants (year 1) (hrs)	Estimated PRA burden hour effect for non-SRC registrants (for each year 2 through 6) (hrs)	Estimated PRA burden hour effect for SRC registrants (for each year 2 through 6) (hrs)	Estimated PRA burden hour effect for non-SRC registrants (6 year average) (hrs)	Estimated PRA burden hour effect for SRC registrants (6 year average) (hrs)	Estimated average annual assurance costs for climate-related financial statement metrics (6 year average)	Estimated average annual assurance costs for Scopes 1 and 2 emissions disclosure by AFs[2] (6 year average)	Estimated average annual assurance costs for Scopes 1 and 2 emissions disclosure by LAFs[3] (6 year average)
Forms S–1,S–4, S–11,10, and 10–K.	Climate-related disclosures regarding governance, strategy, and risk management.	+2,217	+2,217	+1,995	+1,995	+2,032	+2,032	+$15,000	+$52,500	$124,167
	Financial statement metrics	+70	+70	+63	+63	+64 +1,703	+64			
	GHG emissions metrics and targets.	+2,151	+1,076	+1,613	+807	+852				
Total	....	+4,438	+3,363	+3,671	+2,865	+3,799	+2,948	+$15,000	+$52,500	$124,167
Forms F–1, F–4, and 20–F.	Climate-related disclosures regarding governance, strategy, and risk management. Financial statement metrics GHG emissions metrics and targets.	+2,217 +70 +2,151	NA	+1,995 +63 +1,613	NA.	+2,032 +64 +1,703	NA	+$15,000	+$52,500	$124,167
	Financial statement metrics	+70	....	+63	....	+64				
	GHG emissions metrics and targets.	+2,151	....	+1,613	....	+1,703				
Total	....	+4,438	....	+3,671	....	+3,799	....	+$15,000	+$52,500	$124,167
Forms 10–Q and 6–K.	Material change to 10–K/ 20–F.	0	....	+40	....	+33	....	0	0	0

[1] All numbers rounded to nearest whole number.
[2] Accelerated Filers.
[3] Large Accelerated Filers.

C. Incremental and Aggregate Burden and Cost Estimates for the Proposed Amendments

Below we estimate the incremental and aggregate increase in paperwork burden resulting from the proposed amendments. These estimates represent the average burden for all issuers, both large and small. In deriving our estimates, we recognize that the burdens will likely vary among individual registrants based on a number of factors, including the nature of their business, the size and complexity of their operations, and whether they are subject to similar climate-related disclosure requirements in other jurisdictions or already preparing similar disclosures on a voluntary basis. For purposes of the PRA, the burden is to be allocated between internal burden hours and outside professional costs. The table below sets forth the percentage estimates we typically use for the burden allocation for each affected collection of information. We also estimate that the average cost of retaining outside professionals is $400 per hour.[1061]

PRA TABLE 2—STANDARD ESTIMATED BURDEN ALLOCATION FOR SPECIFIED COLLECTIONS OF INFORMATION

Collection of information	Internal (%)	Outside professionals (%)
Forms S–1, F–1, S–4, F–4, S–11, 10, and 20–F	25	75
Forms 10–K, 10–Q, and 6–K	75	25

We estimate that the proposed amendments would change the burden per response, but not the frequency, of the existing collections of information. The burden increase estimates for each collection of information were calculated by multiplying the number of responses by the increased estimated average amount of time it would take to prepare and review the disclosure required under the affected collection of information (using the estimated three-year average increase). Since 50 percent of the domestic filers in 2020 were non-SRCs and 50 percent were SRCs, we assume for purposes of our PRA estimates that 50 percent of each domestic collection of information was filed by non-SRCs and 50 percent by SRCs. The table below illustrates the incremental change to the annual compliance burden of the affected collections of information, in hours and costs.

[1061] We recognize that the costs of retaining outside professionals may vary depending on the nature of the professional services, but for purposes of this PRA analysis, we estimate that such costs would be an average of $400 per hour.

PRA TABLE 3—CALCULATION OF THE INCREMENTAL CHANGE IN BURDEN ESTIMATES OF CURRENT RESPONSES RESULTING FROM THE PROPOSED AMENDMENTS[1]

Collection of information	Filed by	Number of estimated affected respondents (A)	Burden hour annual increase per affected respondent (B)	Increase in burden hours for affected respondents (C) = (A) × (B)	Increase in internal burden hours for affected respondents (D) = (C) × 0.25 or 0.75	Increase in professional hours for affected respondents (E) = (C) × 0.75 or 0.25	Climate-related financial statement metrics assurance costs for affected respondents[2] (F) = (A) × $15,000	GHG emissions assurance costs for AFs[3] (G) = (A) × 0.11 or 0.15 × $52,500	GHG emissions assurance costs for LAFs[4] (H) = (A) × 0.31 or 0.37 × $124,167	Increase in professional costs for affected respondents (I) = (E) × $400 + (F) + (G) + (H)
S–1	Non-SRCs	447	3,799	1,698,153						
S–1	SRCs	447	2,948	1,317,756						
S–1 (Total)		894		3,015,909	753,977	2,261,932	$13,410,000	$5,145,000	$34,394,259	$957,722,059
S–4	Non-SRCs	294	3,799	1,116,906						
S–4	SRCs	294	2,948	866,712						
S–4 (Total)		588		1,983,618	495,905	1,487,714	8,820,000	3,412,500	22,598,394	629,916,494
S–11	Non-SRCs	34	3,799	129,166						
S–11	SRCs	33	2,948	97,284						
S–11 (Total)		67		226,450	56,613	169,838	1,005,000	367,500	2,607,507	71,915,207
10	Non-SRCs	108	3,799	410,292						
10	SRCs	108	2,948	318,384						
10 (Total)		216		728,676	182,169	546,507	3,240,000	1,260,000	8,319,189	231,421,989
10–K	Non-SRCs	4,146	3,799	15,750,654						
10–K	SRCs	4,146	2,948	12,222,408						
10–K (Total)		8,292		27,973,062	20,979,797	6,993,266	124,380,000	47,880,000	319,233,357	3,288,799,757
10–Q	Non-SRCs	11,463	33	378,279						
10–Q	SRCs	11,462	33	378,246						
10–Q (Total).		22,925		756,525	567,394	189,131	0	0	0	75,652,400
F–1	Both	66	3,799	250,734	62,684	188,051	990,000	525,000	2,980,008	79,715,408
F–4	Both	39	3,799	148,161	37,040	111,121	585,000	315,000	1,738,338	47,086,738
20–F	Both	729	3,799	2,769,471	692,368	2,077,103	10,935,000	5,722,500	33,525,090	881,023,790
6–K	Both	34,794	33	1,148,202	861,152	287,051	0	0	0	114,820,400

[1] All numbers rounded to nearest whole number.
[2] We have not assumed assurance costs for Form 10–Q or Form 6–K because these forms typically have only marginal assurance costs. We expect these forms to be filed in the 2nd year, at the earliest.
[3] AFs filed 11% of domestic forms and 15% of foreign private issuer forms in 2020.
[4] LAFs filed 31% of domestic forms and 37% of foreign private issuer forms in 2020.

The table below illustrates the program change expected to result from the proposed rule amendments together with the total requested change in reporting burden and costs.

PRA TABLE 4—REQUESTED PAPERWORK BURDEN UNDER THE PROPOSED AMENDMENTS

Collection of Information	Current burden			Program change			Requested change in burden		
	Current annual responses	Current internal burden hours	Current external cost burden	Number of affected responses	Change in internal burden hours	Change in external costs	Annual responses	Internal burden hours	External cost burden
	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H) = (B) + (E)	(I) = (C) + (F)
S–1	894	146,067	$178,922,043	894	753,977	$957,722,059	894	900,044	$1,134,929,102
S–4	588	562,362	677,255,579	588	495,905	629,916,494	588	1,058,267	1,306,034,573
S–11	67	12,229	14,943,768	67	56,613	71,915,207	67	68,842	86,736,475
10	216	11,855	14,091,488	216	182,169	231,421,989	216	194,024	245,093,477
10–K	8,292	14,188,040	1,893,793,119	8,292	20,979,797	3,288,799,757	8,292	35,167,837	5,166,632,876
10–Q	22,925	3,182,333	421,490,754	22,925	567,394	75,652,400	22,925	3,749,727	497,143,154
F–1	66	26,707	32,293,375	66	62,684	79,715,408	66	89,391	111,833,783
F–4	39	14,049	17,073,825	39	37,040	47,086,738	39	51,089	64,055,563
20–F	729	479,261	576,824,025	729	692,368	881,023,790	729	1,171,629	1,455,940,315
6–K	34,794	227,031	30,270,780	34,794	861,152	114,820,400	34,794	1,088,183	145,091,180
Total		18,849,934	3,856,958,756		24,689,099	6,378,073,242		43,539,033	10,235,031,998

D. Request for Comment

We request comment in order to:

• Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the agency, including whether the information would have practical utility;

• Evaluate the accuracy of our estimate of the burden of the proposed collections of information, including any assumptions used;

• Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected;

• Evaluate whether there are ways to minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology; and

• Evaluate whether the proposed amendments would have any effects on any other collections of information not previously identified in this section.[1062]

Any member of the public may direct to us any comments about the accuracy of these burden estimates and any suggestions for reducing these burdens. Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549–1090, with reference to File No. S7–10–22. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7–10–22, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE, Washington, DC 20549–2736. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication.

VI. Initial Regulatory Flexibility Act Analysis

This Initial Regulatory Flexibility Act Analysis (''IRFA'') has been prepared, and made available for public comment, in accordance with the Regulatory Flexibility Act (''RFA'').[1063] It relates to the proposal to add new subpart 1500 to Regulation S–K and new Article 14 to Regulation S–X, which would require registrants to provide certain climate-related disclosures in their Securities Act and Exchange Act registration statements and Exchange Act reports. As required by the RFA, this IRFA describes the impact of these proposed amendments of Regulations S–K and S–X on small entities.[1064]

A. Reasons for, and Objectives of, the Proposed Action

We are proposing to require registrants to provide certain climate-related information in their registration statements and annual reports, including certain information about climate-related financial risks and climate-related financial metrics in their financial statements. The disclosure of this information would provide consistent, comparable, and decision-useful information to investors to enable them to make informed judgments about the impact of climate-related risks on current and potential investments. Information about climate-related risks can have an impact on public companies' financial performance or position and may be material to investors in making investment or voting decisions. For this reason, many investors—including shareholders, investment advisors, and investment management companies—currently seek information about climate-related risks from companies to inform their investment decision-making. Furthermore, many companies have begun to provide some of this information voluntarily in response to investor demand and in recognition of the potential financial effects of climate-related risks on their businesses. We are concerned that the existing voluntary disclosures of climate-related risks do not adequately protect investors. For this reason, mandatory disclosures may be necessary or appropriate to improve the consistency, comparability, and reliability of this information. The reasons for, and objectives of, the proposed amendments are discussed in more detail in Section II above.

B. Legal Basis

We are proposing the amendments contained in this release under the authority set forth in Sections 7, 10, 19(a), and 28 of the Securities Act, as amended, and Sections 3(b), 12, 13, 15, 23(a), and 36 of the Exchange Act, as amended.

