Federal Register

Monday,
February 8, 2010

Part III

Securities and Exchange Commission

17 CFR Parts 211, 231 and 241
Commission Guidance Regarding Disclosure Related to Climate Change; Final Rule

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 211, 231 and 241

[Release Nos. 33–9106; 34–61469; FR–82]

Commission Guidance Regarding Disclosure Related to Climate Change

AGENCY: Securities and Exchange Commission.

ACTION: Interpretation.

SUMMARY: The Securities and Exchange Commission ("SEC" or "Commission") is publishing this interpretive release to provide guidance to public companies regarding the Commission's existing disclosure requirements as they apply to climate change matters.

DATES: *Effective Date:* February 8, 2010.

FOR FURTHER INFORMATION CONTACT: Questions about specific filings should be directed to staff members responsible for reviewing the documents the registrant files with the Commission. For general questions about this release, contact James R. Budge at (202) 551–3115 or Michael E. McTiernan, Office of Chief Counsel at (202) 551–3500, in the Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

I. Background and Purpose of Interpretive Guidance

A. Introduction

Climate change has become a topic of intense public discussion in recent years. Scientists, government leaders, legislators, regulators, businesses, including insurance companies, investors, analysts and the public at large have expressed heightened interest in climate change. International accords, federal regulations, and state and local laws and regulations in the U.S. address concerns about the effects of greenhouse gas emissions on our environment,[1] and international efforts to address the concerns on a global basis continue.[2] The Environmental Protection Agency is taking action to address climate change concerns,[3] and Congress is considering climate change legislation.[4] Some business leaders are increasingly recognizing the current and potential effects on their companies' performance and operations, both positive and negative, that are associated with climate change and with efforts to reduce greenhouse gas emissions.[5] Many companies are providing information to their peers and to the public about their carbon footprints and their efforts to reduce them.[6]

This release outlines our views with respect to our existing disclosure requirements as they apply to climate change matters. This guidance is intended to assist companies in satisfying their disclosure obligations under the federal securities laws and regulations.

B. Background

1. Recent Regulatory, Legislative and Other Developments

In the last several years, a number of state and local governments have enacted legislation and regulations that result in greater regulation of greenhouse gas emissions.[7] Climate change related legislation is currently pending in Congress. The House of Representatives has approved one version of a bill,[8] and a similar bill was introduced in the Senate in the fall of 2009.[9] This legislation, if enacted, would limit and reduce greenhouse gas emissions through a "cap and trade" system of allowances and credits, among other provisions.

The Environmental Protection Agency has been taking steps to regulate greenhouse gas emissions. On January 1, 2010, the EPA began, for the first time, to require large emitters of greenhouse gases to collect and report data with respect to their greenhouse gas emissions.[10] This reporting requirement is expected to cover 85% of the nation's greenhouse gas emissions generated by roughly 10,000 facilities.[11] In December 2009, the EPA issued an "endangerment and cause or contribute finding" for greenhouse gases under the Clean Air Act, which will allow the EPA to craft rules that directly regulate greenhouse gas emissions.[12]

Some members of the international community also have taken actions to address climate change issues on a global basis, and those actions can have a material impact on companies that report with the Commission. One such effort in the 1990s resulted in the Kyoto Protocol. Although the United States has never ratified the Kyoto Protocol, many registrants have operations outside of the United States that are subject to its standards.[13] Another important international regulatory system is the European Union Emissions Trading System (EU ETS), which was launched as an international

[1] For a listing of state and local government laws and regulations in this field, *see http://www.epa.gov/climatechange/wycd/stateandlocalgov/index.html.* Two significant international accords related to this topic are the Kyoto Protocol, which was adopted in Kyoto, Japan, on December 11, 1997 and became effective on February 16, 2005, and the European Union Emissions Trading System (EU ETS), which was launched as an international "cap and trade" system of allowances for emitting carbon dioxide and other greenhouse gases, built on the mechanisms set up under the Kyoto Protocol. *See http://unfccc.int/kyoto_protocol/items/2830.php* and *http://ec.europa.eu/environment/climat/pdf/brochures/ets_en.pdf* for a more detailed discussion of the Kyoto Protocol and EU ETS, respectively.

[2] For example, in December 2009, Copenhagen, Denmark hosted the United Nations Climate Change Conference.

[3] *See e.g.*, Current and Near-Term Greenhouse Gas Reduction Initiatives, available at *http://www.epa.gov/climatechange/policy/neartermghgreduction.html*, for a discussion of EPA initiatives as well as other federal initiatives.

[4] *See e.g.*, American Clean Energy and Security Act of 2009, H.R. 2454, 111th Cong., 1st Sess. (2009), passed by the House of Representatives on June 26, 2009, and Clean Energy Jobs and American Power Act of 2009, S. 1733, 111th Cong., 1st Session (2009), introduced in the Senate September 30, 2009.

[5] *See* Appendix F to the Petition for Interpretive Guidance on Climate Risk Disclosure submitted September 18, 2007, File No. 4–547, for a sampling of comments by business leaders relating to climate change regulation and disclosure, available at *http://www.sec.gov/rules/petitions/2007/petn4-547.pdf.*

[6] Companies are assessing and reporting on their greenhouse gas emissions and other climate change related matters using standards and guidelines promulgated by organizations with specific expertise in the field. Three such organizations are the Climate Registry, the Carbon Disclosure Project and the Global Reporting Initiative. We discuss this in more detail below.

[7] For example, in California, the Global Warming Solutions Act of 2006 and regulatory actions by the California Air Resources Board have resulted in restrictions on greenhouse gas emissions. In addition, state and regional programs, such as the Regional Greenhouse Gas Initiative (including ten Northeast and Mid-Atlantic states), the Western Climate Initiative (including seven Western states and four Canadian provinces) and the Midwestern Greenhouse Gas Reduction Accord (including six states and one Canadian province) have been developed to restrict greenhouse gas emissions. For a more detailed list of state action on climate change, *see* Pew Center on Global Climate Change, States News (available at *http://www.pewclimate.org/states-regions/news?page=1*).

[8] *See* American Clean Energy and Security Act of 2009.

