MYLOGIQ

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Climate-Related Comment Letter Themes

December 2022

Environmental, Social and Governance: Climate-Related Comment Letter Themes

When making investment decisions, today's investors are placing greater emphasis on companies' environmental, social and governance (ESG) disclosures, including, but not limited to, climate-related matters, carbon footprint, green initiatives, human capital, executive compensation and cybersecurity. The Securities and Exchange Commission (SEC) is aware of this heightened interest in ESG matters and believes it is responsible for ensuring that investors have access to material information about companies' ESG risks and opportunities, strategies, initiatives, efforts, and financial impacts.

The SEC staff frequently issues comments related to social and governance issues. However, much of its focus is on the environmental category of ESG, specifically the sufficiency of disclosures in periodic filings (e.g., Annual Reports on Forms 10-K or Form 20-F, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K) regarding climate-related matters and compliance with existing disclosure requirements. Although companies should continue to challenge the adequacy of their social and governance disclosures, the following discussion specifically relates to SEC comment letter themes associated with environmental and climate-related matters.

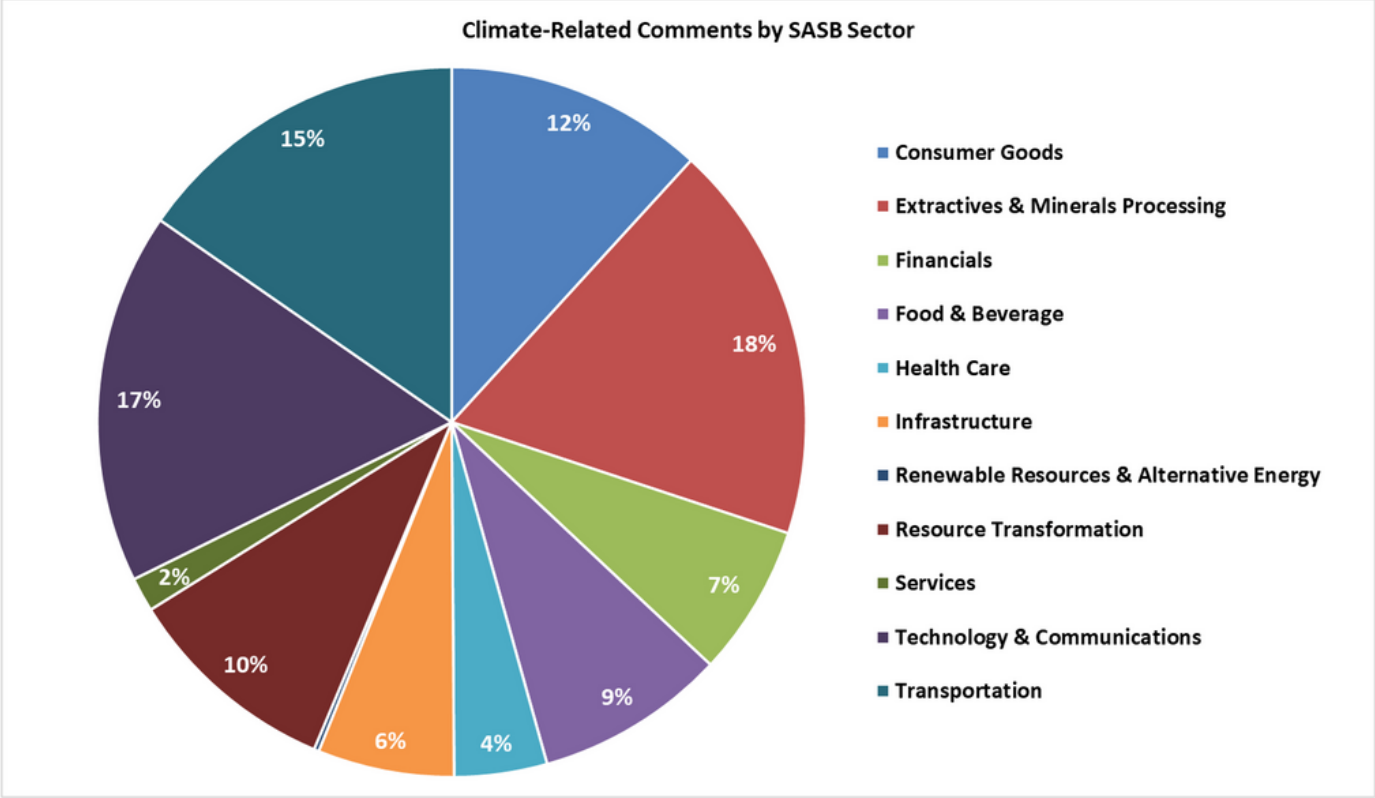
In March 2022, the SEC issued its proposed rule, ***The Enhancement and Standardization of Climate-Related Disclosures for Investors***, to require companies to provide consistent, comparable, and reliable disclosure about climate-related matters. Even though this rule has not been finalized, the SEC staff has increased its focus on ensuring that companies comply with existing disclosure requirements. Specifically, the SEC staff believes that "information related to climate change-related risks and opportunities may be required in disclosures related to a company's description of business, legal proceedings, risk factors, and management's discussion and analysis (MD&A) of financial condition and results of operations."