C. Small Entities Subject to the Proposed Rules

The proposed amendments would affect some issuers that are small entities. The RFA defines ''small entity'' to mean ''small business,'' ''small organization,'' or ''small governmental jurisdiction.'' [1065] For purposes of the RFA, under 17 CFR 240.0–10(a), an issuer, other than an investment company, is a ''small business'' or ''small organization'' if it had total assets of $5 million or less on the last day of its most recent fiscal year and, under 17 CFR 230.157, is also engaged or proposing to engage in an offering of securities that does not exceed $5 million.

The proposed rules would apply to a registrant when filing a Securities Act or Exchange Act registration statement or an Exchange Act annual or other periodic report. We estimate that there are 1,004 registrants that are small entities that would be affected by the proposed rules.

D. Reporting, Recordkeeping, and Other Compliance Requirements

The proposed amendments would require a registrant, including a small entity, to disclose certain climate-related information, including data about their GHG emissions, when filing a Securities Act or Exchange Act registration statement or Exchange Act annual or other periodic report. In particular, like larger registrants, small entities would be required to disclose information about: The oversight of their boards and management regarding climate-related risks; any material impacts of climate-related risks on their consolidated financial statements, business, strategy, and outlook; their risk management of climate-related risks; climate-related targets or goals, if any; and certain financial statement metrics. In addition, like other registrants, small entities would be required to disclose their Scopes 1 and 2 emissions. We anticipate that the nature of any benefits or costs associated with the above proposed amendments would be similar for large and small entities. Accordingly, we refer to the discussion of the proposed amendments' economic effects on all affected parties, including small entities, in Section IV.C. Consistent with that discussion, we anticipate that the economic benefits and costs likely would vary widely among small entities based on a number of factors, including the nature and conduct of their businesses, which makes it difficult to

[1062] We request comment pursuant to 44 U.S.C. 3506(c)(2)(B).

[1063] 5 U.S.C. 601 *et seq.*

[1064] 5 U.S.C. 603(a).

[1065] 5 U.S.C. 601(6).

project the economic impact on small entities with precision. However, we request comment on how the proposed amendments would affect small entities.

While small entities would not be exempt from the full scope of the proposed amendments, they would be exempt from the Scope 3 emissions disclosure requirements, which would likely impose the greatest compliance burden for registrants due to the complexity of data gathering, calculation, and assessment required for that type of emissions.[1066] Small entities would also have a longer transition period to comply with the proposed rules than other registrants.[1067] We believe that these accommodations would reduce the proposed rules' compliance burden for small entities that, compared to larger registrants with more resources, may be less able to absorb the costs associated with reporting of Scope 3 emissions and may need additional time to allocate the resources necessary to begin providing climate-related disclosures.

E. Duplicative, Overlapping, or Conflicting Federal Rules

The proposed rules do not duplicate or conflict with other existing federal rules. As discussed in Section IV, some registrants currently report certain GHG emissions via the EPA's 2009 mandatory Greenhouse Gas Reporting Program. However, as discussed above, the reporting requirements of the EPA's program and the resulting data are different and more suited to the purpose of building a national inventory of GHG emissions rather than allowing investors to assess emissions-related risks to individual registrants.

F. Significant Alternatives

The RFA directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant economic impact on small entities. In connection with the proposed amendments, we considered the following alternatives:

- Establishing different compliance or reporting requirements that take into account the resources available to small entities;
- Clarifying, consolidating, or simplifying compliance and reporting requirements under the rules for small entities;
- Using performance rather than design standards; and
- Exempting small entities from all or part of the requirements.

As discussed above, the proposed amendments would exempt small entities from certain GHG emissions disclosure requirements that would likely impose the greatest compliance burden on registrants compared to other proposed disclosure requirements. In addition, while there would be a transition period for all registrants to comply with the proposed amendments, small entities would have an additional two more years to comply with the proposed rules than large accelerated filers and an additional year compared to other registrants. We believe that this scaled and phased-in approach would help minimize the economic impact of the proposed amendments on small entities. We are not, however, proposing a complete exemption from the proposed amendments for SRCs because, due to their broad impact across industries and jurisdictions, climate-related risks may materially impact the operations and financial condition of domestic and foreign issuers, both large and small.

For similar reasons, other than the exemption for reporting Scope 3 emissions by SRCs, we are not proposing to clarify, consolidate, or simplify the proposed disclosure requirements for small entities. A key objective of the proposed amendments is to elicit consistent, comparable and reliable information about climate-related risks across registrants. Alternative compliance requirements for small entities could undermine that goal.

The proposed amendments are primarily based on performance standards with some provisions that are more like design standards. For example, while the proposed amendments include certain concepts, such as scopes, developed by the GHG Protocol, they do not require a registrant to use the GHG Protocol's methodology when calculating its GHG emissions if another methodology better suits its circumstances. Using a performance standard for calculation of GHG emissions would provide registrants with some flexibility regarding how to comply with the proposed GHG emissions requirement while still providing useful information for investors about the various scopes of emissions. Similarly, the proposed amendments would require a registrant that is a large accelerated filer or an accelerated filer to include an attestation report covering its Scopes 1 and 2 emissions that would require the report to meet certain minimum criteria while permitting the filer, at its option, to obtain additional levels of assurance. In contrast, the proposed amendments would require all registrants, including small entities, to express their GHG emissions both disaggregated by each constituent greenhouse gas and in the aggregate, expressed in terms of carbon dioxide equivalent (CO_2e). Using a design standard for the expression of a registrant's GHG emissions would enhance the comparability of this disclosure for investors.

Request for Comment

We encourage the submission of comments with respect to any aspect of this IRFA. In particular, we request comments regarding:

- How the proposed rule and form amendments can achieve their objective while lowering the burden on small entities;
- The number of small entity companies that may be affected by the proposed rule and form amendments;
- The existence or nature of the potential effects of the proposed amendments on small entity companies discussed in the analysis;
- How to quantify the effects of the proposed amendments; and
- Whether there are any federal rules that duplicate, overlap, or conflict with the proposed amendments.

Commenters are asked to describe the nature of any effect and provide empirical data supporting the extent of that effect. Comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed rules are adopted, and will be placed in the same public file as comments on the proposed rules themselves.

VII. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (''SBREFA''),[1068] the Commission must advise OMB as to whether the proposed amendments constitute a ''major'' rule. Under SBREFA, a rule is considered ''major'' where, if adopted, it results in or is likely to result in:

- An annual effect on the U.S. economy of $100 million or more;
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment, or innovation.

We request comment on whether our proposal would be a ''major rule'' for purposes of SBREFA. In particular, we request comment and empirical data on:

[1066] *See supra* Section II.G.3 and II.L (discussing the proposed exemption from Scope 3 emissions disclosure for smaller reporting companies).

[1067] *See supra* Section II.L (discussing the proposed additional two years for smaller reporting companies to comply with the proposed rules compared to large accelerated filers).

[1068] 5 U.S.C. 801 *et seq.*

- The potential effect on the U.S. economy on an annual basis;
- Any potential increase in costs or prices for consumers or individual industries; and
- Any potential adverse effect on competition, investment, or innovation.

VIII. Statutory Authority

The amendments contained in this release are being proposed under the authority set forth in Sections 7, 10, 19(a), and 28 of the Securities Act, as amended, and Sections 3(b), 12, 13, 15, 23(a), and 36 of the Exchange Act, as amended.

List of Subjects in 17 CFR Parts 210, 229, 232, 239, and 249

Accountants; Accounting; Administrative practice and procedure, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, the Commission is proposing to amend title 17, chapter II of the Code of Federal Regulations as follows:

PART 210—FORM AND CONTENT OF AND REQUIREMENTS FOR FINANCIAL STATEMENTS, SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934, INVESTMENT COMPANY ACT OF 1940, INVESTMENT ADVISERS ACT OF 1940, AND ENERGY POLICY AND CONSERVATION ACT OF 1975

■ 1. The authority citation for part 210 continues to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z–2, 77z–3, 77aa(25), 77aa(26), 77nn(25), 77nn(26), 78c, 78j–1, 78*l,* 78m, 78n, 78o(d), 78q, 78u-5, 78w, 78ll, 78mm, 80a–8, 80a20, 80a–29, 80a–30, 80a–31, 80a–37(a), 80b–3, 80b–11, 7202 and 7262, and sec. 102(c), Pub. L. 112–106, 126 Stat. 310 (2012), unless otherwise noted.

■ 2. Amend § 210.8–01 by revising paragraph (b) to read as follows:

§ 210.8–01 General requirements for Article 8.

* * * * *

(b) Smaller reporting companies electing to prepare their financial statements with the form and content required in Article 8 need not apply the other form and content requirements in 17 CFR part 210 (Regulation S–X) with the exception of the following:

(1) The report and qualifications of the independent accountant shall comply with the requirements of §§ 210.2–01 through 210.2–07 (Article 2); and

(2) The description of accounting policies shall comply with § 210.4–08(n);

(3) Smaller reporting companies engaged in oil and gas producing activities shall follow the financial accounting and reporting standards specified in § 210.4–10 with respect to such activities; and

(4) Sections 210.14–01 and 210.14–02 (Article 14).

* * * * *

■ 3. Add an undesignated center heading and §§ 210.14–01 and 210.14–02 to read as follows:

Article 14—Climate-Related Disclosure

§ 210.14–01 Climate-related disclosure instructions.

(a) *General.* A registrant must include disclosure pursuant to § 210.14–02 in any filing that is required to include disclosure pursuant to subpart 229.1500 of this chapter and that also requires the registrant to include its audited financial statements. The disclosure pursuant to § 210.14–02 must be included in a note to the financial statements included in such filing.

(b) *Definitions.* The definitions in § 229.1500 (Item 1500 of Regulation S–K) apply to this Article 14 of Regulation S–X.

(c) *Basis of calculation.* When calculating the metrics in this Article 14, except where otherwise indicated, a registrant must:

(1) Use financial information that is consistent with the scope of the rest of its consolidated financial statements included in the filing; and

(2) Whenever applicable, apply the same accounting principles that it is required to apply in preparation of the rest of its consolidated financial statements included in the filing.

(d) *Historical periods.* Disclosure must be provided for the registrant's most recently completed fiscal year, and for the historical fiscal year(s) included in the consolidated financial statements in the filing (*e.g.,* a registrant that is required to include balance sheets as of the end of its two most recent fiscal years and income statements and cash flow statements as of the end of its three most recent fiscal years would be required to disclose two years of the climate-related metrics that correspond to balance sheet line items and three years of the climate-related metrics that correspond to income statement or cash flow statement line items).

§ 210.14–02 Climate-related metrics.

(a) *Contextual information.* Provide contextual information, describing how each specified metric was derived, including a description of significant inputs and assumptions used, and, if applicable, policy decisions made by the registrant to calculate the specified metrics.

(b) *Disclosure thresholds.* (1) Disclosure of the financial impact on a line item in the registrant's consolidated financial statements pursuant to paragraphs (c) and (d) of this section (including any impacts included pursuant to paragraphs (i) and (j) of this section) is not required if the sum of the absolute values of all the impacts on the line item is less than one percent of the total line item for the relevant fiscal year.

(2) Disclosure of the aggregate amount of expenditure expensed or the aggregate amount of capitalized costs incurred pursuant to paragraphs (e) and (f) of this section (including any impacts included pursuant to paragraphs (i) and (j) of this section) is not required if such amount is less than one percent of the total expenditure expensed or total capitalized costs incurred, respectively, for the relevant fiscal year.