[9] *See* Clean Energy Jobs and American Power Act of 2009.

[10] *See* Mandatory Reporting of Greenhouse Gases, Docket No. EPA–HQ–OAR–2008–0508, 74 FR 56260 (October 30, 2009).

[11] *See* EPA Press Release "EPA Finalizes the Nation's First Greenhouse Gas Reporting System/Monitoring to begin in 2010" dated September 22, 2009, available at *http://yosemite.epa.gov/opa/admpress.nsf/d0cf6618525a9efb85257359003fb69d/194e412153fcffea8525763900530d75!OpenDocument.*

[12] Endangerment and Cause or Contribute Findings for Greenhouse Gases Under Section 202(a) of the Clean Air Act, Docket ID No. EPA–HQ–OAR–2009–0171, 74 FR 66496 (December 15, 2009). The Clean Air Act is found in 42 U.S.C. ch. 85.

[13] One of the major features of the Kyoto Protocol is that it sets binding targets for industrialized countries for reducing greenhouse gas emissions. These amount to an average of five per cent against 1990 levels over the five-year period 2008–2012.

"cap and trade" system of allowances for emitting carbon dioxide and other greenhouse gases, based on mechanisms set up under the Kyoto Protocol.[14] In addition, the United States government is participating in ongoing discussions with other nations, including the recent United Nations Climate Conference in Copenhagen, which may lead to future international treaties focused on remedying environmental damage caused by greenhouse gas emissions. Those accords ultimately could have a material impact on registrants that file disclosure documents with the Commission.[15]

The insurance industry is already adjusting to these developments. A 2008 study listed climate change as the number one risk facing the insurance industry.[16] Reflecting this assessment, the National Association of Insurance Commissioners recently promulgated a uniform standard for mandatory disclosure by insurance companies to state regulators of financial risks due to climate change and actions taken to mitigate them.[17] We understand that insurance companies are developing new actuarial models and designing new products to reshape coverage for green buildings, renewable energy, carbon risk management and directors' and officers' liability, among other actions.[18]

2. Potential Impact of Climate Change Related Matters on Public Companies

For some companies, the regulatory, legislative and other developments noted above could have a significant effect on operating and financial decisions, including those involving capital expenditures to reduce emissions and, for companies subject to "cap and trade" laws, expenses related to purchasing allowances where reduction targets cannot be met. Companies that may not be directly affected by such developments could nonetheless be indirectly affected by changing prices for goods or services provided by companies that are directly affected and that seek to reflect some or all of their changes in costs of goods in the prices they charge. For example, if a supplier's costs increase, that could have a significant impact on its customers if those costs are passed through, resulting in higher prices for customers. New trading markets for emission credits related to "cap and trade" programs that might be established under pending legislation, if adopted, could present new opportunities for investment. These markets also could allow companies that have more allowances than they need, or that can earn offset credits through their businesses, to raise revenue through selling these instruments into those markets. Some companies might suffer financially if these or similar bills are enacted by the Congress while others could benefit by taking advantage of new business opportunities.

In addition to legislative, regulatory, business and market impacts related to climate change, there may be significant physical effects of climate change that have the potential to have a material effect on a registrant's business and operations. These effects can impact a registrant's personnel, physical assets, supply chain and distribution chain. They can include the impact of changes in weather patterns, such as increases in storm intensity, sea-level rise, melting of permafrost and temperature extremes on facilities or operations. Changes in the availability or quality of water, or other natural resources on which the registrant's business depends, or damage to facilities or decreased efficiency of equipment can have material effects on companies.[19] Physical changes associated with climate change can decrease consumer demand for products or services; for example, warmer temperatures could reduce demand for residential and commercial heating fuels, service and equipment.

For some registrants, financial risks associated with climate change may arise from physical risks to entities other than the registrant itself. For example, climate change-related physical changes and hazards to coastal property can pose credit risks for banks whose borrowers are located in at-risk areas. Companies also may be dependent on suppliers that are impacted by climate change, such as companies that purchase agricultural products from farms adversely affected by droughts or floods.

3. Current Sources of Climate Change Related Disclosures Regarding Public Companies

There have been increasing calls for climate-related disclosures by shareholders of public companies. This is reflected in the several petitions for interpretive advice submitted by large institutional investors and other investor groups.[20] The New York

[14] *See* n. 1, *supra*.

[15] The terms of the Kyoto Protocol are set to expire in 2012. Ongoing international discussions, including the United Nations Climate Change Conference held in Copenhagen, Denmark in mid-December 2009, are intended to further develop a framework to carry on international greenhouse gas emission reduction standards beyond 2012.

[16] *Strategic business risk 2008—Insurance*, a report prepared by Ernst & Young and Oxford Analytica. *See* Ernst & Young press release dated March 12, 2008, available at *http://www.ey.com/GL/en/Newsroom/News-releases/Media_Press-Release_Strategic-Risk-to-Insurance-Industry*.

[17] On March 17, 2009, the NAIC adopted a mandatory requirement that insurance companies disclose to regulators the financial risks they face from climate change, as well as actions the companies are taking to respond to those risks. All insurance companies with annual premiums of $500 million or more will be required to complete an Insurer Climate Risk Disclosure Survey every year, with an initial reporting deadline of May 1, 2010. The surveys must be submitted in the state where the insurance company is domesticated. *See Insurance Regulators Adopt Climate Change Risk Disclosure*, available at *www.naic.org/Releases/2009_docs/climate_change_risk_disclosure_adopted.htm*.

[18] *See* Klein, Christopher, *Climate Change, Part IV: (Re)insurance Industry response*, May 28, 2009, available at *www.gccapitalideas.com/2009/05/28/climate-change-part-iv-reinsurance-industry-response*.

