Electricity Matters

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Digitizing Climate Reporting Compliance

The Security and Exchange Commission (SEC) has issued long-awaited rules for public comment that would require registrants to include certain climate-related disclosures in their registration statements and periodic reports to the SEC. The requirement would be for all companies under the federal securities law offering or selling securities unless otherwise exempted by the SEC. Consistent with the Securities Act of 1933 ("Act") the rule fits within the two basic objectives of the Act: (1) to require that investors receive financial and other significant information concerning securities being offered for public sale, and (2) to prohibit deceit, misrepresentations, and other fraud in the sale of securities. Given the growing appetite from elected officials for future climate-related regulation and costs associated with decarbonization, and mitigation and disaster recovery from severe weather events, the proposed rules are timely.

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Climate-related disclosures are intended to provide prospective investors with data on climate-related risks, including greenhouse gas (GHG) emissions, which have become a commonly used metric for assessing exposure to climate-related risks.

SEC proposes to fulfill these objectives by requiring companies to disclose key financial information enabling investors to make informed decisions considering climate-related risks and exposure prior to investing in a company's securities. This requirement covers all securities offered in the United States since all companies offering securities must be registered with the SEC or be exempt from registration requirements. Common exemptions from SEC registration include: (1) private offerings to a limited number of persons or institutions, (2) offerings of limited size, and (3) intrastate offerings, and municipal, state, and federal government securities.

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have become a commonly used metric for assessing exposure to climate-related risks. As countries around the globe take actions to decarbonize their economies, timely reporting of such information is becoming more critical to investment decisions. Government at all levels, companies, and investors—including many private equity firms—support such disclosure. The SEC press release announcing the proposed rules makes clear that "investors representing literally tens of trillions of dollars support climate-related disclosures because they recognize that climate risks can pose significant financial risks to companies, and investors need reliable information about climate risks to make informed investment decisions."[1]

The proposal would help issuers disclose climate-related risks in a more formal and standardized format, enabling comparisons among security offerings thereby meeting investor demands. SEC sees its role as making available consistent and comparable information that could potentially affect a company's financial performance. The proposed rule would require registrants to "disclose information about: (1) the registrant's governance of climate-related risks and relevant risk management processes; (2) how any climate-related risks identified by the registrant have had or are likely to have a material impact on its business and consolidated financial statements, which may manifest over the short-, medium-, or long-term; (3) how any identified climate-related risks have affected or are likely to affect the registrant's strategy, business model, and outlook; and (4) the impact of climate-related events (severe weather events and other natural conditions) and transition activities on the line items of a registrant's consolidated financial statements, as well as on the financial estimates and assumptions used in the financial statements."[2]

Taking stock of their own GHG emissions, SEC registrants have begun developing an inventory of GHG emissions and have started conducting scenario analysis and developing transition plans for meeting GHG reduction and climate-related targets.