(c) *Financial impacts of severe weather events and other natural conditions.* Disclose the impact of severe weather events and other natural conditions, such as flooding, drought, wildfires, extreme temperatures, and sea level rise on any relevant line items in the registrant's consolidated financial statements during the fiscal years presented. Disclosure must be presented, at a minimum, on an aggregated line-by-line basis for all negative impacts and, separately, at a minimum, on an aggregated line-by-line basis for all positive impacts. Impacts may include, for example:

(1) Changes to revenues or costs from disruptions to business operations or supply chains;

(2) Impairment charges and changes to the carrying amount of assets (such as inventory, intangibles, and property, plant and equipment) due to the assets being exposed to severe weather, flooding, drought, wildfires, extreme temperatures, and sea level rise;

(3) Changes to loss contingencies or reserves (such as environmental reserves or loan loss allowances) due to impact from severe weather events; and

(4) Changes to total expected insured losses due to flooding or wildfire patterns.

(d) *Financial impacts related to transition activities.* Disclose the impact of any efforts to reduce GHG emissions or otherwise mitigate exposure to transition risks on any relevant line items in the registrant's consolidated financial statements during the fiscal years presented. Disclosure must be presented, at a minimum, on an aggregated line-by-line basis for all negative impacts and, separately, at a minimum, on an aggregated line-by-line basis for all positive impacts. Impacts may include, for example:

(1) Changes to revenue or cost due to new emissions pricing or regulations resulting in the loss of a sales contract;

(2) Changes to operating, investing, or financing cash flow from changes in upstream costs, such as transportation of raw materials;

(3) Changes to the carrying amount of assets (such as intangibles and property, plant, and equipment) due to, among other things, a reduction of the asset's useful life or a change in the asset's salvage value by being exposed to transition activities; and

(4) Changes to interest expense driven by financing instruments such as climate-linked bonds issued where the interest rate increases if certain climate-related targets are not met.

(e) *Expenditure to mitigate risks of severe weather events and other natural conditions.* Disclose separately the aggregate amount of expenditure expensed and the aggregate amount of capitalized costs incurred during the fiscal years presented to mitigate the risks from severe weather events and other natural conditions, such as flooding, drought, wildfires, extreme temperatures, and sea level rise. For example, a registrant may be required to disclose the amount of expense or capitalized costs, as applicable, to increase the resilience of assets or operations, retire or shorten the estimated useful lives of impacted assets, relocate assets or operations at risk, or otherwise reduce the future impact of severe weather events and other natural conditions on business operations.

(f) *Expenditure related to transition activities.* Disclose separately the aggregate amount of expenditure expensed and the aggregate amount of capitalized costs incurred during the fiscal years presented to reduce GHG emissions or otherwise mitigate exposure to transition risks. For example, a registrant may be required to disclose the amount of expense or capitalized costs, as applicable, related to research and development of new technologies, purchase of assets, infrastructure, or products that are intended to reduce GHG emissions, increase energy efficiency, offset emissions (purchase of energy credits), or improve other resource efficiency. A registrant that has disclosed GHG emissions reduction targets or other climate-related commitments must disclose the expenditures and costs related to meeting its targets, commitments, and goals, if any, in the fiscal years presented.

(g) *Financial estimates and assumptions impacted by severe weather events and other natural conditions.* Disclose whether the estimates and assumptions the registrant used to produce the consolidated financial statements were impacted by exposures to risks and uncertainties associated with, or known impacts from, severe weather events and other natural conditions, such as flooding, drought, wildfires, extreme temperatures, and sea level rise. If yes, provide a qualitative description of how the development of such estimates and assumptions were impacted by such events.

(h) *Financial estimates and assumptions impacted by transition activities.* Disclose whether the estimates and assumptions the registrant used to produce the consolidated financial statements were impacted by risks and uncertainties associated with, or known impacts from, a potential transition to a lower carbon economy or any climate-related targets disclosed by the registrant. If yes, provide a qualitative description of how the development of such estimates and assumptions were impacted by such a potential transition or the registrant's disclosed climate-related targets.

(i) *Impact of identified climate-related risks.* A registrant must also include the impact of any climate-related risks (separately by physical risks and transition risks, as defined in § 229.1500(c) of this chapter), identified by the registrant pursuant to § 229.1502(a) of this chapter, on any of the financial statement metrics disclosed pursuant to paragraphs (c) through (h) of this section.

(j) *Impact of climate-related opportunities.* A registrant may also include the impact of any opportunities arising from severe weather events and other natural conditions, any impact of efforts to pursue climate-related opportunities associated with transition activities, and the impact of any other climate-related opportunities, including those identified by the registrant pursuant to § 229.1502(a) of this chapter, on any of the financial statement metrics disclosed pursuant to paragraphs (c) through (h) of this section. If a registrant makes a policy decision to disclose the impact of an opportunity, it must do so consistently for the fiscal years presented, including for each financial statement line item and all relevant opportunities identified by the registrant.

PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975—REGULATION S–K

■ 4. The authority citation for part 229 continues to read as follows:

Authority: 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z–2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78j-3, 78l, 78m, 78n, 78n–1, 78o, 78u-5, 78w, 78ll, 78 mm, 80a–8, 80a–9, 80a–20, 80a–29, 80a–30, 80a–31(c), 80a37, 80a–38(a), 80a–39, 80b–11 and 7201 *et seq.;* 18 U.S.C. 1350; sec. 953(b), Pub. L. 111–203, 124 Stat. 1904 (2010); and sec. 102(c), Pub. L. 112–106, 126 Stat. 310 (2012).

■ 5. Add subpart 229.1500 (''Climate-Related Disclosure'') to read as follows:

Subpart 229.1500—Climate-Related Disclosure

Sec.

Subpart 229.1500—Climate-Related Disclosure

§ 229.1500 (Item 1500) Definitions.

As used in this subpart, these terms have the following meanings:

(a) *Carbon offsets* represents an emissions reduction or removal of greenhouse gases (''GHG'') in a manner calculated and traced for the purpose of offsetting an entity's GHG emissions.

(b) *Climate-related opportunities* means the actual or potential positive impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations, or value chains, as a whole.

(c) *Climate-related risks* means the actual or potential negative impacts of climate-related conditions and events on a registrant's consolidated financial statements, business operations, or value chains, as a whole. Climate-related risks include the following:

(1) *Physical risks* include both acute risks and chronic risks to the registrant's business operations or the operations of those with whom it does business.

(2) *Acute risks* are event-driven and may relate to shorter term extreme weather events, such as hurricanes, floods, and tornadoes, among other events.

(3) *Chronic risks* relate to longer term weather patterns and related effects, such as sustained higher temperatures, sea level rise, drought, and increased wildfires, as well as related effects such as decreased arability of farmland, decreased habitability of land, and decreased availability of fresh water.

(4) *Transition risks* are the actual or potential negative impacts on a registrant's consolidated financial statements, business operations, or value chains attributable to regulatory, technological, and market changes to address the mitigation of, or adaptation to, climate-related risks, such as increased costs attributable to changes in law or policy, reduced market demand for carbon-intensive products leading to decreased prices or profits for such products, the devaluation or abandonment of assets, risk of legal liability and litigation defense costs, competitive pressures associated with the adoption of new technologies, reputational impacts (including those stemming from a registrant's customers or business counterparties) that might trigger changes to market behavior, consumer preferences or behavior, and registrant behavior.

(d) *Carbon dioxide equivalent* (''CO_2e'') means the common unit of measurement to indicate the global warming potential (''GWP'') of each greenhouse gas, expressed in terms of the GWP of one unit of carbon dioxide (''CO_2'').

(e) *Emission factor* means a multiplication factor allowing actual GHG emissions to be calculated from available activity data or, if no activity data is available, economic data, to derive absolute GHG emissions. Examples of activity data include kilowatt-hours of electricity used, quantity of fuel used, output of a process, hours of operation of equipment, distance travelled, and floor area of a building.

(f) *Global warming potential* (''GWP'') means a factor describing the global warming impacts of different greenhouse gases. It is a measure of how much energy will be absorbed in the atmosphere over a specified period of time as a result of the emission of one ton of a greenhouse gas, relative to the emissions of one ton of carbon dioxide (CO_2).

(g) *Greenhouse gases* (''GHG'') means carbon dioxide (CO_2), methane (''CH_4''), nitrous oxide (''N_2O''), nitrogen trifluoride (''NF_3''), hydrofluorocarbons (''HFCs''), perfluorocarbons (''PFCs''), and sulfur hexafluoride (''SF_6'').

(h) *GHG emissions* means direct and indirect emissions of greenhouse gases expressed in metric tons of carbon dioxide equivalent (CO_2e), of which:

(1) Direct emissions are GHG emissions from sources that are owned or controlled by a registrant.

(2) Indirect emissions are GHG emissions that result from the activities of the registrant, but occur at sources not owned or controlled by the registrant.

(i) *GHG intensity* (or *carbon intensity*) means a ratio that expresses the impact of GHG emissions per unit of economic value (*e.g.,* metric tons of CO_2e per unit of total revenues, using the registrant's reporting currency) or per unit of production (*e.g.,* metric tons of CO_2e per product produced).

(j) *Internal carbon price* means an estimated cost of carbon emissions used internally within an organization.

(k) *Location* means a ZIP code or, in a jurisdiction that does not use ZIP codes, a similar subnational postal zone or geographic location.

(l) *Operational boundaries* means the boundaries that determine the direct and indirect emissions associated with the business operations owned or controlled by a registrant.

(m) *Organizational boundaries* means the boundaries that determine the operations owned or controlled by a registrant for the purpose of calculating its GHG emissions.

(n) *Renewable energy credit or certificate* (''*REC*'') means a credit or certificate representing each megawatt-hour (1 MWh or 1,000 kilowatt-hours) of renewable electricity generated and delivered to a power grid.

(o) *Scenario analysis* means a process for identifying and assessing a potential range of outcomes of various possible future climate scenarios, and how climate-related risks may impact a registrant's operations, business strategy, and consolidated financial statements over time. For example, registrants might use scenario analysis to test the resilience of their strategies under certain future climate scenarios, such as those that assume global temperature increases of 3 °C, 2 °C, and 1.5 °C above pre-industrial levels.

(p) *Scope 1 emissions* are direct GHG emissions from operations that are owned or controlled by a registrant.

(q) *Scope 2 emissions* are indirect GHG emissions from the generation of purchased or acquired electricity, steam, heat, or cooling that is consumed by operations owned or controlled by a registrant.

(r) *Scope 3 emissions* are all indirect GHG emissions not otherwise included in a registrant's Scope 2 emissions, which occur in the upstream and downstream activities of a registrant's value chain.

(1) Upstream activities in which Scope 3 emissions might occur include:

(i) A registrant's purchased goods and services;

(ii) A registrant's capital goods;

(iii) A registrant's fuel and energy related activities not included in Scope 1 or Scope 2 emissions;

(iv) Transportation and distribution of purchased goods, raw materials, and other inputs;

(v) Waste generated in a registrant's operations;

(vi) Business travel by a registrant's employees;

(vii) Employee commuting by a registrant's employees; and

(viii) A registrant's leased assets related principally to purchased or acquired goods or services.

(2) Downstream activities in which Scope 3 emissions might occur include:

(i) Transportation and distribution of a registrant's sold products, goods or other outputs;

(ii) Processing by a third party of a registrant's sold products;

(iii) Use by a third party of a registrant's sold products;

(iv) End-of-life treatment by a third party of a registrant's sold products;

(v) A registrant's leased assets related principally to the sale or disposition of goods or services;

(vi) A registrant's franchises; and

(vii) Investments by a registrant.