[19] For one view of the anticipated business-related physical risks resulting from climate change, *see Industry Update: Global Warming & the Insurance Industry—Will Insurers Be Burned by the Climate Change Phenomenon?*, available at *http://www.aon.com/about-aon/intellectual-capital/attachments/risk-services/will_insurers_be_burned_by_the_climate_change_phenomenon.pdf*. Another example of how physical risks attributable to climate change are changing business and risk assessments is the Federal Emergency Management Agency's plan to update its risk mapping, assessment and planning to better reflect the effects of climate change, such as changing rainfall data, and hurricane patterns and intensities. *See* "Risk Mapping, Assessment, and Planning (Risk MAP): Fiscal Year 2009 Flood Mapping Production Plan," Version 1, May 2009, available at *http://www.fema.gov/library/viewRecord.do?id=3680*.

[20] *See* Petition for Interpretive Guidance on Climate Risk Disclosures, dated September 19, 2007, File No. 4-547, available at *http://www.sec.gov/rules/petitions/2007/petn4-547.pdf*; supplemental petition dated June 12, 2008, available at *http://www.sec.gov/rules/petitions/2008/petn4-547-supp.pdf*; second supplemental petition dated November 23, 2009, available at *http://www.sec.gov/rules/petitions/2009/petn4-547-supp.pdf*. For other petitions on point, *see also* Petition for Interpretive Guidance on Business Risk of Global Warming Regulation, submitted on behalf of the Free Enterprise Action Fund on October 22, 2007, File Number 4–549, available at *http://www.sec.gov/rules/petitions/2007/petn4-549.pdf*. One petition urges the Commission to issue guidance warning companies not to include information on climate change that may be false and misleading; *see* Petition for Interpretive Guidance on Public Statements Concerning Global Warming and Other Environmental Issues, submitted on behalf of the Free Enterprise Action Fund on July 21, 2008, File No. 4-563, available at *http://www.sec.gov/rules/petitions/2008/petn4-563.pdf*. While not a formal petition, Ceres has provided the Commission with the results of a study it commissioned in conjunction with the Environmental Defense Fund regarding climate risk disclosure in SEC filings and suggests that the Commission issue guidance on this topic. *See* Climate Risk Disclosure in SEC Filings: An Analysis of 10–K Reporting by Oil and Gas, Insurance, Coal, and Transportation and Electric Power Companies, June 2009, available at *http://www.ceres.org/Document.Doc?id=473*.

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Attorney General's Office recently has entered into settlement agreements with three energy companies under its investigation regarding their disclosures about their greenhouse gas emissions and potential liabilities to the companies resulting from climate change and related regulation. The companies agreed in the settlement agreements to enhance their disclosures relating to climate change and greenhouse gas emissions in their annual reports filed with the Commission.[21]

Although some information relating to greenhouse gas emissions and climate change is disclosed in SEC filings,[22] much more information is publicly available outside of public company disclosure documents filed with the SEC as a result of voluntary disclosure initiatives or other regulatory requirements. For example, in addition to the disclosure requirements mandated in several states [23] and the disclosure that the EPA began requiring at the start of 2010, The Climate Registry provides standards for and access to climate-related information. The Registry is a non-profit collaboration among North American states, provinces, territories and native sovereign nations that sets standards to calculate, verify and publicly report greenhouse gas emissions into a single public registry. The Registry supports both voluntary and state-mandated reporting programs and provides data regarding greenhouse gas emissions.[24]

The Carbon Disclosure Project collects and distributes climate change information, both quantitative (emissions amounts) and qualitative (risks and opportunities), on behalf of 475 institutional investors.[25] Over 2500 companies globally reported to the Carbon Disclosure Project in 2009; over 500 of those companies were U.S. companies. Sixty-eight percent of the companies that responded to the Carbon Disclosure Project's investor requests for information made their reports available to the public.[26]

The Global Reporting Initiative has developed a widely used sustainability reporting framework.[27] That framework is developed by GRI participants drawn from business, labor and professional institutions worldwide. The GRI framework sets out principles and indicators that organizations can use to measure and report their economic, environmental, and social performance, including issues involving climate change. Sustainability reports based on the GRI framework are used to benchmark performance with respect to laws, norms, codes, performance standards and voluntary initiatives, demonstrate organizational commitment to sustainable development, and compare organizational performance over time.

These and other reporting mechanisms can provide important information to investors outside of disclosure documents filed with the Commission. Although much of this reporting is provided voluntarily, 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.

II. Historical Background of SEC Environmental Disclosure

The Commission first addressed disclosure of material environmental issues in the early 1970s. The Commission issued an interpretive release stating that registrants should consider disclosing in their SEC filings the financial impact of compliance with environmental laws, based on the materiality of the information.[28] 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.[29] The Commission adopted these rules, which we discuss below, in final and current form in 1982, after a decade of evaluation and experience with the subject matter.[30]

Earlier, beginning in 1968, we began to develop and fine-tune our requirements for management to discuss and analyze their company's financial condition and results of operations in disclosure documents filed with the Commission.[31] During the 1970s and 1980s, materiality standards for disclosure under the federal securities laws also were more fully articulated.[32] Those standards provide that

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Housing, and Urban Development held a hearing on corporate disclosure of climate-related issues on October 31, 2007; representatives of signatories to the September 19, 2007 petition, among others, testified in that hearing. *See* "Climate Disclosure: Measuring Financial Risks and Opportunities," available at *http://banking.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=ed7a4968-1019-411d-9a22-c193c6b689ea*. Following the hearing, Senators Christopher Dodd and Jack Reed wrote to Chairman Christopher Cox urging the Commission to issue guidance regarding climate disclosure. *See http://dodd.senate.gov/multimedia/2007/120607_CoxLetter.pdf*.

[21] For information about the settlement agreements, *see* the New York Attorney General's Office press releases relating to: Xcel Energy, available at *http://www.oag.state.ny.us/media_center/2008/aug/aug27a_08.html*; Dynegy Inc., available at *http://www.oag.state.ny.us/media_center/2008/oct/oct23a_08.html*; and AES Corporation, available at *http://www.oag.state.ny.us/media_center/2009/nov/nov19a_09.html*.

