

Climate investment update

Free to View
Climate Change - Global

US climate disclosures: California takes the initiative

- ◆ California mandates climate risk and emissions reporting for corporates, ahead of SEC climate risk disclosure rule
- ◆ The rule can harmonize well with other established frameworks, but the pending SEC rule could bring confusion
- ◆ We think this could lead to a substantial rise in US disclosures

California is done waiting for SEC climate risk disclosure requirements. This week California's governor signed into law two bills for public and private companies who "do business in California" to:

- ◆ Disclose publicly their Scope 1, 2 and 3 GHG emissions ([SB 253](#))
- ◆ Report on climate risks in accordance with the TCFD framework ([SB 261](#))

With pressure from climate disclosure mandates in other markets, there has been encouraging growth in TCFD-aligned reporting among US companies. Nonetheless, given the absence of a final climate risk rule by the SEC and the unquestionable rise in anti-ESG sentiment in the US (See [HSBC ESG Sentiment Survey](#), July 2023), disclosures in the US are significantly less than those in European markets. California's rule will apply to an estimated 5,300 companies — this could lead to a dramatic and much needed increase in quality data and disclosures in the US.

California is the climate trendsetter. California has traditionally put in place more stringent climate policy in the absence of federal regulations, and this has often influenced the initiatives of other states — think appliance efficiency standards and vehicle emission standards. In the absence of a [robust] climate risk disclosure requirement by the SEC, there could be a scenario in which sustainability disclosure requirements advance at the state level.

Global reporting is evolving fast and comparability concerns are top of mind. With several climate risk frameworks being utilized across jurisdictions, the current climate disclosure environment can be tricky to navigate. Nonetheless, there is a growing global alignment in the development of climate risk frameworks. We find that the inclusion of Scope 3 emissions, TCFD alignment, and third-party assurance are shared focuses across sustainability standards like ESRS, ISSB, and the newest California rule. We think that the California rules - although simple - harmonize well with other frameworks. This can help drive momentum towards a consistent global reporting baseline and increased transparency in US companies.

We think increased reporting will help US corporates realize unchecked climate risks and prioritize climate action. However, differences in SEC and California disclosure requirements could bring added confusion for companies who fall under both jurisdictions. If a final rule is made by the SEC, clarity around how to comply with both rules most efficiently will need to be ironed out, in our view.

This is a Free to View version of a report with the same title published on 12-Oct-23. Please contact your HSBC representative or email us at AskResearch@hsbc.com for more information.

Camila Sarmiento
ESG Analyst
HSBC Securities (USA) Inc.

Anushua Chowdhury
ESG Research
HSBC Securities and Capital Markets (India) Private Limited

Wai-Shin Chan, CFA
Head, Climate Change Centre; Head, ESG Research
The Hongkong and Shanghai Banking Corporation Limited

Disclosures & Disclaimer

This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it.

Issuer of report: HSBC Securities (USA) Inc.

View HSBC Global Research at:
<https://www.research.hsbc.com>

California's climate risk disclosure rules will follow many other jurisdictions, including the UK and New Zealand, which have mandated TCFD-aligned disclosures. The adoption of the TCFD (Task Force on Climate-Related Financial Disclosures) across the world has encouraging growth in TCFD-aligned reporting among US companies over the past several years, despite the absence of mandatory disclosure. Of the 687 North American companies reviewed by the TCFD, the average level of disclosure increased from 12% in 2019 to 29% in 2021. While this remains lower than the 60% average TCFD disclosures in Europe, it signifies growth in voluntary reporting, despite the lack of regulatory pressure. We expect the forthcoming California rule to further boost these numbers.

1. Summary of new rules in California

	Disclosure	Who	alignment	start date	Assurance level	Occurrence	Penalties
SB-253	Scope 1+ 2	Public and private US companies that are "doing business" in California, and have annual revenues greater than USD1bn	GHG protocol used for definition and calculation of emissions	2026	Limited assurance level beginning in 2026 and at a reasonable assurance level beginning in 2030.	Annually	Penalties for non-filing, late filing and failure to meet requirements- Fines will not exceed USD500,000 in a reporting year
	Scope 3			2027	Limited assurance level beginning in 2030.	Annually	2027-2030- penalties only for failure to file disclosures (fines as above). Post-2030- misstatements will not be penalized if "made with a reasonable basis and disclosed in good faith."
SB-261	Climate-related financial risk and measures adopted to reduce and adapt to risk	Public and private US companies that are "doing business" in California, and have annual revenues greater than USD500mn	TCFD and ISSB	2026		Biennially	Fines will not exceed USD50,000 in a reporting year