(s) *Transition plan* means a registrant's strategy and implementation plan to reduce climate-related risks, which may include a plan to reduce its GHG emissions in line with its own commitments or commitments of jurisdictions within which it has significant operations.

(t) *Value chain* means the upstream and downstream activities related to a registrant's operations. Upstream activities in connection with a value chain may include activities by a party other than the registrant that relate to the initial stages of a registrant's production of a good or service (*e.g.,* materials sourcing, materials processing, and supplier activities). Downstream activities in connection with a value chain may include activities by a party other than the registrant that relate to processing materials into a finished product and delivering it or providing a service to the end user (*e.g.,* transportation and distribution, processing of sold products, use of sold products, end of life treatment of sold products, and investments).

§ 229.1501 (Item 1501) Governance.

(a)(1) Describe the board of director's oversight of climate-related risks. Include the following, as applicable:

(i) The identity of any board members or board committee responsible for the oversight of climate-related risks;

(ii) Whether any member of the board of directors has expertise in climate-related risks, with disclosure in such detail as necessary to fully describe the nature of the expertise;

(iii) The processes by which the board of directors or board committee discusses climate-related risks, including how the board is informed about climate-related risks, and the frequency of such discussion;

(iv) Whether and how the board of directors or board committee considers climate-related risks as part of its business strategy, risk management, and financial oversight; and

(v) Whether and how the board of directors sets climate-related targets or goals, and how it oversees progress against those targets or goals, including the establishment of any interim targets or goals.

(2) If applicable, a registrant may also describe the board of director's oversight of climate-related opportunities.

(b)(1) Describe management's role in assessing and managing climate-related risks. Include the following, as applicable:

(i) Whether certain management positions or committees are responsible for assessing and managing climate-related risks and, if so, the identity of such positions or committees and the relevant expertise of the position holders or members in such detail as necessary to fully describe the nature of the expertise;

(ii) The processes by which such positions or committees are informed about and monitor climate-related risks; and

(iii) Whether and how frequently such positions or committees report to the board or a committee of the board on climate-related risks.

(2) If applicable, a registrant may also describe management's role in assessing and managing climate-related opportunities.

§ 229.1502 (Item 1502) Strategy, business model, and outlook.

(a) Describe any climate-related risks reasonably likely to have a material impact on the registrant, including on its business or consolidated financial statements, which may manifest over the short, medium, and long term. If applicable, a registrant may also disclose the actual and potential impacts of any climate-related opportunities when responding to any of the provisions in this section.

(1) Discuss such climate-related risks, specifying whether they are physical or transition risks and the nature of the risks presented.

(i) For physical risks, describe the nature of the risk, including if it may be categorized as an acute or chronic risk, and the location and nature of the properties, processes, or operations subject to the physical risk.

(A) If a risk concerns the flooding of buildings, plants, or properties located in flood hazard areas, disclose the percentage of those assets (square meters or acres) that are located in flood hazard areas in addition to their location.

(B) If a risk concerns the location of assets in regions of high or extremely high water stress, disclose the amount of assets (*e.g.,* book value and as a percentage of total assets) located in those regions in addition to their location. Also disclose the percentage of the registrant's total water usage from water withdrawn in those regions.

(ii) For transition risks, describe the nature of the risk, including whether it relates to regulatory, technological, market (including changing consumer, business counterparty, and investor preferences), liability, reputational, or other transition-related factors, and how those factors impact the registrant. A registrant that has significant operations in a jurisdiction that has made a GHG emissions reduction commitment may be exposed to transition risks related to the implementation of the commitment.

(2) Describe how the registrant defines short-, medium-, and long-term time horizons, including how it takes into account or reassesses the expected useful life of the registrant's assets and the time horizons for the registrant's climate-related planning processes and goals.

(b) Describe the actual and potential impacts of any climate-related risks identified in response to paragraph (a) of this section on the registrant's strategy, business model, and outlook.

(1) Include impacts on the registrant's:

(i) Business operations, including the types and locations of its operations;

(ii) Products or services;

(iii) Suppliers and other parties in its value chain;

(iv) Activities to mitigate or adapt to climate-related risks, including adoption of new technologies or processes;

(v) Expenditure for research and development; and

(vi) Any other significant changes or impacts.

(2) Include the time horizon for each described impact (*i.e.,* in the short, medium, or long term, as defined in response to paragraph (a) of this section).

(c) Discuss whether and how any impacts described in response to paragraph (b) of this section are considered as part of the registrant's business strategy, financial planning, and capital allocation. Provide both current and forward-looking disclosures that facilitate an understanding of whether the implications of the identified climate-related risks have been integrated into the registrant's business model or strategy, including how any resources are being used to mitigate climate-related risks. Include in this discussion how any of the metrics referenced in § 210.14–02 of this chapter and § 229.1504 or any of the targets referenced in § 229.1506 relate to the registrant's business model or business strategy. If applicable, include in this discussion the role that carbon offsets or RECs play in the registrant's climate-related business strategy.

(d) Provide a narrative discussion of whether and how any climate-related risks described in response to paragraph (a) of this section have affected or are reasonably likely to affect the registrant's consolidated financial statements. The discussion should include any of the climate-related metrics referenced in § 210.14–02 of this chapter that demonstrate that the identified climate-related risks have had a material impact on reported financial condition or operations.

(e)(1) If a registrant maintains an internal carbon price, disclose:

(i) The price in units of the registrant's reporting currency per metric ton of CO_2e;

(ii) The total price, including how the total price is estimated to change over time, if applicable;

(iii) The boundaries for measurement of overall CO_2e on which the total price is based if different from the GHG emission organizational boundary required pursuant to § 229.1504(e)(2); and

(iv) The rationale for selecting the internal carbon price applied.

(2) Describe how the registrant uses any internal carbon price described in response to paragraph (e)(1) of this section to evaluate and manage climate-related risks.

(3) If a registrant uses more than one internal carbon price, it must provide the disclosures required by this section for each internal carbon price, and disclose its reasons for using different prices.

(f) Describe the resilience of the registrant's business strategy in light of potential future changes in climate-related risks. Describe any analytical tools, such as scenario analysis, that the registrant uses to assess the impact of climate-related risks on its business and consolidated financial statements, and to support the resilience of its strategy and business model. If the registrant uses scenario analysis to assess the resilience of its business strategy to climate-related risks, disclose the scenarios considered (*e.g.,* an increase of no greater than 3 °C, 2 °C, or 1.5 °C above pre-industrial levels), including parameters, assumptions, and analytical choices, and the projected principal financial impacts on the registrant's business strategy under each scenario. The disclosure should include both qualitative and quantitative information.

§ 229.1503 (Item 1503) Risk management.

(a) Describe any processes the registrant has for identifying, assessing, and managing climate-related risks. If applicable, a registrant may also describe any processes for identifying, assessing, and managing climate-related opportunities when responding to any of the provisions in this section.

(1) When describing any processes for identifying and assessing climate-related risks, disclose, as applicable, how the registrant:

(i) Determines the relative significance of climate-related risks compared to other risks;

(ii) Considers existing or likely regulatory requirements or policies, such as GHG emissions limits, when identifying climate-related risks;

(iii) Considers shifts in customer or counterparty preferences, technological changes, or changes in market prices in assessing potential transition risks; and

(iv) Determines the materiality of climate-related risks, including how it assesses the potential scope and impact of an identified climate-related risk, such as the risks identified in response to § 229.1502.

(2) When describing any processes for managing climate-related risks, disclose, as applicable, how the registrant:

(i) Decides whether to mitigate, accept, or adapt to a particular risk;

(ii) Prioritizes whether to address climate-related risks; and

(iii) Determines how to mitigate any high priority risks.

(b) Disclose whether and how any processes described in response to paragraph (a) of this section are integrated into the registrant's overall risk management system or processes. If a separate board or management committee is responsible for assessing and managing climate-related risks, a registrant should disclose how that committee interacts with the registrant's board or management committee governing risks.

(c)(1) If the registrant has adopted a transition plan as part of its climate-related risk management strategy, describe the plan, including the relevant metrics and targets used to identify and manage any physical and transition risks. To allow for an understanding of the registrant's progress to meet the plan's targets or goals over time, a registrant must update its disclosure about the transition plan each fiscal year by describing the actions taken during the year to achieve the plan's targets or goals.

(2) If the registrant has adopted a transition plan, discuss, as applicable:

(i) How the registrant plans to mitigate or adapt to any identified physical risks, including but not limited to those concerning energy, land, or water use and management;

(ii) How the registrant plans to mitigate or adapt to any identified transition risks, including the following:

(A) Laws, regulations, or policies that:

(*1*) Restrict GHG emissions or products with high GHG footprints, including emissions caps; or

(*2*) Require the protection of high conservation value land or natural assets;

(B) Imposition of a carbon price; and

(C) Changing demands or preferences of consumers, investors, employees, and business counterparties.

(3) If applicable, a registrant that has adopted a transition plan as part of its climate-related risk management strategy may also describe how it plans to achieve any identified climate-related opportunities, such as:

(i) The production of products that may facilitate the transition to a lower carbon economy, such as low emission modes of transportation and supporting infrastructure;

(ii) The generation or use of renewable power;

(iii) The production or use of low waste, recycled, or other consumer products that require less carbon intensive production methods;

(iv) The setting of conservation goals and targets that would help reduce GHG emissions; and

(v) The provision of services related to any transition to a lower carbon economy.

§ 229.1504 (Item 1504) GHG emissions metrics.

(a) *General.* Disclose a registrant's GHG emissions, as defined in § 229.1500(h), for its most recently completed fiscal year, and for the historical fiscal years included in its consolidated financial statements in the filing, to the extent such historical GHG emissions data is reasonably available.

(1) For each required disclosure of a registrant's Scopes 1, 2, and 3 emissions, disclose the emissions both disaggregated by each constituent greenhouse gas, as specified in § 229.1500(g), and in the aggregate, expressed in terms of CO_2e.

(2) When disclosing a registrant's Scopes 1, 2, and 3 emissions, exclude the impact of any purchased or generated offsets.

(b) *Scopes 1 and 2 emissions.* (1) Disclose the registrant's total Scope 1 emissions and total Scope 2 emissions separately after calculating them from all sources that are included in the registrant's organizational and operational boundaries.

(2) When calculating emissions pursuant to paragraph (b)(1) of this section, a registrant may exclude emissions from investments that are not consolidated, are not proportionately consolidated, or that do not qualify for the equity method of accounting in the registrant's consolidated financial statements.

(c) *Scope 3 emissions.* (1) Disclose the registrant's total Scope 3 emissions if material. A registrant must also disclose its Scope 3 emissions if it has set a GHG emissions reduction target or goal that includes its Scope 3 emissions. Disclosure of a registrant's Scope 3 emissions must be separate from disclosure of its Scopes 1 and 2 emissions. If required to disclose Scope 3 emissions, identify the categories of upstream or downstream activities that have been included in the calculation of the Scope 3 emissions. If any category of Scope 3 emissions is significant to the registrant, identify all such categories and provide Scope 3 emissions data separately for them, together with the registrant's total Scope 3 emissions.