[22] For example, in the electric utility industry, we have been informed by the Edison Electric Institute that 95% of the member companies it recently surveyed reported that they included at least some disclosure related to greenhouse gas emissions in their SEC filings, with 34% discussing quantities of greenhouse gases emitted and 23% discussing costs of climate-related compliance. Registrants include this type of disclosure in the risk factors, business description, legal proceedings, executive compensation, MD&A and financial statements sections of their annual reports. The Edison Electric Institute is an association of U.S. shareholder-owned electric companies. Their members serve 95 percent of the customers in the shareholder-owned segment of the industry, and represent approximately 70 percent of the U.S. electric power industry. The EEI also has more than 80 international electric companies as affiliate members, and nearly 200 industry suppliers and related organizations as associate members. The EEI described the results of its survey in a presentation to staff members of the Division of Corporation Finance.

[23] State requirements include CO_2 emissions disclosure requirements for electricity providers, greenhouse gas registries for reporting of entity emissions levels and emissions changes, and required reporting of greenhouse gas emissions. For a discussion of specific state requirements, *see http://epa.gov/climatechange/wycd/stateandlocalgov/state_reporting.html*.

[24] The Climate Registry's Web site is at www.theclimateregistry.org. Reports are publicly available through their Web site at no charge. *See http://www.theclimateregistry.org/resources/climate-registry-information-system-cris/public-reports/*.

[25] The Carbon Disclosure Project's Web site is at *http://www.cdproject.net*.

[26] These figures were provided to the Commission staff by representatives of the Carbon Disclosure Project.

[27] The GRI's Web site is at *http://www.globalreporting.org*.

[28] Release No. 33–5170 (July 19, 1971) [36 FR 13989].

[29] *See* Interpretive Release No. 33–6130 (September 27, 1979) [44 FR 56924] (the "1979 Release"), which includes a brief summary of the legal and administrative actions taken with regard to environmental disclosure during the 1970s. More information relating to the Commission's efforts in this area is chronicled in Release No. 33–6315 (May 4, 1981) [46 FR 25638].

[30] Release No. 33–6383 (March 3, 1982) [47 FR 11380].

[31] *See* Release No. 33–6835 (May 18, 1989) [54 FR 22427] (the "1989 Release") and Release No. 33–8350 (December 19, 2003) [68 FR 75055] (the "2003 Release") for detailed histories of Commission releases that outline the background of, and interpret, our MD&A rules.

[32] *See TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438 (1976) (adopting a standard for materiality in connection with proxy statement disclosures supported by the Commission, *see id.* at n. 10) and *Basic Inc.* v. *Levinson*, 485 U.S. 224 (1988).

information is material if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to vote or make an investment decision, or, put another way, if the information would alter the total mix of available information.[33] In the articulation of the materiality standards, it was recognized that doubts as to materiality of information would be commonplace, but that, particularly in view of the prophylactic purpose of the securities laws and the fact that disclosure is within management's control, "it is appropriate that these doubts be resolved in favor of those the statute is designed to protect."[34] With these developments, registrants had clearer guidance about what they should disclose in their filings.

More recently, the Commission reviewed its full disclosure program relating to environmental disclosures in SEC filings in connection with a Government Accountability Office review.[35] The Commission also has had the opportunity to consider the thoughtful suggestions that many organizations have provided us recently about how the Commission could direct registrants to enhance their disclosure about climate change related matters.[36]

III. Overview of Rules Requiring Disclosure of Climate Change Issues

When a registrant is required to file a disclosure document with the Commission, the requisite form will largely refer to the disclosure requirements of Regulation S–K[37] and Regulation S–X.[38] Securities Act Rule 408 and Exchange Act Rule 12b–20 require a registrant to disclose, in addition to the information expressly required by Commission regulation, "such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading."[39] In this section, we briefly describe the most pertinent non-financial statement disclosure rules that may require disclosure related to climate change; in the following section, we discuss their application to disclosure of certain specific climate change related matters.

A. Description of Business

Item 101 of Regulation S–K requires a registrant to describe its business and that of its subsidiaries. The Item lists a variety of topics that a registrant must address in its disclosure documents, including disclosure about its form of organization, principal products and services, major customers, and competitive conditions. The disclosure requirements cover the registrant and, in many cases, each reportable segment about which financial information is presented in the financial statements. If the information is material to individual segments of the business, a registrant must identify the affected segments.

Item 101 expressly requires disclosure regarding certain costs of complying with environmental laws.[40] In particular, Item 101(c)(1)(xii) states:

> Appropriate disclosure also shall be made as to the material effects that compliance with Federal, State and local provisions which have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, may have upon the capital expenditures, earnings and competitive position of the registrant and its subsidiaries. The registrant shall disclose any material estimated capital expenditures for environmental control facilities for the remainder of its current fiscal year and its succeeding fiscal year and for such further periods as the registrant may deem material.[41]

A registrant meeting the definition of "smaller reporting company" may satisfy its disclosure obligation by providing information called for by Item 101(h). Item 101(h)(4)(xi) requires disclosure of the "costs and effects of compliance with environmental laws (federal, state and local)."[42]

B. Legal Proceedings

Item 103 of Regulation S–K[43] requires a registrant to briefly describe any material pending legal proceeding to which it or any of its subsidiaries is a party. A registrant also must describe material pending legal actions in which its property is the subject of the litigation.[44] If a registrant is aware of similar actions contemplated by governmental authorities, Item 103 requires disclosure of those proceedings as well. A registrant need not disclose ordinary routine litigation incidental to its business or other types of proceedings when the amount in controversy is below thresholds designated in this Item.

Instruction 5 to Item 103 provides some specific requirements that apply to disclosure of certain environmental litigation.[45] Instruction 5 states:

> Notwithstanding the foregoing, an administrative or judicial proceeding (including, for purposes of A and B of this Instruction, proceedings which present in large degree the same issues) arising under any Federal, State or local provisions that have been enacted or adopted regulating the discharge of materials into the environment or primary for the purpose of protecting the environment shall not be deemed "ordinary routine litigation incidental to the business" and shall be described if:
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> (A) Such proceeding is material to the business or financial condition of the registrant;

[33] *Basic* at 231, quoting *TSC Industries* at 449.

[34] *TSC Industries* at 448.