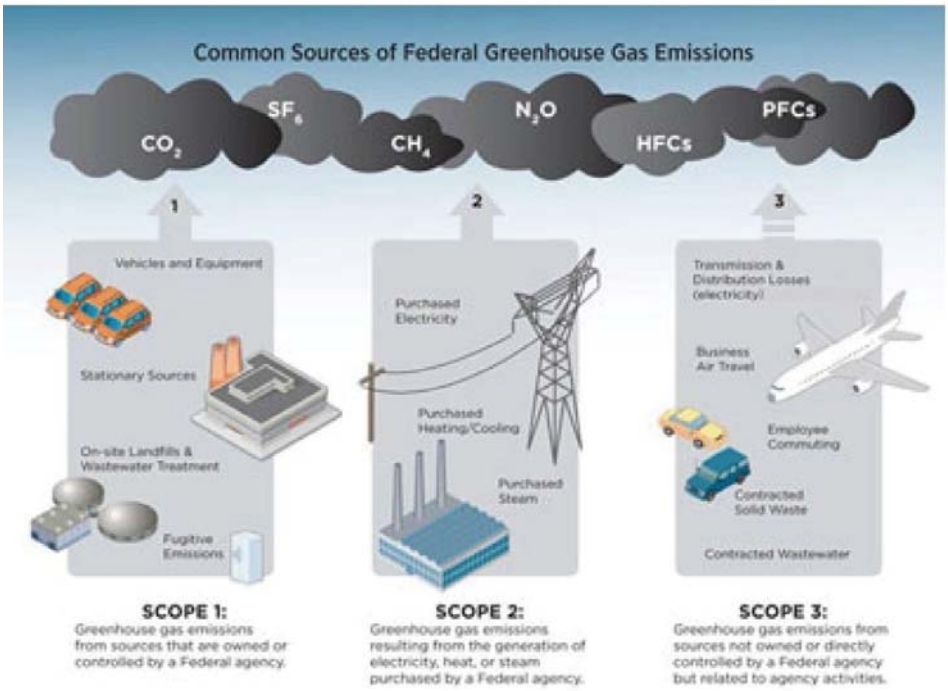
Companies have been anticipating that SEC would require disclosure for several years now, and many have been preparing for the eventuality. The United States Environmental Protection Agency ("EPA" or "Agency") for example, has defined a method and process for tracking its GHG emissions. The three scope areas defined by EPA are guiding how EPA defines and estimates its own emission profile and helps guide the actions taken to reduce emissions in each scope category. Companies, for a variety of reasons, have been taking inventory of their own GHG emissions and taking actions to reduce emissions voluntarily in a similar manner to EPA. The "Final Greenhouse Gas Mandatory Reporting Rule" adopted by EPA in 2009 requires GHG emissions reporting from sources that emit 25,000 metric tons or more of carbon dioxide equivalent per year in the United States. Following EPA's lead, many companies are defining their GHG emission using the EPA's terminology as illustrated in **Figure 1**.

EPA defines Scope 1 GHG emissions as the direct emissions from sources that are owned or controlled by EPA, including from on-site fossil fuel combustion and vehicle fleet fuel use. Scope 2 emissions are indirect emissions

[1] U.S. Securities and Exchange Commission. (2022, March 21). *SEC proposes rules to enhance and standardize climate-related disclosures for investors.* SEC.gov. https://bit.ly/3rqFMmN

[2] Ibid.

Figure 1. US EPA GHG Emissions Reporting



Source: United States Environmental Protection Agency. (2021). *Greenhouse gases at EPA.* https://bit.ly/3OcsIeb

from sources that are owned or controlled by the Agency, including emissions resulting from the generation of electricity and heat or steam purchased by the Agency from an energy service provider. Scope 3 emissions are from sources not owned or directly controlled by EPA but are related to the Agency and its staff's work-related activities, including emissions from employee commuting and travel, emissions associated with contracted solid waste disposal and wastewater treatment, and emissions resulting from transportation and distribution losses associated with electricity use.[3]

EPA reports progress in reducing emissions in each scope area compared against 2008 levels. In fiscal year (FY) 2020, EPA reported a reduction in Scopes 1 and 2 GHG emissions of 51.7 percent compared to FY 2008. These reductions are attributable to improvements in the energy efficiency of its facilities, and its purchase and use of renewable energy resources. EPA has reduced total fleet fuel use and increased its percentage of alternative fuel in vehicle use compared to petroleum. Over the same period, EPA reported a 57.4 percent reduction in Scope 3 emissions compared to FY 2008. EPA has reduced its Scope 3 GHG emissions through a reduction in employee travel, and more frequent and widespread use of video-teleconferencing and reduced employee commuting.

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[3] United States Environmental Protection Agency. *Greenhouse gases at EPA.* Epa.gov. https://bit.ly/3OcsIeb

and other clean energy and climate-related targets. "Scope 1 and 2 emissions reporting is well-developed and already disclosed by many companies. Investors increasingly request corporate disclosures on Scope 3 emissions but collecting information on suppliers' GHG emissions remains a work in progress. Nonetheless, Scope 3 emissions are an increasingly important data point for investors, and companies are developing processes to formalize collection of this information."[4]

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In anticipation of climate-related reporting requirements and the need for uniformity and consistency for comparison purposes, several digital GHG emission tracking and reporting platforms are hitting the market. Some of these platforms also provide the framework and rigor for forecasting and planning and scenario analysis. With a digital record of emissions for Scopes 1 through 3, and the ability to forecast and plan, companies can develop mitigation roadmaps and strategies and blueprints to operationalize plans to directly address climate-related risks. Tracking performance from year to year would also provide investors with some certainty that actions are being taken to reduce climate-related risks. And if not, investors would know and be able to make more informed investment decisions than they might have otherwise.

