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The SEC's climate plan is bringing the heat

Corporate America is hot and bothered by the regulator's call to report on 'Scope 3' emissions. But even if this rule change goes nowhere, there's a business case for Canadian companies to meet it, writes **Prasanthi Vasanthakumar**

AS A SHAREHOLDER, Anne Sheehan has spent a lot of time wishing for greater environmental risk information from organizations, as well as reductions to greenhouse gas (GHG) emissions – both for the betterment of company operations and the planet. The U.S. Securities and Exchange Commission's Investment Advisory Council, which Sheehan chaired for eight years, had urged the SEC to come up with a rule that would address climate change issues.

So, when the Wall Street regulator put forward its climate rule proposals last March, Sheehan was not surprised. What caught her off guard was its magnitude. "The breadth of that proposal was quite something," Sheehan, who serves on the board of Victoria's Secret & Co., said in an interview.

The rules, in a nutshell

The SEC's proposal aims to enhance and standardize climate-related disclosure for investors. Among other things, it calls for more information on a company's governance of climate-related risks and its greenhouse gas emissions, and any financial risks the organization faces from global warming.

One of the sticking points for many large companies in the United States is the requirement they report on emissions generated by their suppliers, employees and customers. Unlike a company's direct GHG emissions (Scope 1) and indirect emissions from purchased electricity or energy sources (Scope 2), emissions from third parties (Scope 3) are out of an organization's direct control.

Facing corporate objections to the Scope 3 proposal, the commission may water down its final rule, expected in April. But even if that happens, it may be too late to turn back the clock.

According to Steven Rothstein's analysis of the comments received on the SEC's climate proposal, 97 per cent of investors support the requirement to disclose Scope 3 emissions. The managing director of the Ceres Accelerator for Sustainable Capital Markets, a U.S. not-for-profit that promotes market-based and policy solutions to environmental and social problems, notes that agencies like the International Sustainability Standards Board (ISSB) will also require Scope 3 disclosures.

“The market is clearly moving in this direction,” Rothstein says. “Literally, investors representing over \$60-trillion of assets under management say they want better climate information. They want to move their portfolio to be net-zero and they can only do that if Scope 3 is included.”

The Canadian context

The SEC’s draft proposal exempts cross-listed issuers from Scope 3 disclosures, but that doesn’t mean Canadian companies are off the hook. Canadian boards should be paying attention for two reasons, says Sarah Keyes, CEO of ESG Global Advisors and the national academic director for the Institute of Corporate Directors’ short course, Board Oversight of Climate Change.

First, investors will likely choose the higher bar of disclosure and ask Canadian companies to report on Scope 3 emissions to make comparisons with U.S. firms easier. Second, any Canadian organization with a large, publicly traded U.S. customer will be asked to disclose its emissions so that the U.S. company can fulfill its obligations to the SEC.

A recent report by the Canadian Climate Institute finds only one-third of TSX 60 companies disclosed their most material Scope 3 categories in their latest reporting year. According to the report, the lacklustre momentum for emissions disclosure requirements in Canada jeopardizes the ability of domestic companies to compete in the low-carbon transition.

Data paralysis

Nonetheless, reporting on Scope 3 emissions can be daunting for many organizations. Because it’s new territory, there is a lack of resources, knowledge and standardized methodology. Moreover, the data can be difficult to obtain and verify as it lies beyond a company’s walls.

But Laura Zizzo worries some organizations are missing the big picture by dwelling on the numbers.

“We need to be talking about the trends,” says Zizzo, CEO of Manifest Climate, a climate-risk software company. “The big-picture directors’ responsibility is keeping your eye on the trends. The uncertainty around data is a red herring [that distracts from] doing the hard work to understand how your company interacts with emissions in the economy.”

When Zizzo recently advised the board of a large financial institution to make “educated estimates” about emissions, one board member balked, citing “the auditors.” Zizzo says she understands this fear, as financial disclosures bring greater scrutiny. However, she observes many financial disclosures were made using assumptions of interest rates that didn’t pan out, and no one was sued.