[35] "Environmental Disclosure: SEC Should Explore Ways to Improve Tracking and Transparency of Information," United States Government Accountability Office Report to Congressional Requesters, GAO–04–808 (July 2004). Eleven years before, at the request of the Chairman of the House Committee on Energy and Commerce, the GAO had prepared a report relating to environmental liability disclosure involving property and casualty insurers and Superfund cleanup costs. *See* "Environmental Liability: Property and Casualty Insurer Disclosure of Environmental Liabilities," GAO/RCED–93–108 (June 1993), available at *http://74.125.93.132/search?q=cache:tWeHLDHoIcUJ:www.gao.gov/cgi-bin/getrpt%3FGAO/RCED-93-108+GAO/RCED-93-108&cd=1&hl=en&ct=clnk&gl=us.*

[36] *See* n. 20, *supra*.

[37] 17 CFR Part 229.

[38] 17 CFR Part 210.

[39] 17 CFR 230.408 and 17 CFR 240.12b–20.

[40] The Commission first addressed disclosure of material costs and other effects on business resulting from compliance with existing environmental law in its first environmental disclosure interpretive release in 1971. *See* Release 33–5170 (July 19, 1971) [36 FR 13989]. The Commission codified that interpretive position in the disclosure forms two years later. *See* Release 33–5386 (April 20, 1973) [38 FR 12100]. The Commission provided additional interpretive guidance in the 1979 Release. With some adjustments to reflect experience with the subject matter, the requirements were moved to Item 101 in 1982, and they have not changed since that time. *See* Release No. 33–6383 (March 3, 1982) [47 FR 11380].

[41] 17 CFR 229.101(c)(1)(xii).

[42] 17 CFR 229.101(h)(4)(xi).

[43] 17 CFR 229.103.

[44] *Id.*

[45] Instruction 5 in its current form was the product of the Commission's experience with environmental litigation disclosure. In 1973, we added provisions to the legal proceedings requirements of various disclosure forms singling out legal actions involving environmental matters. *See* Release No. 33–5386 (Apr. 20, 1973) [38 FR 12100]. The new rules required disclosure of any pending legal proceeding arising under environmental laws if a governmental entity was involved in the proceeding, and any other legal proceeding arising under environmental laws unless it was not material, or if in a civil suit for damages, unless it involved less than 10% of the current assets of the registrant on a consolidated basis. The Commission provided additional interpretive guidance regarding environmental litigation in the 1979 Release. When the Commission, in connection with its development of the integrated disclosure system, moved these rules out of various forms and into Item 103 of Regulation S–K, the Commission modified the requirements related to actions involving governmental authorities to allow registrants to omit disclosure of a proceeding if they reasonably believed the action would result in a monetary sanction of less than $100,000. *See* Release No. 33–6383 (Mar. 3, 1982) [47 FR 11380]. At the time, the Commission noted that the reason for the revision was to address the problem that disclosure documents were being filled with descriptions of minor infractions that distracted from the other material disclosures included in the document.

(B) Such proceeding involves primarily a claim for damages, or involves potential monetary sanctions, capital expenditures, deferred charges or charges to income and the amount involved, exclusive of interest and costs, exceeds 10 percent of the current assets of the registrant and its subsidiaries on a consolidated basis; or

(C) A governmental authority is a party to such proceeding and such proceeding involves potential monetary sanctions, unless the registrant reasonably believes that such proceeding will result in no monetary sanctions, or in monetary sanctions, exclusive of interest and costs, of less than $100,000; provided, however, that such proceedings which are similar in nature may be grouped and described generically.

C. Risk Factors

Item 503(c) of Regulation S–K [46] requires a registrant to provide where appropriate, under the heading "Risk Factors," a discussion of the most significant factors that make an investment in the registrant speculative or risky. Item 503(c) specifies that risk factor disclosure should clearly state the risk and specify how the particular risk affects the particular registrant; registrants should not present risks that could apply to any issuer or any offering.[47]

D. Management's Discussion and Analysis

Item 303 of Regulation S–K [48] requires disclosure known as the Management's Discussion and Analysis of Financial Condition and Results of Operations, or MD&A. The MD&A requirements are intended to satisfy three principal objectives:

- To provide a narrative explanation of a registrant's financial statements that enables investors to see the registrant through the eyes of management;
- To enhance the overall financial disclosure and provide the context within which financial information should be analyzed; and
- To provide information about the quality of, and potential variability of, a registrant's earnings and cash flow, so that investors can ascertain the likelihood that past performance is indicative of future performance.[49]

MD&A disclosure should provide material historical and prospective textual disclosure enabling investors to assess the financial condition and results of operations of the registrant, with particular emphasis on the registrant's prospects for the future.[50] Some of this information is itself non-financial in nature, but bears on registrants' financial condition and operating performance.

The Commission has issued several releases providing guidance on MD&A disclosure, including on the general requirements of the item and its application to specific disclosure matters.[51] Over the years, the flexible nature of this requirement has resulted in disclosures that keep pace with the evolving nature of business trends without the need to continuously amend the text of the rule. Nevertheless, we and our staff continue to have to remind registrants, through comments issued in the filing review process, public statements by staff and Commissioners and otherwise, that the disclosure provided in response to this requirement should be clear and communicate to shareholders management's view of the company's financial condition and prospects.[52]

Item 303 includes a broad range of disclosure items that address the registrant's liquidity, capital resources and results of operations. Some of these provisions, such as the requirement to provide tabular disclosure of contractual obligations,[53] clearly specify the disclosure required for compliance. But others instead identify principles and require management to apply the principles in the context of the registrant's particular circumstances. For example, registrants must identify and disclose known trends, events, demands, commitments and uncertainties that are reasonably likely [54] to have a material effect on financial condition or operating performance. This disclosure should highlight issues that are reasonably likely to cause reported financial information not to be necessarily indicative of future operating performance or of future financial condition.[55] Disclosure decisions concerning trends, demands, commitments, events, and uncertainties generally should involve the:

- Consideration of financial, operational and other information known to the registrant;
- Identification, based on this information, of known trends and uncertainties; and
- Assessment of whether these trends and uncertainties will have, or are reasonably likely to have, a material impact on the registrant's liquidity, capital resources or results of operations.[56]