Source: HSBC, California State

SEC vs California

California's new rule and the pending SEC climate risk disclosure rule do overlap in many ways, but also have key differences. US companies would need to navigate two different disclosure formats. While both disclosures are limited to climate change, the SEC proposal is more prescriptive, with a focus on the financial impact of climate change on a company, to be reported within financial statements (10-K filings), and using different metrics and data collection. This sets the scene for diverging requirements across both standards. In our view, California disclosures better align with global standards, such as the ISSB and ESRS, and can help prepare companies for global alignment and comparability across regions. We look at the main reasons below:

- ◆ **Focus on the TCFD:** The TCFD serves as a foundational template for many standards. All TCFD disclosures are covered in California’s rules, similar to ISSB and ESRS, and other country-specific legislation. On the other hand, the SEC uses the TCFD only as a guide in developing disclosure requirements, and therefore does not fully align with all of its components. This means companies covered under the California rule will be better positioned and ready to align with these frameworks.
- ◆ **Scope 3 emissions reporting:** California’s rule calls for disclosure of scope 3 emissions reporting, in line with ESRS and ISSB. However, for the SEC, Scope 3 emissions are required if material, or if the registrant has set a reduction target or goal relating to Scope 3 emissions.
- ◆ **Third party assurance:** Assurance guidance and requirements are increasingly top-of-mind for both ESRS and ISSB, and now California’s new rule, for scope 1,2 and 3 emissions. The SEC rule also considers assurance requirements, but only for scope 1 and 2 emissions.
- ◆ **Acceptance of alternative compliance:** With jurisdictions adopting various disclosure standards, stakeholders are recognizing the need for including provision for substituted compliance with other jurisdictions. For example, the ESRS indicates other reporting standards can be used to reach compliance for in-scope non-E.U. companies. While the California rule focuses on TCFD alignment, it also accepts ISSB alignment which in our view reflects the growing awareness among California policymakers for globally harmonized standards - many TCFD-adopting countries have also declared their intentions to adopt the ISSB. The SEC proposal did not include a provision for alternative compliance.

As the US climate disclosure story unfolds, we think companies need to be assessing the gaps between the climate-related information they currently disclose and requirements of current (California and requirements of other jurisdictions) and pending (SEC proposal) legislation.

2. Sustainability disclosure comparison

	California	SEC	ESRS under CSRD	ISSB
Who	Public and private US companies that are "doing business" in California, and have annual revenues greater than	US domestic and foreign public companies registered with SEC	EU companies with >250 employees, >GBP40m turnover, >GBP20m assets	Depends on jurisdiction and regulator that align with it
Companies under coverage	5,300	12,000	49,000	N/A
Purpose	Increase transparency for business to account for their carbon emissions and climate risk	Investor protections- focus on financial impact of climate change on reporting companies and their financial position	Double materiality- focus on how sustainability matters impact reporting companies, and how reporting companies impact the environment and society	Global baseline: focus on companies' sustainability related risk and opportunities to help inform investment decisions
focus area	Climate disclosures	Climate disclosures	ESG disclosures	Climate disclosures with intention to expand to more ESG topics
TCFD alignment	Yes	No	Yes	Yes
GHG emissions disclosures	Scope 1, 2 and 3	Scope 1 and 2. Scope 3 were considered material or when the company has already issued a Scope 3 GHG reduction target	Scope 1, 2 and 3	Scope 1, 2 and 3
Assurance requirement	Limited assurance over Scope 1 and 2 until 2030 when reasonable assurance is required; limited assurance over Scope 3 starting in 2030	Limited assurance over Scope 1 and 2 for the 2nd and 3rd years of implementation; reasonable assurance required beginning in the 4th year; no assurance required over Scope 3 emissions or from smaller reporting companies	Limited Assurance expected within three years of implementation; reasonable assurance after six years	Requirements are not included within the scope, guidelines for audit and oversight of disclosures from third parties are given
Biodiversity considerations	No	No	Includes 'Biodiversity and ecosystems' standards (ESRS E4)	Will integrate Task force on Nature-related Financial Disclosures (TNFD) into requirements

Source: Government sources, HSBC

Disclosure appendix

The following analyst(s), who is(are) primarily responsible for this document, certifies(y) that the opinion(s), views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Camila Sarmiento, Anushua Chowdhury and Wai-Shin Chan, CFA

This document has been issued by the Research Department of HSBC.

HSBC and its affiliates will from time to time sell to and buy from customers the securities/instruments, both equity and debt (including derivatives) of companies covered in HSBC Research on a principal or agency basis or act as a market maker or liquidity provider in the securities/instruments mentioned in this report.