“For some reason, with climate, people are scared to do this,” Zizzo says. “We’re saying, ‘Make some educated estimates and be clear that you may be wrong. And that’s okay.’ Because while we discuss data accuracy, emissions continue to rise.”

A place to begin

Companies can take steps to prepare for this brave new world of emissions disclosure. According to Keyes, organizations should first conduct a climate change materiality assessment to determine their most

financially material climate change risks and opportunities. Second, a baseline of emissions must be taken if not already completed.

Gauging this baseline is far less resource-intensive than most people realize, especially since the Greenhouse Gas Protocol, a globally accepted accounting standard, can be used to calculate it. The hard part is reducing your emissions – which Keyes likens to losing weight.

“If you’re going on a weight-loss program, you won’t know how much weight you need to lose until you step on the scale,” Keyes says. “Yes, it’s a bit painful the first time you do something, but it’s not as complex. The hard part is the diet and exercise to get that number down, right? It’s the same thing with emissions. The hard part isn’t taking the baseline. Year over year, it’s about pressure from your customers and investors to reduce it. That’s what gets complicated.”

‘Crawl, walk, run’

For many boards, this means coming to grips with a new reality. “The first thing you’ve got to recognize, if you haven’t already, is that mandatory disclosure of greenhouse gas emissions for public companies is happening,” says Mary Anne Bueschgens, a corporate director at Algoma Steel Inc. “It isn’t something you can put on the back burner while you’re doing everything else. It has to be done right now.”

Given investor and stakeholder expectations, companies must, at minimum, report on Scope 1 and 2 emissions, while putting together a roadmap for Scope 3, Bueschgens says. She urges boards and management to take a “crawl, walk, run” approach to quantifying and reporting on Scope 3 – one that means understanding what Scope 3 emissions are (and aren’t), how the company compares to its peers, and where the information gaps are.

Jessica McDonald, a corporate director at Coeur Mining Inc. and GFL Environmental Inc., agrees that boards need to do their homework. It’s important for directors to educate themselves on this new landscape so everyone can draw from a common knowledge base to discuss issues and make judgment calls, McDonald says. It means getting comfortable with your company’s

sustainability report and its GHG reduction targets, or conversely, if they don't exist, understanding why. It also means coming to grips with whether your company is simply following a check-the-box exercise that can leave it vulnerable to missing commitments or accusations of greenwashing, or if its approach is genuine, with thoughtful targets and measurable results.

McDonald also urges boards to figure out how to assign oversight in this area. Will it belong to the audit committee? Should it be part of the risk committee? Or does it need a special-purpose committee?

"This isn't going to be a one-and-done thing," McDonald says. "It's an evolving area and it's not the kind of topic that fits into regular board agendas."

New opportunities

Despite the challenges of Scope 3, McDonald sees it as a "logical extension" of reporting on Scope 1 and 2 emissions. Many companies would be hamstrung in meeting any proposed emission reduction targets – in addition to showing climate competitiveness – without factoring in emissions from their supply chain.

Scope 3 reporting is also an excellent opportunity to engage with a company's supply chain on the climate transition, net-zero commitments and clean economic growth, Bueschkens says. "Let's hug our upstream and downstream partners more closely and try to work together to get this level of disclosure," she says. "This can only strengthen these relationships."

It's anyone's guess what the SEC's final climate rule will be.

But even if Scope 3 emissions reporting is scrapped, Keyes believes reporting and reducing them will present a competitive advantage. "If you are doing this authentically and saying, 'The train is out of the station, we have to measure our emissions and then reduce them,' and if you do that well and with transparency, that can offer opportunities for new pools of capital and better relationships with customers," Keyes says.

And at the end of the day, it's critical not to miss the forest for the trees. "Scope 3 is important, but it's just part of a big transition," Zizzo says. "The more important best practices have to do with governance and the processes in place to ensure that someone is paying attention and has enough oversight and power in the organization to create change. All these articles get written about Scope 3 emissions when the crux of the [SEC disclosure rules] is how you're planning from a strategic perspective for the climate transformation." **DJ**

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