This view was first expressed in the SEC's 2010 Interpretive Release, ***Commission Guidance Regarding Disclosure Related to Climate Change*** (2010 Interpretive Release) and was re-emphasized in the SEC's 2021 ***Sample Letter to Companies Regarding Climate Change Disclosures*** (2021 Sample Letter).

MyLogIQ used its CompanyIQ® platform to accumulate environmental and climate-related comments issued by the SEC staff to companies, primarily pertaining to Annual Reports on Forms 10-K and 20-F, from July 2021 through November 2022 and partnered with **CFGI** to analyze the data and identify key findings and themes.

All Industries Are Affected

Climate-related matters and the requirement for transparent disclosure of material items can affect companies, both public and private, in all industries. The following chart illustrates the distribution of climate-related SEC staff comments across industries, based on companies' **Sustainability Accounting Standards Board (SASB) sector classification**.



Source: MyLogIQ CompanyIQ® Public Company Research Platform

Key Findings and Themes

The 2010 Interpretive Release described how certain rules under Regulation S-K could require disclosure related to climate change, and this guidance was re-emphasized in the 2021 Sample Letter. These disclosure rules include the following four items:

- Item 101 – Description of Business.
- Item 103 – Legal Proceedings.
- Item 105 – Risk Factors.[1]
- Item 303 – Management's Discussion and Analysis of Financial Condition and Results of Operations.

Our analysis identified 11 common themes of climate-related comments issued by the SEC staff in relation to the items listed above and provides insight into areas of staff scrutiny as well as potential areas of concern, which include:

1) **Consistency** between Corporate Social Responsibility (CSR) reports and disclosures provided in SEC filings.

Providing disclosure about:

2) **The Board of Directors and its oversight role (role of board).**
3) **Capital expenditures (capex)** related to initiatives.
4) Purchase or sale of **carbon credits or offsets.**
5) **Compliance costs.**
6) **Indirect consequences** of regulation or business trends.
7) **Material litigation** and risks.
8) Timing and effect of **pending legislation.**
9) **Physical effects** of climate change on **operations and cost of insurance.**
10) **Reputational risks.**
11) Material effects of **transition risks** (i.e., risks attributable to regulatory, technological, and market changes to address the mitigation of, or adaptation to, climate-related risks).

