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INSIDE THIS PUBLICATION:

Environmental, social & governance demands take center stage

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CCOs extended valuable sustainability reporting resource

An online database that examines the environmental, social, and governance reporting requirements for 60 countries might just be the answer to calls for more harmonisation and alignment of ESG reporting. **Paul Hodgson** reports.

An online database that examines the environmental, social, and governance reporting requirements for 60 countries might just be the answer to calls for more harmonisation and alignment of ESG reporting.

The Reporting Exchange is a free online platform run by the World Business Council for Sustainable Development (WBCSD), a CEO-led organization of more than 200 businesses striving toward a sustainable world. The site compiles data in more than 70 sectors and provides comparable information on sustainability reporting requirements and resources.

Non-financial reporting, which covers ESG disclosures, has been described as "complex and overwhelming" and has evolved rapidly and unevenly over the last several years, overwhelmed by a plethora of regulations, reporting frameworks, processes, avenues, and tools for reporting material and non-material ESG issues.

The Exchange allows users to search, using a variety of functions, country by country, or internationally in the case of United Nations requirements, for every type of reporting provision. For example, if one were to click on South Africa on the world map, the Exchange would provide a summary of the regulatory environment in the country and a link to every reporting provision in place, including links to the actual legislation or guidance and information as to where it is applicable, whether it is mandatory or voluntary, comply or explain, a regulation or a code, and whether conditions apply. Users can further refine searches by region, type of provision, sector, and subject. For a company setting up operations in a new country, it would be hard to imagine a more useful resource for a compliance officer.

The Exchange's database records even more reporting provisions than requirements—1,788 provisions, of which 957 were mandatory. "Reporting provision" encompasses three reporting types: reporting requirements; reporting resources, which help companies prepare reports; and management resources, which help companies embed ESG into management behaviours.

The WBCSD's report, "ESG Reporting Trends," which contains information on the Asia-Pacific region, Europe, North America (including Central America), South America, Israel, Kazakhstan, Nigeria, Russia, South Africa, and Turkey identifies a number of other reporting styles beyond mandatory requirements. The first, "comply or explain," where the market decides whether certain standards are appropriate for individual companies, is still relatively limited in popularity but growing. "From just two reporting provisions at the turn of the millennium," says the report, "there are now over 30 provisions with this obligation." Comply or explain first made an appearance in the U.K.'s Corporate Governance Code in 1992, but later was referenced in the OECD/G20 Principles of Corporate Governance and the South African King Code.

Beyond mandatory and comply or explain, the number of voluntary reporting codes for ESG has increased from less than 10 in the early 1990s to 182 today. Four-fifths of these are issued by non-governmental organizations such as CDP, the Global Reporting Initiative (GRI), and the Sustainability Accounting Standards Board (SASB). These provisions are focused on providing information to investors and stakeholders, rather than regulators.

While there have been an increasing number of reporting provisions for ESG disclosures, companies around the world have been moving this data from standalone sustainability reports into mainstream financial reports that they are required to file with

"The focus is spread across the ESG spectrum ... Such issues as diversity, energy, supply chain, remuneration, role and structure of the board, political contributions, human rights, employment conditions, policies and practices, social impacts/value creation are the subjects that are most common across the U.K. reporting landscape."

Andrew Beanland, Manager, Redefining Value Program, WBCSD regulators and/or exchanges. In the European Union and the United States this has largely been due to EU directives and the Task Force on Climate-Related Financial Disclosures, respectively.

Another report from the WBCSD published in February focused on the United States and Canada. According to Rodney Irwin, managing director of the WBCSD's Redefining Value Program, that report found that mandatory reporting requirements are, "less in the U.S., around 37 percent, though there are more mandatory provisions in Canada." Irwin added, "But here in Europe, and maybe South Africa and Brazil, we are ahead of the curve."

Irwin attributed some of this to the forthcoming EU non-financial reporting directive. "Certain jurisdictions within Europe are going further with the way ESG risks are being disclosed," he noted.