(2) If required to disclose Scope 3 emissions, describe the data sources used to calculate the registrant's Scope 3 emissions, including the use of any of the following:

(i) Emissions reported by parties in the registrant's value chain, and whether such reports were verified by the registrant or a third party, or unverified;

(ii) Data concerning specific activities, as reported by parties in the registrant's value chain; and

(iii) Data derived from economic studies, published databases, government statistics, industry associations, or other third-party sources outside of a registrant's value chain, including industry averages of emissions, activities, or economic data.

(3) A smaller reporting company, as defined by §§ 229.10(f)(1), 230.405, and 240.12b–2 of this chapter, is exempt from, and need not comply with, the disclosure requirements of this paragraph (c).

(d) *GHG intensity.* (1) Using the sum of Scope 1 and 2 emissions, disclose GHG intensity in terms of metric tons of CO_2e per unit of total revenue (using the registrant's reporting currency) and per unit of production relevant to the registrant's industry for each fiscal year included in the consolidated financial statements. Disclose the basis for the unit of production used.

(2) If Scope 3 emissions are otherwise disclosed, separately disclose GHG intensity using Scope 3 emissions only.

(3) If a registrant has no revenue or unit of production for a fiscal year, it must disclose another financial measure of GHG intensity or another measure of GHG intensity per unit of economic output, as applicable, with an explanation of why the particular measure was used.

(4) A registrant may also disclose other measures of GHG intensity, in addition to metric tons of CO_2e per unit of total revenue (using the registrant's reporting currency) and per unit of production, if it includes an explanation of why a particular measure was used and why the registrant believes such measure provides useful information to investors.

(e) *Methodology and related instructions.* (1) A registrant must describe the methodology, significant inputs, and significant assumptions used to calculate its GHG emissions. The description of the registrant's methodology must include the registrant's organizational boundaries, operational boundaries (including any approach to categorization of emissions and emissions sources), calculation approach (including any emission factors used and the source of the emission factors), and any calculation tools used to calculate the GHG emissions. A registrant's description of its approach to categorization of emissions and emissions sources should explain how it determined the emissions to include as direct emissions, for the purpose of calculating its Scope 1 emissions, and indirect emissions, for the purpose of calculating its Scope 2 emissions.

(2) The organizational boundary and any determination of whether a registrant owns or controls a particular source for GHG emissions must be consistent with the scope of entities, operations, assets, and other holdings within its business organization as those included in, and based upon the same set of accounting principles applicable to, the registrant's consolidated financial statements.

(3) A registrant must use the same organizational boundaries when calculating its Scope 1 emissions and Scope 2 emissions. If required to disclose Scope 3 emissions, a registrant must also apply the same organizational boundaries used when determining its Scopes 1 and 2 emissions as an initial step in identifying the sources of indirect emissions from activities in its value chain over which it lacks ownership and control and which must be included in the calculation of its Scope 3 emissions. Once a registrant has determined its organizational and operational boundaries, a registrant must be consistent in its use of those boundaries when calculating its GHG emissions.

(4) A registrant may use reasonable estimates when disclosing its GHG emissions as long as it also describes the assumptions underlying, and its reasons for using, the estimates.

(i) When disclosing its GHG emissions for its most recently completed fiscal year, if actual reported data is not reasonably available, a registrant may use a reasonable estimate of its GHG emissions for its fourth fiscal quarter, together with actual, determined GHG emissions data for the first three fiscal quarters, as long as the registrant promptly discloses in a subsequent filing any material difference between the estimate used and the actual, determined GHG emissions data for the fourth fiscal quarter.

(ii) In addition to the use of reasonable estimates, a registrant may present its estimated Scope 3 emissions in terms of a range as long as it discloses its reasons for using the range and the underlying assumptions.

(5) A registrant must disclose, to the extent material and as applicable, any use of third-party data when calculating its GHG emissions, regardless of the particular scope of emissions. When disclosing the use of third-party data, it must identify the source of such data and the process the registrant undertook to obtain and assess such data.

(6) A registrant must disclose any material change to the methodology or assumptions underlying its GHG emissions disclosure from the previous fiscal year.

(7) A registrant must disclose, to the extent material and as applicable, any gaps in the data required to calculate its GHG emissions. A registrant's GHG emissions disclosure should provide investors with a reasonably complete understanding of the registrant's GHG emissions in each scope of emissions. If a registrant discloses any data gaps encountered when calculating its GHG emissions, it must also discuss whether it used proxy data or another method to address such gaps, and how its accounting for any data gaps has affected the accuracy or completeness of its GHG emissions disclosure.

(8) When determining whether its Scope 3 emissions are material, and when disclosing those emissions, in addition to emissions from activities in its value chain, a registrant must include GHG emissions from outsourced activities that it previously conducted as part of its own operations, as reflected in the financial statements for the periods covered in the filing.

(9) If required to disclose Scope 3 emissions, when calculating those emissions, if there was any significant overlap in the categories of activities producing the Scope 3 emissions, a registrant must describe the overlap, how it accounted for the overlap, and the effect on its disclosed total Scope 3 emissions.

(f) *Liability for Scope 3 emissions disclosures.* (1) A statement within the coverage of paragraph (f)(2) of this section that is made by or on behalf of a registrant is deemed not to be a fraudulent statement (as defined in paragraph (f)(3) of this section), unless it is shown that such statement was made or reaffirmed without a reasonable basis or was disclosed other than in good faith.

(2) This paragraph (f) applies to any statement regarding Scope 3 emissions that is disclosed pursuant to §§ 229.1500 through 229.1506 and made in a document filed with the Commission.

(3) For the purpose of this paragraph (f), the term fraudulent statement shall mean a statement that is an untrue statement of material fact, a statement false or misleading with respect to any material fact, an omission to state a material fact necessary to make a statement not misleading, or that constitutes the employment of a manipulative, deceptive, or fraudulent device, contrivance, scheme, transaction, act, practice, course of business, or an artifice to defraud as those terms are used in the Securities Act of 1933 or the Securities Exchange Act of 1934 or the rules or regulations promulgated thereunder.

§ 229.1505 Attestation of Scope 1 and Scope 2 emissions disclosure.

(a) *Attestation.* (1) A registrant that is required to provide Scope 1 and Scope 2 emissions disclosure pursuant to

§ 229.1504 and that is an accelerated filer or a large accelerated filer must include an attestation report covering such disclosure in the relevant filing. For filings made by an accelerated filer or a large accelerated filer for the second and third fiscal years after the compliance date for § 229.1504, the attestation engagement must, at a minimum, be at a limited assurance level and cover the registrant's Scope 1 and Scope 2 emissions disclosure. For filings made by an accelerated filer or large accelerated filer for the fourth fiscal year after the compliance date for § 229.1504 and thereafter, the attestation engagement must be at a reasonable assurance level and, at a minimum, cover the registrant's Scope 1 and Scope 2 emissions disclosures.

(2) Any attestation report required under this section must be provided pursuant to standards that are publicly available at no cost and are established by a body or group that has followed due process procedures, including the broad distribution of the framework for public comment. An accelerated filer or a large accelerated filer obtaining voluntary assurance prior to the first required fiscal year must comply with subparagraph (e) of this section. Voluntary assurance obtained by an accelerated filer or a large accelerated filer thereafter must follow the requirements of paragraphs (b) through (d) of this section and must use the same attestation standard as the required assurance over Scope 1 and Scope 2.

(b) *GHG emissions attestation provider.* The GHG emissions attestation report required by paragraph (a) of this section must be prepared and signed by a GHG emissions attestation provider. A GHG emissions attestation provider means a person or a firm that has all of the following characteristics:

(1) Is an expert in GHG emissions by virtue of having significant experience in measuring, analyzing, reporting, or attesting to GHG emissions. Significant experience means having sufficient competence and capabilities necessary to:

(i) Perform engagements in accordance with professional standards and applicable legal and regulatory requirements; and

(ii) Enable the service provider to issue reports that are appropriate under the circumstances.

(2) Is independent with respect to the registrant, and any of its affiliates, for whom it is providing the attestation report, during the attestation and professional engagement period.

(i) A GHG emissions attestation provider is not independent if such attestation provider is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that such attestation provider is not, capable of exercising objective and impartial judgment on all issues encompassed within the attestation provider's engagement.

(ii) In determining whether a GHG emissions attestation provider is independent, the Commission will consider:

(A) Whether a relationship or the provision of a service creates a mutual or conflicting interest between the attestation provider and the registrant (or any of its affiliates), places the attestation provider in the position of attesting such attestation provider's own work, results in the attestation provider acting as management or an employee of the registrant (or any of its affiliates), or places the attestation provider in a position of being an advocate for the registrant (or any of its affiliates); and

(B) All relevant circumstances, including all financial or other relationships between the attestation provider and the registrant (or any of its affiliates), and not just those relating to reports filed with the Commission.

(iii) The term ''affiliates'' as used in this section has the meaning provided in 17 CFR 210.2–01, except that references to ''audit'' are deemed to be references to the attestation services provided pursuant to this section.

(iv) The term ''attestation and professional engagement period'' as used in this section means both:

(A) The period covered by the attestation report; and

(B) The period of the engagement to attest to the registrant's GHG emissions or to prepare a report filed with the Commission (''the professional engagement period''). The professional engagement period begins when the GHG attestation service provider either signs an initial engagement letter (or other agreement to attest a registrant's GHG emissions) or begins attest procedures, whichever is earlier.

(c) *Attestation report requirements.* The GHG emissions attestation report required by paragraph (a) of this section must be included in the separately captioned ''Climate-Related Disclosure'' section in the filing. The form and content of the attestation report must follow the requirements set forth by the attestation standard (or standards) used by the GHG emissions attestation provider. Notwithstanding the foregoing, at a minimum the report must include the following:

(1) An identification or description of the subject matter or assertion being reported on, including the point in time or period of time to which the measurement or evaluation of the subject matter or assertion relates;

(2) An identification of the criteria against which the subject matter was measured or evaluated;

(3) A statement that identifies the level of assurance provided and describes the nature of the engagement;

(4) A statement that identifies the attestation standard (or standards) used;

(5) A statement that describes the registrant's responsibility to report on the subject matter or assertion being reported on;

(6) A statement that describes the attestation provider's responsibilities in connection with the preparation of the attestation report;

(7) A statement that the attestation provider is independent, as required by paragraph (a) of this section;

(8) For a limited assurance engagement, a description of the work performed as a basis for the attestation provider's conclusion;

(9) A statement that describes significant inherent limitations, if any, associated with the measurement or evaluation of the subject matter against the criteria;

(10) The GHG emissions attestation provider's conclusion or opinion, based on the applicable attestation standard(s) used;

(11) The signature of the attestation provider (whether by an individual or a person signing on behalf of the attestation provider's firm);

(12) The city and state where the attestation report has been issued; and

(13) The date of the report.

(d) *Additional disclosures by the registrant.* In addition to including the GHG emissions attestation report required by paragraph (a) of this section, a large accelerated filer and an accelerated filer must disclose the following information within the separately captioned ''Climate-Related Disclosure'' section in the filing, after requesting relevant information from any GHG emissions attestation provider as necessary:

(1) Whether the attestation provider has a license from any licensing or accreditation body to provide assurance, and if so, identify the licensing or accreditation body, and whether the attestation provider is a member in good standing of that licensing or accreditation body;

(2) Whether the GHG emissions attestation engagement is subject to any oversight inspection program, and if so, which program (or programs); and

(3) Whether the attestation provider is subject to record-keeping requirements with respect to the work performed for

the GHG emissions attestation engagement and, if so, identify the record-keeping requirements and the duration of those requirements.