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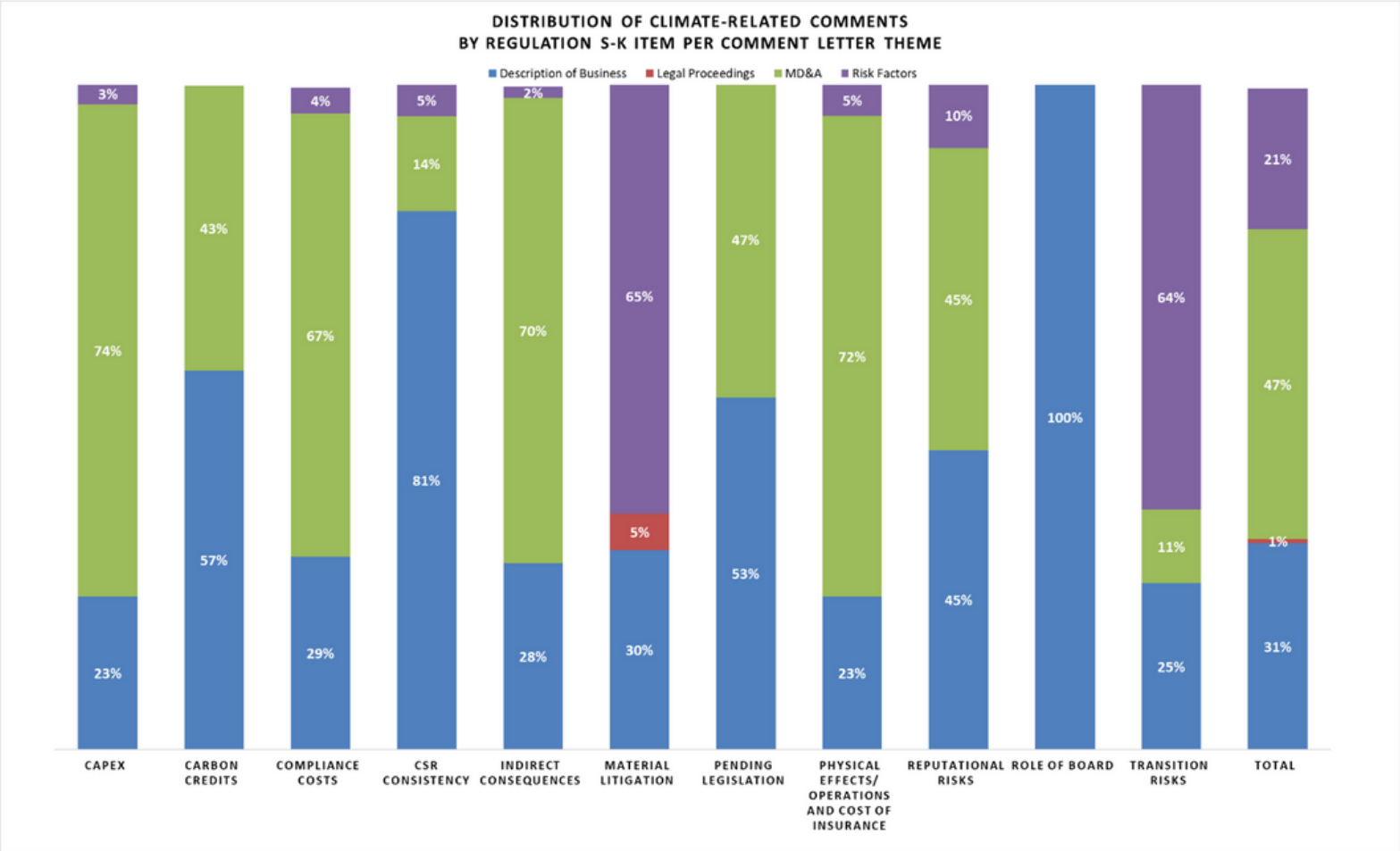
[1] Previously included in Item 503(c) when the 2010 Interpretive Release was issued. In August 2020, the SEC issued a final rule, ***Modernization of Regulation S-K Items 101, 103, and 105***, which relocated Risk Factors to Item 105.

The following chart illustrates, for each of the 11 comment letter themes, the distribution of comments received across the four Regulation S-K items discussed in the 2010 Interpretive Release:



Source: MyLogIQ CompanyIQ® Public Company Research Platform

Analysis and Discussion

The following analysis and discussion is organized by each Regulation S-K item addressed in the 2010 Interpretive Release and provides illustrative comments that reflect the broad themes noted above. As can be seen in the chart above, preparers should note that these themes may affect multiple items within SEC filings, so overlap could occur.

General

The SEC staff's 2021 Sample Letter emphasized the importance of ensuring consistency between disclosures provided in CSR reports and disclosures provided in SEC filings. In addition, informing investors about the Board of Directors' role in overseeing climate-related matters is another key area of SEC staff focus.

Examples of comments issued by the SEC staff related to companies' general disclosures include:

Consistency	*"We note that you provided more expansive disclosure in your CSR report than you provided in your SEC filings, including with respect to projects and agreements you have entered into to lower your greenhouse gas emissions and your assessments of climate- related risks. Please advise us what consideration you gave to providing the same type of climate-related disclosure in your SEC filings as you provided in your CSR report."*
Consistency	*"We note your statement in your CSR report that your commitment to environmental sustainability remains core to the way you operate, particularly with regard to climate, waste and water. We also note that you provided more expansive disclosure in your CSR report than you provided in your SEC filings. Please advise us what consideration you gave to providing the same type of climate-related disclosure in your SEC filings as you provided in your CSR report."*
The Board of Directors and Its Role	*"We note the statements made regarding energy, emissions, and air quality in your Sustainability Report March 2022 along with the sustainability policy you issued in March 2022. Please tell us how the disclosure in your proxy statement addresses the role of your Board of Directors in overseeing climate change-related risks. Your response should explain how the Board administers its oversight function with regard to climate change- related risks and the effect this has on its leadership structure. Refer to Item 407(h) of Regulation S-K."*

Item 101 – Description of Business

The 2010 Interpretive Release reminds companies of the requirements under Item 101 to disclose material effects of compliance with laws that have been enacted or adopted regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment. These material effects include impact on capital expenditures, earnings, and the competitive position of a company and its subsidiaries. For example, environmental laws and regulations issued at the state level, such as low carbon fuel standards, may require companies to apply a multi-level approach to evaluate their costs of compliance. Furthermore, a company is required to disclose how climate-related regulation may have affected its business trends and material estimated current and future capital expenditures related to environmental control facilities.