ESG Reporting Trends' latest analysis shows that there is a total of 411 provisions in 24 countries in Europe and 293 mandatory requirements. By contrast, there are 211 reporting provisions for the United States and, of these, 154 are voluntary provisions. In addition, there has been a slower migration of ESG reporting into mainstream reporting in the United States, though 91 percent of WBCSD member companies in the United States and Canada produce a standalone sustainability report. Earlier research conducted by the WBCSD noted, however, that only around a quarter of companies in the United States and Canada had zero alignment between ESG risk disclosures in their sustainability reports and ESG risk disclosures in their legally required risk reporting in 10-Ks or annual reports. That figure compares to more than a third of companies surveyed worldwide that had zero alignment.

Andrew Beanland, a manager in the WBCSD's Redefining Value Program, put together a set of data from the Reporting Exchange that compares the regulatory environment in the United Kingdom with that in the United States and/or Canada. The 38 reporting provisions in the United Kingdom consist of:

» 12 reporting requirements
» 16 reporting resources
» 10 management resources

Of the 16 reporting resources, five are guidance documents issued by the Financial Reporting Council (FRC) on issues such as clear and concise reporting, risk management, and the strategic directors report. Other significant resources include guidance from the Department for Environment, Food, and Rural Affairs on environmental reporting guidelines and how to measure and report greenhouse gas emissions. The majority of the 10 management resources are guidance on Environment Agency regulations on waste, water usage, treatment and discharge, and other effluents.

By comparison, there are 10 reporting resources in Canada, most of which are mandatory guidance documents issued by the Toronto Stock Exchange or government divisions. And there are 51manage-

EU NON-FINANCIAL REPORTING DIRECTIVE

Large companies (large public-interest companies with more than 500 employees) have to include non-financial statements in their annual reports from 2018 onwards on the policies they implement in relation to:

» environmental protection
» social responsibility and treatment of employees
» respect for human rights
» anti-corruption and bribery
» diversity on company boards (in terms of age, gender, educational and professional background)

Source: Directive 2014/95/EU

ment resources in the United States, which are typically voluntary guidance documents and standards.

The United Kingdom has 18 provisions (both mandatory and voluntary) that direct the disclosure of non-financial information (i.e. ESG) toward the mainstream annual report. The main promulgators of these provisions are the FRC and the London Stock Exchange. By comparison, the Securities and Exchange Commission has issued 11 mandatory provisions that bring disclosure of non-financial information into the mainstream report, the 10-K, for U.S. companies. Beyond these provisions, the work of the SASB—which has been a major actor in developing voluntary reporting standards—has issued 65 provisions focused on reporting environmental issues. In the United States, in total there are 97 provisions that request ESG information in the mainstream report. This is a higher figure than any other country covered by the Reporting Exchange platform. Only 13 of these provisions, however, are mandatory, and more than half of the provisions concern environmental matters. The U.S. Environmental Protection Agency is the major actor, responsible for 10 provisions where disclosure is required on issues such as water, waste, and emissions.

The United Kingdom, in contrast, has only seven reporting provisions that concern environmental matters out of a total of 38. "Rather," says Beanland, "the focus is spread across the ESG spectrum ... Such issues as diversity, energy, supply chain, remuneration, role and structure of the board, political contributions, human rights, employment conditions, policies and practices, social impacts/value creation are the subjects that are most common across the U.K. reporting landscape."

Of these, 11 are mandatory reporting provisions, eight of which require disclosure directly to the authority requesting the information. All other mandatory provisions require disclosures through the mainstream reporting channel. This is a lower proportion of mandatory provisions than is seen in Canada, where there are 38 reporting provisions, but just 29 are mandatory. The vast majority of the provisions, almost three-quarters, ask companies to disclose directly to the authority requesting the information. This suggests a system that is more focused on the regulatory aspect of reporting on ESG issues than that in the United Kingdom, which is more focused on informing investors. ■

DISCLOSURE CHANNELS FOR ESG REPORTING

The four main disclosure channels identified during the development of the Reporting Exchange are:

1. **Mainstream report:** Annual reporting packages which provide information to existing and prospective investors about the financial position and performance of the organization. They generally contain financial, governance statements and management commentary.
2. **Integrated report:** An integrated report explains to financial capital providers how an organization creates value over time. It also seeks to explain how the organization interacts with the external environment to create value over the short, medium, and long term.
3. **Sustainability report:** A report published by a company or organization about the environmental and social impacts caused by its everyday activities, communicating sustainability performance and impacts.
4. **Specialist system:** This allows companies to disclose information through online response systems, questionnaires, or forms and is often directly to an organization or authority requesting the information.