(e) *Disclosure of voluntary attestation.* A registrant that is not required to include a GHG emissions attestation report pursuant to paragraph (a) of this section must disclose within the separately captioned ''Climate-Related Disclosure'' section in the filing the following information if the registrant's GHG emissions disclosures were subject to third-party attestation or verification:

(1) Identify the provider of such attestation or verification;

(2) Describe the attestation or verification standard used;

(3) Describe the level and scope of attestation or verification provided;

(4) Briefly describe the results of the attestation or verification;

(5) Disclose whether the third-party service provider has any other business relationships with or has provided any other professional services to the registrant that may lead to an impairment of the service provider's independence with respect to the registrant; and

(6) Disclose any oversight inspection program to which the service provider is subject (*e.g.,* the AICPA's peer review program).

§ 229.1506 (Item 1506) Targets and goals.

(a)(1) A registrant must provide disclosure pursuant to this section if it has set any targets or goals related to the reduction of GHG emissions, or any other climate-related target or goal (*e.g.,* regarding energy usage, water usage, conservation or ecosystem restoration, or revenues from low-carbon products) such as actual or anticipated regulatory requirements, market constraints, or other goals established by a climate-related treaty, law, regulation, policy, or organization.

(2) A registrant may provide the disclosure required by this section as part of its disclosure in response to § 229.1502 or § 229.1503.

(b) If the registrant has set climate-related targets or goals, disclose the targets or goals, including, as applicable, a description of:

(1) The scope of activities and emissions included in the target;

(2) The unit of measurement, including whether the target is absolute or intensity based;

(3) The defined time horizon by which the target is intended to be achieved, and whether the time horizon is consistent with one or more goals established by a climate-related treaty, law, regulation, policy, or organization;

(4) The defined baseline time period and baseline emissions against which progress will be tracked with a consistent base year set for multiple targets;

(5) Any interim targets set by the registrant; and

(6) How the registrant intends to meet its climate-related targets or goals. For example, for a target or goal regarding net GHG emissions reduction, the discussion could include a strategy to increase energy efficiency, transition to lower carbon products, purchase carbon offsets or RECs, or engage in carbon removal and carbon storage.

(c) Disclose relevant data to indicate whether the registrant is making progress toward meeting the target or goal and how such progress has been achieved. A registrant must update this disclosure each fiscal year by describing the actions taken during the year to achieve its targets or goals.

(d) If carbon offsets or RECs have been used as part of a registrant's plan to achieve climate-related targets or goals, disclose the amount of carbon reduction represented by the offsets or the amount of generated renewable energy represented by the RECS, the source of the offsets or RECs, a description and location of the underlying projects, any registries or other authentication of the offsets or RECs, and the cost of the offsets or RECs.

§ 229.1507 (Item 1507) Interactive data requirement.

Provide the disclosure required by this Subpart 1500 in an Interactive Data File as required by § 232.405 of this chapter (Rule 405 of Regulation S–T) in accordance with the EDGAR Filer Manual.

PART 232—REGULATION S–T—GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

■ 6. The general authority citation for part 232 continues to read as follows:

Authority: 15 U.S.C. 77c, 77f, 77g, 77h, 77j, 77s(a), 77z–3, 77sss(a), 78c(b), 78*l,* 78m, 78n, 78o(d), 78w(a), 78*ll,* 80a–6(c), 80a–8, 80a–29, 80a–30, 80a–37, 7201 *et seq.;* and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

■ 7. Amend § 232.405 by adding paragraphs (b)(1)(iii), (b)(3)(i)(C), and (b)(4) as follows:

§ 232.405 Interactive Data File submissions.

* * * * *

(b) * * *

(1) * * *

(iii) As applicable, the disclosure set forth in paragraph (4) of this section.

* * * * *

(3) * * *

(i) * * *

(C) The disclosure set forth in paragraph (4) of this section.

(4) An Interactive Data File must consist of the disclosure provided under 17 CFR 229 (Regulation S–K) and related provisions that is required to be tagged, including, as applicable:

(i) The climate-related information required by Subpart 1500 of Regulation S–K (§§ 229.1500 through 229.1507 of this chapter).

* * * * *

PART 239—FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

■ 8. The general authority citation for part 239 continues to read as follows:

Authority: 15 U.S.C. 77c, 77f, 77g, 77h, 77j, 77s, 77z–2, 77z–3, 77sss, 78c, 78*l,* 78m,78n, 78o(d), 78o-7 note, 78u-5, 78w(a), 78*ll,* 78mm, 80a–2(a), 80a–3, 80a–8, 80a–9, 80a–10, 80a–13, 80a–24, 80a–26, 80a–29, 80a–30, and 80a–37; and sec. 107, Pub. L. 112–106, 126 Stat. 312, unless otherwise noted.

* * * * *

■ 9. Amend Form S–1 (referenced in § 239.11) by adding Item 11(o) to Part I to read as follows:

Note: The text of Form S–1 does not, and these amendments will not, appear in the Code of Federal Regulations.

FORM S–1

* * * * *

PART I—INFORMATION REQUIRED IN PROSPECTUS

* * * * *

Item 11. Information With Respect to the Registrant.

* * * * *

(o) Information required by Subpart 1500 of Regulation S–K (17 CFR 229.1500 through 229.1507), in a part of the registration statement that is separately captioned as *Climate-Related Disclosure.* Pursuant to Rule 411 (17 CFR 230.411) and General Instruction VII of this form, a registrant may incorporate by reference disclosure from other parts of the registration statement (*e.g.,* Risk Factors, Business, Management's Discussion and Analysis, or the financial statements) or from a separately filed annual report or other periodic report into the Climate-Related Disclosure item if it is responsive to the topics specified in Items 1500 through 1507 of Regulation S–K.

* * * * *

■ 10. Amend Form S–11 (referenced in § 239.18) by adding Item 9 to Part I to read as follows:

Note: The text of Form S–11 does not, and these amendments will not, appear in the Code of Federal Regulations.

FORM S–11

* * * * *

PART I. INFORMATION REQUIRED IN PROSPECTUS

* * * * *

Item 9. Climate-related disclosure. Provide the information required by Subpart 1500 of Regulation S–K (17 CFR 229.1500 through 229.1507), in a part of the registration statement that is separately captioned as *Climate-Related Disclosure.* Pursuant to Rule 411 (17 CFR 230.411) and General Instruction H of this form, a registrant may incorporate by reference disclosure from other parts of the registration statement (*e.g.,* Risk Factors, Management's Discussion and Analysis, or the financial statements) or from a separately filed annual report or other periodic report into the Climate-Related Disclosure item if it is responsive to the topics specified in Items 1500 through 1507 of Regulation S–K.

* * * * *

■ 11. Amend Form S–4 (referenced in § 239.25) by:

■ a. Adding paragraph (k) to Item 14 to Part I; and

■ b. Adding paragraph (b)(11) to Item 17 to Part I.

The additions read as follows:

Note: The text of Form S–4 does not, and these amendments will not, appear in the Code of Federal Regulations.

FORM S–4

* * * * *

PART I

INFORMATION REQUIRED IN THE PROSPECTUS

* * * * *

Item 14. Information With Respect to Registrants Other Than S–3 Registrants.

* * * * *

(k) Information required by Subpart 1500 of Regulation S–K (17 CFR 229.1500 through 229.1507), in a part of the registration statement that is separately captioned as *Climate-Related Disclosure.* Pursuant to Rule 411 (17 CFR 230.411) a registrant may incorporate by reference disclosure from other parts of the registration statement (*e.g.,* Risk Factors, Description of Business, Management's Discussion and Analysis, or the financial statements) into the Climate-Related Disclosure item if it is responsive to the topics specified in Items 1500 through 1507 of Regulation S–K.

* * * * *

Item 17. Information With Respect to Companies Other Than S–3 Companies.

* * * * *

(b) * * *

(11) Information required by Items 1500–1507 of Regulation S–K (17 CFR 229.1500 through § 229.1507), in a part of the registration statement that is separately captioned as *Climate-Related Disclosure of Company Being Acquired.*

* * * * *

■ 12. Amend Form F–4 (referenced in § 239.34) by:

■ a. Adding paragraph (k) to Item 14 to Part I; and

■ b. Amending paragraph (3) to Item 17(b) to Part I.

The additions read as follows:

Note: The text of Form F–4 does not, and these amendments will not, appear in the Code of Federal Regulations.

FORM F–4

* * * * *

PART I

INFORMATION REQUIRED IN THE PROSPECTUS

* * * * *

Item 14. Information With Respect to Foreign Registrants Other Than F–3 Registrants.

* * * * *

(k) Item 3.E of Form 20–F, climate-related disclosure.

* * * * *

Item 17. Information With Respect to Foreign Companies Other Than F–3 Companies.

* * * * *

(b) * * *

(3) Item 3.E of Form 20–F, climate-related disclosure;

* * * * *

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

■ 13. The authority citation for part 249 continues to read as follows:

Authority: 15 U.S.C. 78a *et seq.* and 7201 *et seq.;* 12 U.S.C. 5461 *et seq.;* 18 U.S.C. 1350; Sec. 953(b) Pub. L. 111–203, 124 Stat. 1904; Sec. 102(a)(3) Pub. L. 112–106, 126 Stat. 309 (2012), Sec. 107 Pub. L. 112–106, 126 Stat. 313 (2012), Sec. 72001 Pub. L. 114–94, 129 Stat. 1312 (2015), and secs. 2 and 3 Pub. L. 116–222, 134 Stat. 1063 (2020), unless otherwise noted.

* * * * *

Section 249.220f is also issued under secs. 3(a), 202, 208, 302, 306(a), 401(a), 401(b), 406 and 407, Pub. L. 107–204, 116 Stat. 745, and secs. 2 and 3, Pub. L. 116–222, 134 Stat. 1063.

Section 249.308a is also issued under secs. 3(a) and 302, Pub. L. 107–204, 116 Stat. 745.

* * * * *

Section 249.310 is also issued under secs. 3(a), 202, 208, 302, 406 and 407, Pub. L. 107–204, 116 Stat. 745.

* * * * *

■ 14. Amend Form 10 (referenced in § 249.210) by adding Item 3.A (''Climate-Related Disclosure'') to read as follows:

Note: The text of Form 10 does not, and these amendments will not, appear in the Code of Federal Regulations.

FORM 10

* * * * *

Item 3.A Climate-Related Disclosure. Provide the information required by Subpart 1500 of Regulation S–K (17 CFR 229.1500 through 229.1507), in a part of the registration statement that is separately captioned as *Climate-Related Disclosure.* Pursuant to Exchange Act Rule 12b–23 (17 CFR 240.12b–23) and General Instruction F of this form, a registrant may incorporate by reference disclosure from other parts of the registration statement (*e.g.,* Risk Factors, Business, Management's Discussion and Analysis, or the financial statements) into the Climate-Related Disclosure item if it is responsive to the topics specified in Item 1500 through 1507 of Regulation S–K.

* * * * *

■ 15. Amend Form 20–F (referenced in § 249.220f) by adding Item 3.E (''Climate-related disclosure'') to Part I to read as follows:

Note: The text of Form 20–F does not, and these amendments will not, appear in the Code of Federal Regulations.