DIGITIZING CLIMATE REPORTING

SEC's proposed rules would require a registrant to disclose information about its Scope 1 direct GHG emissions, Scope 2 indirect emissions from purchased energy, and Scope 3 GHG emissions from its upstream and downstream activities if material or if the registrant has set a GHG emissions target or goal that includes Scope 3 emissions. The proposed disclosures are similar to the broadly accepted Task Force on Climate-Related Financial Disclosures and the Greenhouse Gas Protocol frameworks.[5]

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The ESG (environmental, social and governance) movement is gaining traction as governments and companies across the globe recognize the need to demonstrate greater responsibility in protecting the environment for future generations through their actions in the area of sustainability. Governance in this context speaks to how a company is managed and how well it provides for the interests of the company's stakeholders, including employees, suppliers, shareholders and customers. Climate-related risk and sustainability

[4] Hunter, L. (2021, July 8). *The opportunity for SEC regulation of climate disclosures. Harvard.edu*. https://bit.ly/3JFSQe7

[5] Clarkson, B. D., Kirwan, M. B., Pearson, E. G., Slack, S. A., Tomasi, P. A., Vedvig, H. N., & Winer, S. J. (2022, March 24). *Securities and Exchange Commission or Securities and Environment Commission? The SEC proposes new rules for climate-related disclosures.* Foley & Larper LLP. https://bit.ly/3vgG4O5

reporting is often an effort in data collection across various departments housed in spreadsheets with little data governance or quality control. As sophistication grows and reporting needs increase to comply with regulations, standardization and conformity must follow.

The value of having a digital product or platform for collecting and storing climate-related data, including GHG emissions, integrated across business units and processes, performing analytics, forecasting the impact of actions on sustainability planning, and improving sustainability management and reporting cannot be overestimated. In this context, climate-risk reporting and planning can be easily incorporated into the broader category of sustainability.

Forrester Research recently assessed 14 leading sustainability management platforms across 10 criteria to inform companies of the availability of digital platforms for use in meeting their sustainability management and reporting needs. This would certainly apply and be of value for companies covered by the SEC regulations.

Companies needing to collect, measure and report on sustainability data and simplify the performance of their sustainability programs are turning to digital sustainability management solutions.

As more companies commit to climate action plans, and realize the risks and opportunities of sustainability, they are looking for technical and strategic support from vendors to reduce their environmental impact and provide transparency for increasingly interested and demanding stakeholders. Companies needing to collect, measure and report on sustainability data and simplify the performance of their sustainability programs are turning to digital sustainability management solutions.

Forrester reviewed platforms from 14 vendors, although several others are being market-tested and are not included among the 14. Forrester assessed the following platforms: CEMAsys, Diligent, FigBytes, IBM, OneTrust, Persefoni, Salesforce, SINAI Technologies, Sphera, Sweep, UL, Watershed, Wolters Kluwer Enablon and Worldfavor. According to the research, each is credited with being a purpose-built sustainability management product or service.[6]

While this column is not intending to report on the findings of Forrester's research, it is intending to amplify and spread knowledge of platforms—specifically, that platforms can assist companies in managing their GHG emissions and risk mitigation strategies easily and quickly to facilitate reporting. Companies can conduct their own research to assess the platforms' relevance and applicability to their cause. Ten criteria were used to assess and compare the platforms deemed most relevant to Forrester's client base. The vendors evaluated were mentioned often in Forrester client inquiries, vendor selection requests for proposals, shortlists, consulting projects, and case studies. The vendors were also mentioned by other vendors during Forrester briefings as being viable and formidable. The assessment criteria included were:

1. Materiality – assessing how the solution helps companies decide what is material to disclose and where to focus their risk-mitigation strategies, and how does it help define priority areas of focus

[6] Murphy, R., Schiano, S., DeMartine, A., Provost, C., & Dostie, P. (2022, February 24). *The Forrester New Wave™: Sustainability management software, Q1 2022 – The 14 providers that matter most and how they stack up.* Forrester Research. https://bit.ly/3uEBzh7

2. Carbon calculation – considering how the platform solution supports carbon calculations and GHG accounting, how it supports third-party collaboration and cooperation, and how it supports audit and assurance capabilities