Source: ESG Reporting Trends

Get listed in the Dow Jones sustainability index

How does one get listed in the Dow Jones Sustainability Index? It's a little complicated—but worth it, writes **Jaclyn Jaeger**.

Over the last several years, an increasing number of institutional investors, ratings agencies, and other stakeholders have turned up the heat on companies to disclose their environmental, social, and governance (ESG) initiatives. The idea is that such information provides a more complete performance picture than traditional, purely financial, measures.

"The corporate community is responding to this heightened and accelerated interest on the part of global investors," said Hank Boerner, chairman and co-founder of the Governance & Accountability Institute (G&A), during a recent webinar on sustainability reporting trends.

A report conducted by the G&A Institute says just under 20 percent of S&P 500 companies published a sustainability report in 2011. By 2015, however, 81 percent of the S&P 500 were publishing reports.

Pressure on companies to improve their ESG initiatives and disclosures only continues to mount, with trillions being poured into ESG investing. Consider the following groups:

» **Carbon Disclosure Project:** Established in 2002, CDP currently represents 827 investors with $100 trillion in assets.

» **Principles for Responsible Investment:** Established in 2006, PRI currently represents nearly 1,500 signatories from over 50 countries with $60 trillion in investment capital.
» **Institutional Investors Group on Climate Change:** Established in 2001, the organization currently has over 130 members from nine countries, representing over €18 trillion (U.S.$19 trillion) in assets.
» Investor Network on Climate Risk: Established in 2003, the INCR currently represents over 120 institutional investors representing more than $15 trillion in assets.
» **Interfaith Center on Corporate Responsibility:** Established in 1972, ICCR currently compromises nearly 300 organizations with $200 billion in investment capital.

From these growing requests for ESG disclosures, a number of reporting initiatives have emerged to provide information to investors about companies' ESG efforts. One of those is the Dow Jones Sustainability Indices (DJSI), launched in 1999, making it the first global sustainability benchmark that tracks the stock performance of the world's leading companies in terms of economic, environmental, and social criteria.

Each year, RobecoSAM, an investment specialist focused exclusively on sustainability investing, invites more than 3,400 companies to participate in the Corporate Sustainability Assessment (CSA) questionnaire. Together with the S&P Dow Jones Indices, RobecoSAM publishes the DJSI, compiled from the results of the CSA, creating a comprehensive database of financially material sustainability information.

"First and foremost, we're an asset management firm. Our approach to sustainability is, therefore, through the eyes of investors," said Robert Dornau, senior manager of sustainability services at RobecoSAM.

Of the 3,400 companies invited to participate in the CSA, the largest 2,500 global companies by market capitalization are eligible for inclusion in the flagship DJSI World index. Additional companies are eligible for the growing family of regional and country-specific sustainability indices, such as the DJSI North America, Europe, Asia Pacific, and Emerging Markets.

As part of that process, RobecoSAM also annually publishes its Sustainability Yearbook. In order to be listed in the Yearbook, companies must be within the top 15 percent of their industry and must achieve a score within 30 percent of their industry's top performing company.

"Our aim with this whole assessment is to take companies through an annual process of competitive benchmarking regarding their sustainability performance," Dornau said.

In the Yearbook, companies are classified into three categories:

» **Gold Class:** Companies with a minimum total score of 60 and whose score is within 1 percent of the top performing company's score;
» **Silver Class:** Companies whose total score is at least 57 and whose score is within a range of 1 percent to 5 percent of the industry's top performing company's score; and
» **Bronze Class:** Companies whose score is at least 54 and is within a range of 5 percent to 10 percent of the industry's top performing company's score.

This year, RobecoSAM awarded 77 Gold Class medals, 83 Silver Class medals, and 107 Bronze Class medals to the evaluated companies.

By region, many of the world's most sustainable companies are located in Europe. In total, 198 European companies were included in the Yearbook, receiving 39 gold medals. Following European companies, 13 out of 122 Asia Pacific companies received gold medals.

In North America, 14 out of 82 companies received gold medals. These include Abbott Laborato-

SUSTAINABILITY YEARBOOK METHODOLOGY

Gold Class: Within each industry, companies with a minimum total score of 60 and whose score is within 1 percent of the top-performing comany's score receive the RobecoSAM Gold Class award.