The Commission has not quantified, in Item 303 or otherwise, a specific future time period that must be considered in assessing the impact of a known trend, event or uncertainty that is reasonably likely to occur. As with any other judgment required by Item 303, the necessary time period will depend on a registrant's particular circumstances and the particular trend, event or uncertainty under consideration. For example, a registrant considering its disclosure obligation with respect to its liquidity needs would have to consider the duration of its known capital requirements and the periods over which cash flows are managed in determining the time period of its disclosure regarding future capital sources.[57] In addition, the time horizon of a known trend, event or uncertainty may be relevant to a registrant's assessment of the materiality of the matter and whether or not the impact is reasonably likely. As with respect to other subjects of disclosure, materiality "with respect to contingent or speculative information or events * * * 'will depend at any given time upon a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity.' " [58]

The nature of certain MD&A disclosure requirements places particular importance on a registrant's materiality determinations. The Commission has recognized that the effectiveness of MD&A decreases with the accumulation of unnecessary detail or duplicative or uninformative disclosure that obscures material information.[59] Registrants drafting MD&A disclosure should focus on material information and eliminate immaterial information that does not promote understanding of registrants' financial condition, liquidity and capital resources, changes in financial condition and results of operations.[60] While these materiality determinations may limit what is actually disclosed,

[46] 17 CFR 229.503(c).

[47] *Id.*

[48] 17 CFR 229.303.

[49] 2003 Release.

[50] 1989 Release.

[51] *See, e.g.*, the 2003 Release; Release No. 33–8182 (Jan. 28, 2003) [68 FR 5982]; Release No. 33–8056 (Jan. 22, 2002) [67 FR 3746]; Release. No. 33–7558 (Jul. 29, 1998) [63 FR 41394]; and 1989 Release.

[52] *See, e.g.*, speech by Commissioner Cynthia A. Glassman to the Corporate Counsel Institute (Mar. 9, 2006) available at *www.sec.gov/news/speech/spch030906cag.htm*; and speech by Commissioner Elisse B. Walter to the Corporate Counsel Institute (Oct. 2, 2009) available at *www.sec.gov/news/speech/2009/spch100209ebw.htm*.

[53] 17 CFR 229.303(a)(5).

[54] "Reasonably likely" is a lower disclosure standard than "more likely than not." Release No. 33–8056 (Jan. 22, 2002) [67 FR 3746].

[55] 2003 Release.

[56] *Id.*

[57] *Id.* at n.43.

[58] *Basic* at 238, quoting *Texas Gulf Sulfur Co.,* 401 F. 2d 833 (2d Cir. 1968) at 849.

[59] 2003 Release.

[60] *Id.*

they should not limit the information that management considers in making its determinations. Improvements in technology and communications in the last two decades have significantly increased the amount of financial and non-financial information that management has and should evaluate, as well as the speed with which management receives and is able to use information. While this should not necessarily result in increased MD&A disclosure, it does provide more information that may need to be considered in drafting MD&A disclosure. In identifying, discussing and analyzing known material trends and uncertainties, registrants are expected to consider all relevant information even if that information is not required to be disclosed,[61] and, as with any other disclosure judgments, they should consider whether they have sufficient disclosure controls and procedures to process this information.[62]

Analyzing the materiality of known trends, events or uncertainties may be particularly challenging for registrants preparing MD&A disclosure. As the Commission explained in the 1989 Release, when a trend, demand, commitment, event or uncertainty is known, "management must make two assessments:

- Is the known trend, demand, commitment, event or uncertainty likely to come to fruition? If management determines that it is not reasonably likely to occur, no disclosure is required.
- If management cannot make that determination, it must evaluate objectively the consequences of the known trend, demand, commitment, event or uncertainty, on the assumption that it will come to fruition. Disclosure is then required unless management determines that a material effect on the registrant's financial condition or results of operations is not reasonably likely to occur."[63]

Identifying and assessing known material trends and uncertainties generally will require registrants to consider a substantial amount of financial and non-financial information available to them, including information that itself may not be required to be disclosed.[64]

Registrants should address, when material, the difficulties involved in assessing the effect of the amount and timing of uncertain events, and provide an indication of the time periods in which resolution of the uncertainties is anticipated.[65] In accordance with Item 303(a), registrants must also disclose any other information a registrant believes is necessary to an understanding of its financial condition, changes in financial condition and results of operations.

E. Foreign Private Issuers

The Securities Act and Exchange Act disclosure obligations of foreign private issuers are governed principally by Form 20–F's[66] disclosure requirements and not those under Regulation S–K. However, most of the disclosure requirements applicable to domestic issuers under Regulation S–K that are most likely to require disclosure related to climate change have parallels under Form 20–F, although some of the requirements are not as prescriptive as the provisions applicable to domestic issuers. For example, the following provisions of Form 20–F may require a foreign private issuer to provide disclosure concerning climate change matters that are material to its business:

- Item 3.D, which requires a foreign private issuer to disclose its material risks;
- Item 4.B.8, which requires a foreign private issuer to describe the material effects of government regulation on its business and to identify the particular regulatory body;
- Item 4.D, which requires a foreign private issuer to describe any environmental issues that may affect the company's utilization of its assets;
- Item 5, which requires management's explanation of factors that have affected the company's financial condition and results of operations for the historical periods covered by the financial statements, and management's assessment of factors and trends that are anticipated to have a material effect on the company's financial condition and results of operations in future periods; and
- Item 8.A.7, which requires a foreign private issuer to provide information on any legal or arbitration proceedings, including governmental proceedings, which may have, or have had in the recent past, significant effects on the company's financial position or profitability.

Forms F–1[67] and F–3,[68] Securities Act registration statement forms for foreign private issuers, also require a foreign private issuer to provide the information, including risk factor disclosure, required under Regulation S–K Item 503.

IV. Climate Change Related Disclosures

In the previous section we summarized a number of Commission rules and regulations that may be the source of a disclosure obligation for registrants under the federal securities laws. Depending on the facts and circumstances of a particular registrant, each of the items discussed above may require disclosure regarding the impact of climate change. The following topics are some of the ways climate change may trigger disclosure required by these rules and regulations.[69] These topics are examples of climate change related issues that a registrant may need to consider.