FORM 20–F

* * * * *

PART I

* * * * *

Item 3. Key Information

* * * * *

E. Climate-Related Disclosure

1. *Required disclosure.* The company must provide disclosure responsive to the topics specified in Subpart 1500 of Regulation S–K (17 CFR 229.1500 through 229.1507) in a part of the registration statement or annual report that is separately captioned as *Climate-Related Disclosure.*

2. *Incorporation by reference.* Pursuant to Rule 12b–23 (17 CFR 240.12b–23), the company may incorporate by reference disclosure from other parts of the registration statement

or annual report (*e.g.,* Risk Factors, Information on the Company, Operating and Financial Review and Prospects, or the financial statements) into the Climate-Related Disclosure item if it is responsive to the topics specified in Item 1500 through 1507 of Regulation S–K.

* * * * *

■ 16. Amend Form 6–K (referenced in § 249.306) by adding the phrase ''climate-related disclosure;'' before the phrase ''and any other information which the registrant deems of material importance to security holders.'' in the second paragraph of General Instruction B.

■ 17. Amend Form 10–Q (referenced in § 249.308a) by adding Item 1.B (''Climate-Related disclosure'') to Part II (''Other Information'') to read as follows:

Note: The text of Form 10–Q does not, and these amendments will not, appear in the Code of Federal Regulations.

FORM 10–Q

* * * * *

Item 1B. Climate-Related Disclosure. Disclose any material changes to the disclosures provided in response to Item 6 (''Climate-related disclosure'') of Part II to the registrant's Form 10–K (17 CFR 229.310).

* * * * *

■ 18. Amend Form 10–K (referenced in § 249.310) by:

■ a. Revising paragraph (1)(g) of General Instruction J (''Use of this Form by Asset-backed Issuers''); and

■ b. Adding Item 6 (''Climate-Related Disclosure'') to Part II to read as follows:

The revision and addition read as follows:

Note: The text of Form 10–K does not, and these amendments will not, appear in the Code of Federal Regulations.

FORM 10–K

* * * * *

GENERAL INSTRUCTIONS

* * * * *

J. Use of This Form by Asset-Backed Issuers.

* * * * *

(1) * * *

(g) Item 6, Climate-Related Disclosure;

* * * * *

Part II

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Item 6. Climate-Related Disclosure

Provide the disclosure required by Subpart 1500 of Regulation S–K (17 CFR 229.1500 through 229.1507) in a part of the annual report that is separately captioned as *Climate-Related Disclosure.* Pursuant to Rule 12b–23 (17 CFR 240.12b–23) and General Instruction G of this form, a registrant may incorporate by reference disclosure from other parts of the registration statement or annual report (*e.g.,* Risk Factors, Business, Management's Discussion and Analysis, or the financial statements) into the Climate-Related Disclosure item if it is responsive to the topics specified in Item 1500 through 1507 of Regulation S–K.

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By the Commission.

Dated: March 21, 2022.

Vanessa A. Countryman,

Secretary.

[FR Doc. 2022–06342 Filed 4–8–22; 8:45 am]

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FEDERAL TRADE COMMISSION
PROTECTING AMERICA'S CONSUMERS

For Release

FTC Enforcement Action to Bar GoodRx from Sharing Consumers' Sensitive Health Info for Advertising

Under proposed order, GoodRx will pay a $1.5 million civil penalty for failing to report its unauthorized disclosure of consumer health data to Facebook, Google, and other companies

February 1, 2023

Tags: Consumer Protection | Regional Offices | Bureau of Consumer Protection | Western Region San Francisco | Health | Advertising and Marketing | Online Advertising and Marketing | Privacy and Security | Consumer Privacy | Health Privacy

The Federal Trade Commission has taken enforcement action for the first time under its Health Breach Notification Rule against the telehealth and prescription drug discount provider GoodRx Holdings Inc., for failing to notify consumers and others of its unauthorized disclosures of consumers' personal health information to Facebook, Google, and other companies.

In a first-of-its-kind proposed order, filed by the Department of Justice on behalf of the FTC, GoodRx will be prohibited from sharing user health data with applicable third parties for advertising purposes, and has agreed to pay a $1.5 million civil penalty for violating the rule. The proposed order must be approved by the federal court to go into effect.

"Digital health companies and mobile apps should not cash in on consumers' extremely sensitive and personally identifiable health information," said Samuel Levine, Director of the FTC's Bureau of Consumer Protection. "The FTC is serving notice that it will use all of its legal authority to protect American consumers' sensitive data from misuse and illegal exploitation."

California-based GoodRx operates a digital health platform that offers prescription drug discounts, telehealth visits, and other health services. The company collects personal and health information about its users, including information from users themselves and from pharmacy benefit managers confirming when a consumer purchases a medication using a GoodRx coupon. Since January 2017, more than 55 million consumers have visited or used GoodRx's website or mobile apps.

According to the FTC's complaint, GoodRx violated the FTC Act by sharing sensitive personal health information for years with advertising companies and platforms—contrary to its privacy promises—and failed to report these unauthorized disclosures as required by the Health Breach Notification Rule. Specifically, the FTC said GoodRx:

- **Shared Personal Health Information with Facebook, Google, Criteo, and Others:** Since at least 2017, GoodRx deceptively promised its users that it would never share personal health information with advertisers or other third parties. GoodRx repeatedly violated this promise by sharing sensitive personal health information—including its users' prescription medications and personal health conditions—with third party advertising companies and advertising platforms like Facebook, Google, and Criteo, and other third parties like Branch and Twilio.

- **Used Personal Health Information to Target its Users with Ads:** GoodRx monetized its users' personal health information, and used data it shared with Facebook to target GoodRx's own users with personalized health- and medication-specific advertisements on Facebook and Instagram. For example, in August 2019, GoodRx compiled lists of its users who had purchased particular medications such as those used to treat heart disease and blood pressure, and uploaded their email addresses, phone numbers, and mobile advertising IDs to Facebook so it could identify their profiles. GoodRx then used that information to target these users with health-related advertisements.

- **Failed to Limit Third-Party Use of Personal Health Information:** GoodRx allowed third parties it shared data with to use that information for their own internal purposes, including for research and development or to improve advertising. It also falsely claimed that it complied with the Digital Advertising Alliance principles, which require companies to get consent before using health information for advertising.

- **Misrepresented its HIPAA Compliance:** GoodRx displayed a seal at the bottom of its telehealth services homepage falsely suggesting to consumers that it complied with the Health Insurance Portability and Accountability Act of 1996 (HIPAA), a law that sets forth privacy and information security protections for health data.

- **Failed to Implement Policies to Protect Personal Health Information**: GoodRx failed to maintain sufficient policies or procedures to protect its users' personal health information. Until a consumer watchdog publicly revealed GoodRx's actions in February 2020, GoodRx had no sufficient formal, written, or standard privacy or data sharing policies or compliance programs in place.

Health Breach Notification Rule Violation

According to the FTC complaint, as a vendor of personal health records, GoodRx is subject to the Health Breach Notification Rule. GoodRx lets users keep track of their personal health information, including to save, track, and receive alerts about their prescriptions, refills, pricing, and medication purchase history.

GoodRx violated the Health Breach Notification Rule by failing to notify consumers, the FTC, and the media about the company's unauthorized disclosure of individually identifiable health information to Facebook, Google, Criteo, Branch, and Twilio. The FTC issued a policy statement in September 2021 warning health apps and others that collect or use consumers' health information that they must comply with the Health Breach Notification Rule. More information on compliance and reporting breaches under the Health Breach Notification Rule are available at the FTC's Health Privacy page.

Proposed Order

In addition to the $1.5 million penalty for violating the rule, the proposed federal court order also prohibits GoodRx from engaging in the deceptive practices outlined in the complaint and requires the company to comply with the Health Breach Notification Rule. To remedy the FTC's numerous allegations, other provisions of the proposed order against GoodRx also:

- **Prohibit the sharing of health data for ads:** GoodRx will be permanently prohibited from disclosing user health information with applicable third parties for advertising purposes.
- **Require user consent for any other sharing:** The company must obtain users' affirmative express consent before disclosing user health information with applicable third parties for other purposes. The order requires the company to clearly and conspicuously detail the categories of health information that it will disclose to third parties and prohibits the company from using manipulative designs, known as dark patterns, to obtain users' consent to share the information.
- **Require company to seek deletion of data:** The company must direct third parties to delete the consumer health data that was shared with them and inform consumers about the breaches and the FTC's enforcement action against the company.
- **Limit Retention of Data:** GoodRx will be required to limit how long it can retain personal and health information according to a data retention schedule. It also must publicly post a retention schedule, and detail the information it collects and why such data collection is necessary.
- **Implement Mandated Privacy Program:** It must put in place a comprehensive privacy program that includes strong safeguards to protect consumer data.

The Commission voted 4-0 to refer the complaint and stipulated final order to the Department of Justice for filing. Commissioner Christine S. Wilson issued a concurring statement. The DOJ filed the complaint and stipulated order in the U.S. District Court for the Northern District of California.

NOTE: The Commission authorizes the filing of a complaint when it has "reason to believe" that the named defendant is violating or is about to violate the law and it appears to the Commission that a proceeding is in the public interest. Stipulated final orders have the force of law when approved and signed by the District Court judge.

The lead staff attorney on the GoodRx matter was Ronnie Solomon of the FTC's Bureau of Consumer Protection.

The Federal Trade Commission works to promote competition and protect and educate consumers. Learn more about consumer topics at consumer.ftc.gov, or report fraud, scams, and bad business practices at ReportFraud.ftc.gov. Follow the FTC on social media, read consumer alerts and the business blog, and sign up to get the latest FTC news and alerts.

Contact Information

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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF NEW YORK

Lindsey Finster, individually and on behalf of all others similarly situated, Plaintiff, - against - Sephora USA Inc., Defendant	Case No. 6:22-cv-1187 (GLS/ML) Class Action Complaint Jury Trial Demanded

Plaintiff alleges upon information and belief, except for allegations about Plaintiff, which are based on personal knowledge:

1. Sephora USA Inc. ("Defendant") manufactures, labels, markets, certifies and/or sells cosmetics advertised as "Clean" under its "Clean At Sephora" program ("Products").

2. Consumers understand "clean" consistent with its dictionary definitions, which define it as describing something free from impurities, or unnecessary and harmful components, and pure.

3. In the context of cosmetics, this means products made without synthetic chemicals and ingredients that could harm the body, skin or environment.

4. One pioneer of "clean" cosmetics described "clean beauty [products]" as having minimal to no synthetic ingredients.

5. A recent survey revealed that purchasing clean beauty products was important to sixty-four percent of American consumers, who are willing to pay more for them.

6. Sales of clean cosmetics in the United States is approaching $2 billion per year.

7. According to the Environmental Working Group ("EWG"), the average woman uses 12 cosmetic products with 168 different ingredients every day.

8. Despite increased knowledge of the possible harms of numerous ingredients, regulatory agencies have only banned nine ingredients.

9. In fact, the EWG described cosmetics as the least regulated consumer product, below cars, food, toys, and other essential items.

10. In this regulatory vacuum, companies have developed their own standards and terms purporting to inform consumers about the attributes of their products.

11. Defendant's "Clean At Sephora" initiative is a way for customers to select products which Sephora has evaluated to provide "The beauty you want, minus the ingredients you might not. This seal means formulated without parabens, sulfates SLS and SLES, phthalates, mineral oils, formaldehyde, and more."

12. Where products meet this criteria, they are promoted with the green "Clean At Sephora" seal bearing a checkmark and leaf symbol, in Sephora stores and online.