Pending Legislation	*"There have been significant developments in federal and state legislation and regulation and international accords regarding climate change. We note that you have not discussed the impact of pending or existing climate change-related legislation, regulations, and international accords in your SEC filings. Please revise your disclosure to identify material existing climate change-related legislation, regulations, and international accords and any material effect on your business, financial condition, and results of operations."*
Indirect Consequences	*"To the extent material, discuss the indirect consequences of climate-related regulation or business trends, such as the following:* • *decreased demand for goods or services that produce significant greenhouse gas emissions or are related to carbon-based energy sources;* • *increased demand for goods that result in lower emissions than competing products;* • *increased competition to develop innovative new products that result in lower emissions;* • *increased demand for generation and transmission of energy from alternative energy sources; and* • *any anticipated reputational risks resulting from operations or products that produce material greenhouse gas emissions."*
Physical Effects / Operations and Cost of Insurance	*"If material, discuss the significant physical effects of climate change on your operations and results. This disclosure may include the following:* • *severity of weather, such as floods, hurricanes, extreme fires, and water availability and quality;* • *quantification of material weather-related damages to your property or operations; and* • *any weather-related impacts on the cost or availability of insurance."*

Item 103 – Legal Proceedings

As discussed in the 2010 Interpretive Release, Item 103 requires a company to disclose any material pending legal proceedings in which it is a party, material legal actions where its property is the subject of litigation and, to the extent a company is aware, legal actions contemplated by governmental authorities. Disclosure of ordinary routine litigation incidental to the business and other types of proceedings below certain thresholds designated in Item 103 is not required.

Item 103 further specifies that proceedings arising under a federal, state, or local provision 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." Disclosure is required if such proceedings meet any of these criteria:

- Are material to the business or financial condition.
- Involve primarily a claim for damages, potential monetary sanctions, capital expenditures, deferred charges, or charges to income, and the amount involved, exclusive of interest and costs, exceeds 10% of consolidated current assets.
- Involve a governmental authority and monetary sanctions greater than the thresholds specified in the rule.

Therefore, there is a lower disclosure threshold for legal proceedings related to climate matters.

The following is an example of a comment issued by the SEC staff related to legal proceedings:

Material Litigation	*"Disclose any material litigation risks related to climate change and the potential impact to the company."*

Item 105 – Risk Factors

Companies are required to disclose the most significant factors that make an investment in a company speculative or risky. The 2021 Sample Letter clarifies that the SEC staff expects disclosure of the material effects of transition risks that may affect the business, financial condition, and results of operations and litigation risks, including the potential impact to the company, related to climate change.

Examples of comments issued by the SEC staff related to risk factors include:

Transition Risks	*"Disclose the material effects of transition risks related to climate change that may affect your business, financial condition, and results of operations, such as policy and regulatory changes that could impose operational and compliance burdens, market trends that may alter business opportunities, credit risks, or technological changes."*
Transition Risks	*"Your Sustainability Report identifies a number of transition risks related to climate change, including mandates on and regulation of existing products and services, supply chain sustainability, and changing customer behavior. Tell us how you evaluated disclosing in your Form 10-K the effects of these and other transition risks on your business, financial condition, and results of operations."*
Transition Risks	*"It appears that you have identified transitioning to a "low-carbon economy" as a transition risk related to climate change. Tell us how you considered providing expanded disclosure regarding your low-carbon transition plan and the potential effects on your business, financial condition, and results of operations. In addition, describe the material effects of other transition risks related to climate change you have considered, such as policy and regulatory changes that could impose operational and compliance burdens, market trends that may alter business opportunities, credit risks, or technological changes."*
Material Litigation	*"Your response to prior comment 1 states that you have not identified material litigation risks related to climate change. Please tell us whether you have identified any indirect litigation risks that could have a material impact. Please also tell us about your process for identifying direct and indirect litigation risks and assessing materiality."*
Material Litigation	*"We note that you are a party to various routine legal proceedings, disputes, and claims arising in the ordinary course of your business, including those that arise from environmental claims. Disclose any material litigation risks related to climate change and explain the potential impact to the company."*