Analysts, economists, and strategists are paid in part by reference to the profitability of HSBC which includes investment banking, sales & trading, and principal trading revenues.

Whether, or in what time frame, an update of this analysis will be published is not determined in advance.

For disclosures in respect of any company mentioned in this report, please see the most recently published report on that company available at www.hsbcnet.com/research.

Additional disclosures

- 1 This report is dated as at 12 October 2023.
- 2 All market data included in this report are dated as at close 11 October 2023, unless a different date and/or a specific time of day is indicated in the report.
- 3 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking, Principal Trading, and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.
- 4 You are not permitted to use, for reference, any data in this document for the purpose of (i) determining the interest payable, or other sums due, under loan agreements or under other financial contracts or instruments, (ii) determining the price at which a financial instrument may be bought or sold or traded or redeemed, or the value of a financial instrument, and/or (iii) measuring the performance of a financial instrument or of an investment fund.

Disclaimer

Issuer of report
HSBC Securities (USA) Inc.

This document has been issued by HSBC Securities (USA) Inc., which has based this document on information obtained from sources it believes to be reliable but which it has not independently verified. Neither HSBC Securities (USA) Inc. nor any member of its group companies ("HSBC") make any guarantee, representation or warranty nor accept any responsibility or liability as to the accuracy or completeness of this document and is not responsible for errors of transmission of factual or analytical data, nor is HSBC liable for damages arising out of any person's reliance on this information. The information and opinions contained within the report are based upon publicly available information at the time of publication, represent the present judgment of HSBC and are subject to change without notice.

This document is not and should not be construed as an offer to sell or solicitation of an offer to purchase or subscribe for any investment or other investment products mentioned in it and/or to participate in any trading strategy. It does not constitute a prospectus or other offering document. Information in this document is general and should not be construed as personal advice, given it has been prepared without taking account of the objectives, financial situation or needs of any particular investor. Accordingly, investors should, before acting on it, consider the appropriateness of the information, having regard to their objectives, financial situation and needs. If necessary, seek professional investment and tax advice.

The decision and responsibility on whether or not to purchase, subscribe or sell (as applicable) must be taken by the investor. In no event will any member of the HSBC group be liable to the recipient for any direct or indirect or any other damages of any kind arising from or in connection with reliance on any information and materials herein.

Past performance is not necessarily a guide to future performance. The value of any investment or income may go down as well as up and you may not get back the full amount invested. Where an investment is denominated in a currency other than the local currency of the recipient of the research report, changes in the exchange rates may have an adverse effect on the value, price or income of that investment. In case of investments for which there is no recognised market it may be difficult for investors to sell their investments or to obtain reliable information about its value or the extent of the risk to which it is exposed. Some of the statements contained in this document may be considered forward looking statements which provide current expectations or forecasts of future events. Such forward looking statements are not guarantees of future performance or events and involve risks and uncertainties. Actual results may differ materially from those described in such forward-looking statements as a result of various factors.

This document is for information purposes only and may not be redistributed or passed on, directly or indirectly, to any other person, in whole or in part, for any purpose. The distribution of this document in other jurisdictions may be restricted by law, and persons into whose possession this document comes should inform themselves about, and observe, any such restrictions. By accepting this report, you agree to be bound by the foregoing instructions. If this report is received by a customer of an affiliate of HSBC, its provision to the recipient is subject to the terms of business in place between the recipient and such affiliate. The document is intended to be distributed in its entirety. Unless governing law permits otherwise, you must contact a HSBC Group member in your home jurisdiction if you wish to use HSBC Group services in effecting a transaction in any investment mentioned in this document.

Certain investment products mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors. Investors should consult with their HSBC representative regarding the suitability of the investment products mentioned in this document.

HSBC and/or its officers, directors and employees may have positions in any securities in companies mentioned in this document. HSBC may act as market maker or may have assumed an underwriting commitment in the securities of companies discussed in this document (or in related investments), may sell or buy securities and may also perform or seek to perform investment banking or underwriting services for or relating to those companies and may also be represented on the supervisory board or any other committee of those companies.

From time to time research analysts conduct site visits of covered issuers. HSBC policies prohibit research analysts from accepting payment or reimbursement for travel expenses from the issuer for such visits.

HSBC Securities (USA) Inc., ("HSI") is a member of the HSBC Group, the NYSE and FINRA.

© Copyright 2023, HSBC Securities (USA) Inc., ALL RIGHTS RESERVED. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, on any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of insert issuing entity name. MCI (P) 017/01/2023, MCI (P) 061/09/2023, MCI (P) 073/10/2023, MCI (P) 007/10/2023

[1222329]