13. Elsewhere in its marketing materials, Defendant states, “Clean at Sephora means all of our clean brands comply with the criteria, which are focused on transparency in formulation and sourcing and the avoidance of certain ingredients.”

14. Consumers who “see [the] Clean seal, [] can be assured that the product is formulated without specific ingredients that are known or suspected to be potentially harmful to human health and/or the environment.”

15. However, a significant percentage of products with the “Clean At Sephora” contain ingredients inconsistent with how consumers understand this term.

16. For instance, the Saie Mascara 101 contains numerous synthetic ingredients, several of which have been reported to cause possible harms.

17. Its most predominant ingredient, polyglyceryl-6 distearate, is a compound of glycerol and stearic acid.

18. Glycerol is manufactured through hydrogenolysis, a chemical reaction whereby a carbon-carbon or carbon-heteroatom single bond is cleaved or undergoes lysis by hydrogen.

19. Because the global cosmetic industry uses millions of metric tons of glycerol per year, the only viable source for glycerol is as a byproduct in biodiesel production.

20. Though stearic acid is based on the natural source of palm oil, it is significantly altered through saponification, a chemical reaction where fats, oils, and lipids are converted by heat in the presence of aqueous alkali such as sodium hydroxide.

21. Another synthetic ingredient, polyglyceryl-10 myristate, is a type of polyglycerol ester of fatty acid (PGE), classified by one respected source as a toxin.[1]

22. PGEs are made by esterifying condensed glycerol with fatty acids in the presence of

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[1] Sun Sara Spa.

alkaline catalysts at high temperatures and with vacuum pressure.

23. The Product contains cetyl alcohol, a synthetic substance manufactured by reducing ethyl palmitate with metallic sodium or under acidic conditions with lithium aluminum hydride as a catalyst.

24. Though the Cosmetic Ingredient Review Expert Panel and the FDA consider cetyl alcohol safe for use in cosmetics, numerous dermatologists believe it can be irritating for those with sensitive skin by altering the lipid bilayer of the epidermis and cause allergic dermal reactions.

25. The synthetic ingredient glyceryl caprylate is manufactured through chemical reactions such as esterification.

26. According to the book, Toxic Beauty, glyceryl caprylate is not a "clean" cosmetic ingredient because it is used as an agricultural pesticide to protect crops from mites and fungi.

27. Phenethyl alcohol, a preservative and fragrance ingredient, has never been assessed for safety, but reports based on animal studies show skin irritation at low doses, while moderate doses have a detrimental impact on the brain, nervous and reproductive system.

28. Sodium benzoate is another synthetic ingredient in the Product, produced when benzoic acid is combined with sodium hydroxide.

29. While the FDA has declared sodium benzoate by itself as "safe," numerous sources have cited the ease with which it converts to the carcinogen, benzene.[2]

30. This can occur based on the length of time a product with this ingredient is stored prior to use.

31. Potassium sorbate, a synthetic preservative, has been shown through in-vitro studies

[2] Nature's Repair, Dangers of Sodium Benzoate.

to be toxic to DNA and detrimental to immunity.[3]

32. Xanthan gum is a synthetic ingredient used as a viscosity agent in cosmetics.

33. It is manufactured from carbon sources by fermentation using the gram-negative bacterium Xanthomonas campestris.

34. Defendant makes other representations and omissions with respect to the Product which are false and misleading.

35. As a result of the false and misleading representations, the Product is sold at a premium price, approximately no less than $26.00 for 0.31 oz (10g), excluding tax and sales, higher than similar products, represented in a non-misleading way, and higher than it would be sold for absent the misleading representations and omissions.

Jurisdiction and Venue

36. Jurisdiction is based on the Class Action Fairness Act of 2005 ("CAFA"). 28 U.S.C. § 1332(d)(2).

37. The aggregate amount in controversy exceeds $5 million, including any statutory and punitive damages, exclusive of interest and costs.

38. Plaintiff is a citizen of New York.

39. Defendant is a Michigan corporation with a principal place of business in San Francisco, San Francisco County, California.

40. The class of persons Plaintiff seeks to represent includes persons who are citizens of different states from which Defendant is a citizen.

41. The members of the class Plaintiff seeks to represent are more than 100, because products designated as "Clean At Sephora" are sold from hundreds of Sephora stores and available

[3] Honest Weight Food Co-Op, The Banned List.

online in the States Plaintiff seeks to represent.

42. Venue is in this District because a substantial part of the events or omissions giving rise to these claims occurred in Onondaga County, including Plaintiff's purchase, reliance on the identified statements, and subsequent awareness these were false and misleading.

Parties

43. Plaintiff Lindsey Finster is a citizen of Cleveland, Oneida County, New York.

44. Defendant Sephora USA Inc. is a Michigan corporation with a principal place of business in San Francisco, San Francisco County, California.

45. Defendant operates over a thousand Sephora stores in the United States and the Sephora website which sell beauty and cosmetic products.

46. Plaintiff purchased the Product from Sephora, 9090 Destiny USA Dr, Syracuse, NY 13290, between August and October 2022, and/or 2022, among other times.

47. Plaintiff read and relied on the "Clean at Sephora" seal to believe the Product's ingredients were not synthetic nor connected to causing physical harm and irritation.

48. Plaintiff bought the Product at or exceeding the above-referenced price.

49. Plaintiff paid more for the Product than she would have had she known the "clean" representations were false and misleading, or would not have purchased it.

50. Plaintiff chose between Defendant's Product and products represented similarly, but which did not misrepresent their attributes, requirements, features, and/or components.

Class Allegations

51. Plaintiff seeks certification under Fed. R. Civ. P. 23 of the following classes:

> **New York Class:** All persons in the State of New York who purchased the Products during the statutes of limitations for each cause of action alleged; and
>
> **Consumer Fraud Multi-State Class**: All persons in

> the States of Texas, North Dakota, Wyoming, Idaho, Alaska, Iowa, West Virginia, North Carolina, and Utah who purchased the Products during the statutes of limitations for each cause of action alleged.

52. Common questions of issues, law, and fact predominate and include whether Defendant's representations were and are misleading and if Plaintiff and class members are entitled to damages.

53. Plaintiff's claims and basis for relief are typical to other members because all were subjected to the same unfair, misleading, and deceptive representations, omissions, and actions.

54. Plaintiff is an adequate representative because her interests do not conflict with other members.

55. No individual inquiry is necessary since the focus is only on Defendant's practices and the class is definable and ascertainable.

56. Individual actions would risk inconsistent results, be repetitive and are impractical to justify, as the claims are modest relative to the scope of the harm.

57. Plaintiff's counsel is competent and experienced in complex class action litigation and intends to protect class members' interests adequately and fairly.

<u>New York General Business Law ("GBL") §§ 349 and 350</u>

58. Plaintiff incorporates by reference all preceding paragraphs.

59. Plaintiff saw and relied on the "Clean at Sephora" seal to believe the Product's ingredients were not synthetic nor connected to causing physical harm and irritation.

60. Defendant's false, misleading, and deceptive representations and omissions are material in that they are likely to influence consumer purchasing decisions, because the lack of synthetic and potentially harm-causing ingredients is important to consumers like Plaintiff.

61. Plaintiff would not have purchased the Product or paid as much if the true facts had

been known, suffering damages.

Violation of State Consumer Fraud Acts
(Consumer Fraud Multi-State Class)

62. The Consumer Fraud Acts of the States in the Consumer Fraud Multi-State Class are similar to the consumer protection statute invoked by Plaintiff and prohibit the use of unfair or deceptive business practices in the conduct of commerce.

63. The members of the Consumer Fraud Multi-State Class reserve their rights to assert their consumer protection claims under the Consumer Fraud Acts of the States they represent and/or the consumer protection statute invoked by Plaintiff.

64. Defendant intended that members of the Consumer Fraud Multi-State Class would rely upon its deceptive conduct, which they did, suffering damages.

Breaches of Express Warranty,
Implied Warranty of Merchantability/Fitness for a Particular Purpose
and Magnuson Moss Warranty Act, 15 U.S.C. §§ 2301, *et seq*.

65. The Product was manufactured, identified, marketed, and sold by Defendant and expressly and impliedly warranted to Plaintiff that its ingredients were not synthetic nor connected to causing physical harm and irritation.

66. Defendant directly marketed the Product to Plaintiff through its advertisements and marketing, through various forms of media, on the packaging, in print circulars, direct mail, product descriptions, and targeted digital advertising.

67. Defendant knew the product attributes that potential customers like Plaintiff were seeking and developed its marketing and labeling to directly meet those needs and desires, such as the high percentage of Americans who seek cosmetics described as "clean."

68. Defendant's representations about the Product were conveyed in writing and promised it would be defect-free, and Plaintiff understood this meant its ingredients were not

synthetic nor connected to causing physical harm and irritation.

69. Defendant's representations affirmed and promised that its ingredients were not synthetic nor connected to causing physical harm and irritation.

70. Defendant described the Product so Plaintiff believed its ingredients were not synthetic nor connected to causing physical harm and irritation, which became part of the basis of the bargain that it would conform to its affirmations and promises.

71. Defendant had a duty to disclose and/or provide non-deceptive descriptions and marketing of the Product.

72. This duty is based on Defendant's outsized role in the market for this type of Product, a leading brand in the sale of cosmetics.

73. Plaintiff recently became aware of Defendant's breach of the Product's warranties.

74. Plaintiff provided or provides notice to Defendant, its agents, representatives, retailers, and their employees that it breached the Product's warranties.

75. Defendant received notice and should have been aware of these issues due to complaints by third-parties, including regulators, competitors, and consumers, to its main offices, and by consumers through online forums.

76. The Product did not conform to its affirmations of fact and promises due to Defendant's actions.

77. The Product was not merchantable because it was not fit to pass in the trade as advertised, not fit for the ordinary purpose for which it was intended and did not conform to the promises or affirmations of fact made on the packaging, container, or label, because it was marketed as if its ingredients were not synthetic nor connected to causing physical harm and irritation.

78. The Product was not merchantable because Defendant had reason to know the particular purpose for which the Product was bought by Plaintiff, because she expected that its ingredients were not synthetic nor connected to causing physical harm and irritation, and she relied on Defendant's skill and judgment to select or furnish such a suitable product.

Fraud

79. Defendant misrepresented and/or omitted the attributes and qualities of the Product, that its ingredients were not synthetic nor connected to causing physical harm and irritation.

80. The records Defendant is required to maintain, and/or the information inconspicuously disclosed to consumers, provided it with actual and constructive knowledge of this falsity and deception, through statements and omissions.

Unjust Enrichment

81. Defendant obtained benefits and monies because the Product was not as represented and expected, to the detriment and impoverishment of Plaintiff and class members, who seek restitution and disgorgement of inequitably obtained profits.

Jury Demand and Prayer for Relief

Plaintiff demands a jury trial on all issues.

WHEREFORE, Plaintiff prays for judgment:

1. Declaring this a proper class action, certifying Plaintiff as representative and the undersigned as counsel for the class;
2. Awarding monetary, statutory and/or punitive damages and interest;
3. Awarding costs and expenses, including reasonable fees for Plaintiff's attorneys and experts; and
4. Other and further relief as the Court deems just and proper.

Dated: November 11, 2022

Respectfully submitted,

/s/ Spencer Sheehan

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FASHION LAW INSTITUTE

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NIKE
PENTAGRAM
RALPH LAUREN CORPORATION
TEERICO

We look forward to seeing you again
at our 13th annual symposium,
Friday, April 28, 2023!