Item 303 – Management's Discussion and Analysis of Financial Condition and Results of Operations

The SEC has issued several releases providing guidance on MD&A disclosure under Item 303. The MD&A rules require disclosure of known trends, events, demands, commitments, and uncertainties that are reasonably likely to have a material effect on a company's financial condition or operating performance. The 2010 Interpretive Release also (1) emphasizes that a company should address, if material, the challenges in assessing the amount and timing of uncertain events and indicate the time periods of anticipated resolution of the uncertainties and (2) reminds companies of the requirement to disclose any other information necessary to an understanding of their financial condition, changes in financial condition, and results of operations.

The 2021 Sample Letter emphasized the need for disclosures in MD&A regarding material climate-related matters, including:

- If there have been significant developments in federal and state legislation and regulation and international accords regarding climate change and any material impact on the business, financial condition, and results of operations.
- Identification and quantification of any material past and/or future capital expenditures for climate-related projects.
- The indirect consequences of climate-related regulation or business trends.
- The physical effects of climate change on operations and results.
- Increased compliance costs related to climate change.
- Purchase or sale of carbon credits or offsets and any material effects on your business, financial condition, and results of operations.

Examples of comments issued by the SEC staff related to MD&A include:

Physical Effects / Operations and Cost of Insurance	*"Please discuss the physical effects of climate change on your operations and results. This disclosure may include the following:* • *severity of weather, such as floods, hurricanes, sea levels, extreme fires, and water availability and quality;* • *weather-related impacts on the cost and availability of insurance;* • *quantification of any weather-related damages to your property or operations; and* • *the potential for indirect weather-related impacts that have affected or may affect your major customers.* *Include quantitative information with your response for each of the periods covered by your Form 10-K and explain whether increased amounts are expected in future periods."*

Reputational Risks	*"Your disclosure states that you have "seen a rise in certain stakeholders, such as investors, customers, employees, and lenders placing increasing importance on the impact and social cost of their investments." Please revise this disclosure to more clearly address the consequences of reputational risks resulting from your operations that produce greenhouse gas emissions."*
Carbon Credits or Offsets	*"We note you plan on meeting emissions targets through a combination of annual energy reductions and purchases of renewable energy or carbon free credits. If material, provide disclosure about your purchase or sale of carbon credits or offsets and any material effects on your business, financial condition, and results of operations. Provide us with quantitative information regarding your purchase or sale of carbon credits or offsets during the last three fiscal years and amounts budgeted for future periods."*
Capital Expenditures	*"It appears you have identified climate-related projects in your ESG Report, such as projects to save energy and reduce greenhouse gas emissions. Tell us how you considered providing disclosure regarding past and future capital expenditures for climate-related projects. Include quantitative information for the periods covered by your Form 10-K and for future periods as part of your response."*
Compliance Costs	*"Quantify any material increased compliance costs related to climate change."*
Compliance Costs	*"We note your environmental regulations disclosure, including your disclosure that compliance with each enumerated environmental regulation did not materially impact your operations, costs and/or results. Please revise your disclosure to quantify any material increased compliance costs related to climate change, including compliance costs associated with these regulations in the aggregate."*

Insights in Action

Although all disclosures should be tailored to a company's specific facts and circumstances and the above is not an all-inclusive list, financial reporting groups drafting disclosures can leverage this analysis to assess and challenge the completeness and adequacy of the company's current disclosures about climate-related matters. We understand navigating the ESG-reporting landscape can be complex. Companies should consider the key findings and themes identified when preparing their 2022 year-end financial reporting.

11

Themes

Are you prepared for climate disclosures?

About MyLogIQ

MyLogIQ (www.mylogiq.com) provides 360°public company intelligence through our CompanyIQ® Answer Desk research platform. We offer an unrivaled AI-powered solution for benchmarking public companies with real-time access to research and analytics sourced from SEC filings and company websites on one platform. Our data covers:

- ESG
- Cybersecurity
- SEC Disclosures and Comment Letters
- Risk Factors, Accounting Standards, and MD&A
- Audit Fees & SOX
- Company ESG/CSR Reports, Committee Charters, & Governance Policies
- Proxy Proposals & Shareholder Engagement
- Corporate Governance
- Board Composition, Profiles, and Diversity
- Board & Executive Compensation.

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About CFGI

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