A. Impact of Legislation and Regulation

As discussed above, there have been significant developments in federal and state legislation and regulation regarding climate change. These developments may trigger disclosure obligations under Commission rules and regulations, such as pursuant to Items 101, 103, 503(c) and 303 of Regulation S–K. With respect to existing federal, state and local provisions which relate to greenhouse gas emissions, Item 101 requires disclosure of any material estimated capital expenditures for environmental control facilities for the remainder of a registrant's current fiscal year and its succeeding fiscal year and

[61] *Id.*

[62] Pursuant to Exchange Act Rules 13a–15 and 15d–15, a company's principal executive officer and principal financial officer must make certifications regarding the maintenance and effectiveness of disclosure controls and procedures. These rules define "disclosure controls and procedures" as those controls and procedures designed to ensure that information required to be disclosed by the company in the reports that it files or submits under the Exchange Act is (1) "recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms," and (2) "accumulated and communicated to the company's management * * * as appropriate to allow timely decisions regarding required disclosure." As we have stated before, a company's disclosure controls and procedures should not be limited to disclosure specifically required, but should also ensure timely collection and evaluation of "information potentially subject to [required] disclosure," "information that is relevant to an assessment of the need to disclose developments and risks that pertain to the [company's] businesses," and "information that must be evaluated in the context of the disclosure requirement of Exchange Act Rule 12b–20." Release No. 33–8124 (Aug. 28, 2002) [67 FR 57276].

[63] 1989 Release.

[64] 2003 Release.

[65] *Id.*

[66] 17 CFR 249.220f.

[67] 17 CFR 239.31.

[68] 17 CFR 239.33.

[69] In addition to the Regulation S–K items discussed in this section, registrants must also consider any financial statement implications of climate change issues in accordance with applicable accounting standards, including Financial Accounting Standards Board ("FASB") Accounting Standards Codification Topic 450, Contingencies, and FASB Accounting Standards Codification Topic 275, Risks and Uncertainties.

for such further periods as the registrant may deem material. Depending on a registrant's particular circumstances, Item 503(c) may require risk factor disclosure regarding existing or pending legislation or regulation that relates to climate change. Registrants should consider specific risks they face as a result of climate change legislation or regulation and avoid generic risk factor disclosure that could apply to any company. For example, registrants that are particularly sensitive to greenhouse gas legislation or regulation, such as registrants in the energy sector, may face significantly different risks from climate change legislation or regulation compared to registrants that currently are reliant on products that emit greenhouse gases, such as registrants in the transportation sector.

Item 303 requires registrants to assess whether any enacted climate change legislation or regulation is reasonably likely to have a material effect on the registrant's financial condition or results of operation.[70] In the case of a known uncertainty, such as pending legislation or regulation, the analysis of whether disclosure is required in MD&A consists of two steps. First, management must evaluate whether the pending legislation or regulation is reasonably likely to be enacted. Unless management determines that it is not reasonably likely to be enacted, it must proceed on the assumption that the legislation or regulation will be enacted. Second, management must determine whether the legislation or regulation, if enacted, is reasonably likely to have a material effect on the registrant, its financial condition or results of operations. Unless management determines that a material effect is not reasonably likely,[71] MD&A disclosure is required.[72] In addition to disclosing the potential effect of pending legislation or regulation, the registrant would also have to consider disclosure, if material, of the difficulties involved in assessing the timing and effect of the pending legislation or regulation.[73]

A registrant should not limit its evaluation of disclosure of a proposed law only to negative consequences. Changes in the law or in the business practices of some registrants in response to the law may provide new opportunities for registrants. For example, if a "cap and trade" type system is put in place, registrants may be able to profit from the sale of allowances if their emissions levels end up being below their emissions allotment. Likewise, those who are not covered by statutory emissions caps may be able to profit by selling offset credits they may qualify for under new legislation.

Examples of possible consequences of pending legislation and regulation related to climate change include:

- Costs to purchase, or profits from sales of, allowances or credits under a "cap and trade" system;
- Costs required to improve facilities and equipment to reduce emissions in order to comply with regulatory limits or to mitigate the financial consequences of a "cap and trade" regime; and
- Changes to profit or loss arising from increased or decreased demand for goods and services produced by the registrant arising directly from legislation or regulation, and indirectly from changes in costs of goods sold.

We reiterate that climate change regulation is a rapidly developing area. Registrants need to regularly assess their potential disclosure obligations given new developments.

B. International Accord

Registrants also should consider, and disclose when material, the impact on their business of treaties or international accords relating to climate change. We already have noted the Kyoto Protocol, the EU ETS and other international activities in connection with climate change remediation. The potential sources of disclosure obligations related to international accords are the same as those discussed above for U.S. climate change regulation. Registrants whose businesses are reasonably likely to be affected by such agreements should monitor the progress of any potential agreements and consider the possible impact in satisfying their disclosure obligations based on the MD&A and materiality principles previously outlined.

C. Indirect Consequences of Regulation or Business Trends

Legal, technological, political and scientific developments regarding climate change may create new opportunities or risks for registrants. These developments may create demand for new products or services, or decrease demand for existing products or services. For example, possible indirect consequences or opportunities may include:

- Decreased demand for goods that produce significant greenhouse gas emissions;
- Increased demand for goods that result in lower emissions than competing products;[74]
- Increased competition to develop innovative new products;
- Increased demand for generation and transmission of energy from alternative energy sources; and
- Decreased demand for services related to carbon based energy sources, such as drilling services or equipment maintenance services.

These business trends or risks may be required to be disclosed as risk factors or in MD&A. In some cases, these developments could have a significant enough impact on a registrant's business that disclosure may be required in its business description under Item 101. For example, a registrant that plans to reposition itself to take advantage of potential opportunities, such as through material acquisitions of plants or equipment, may be required by Item 101(a)(1) to disclose this shift in plan of operation. Registrants should consider their own particular facts and circumstances in evaluating the materiality of these opportunities and obligations.