3. Data management – assessing how well the solution collects and manages climate and sustainability data, how well the data is integrated across systems, and the number of emission factors covered

4. Performance monitoring – assessing how well the solution accommodates and supports benchmarking, advanced data analysis, performance reporting and auditing compliance, and how well it incorporates climate-risk and opportunity analysis

5. Reporting – considering how the solution accommodates non-financial reporting and risk disclosure, and the standard of its built-in support, and standard and customized reporting capabilities

6. Climate action strategy – considering how well the solution supports low-carbon strategy development, target setting, progress tracking, and how well it facilitates scenario analysis, forecasting, and carbon offset procurement, and how well it might provide insights for decision-making

7. Intelligence dashboards – assessing the sustainability intelligence and insights the solution provides; the level of visualization detail, benchmarking, and competitive analysis support; and how well it leverages machine learning

8. Product vision – considering how compelling, credible and aligned to customer needs the vendor's vision is and how well the company can both identify and respond to competitive threats and whether the vision supports top-line business outcomes

9. Execution roadmap – assessing confidence in the vendor's roadmap, execution plan and customer alignment

10. Market approach – assessing how the company defines its go-to-market approach, the depth and breadth of its network of partners, and how it demonstrates market success and flexibility to expand[7]

VALUE OF DIGITAL PLATFORMS

Digital platforms and standardized reporting can help companies commit to climate action plans, forecast, manage risks, and demonstrate compliance to plans for reporting purposes. A deliberate and robust framework for sustainability management eases the administrative burden, provides greater transparency across the organization and simplifies regulatory compliance. The planning and forecasting aspects provide the flexibility to define alternative investment strategies and action plans with some predicative capability for meeting sustainability goals, well beyond GHG emission compliance and reporting.

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Take, for example, the challenge of assessing the GHG impact of company operations and planning around each scope area to reduce emissions. While a challenge today, over time, companies will be able to refine their GHG emission profile for various business and operational functions. It is reasonable to assume that a company can readily define its Scope 1 GHG emissions from sources that are owned or controlled by the company, including on-site fossil fuel combustion and vehicle fleet fuel use. Indirect Scope 2 emissions from sources that are

[7] Ibid.

owned or controlled by a company, including emissions resulting from the generation of electricity, heat or steam or purchases of energy from an energy service provider, can be estimated from emission factors for petroleum use, natural gas use, and generated or purchases of electricity since they are more widely available.

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The form of energy generation used to supply electricity by time of day purchased through a wholesale market or through a purchase agreement is generally knowable. It is far more complicated for a company to identify with any granularity the GHG emissions associated with business processes or a company's information technology functions. Companies, for example, are not able to associate GHG emissions with their billing function or customer systems. Nor are they able to associate GHG emissions with warehouse or back-office, mid-office, or front-office business processes. In aggregate, companies can estimate GHG emissions associated with the energy used to run their organization inclusive of all functions. Scope 3 emissions—unlike Scopes 1 and 2—and/or sustainability impacts more broadly present a greater challenge.

Digital platforms can be used to house data on Scopes 1, 2 and 3 GHG emissions and sustainability profiles, and conduct sensitivity analyses associated with a percentage reduction in energy use corporate-wide or across each scope area. If a company can isolate the billing process, for example, and assess energy use when billing processes are not running or are running for a smaller number of accounts, utilities could potentially estimate the GHG emission reductions associated with lower energy use from running billing processes for a smaller number of customers all else being equal. Thinking about individual corporate operations or IT processes and tracking GHG emissions associated with changes in each can provide a foundation for forecasting and planning for GHG reductions. While not granular enough to quantify and verify GHG reductions for monetizing in a credit market, the estimates might be sufficiently indicative to develop climate-risk avoidance strategies.

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CONCLUSION

As companies contemplate end-to-end digital information and operations technology, customer platforms and products, it's important to focus on "being digital" not simply "doing digital." With increasing scrutiny and the need for verifiable compliance with GHG emissions and sustainability reporting, integrating such platforms as those identified herein, is increasingly important. Integrating solutions that are scalable to an organizations' ecosystem will improve the efficiency of data collection, data analysis, forecasting and planning, and reporting. Certainly, a future to create and look forward to.