

The Trickle-Down Effect: Why Counties Should Note SEC’s Proposed Rules on Climate-Related Disclosures

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On March 21, 2022, the Securities and Exchange Commission (SEC) released a proposed amendment to its rules under the Securities Act of 1933 and Securities Exchange Act of 1934 that would require heightened disclosure of certain climate-related risk information by public companies.

The SEC has broad power to issue disclosure requirements that are in the public interest or are for the protection of investors. Relying on this authority, the SEC determined that climate-related risks and their potential impacts on financial performance or strategic position may be material to investors in making investment decisions. In its proposal, the SEC expressed concern that the existing rules governing the disclosure of climate-related risks do not adequately protect investors.

Although the proposed rules do not currently apply to municipal issuers (e.g., counties and municipalities), this shift by the SEC deserves our attention. History shows that disclosure requirements applicable to public companies can often “trickle-down” to municipal issuers.

There’s recent evidence of the trickle-down effect. Since roughly 2012, the SEC has increased efforts to ensure that the buyers of governmental debt have similar protection against false or misleading statements as that provided to buyers of corporate debt. In pursuing this objective, the SEC has often taken concepts that at first apply to corporate issuers and later apply them to municipal issuers. The results have included increased SEC enforcement actions against municipal issuers and, in some cases, have involved personal liability for governmental officials.ⁱ

Increased Investor Concern

The SEC’s proposed rules come in response to calls from the investment community. Investors have placed an increased emphasis on information regarding the economic risks associated with climate change. The SEC reported that several major institutional investors have demanded climate-related information before making investments because they view climate change as a risk to their portfolios. Potential risks may include the financial impacts of acute climate-related disasters such as wildfires, hurricanes, tornadoes, floods, and heatwaves.ⁱⁱ



There may also be longer-term and more gradual impacts from global warming, drought, and sea level rise. Investors are also concerned about the economic impacts of a transition to a less carbon-intensive economy.ⁱⁱⁱ These risks may arise from potential adoption of climate-related regulatory policies or shifts in the international political climate.^{iv}

SEC Proposed Rules

The proposed rules would require information about a public company’s climate-related risks that are reasonably likely to have a material impact on its business, results of operations, or financial condition.^v The SEC and the U.S. Supreme Court view a matter as material if there is a substantial likelihood that a reasonable investor would consider it important when determining whether to buy or sell securities.^{vi}

When considering a future event, the materiality determination requires an assessment of both the probability of the event occurring and its potential magnitude, or significance if it does indeed occur.^{vii}

Specifically, the proposed rules would require a public company to disclose information about:

- The oversight and governance of climate-related risks by the board and management;

- How any climate-related risks identified have had, or are likely to have, a material impact on its business and consolidated financial statements;
- How any identified climate-related risks have affected or are likely to affect strategy, business model, and outlook;
- The processes for identifying, assessing, and managing climate-related risks and whether any such processes are integrated into the overall risk management system or processes;
- The impact of climate-related events (severe weather events and other natural conditions as well as physical risks identified by the public company) on the line items of consolidated financial statements and related expenditures;
- Whether the risk is likely to manifest over the short, medium, or long term;^{viii}
- Greenhouse gas emissions and intensity, if material, or a greenhouse gas emissions reduction target; and
- Climate-related targets or goals, and plan to transition to alternative energy, if any.^{ix}

geographic areas subject to significant weather events, to provide disclosure on climate-related risks.

Clearly, investors view these types of disclosures as being material to their investment decisions. In view of the proposed rules, it would be prudent for municipal issuers to closely examine the impact of climate change on their operations and be prepared to describe the risks and their responses to the investment community.

A municipal issuer should consult with its counsel before concluding which climate-related risks, if any, need to be disclosed. For more information refer to The Enhancement and Standardization of Climate-Related Disclosures for Investors, SEC Release Nos. 33-11042; 34-94478; File No. S7-10-22.

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Takeaways for Local Governments

To be clear, these proposed rules, if adopted, would not directly apply to municipal issuers. However, there is already evidence that investors expect municipal issuers, particularly those located in

ⁱSee e.g. *Sec. & Exch. Comm'n v. Town of Oyster Bay, et al.*, 17-Cv-06809 (E.D.N.Y.), Litigation Release No. 24494 (June 7, 2019); *In Re City of Miami, Fla.*, Release No. 8213 (Mar. 21, 2003); *Sec. & Exch. Comm'n v. Town of Ramapo, et al.*, No. 16-Cv-2779 (S.D.N.Y. Filed Apr. 14, 2016), Litigation Release No. 24161 (June 8, 2018); *Sec. & Exch. Comm'n v. City of Harvey, Illinois & Joseph T. Letke*, United States Dist. Ct. for the N. Dist. of Illinois, Civ. Action No. 1:14-Cv-4744 (N.D. Ill., Filed June 24, 2014), Litigation Release No. 23180 (Jan. 27, 2015); *Sec. & Exch. Comm'n v. Gary J. Burtka*, Civ. Action No. Civ. Action No. 14-Cv-14278 (Cohn) (E.D. Mi) Sec. & Exch. Comm'n, Litigation Release No. 23229 (Apr. 6, 2015); *In the Matter of the City of Harrisburg, Pennsylvania Respondent.*, Release No. 69515 (May 6, 2013); *Sec Initiates Actions in Orange Cnty. Investigation* Sa Cv 96-0074, Litigation Release No. 14792 (Jan. 24, 1996).

ⁱⁱSee proposed 17 CFR 229.1500.

ⁱⁱⁱ*Id.*

^{iv}See proposed 17 CFR 229.1502(a).

^vSee proposed 17 CFR 229.1501, 1502, 1503.

^{vi}See 17 CFR 240.12b-2 (definition of "material"). See also *Basic Inc. v. Levinson*, 485 U.S. 224, 231, 232, and 240 (1988) (holding that information is material if there is a substantial likelihood that a reasonable investor would consider the information important in deciding how to vote or make an investment decision; and quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1977) to further explain that an omitted fact is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available.").

^{vii}See *Basic, Inc. v. Levinson*, 485 U.S. 224, 238 (1988).

^{viii}See proposed Item 1502(a) of Regulation S-K.

^{ix}See proposed 17 CFR 229.1501, 1502, 1503, 1504.

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