Another example of a potential indirect risk from climate change that would need to be considered for risk factor disclosure is the impact on a registrant's reputation. Depending on the nature of a registrant's business and its sensitivity to public opinion, a registrant may have to consider whether the public's perception of any publicly available data relating to its greenhouse gas emissions could expose it to potential adverse consequences to its business operations or financial condition resulting from reputational damage.

D. Physical Impacts of Climate Change

Significant physical effects of climate change, such as effects on the severity of weather (for example, floods or hurricanes), sea levels, the arability of farmland, and water availability and

[70] *See* 1989 Release.

[71] Management should ensure that it has sufficient information regarding the registrant's greenhouse gas emissions and other operational matters to evaluate the likelihood of a material effect arising from the subject legislation or regulation. *See* n. 62, *supra.*

[72] In 2003 we issued additional guidance with respect to how registrants could improve MD&A disclosure, including ideas about how to focus on material issues and how to present information in a more effective manner to be of more value to investors. *See* 2003 Release.

[73] *See* 2003 Release for a discussion of how companies should address, where material, the difficulties involved in assessing the effect of the amount and timing of uncertain events.

[74] For example, recent legislation will ultimately phase out most traditional incandescent light bulbs. This has resulted in the acceleration of the development and marketing of compact fluorescent light bulbs. *See* Energy Independence and Security Act of 2007, Public Law 110–140, 121 Stat. 1492 (2007).

quality,[75] have the potential to affect a registrant's operations and results. For example, severe weather can cause catastrophic harm to physical plants and facilities and can disrupt manufacturing and distribution processes. A 2007 Government Accountability Office report states that 88% of all property losses paid by insurers between 1980 and 2005 were weather-related.[76] As noted in the GAO report, severe weather can have a devastating effect on the financial condition of affected businesses. The GAO report cites a number of sources to support the view that severe weather scenarios will increase as a result of climate change brought on by an overabundance of greenhouse gases.

Possible consequences of severe weather could include:

- For registrants with operations concentrated on coastlines, property damage and disruptions to operations, including manufacturing operations or the transport of manufactured products;
- Indirect financial and operational impacts from disruptions to the operations of major customers or suppliers from severe weather, such as hurricanes or floods;
- Increased insurance claims and liabilities for insurance and reinsurance companies ;[77]
- Decreased agricultural production capacity in areas affected by drought or other weather-related changes; and
- Increased insurance premiums and deductibles, or a decrease in the availability of coverage, for registrants with plants or operations in areas subject to severe weather.

Registrants whose businesses may be vulnerable to severe weather or climate related events should consider disclosing material risks of, or consequences from, such events in their publicly filed disclosure documents.

V. Conclusion

This interpretive release is intended to remind companies of their obligations under existing federal securities laws and regulations to consider climate change and its consequences as they prepare disclosure documents to be filed with us and provided to investors. We will monitor the impact of this interpretive release on company filings as part of our ongoing disclosure review program. In addition, the Commission's Investor Advisory Committee[78] is considering climate change disclosure issues as part of its overall mandate to provide advice and recommendations to the Commission, and the Commission is planning to hold a public roundtable on disclosure regarding climate change matters in the spring of 2010. We will consider our experience with the disclosure review program together with any advice or recommendations made to us by the Investor Advisory Committee and information gained through the planned roundtable as we determine whether further guidance or rulemaking relating to climate change disclosure is necessary or appropriate in the public interest or for the protection of investors.

VI. Codification Update

The "Codification of Financial Reporting Policies" announced in Financial Reporting Release No. 1 (April 15, 1982) [47 FR 21028] is updated by adding new Section 501.15, captioned "Climate change related disclosures," and under that caption including the text in Sections III and IV of this release.

The Codification is a separate publication of the Commission. It will not be published in the **Federal Register**/Code of Federal Regulations.

List of Subjects

17 CFR Part 211

Reporting and recordkeeping requirements, Securities.

17 CFR Parts 231 and 241

Securities.

Amendments to the Code of Federal Regulations

■ For the reasons set forth above, the Commission is amending Title 17, Chapter II of the Code of Federal Regulations as set forth below:

PART 211—INTERPRETATIONS RELATING TO FINANCIAL REPORTING MATTERS

■ 1. Part 211, Subpart A, is amended by adding Release No. FR–82 and the release date of February 2, 2010 to the list of interpretive releases.

PART 231—INTERPRETATIVE RELEASES RELATING TO THE SECURITIES ACT OF 1933 AND GENERAL RULES AND REGULATIONS THEREUNDER

■ 2. Part 231 is amended by adding Release No. 33–9106 and the release date of February 2, 2010 to the list of interpretive releases.

PART 241—INTERPRETATIVE RELEASES RELATING TO THE SECURITIES EXCHANGE ACT OF 1934 AND GENERAL RULES AND REGULATIONS THEREUNDER

■ 3. Part 241 is amended by adding Release No. 34–61469 and the release date of February 2, 2010 to the list of interpretive releases.

By the Commission.

Dated: February 2, 2010.

Elizabeth M. Murphy,

Secretary.

[FR Doc. 2010–2602 Filed 2–5–10; 8:45 am]

BILLING CODE 8011–01–P

[75] *See* "Climate Change: Financial Risks to Federal and Private Insurers in Coming Decades Are Potentially Significant: U.S. Government Accountability Office Report to the Committee on Homeland Security and Governmental Affairs, U.S. Senate," GAO–07–285 (March 2007).

[76] *Id.* at p.17.

[77] Many insurers already have plans in place to address the increased risks that may arise as a result of climate change, with many reducing their near-term catastrophic exposure in both reinsurance and primary insurance coverage along the Gulf Coast and the eastern seaboard. *Id.* at 32.

[78] The Investor Advisory Committee was formed on June 3, 2009 to advise the Commission on matters of concern to investors in the securities markets, provide the Commission with investors' perspectives on current, non-enforcement, regulatory issues and serve as a source of information and recommendations to the Commission regarding the Commission's regulatory programs from the point of view of investors. *See* Press Release No. 2009–126, "SEC Announces Creation of Investor Advisory Committee," available at *http://www.sec.gov/news/press/2009/2009-126.htm.*