Silver Class: All companies receiving a total score of at least 57 and whose score is within a range of 1 percent to 5 percent of the industry's top-performing company's score receive the RobecoSAM Silver Class distinction.

Bronze Class: Companies whose score is at least 54 and is within a range of 5 percent to 10 percent of the industry's top-performing company's score receive the RobecoSAM Bronze Class distinction.

Industry Mover award: Within the top 15 percent of each industry, the company that has achieved the largest proportional improvement in its sustainability performance compared to the previous year is named the RobecoSAM Industry Mover.

Sustainability Yearbook Member: All companies that have been included in the Yearbook, but that have not received a medal distinction, are listed as a Sustainability Yearbook Member.

In order to be listed in the Yearbook, companies must be within the top 15 percent of their industry and must achieve a score within 30 percent of their industry's top performing company.

Source: RobecoSAM

ries, Agilent Technologies, Ball Corp., Hewlett Packard, Humana, Lockheed Martin, Newmont Mining, Owens Corning, and more.

In 2016, RobecoSAM and Bloomberg teamed up to make the results of the CSA available to the global investment community. Only the percentile rankings of the CSA scores are made available to licensed Bloomberg users—not a firm's answers, data points, comments, documents, or other confidential data.

Collaborating with Bloomberg is a positive development for companies, many of which have requested that the results of the CSA be more visible to investors. According to a survey conducted by RobecoSAM in 2015, the vast majority of companies favored increased disclosure around CSA results.

Support of the CSA is also reflected in the numbers. Last year, out of more than 3,400 companies that were invited, a record 867 companies from 42 different countries participated.

Companies should be aware that even if they opt not to formally submit a CSA questionnaire, they will still be rated. To meet market caps for the industries assessed, RobecoSAM uses publicly available data to evaluate companies that have elected to forgo a questionnaire invitation, and then it goes about choosing which companies rank in the top ten percent of their industry.

"If you participate actively, it's very likely that your ranking on Bloomberg will be a lot better than just being assessed based on what is available in the public domain," Dornau said.

Participation, however, does not automatically mean acceptance. NASDAQ, for example, tried for four years to became part of the DJSI before it was accepted last year. "It was a useful process in terms of maturing our operations," said Evan Harvey, director of corporate responsibility at NASDAQ.

The actual process of participating in the CSA questionnaire provides enormous business benefits, Harvey noted, including:

» Involvement of multiple departments in a common goal;

- Exposure of sustainability measure processes to multiple organizational levels;
- Disciplined and seasonal reporting;
- Creating a culture of continuous improvement; and
- Detailed reviews to serve as benchmarks.

Other participating companies have also lauded the CSA's business value. "It provides a credible external perspective that informs internal discussions of how our ESG performance and transparency compares to others in our industry," said Dan Bross, senior director of global corporate citizenship at Microsoft. "This helps us prioritize opportunities and drive to further enhance our efforts and level of transparency. Sustainability benchmarking has helped us to become a better business."

In another example, Canadian multinational aerospace and transportation company Bombardier said it looks to RobecoSAM's CSA as "the key benchmark index of sustainability for our organization, which supports not only improvements in our reporting, but also strategic decisions related to how we manage and anticipate sustainability issues," said Daniel Desjardins, general counsel, corporate secretary, and CSR committee chairman at Bombardier.

Other companies say sustainability reporting results in real and quantifiable business results. "We see many tenders coming by with sustainability questions," said Simon Braaksma, senior director of sustainability reporting at Dutch technology company Philips. "If we can address those questions, and also refer to our position in the Dow Jones as a credible, external, holistic assessment, that helps us to score high in those benchmarks and, thereby, helps us to gain business."

Other reporting initiatives. The DJSI is not the only ESG reporting initiative. Others include the Sustainability Accounting Standards Board (SASB), the Global Reporting Initiative (GRI), the International Integrated Reporting Committee (IIRC), and many more.

All of these reporting initiatives, however, have different missions. SASB's standards, for example, focus on ESG issues that matter most to the operational and financial performance of companies trading on U.S. exchanges. In comparison, the GRI and the IIRC guidelines have a global focus—an important consideration, when European views on ESG issues can be quite different from material disclosures under U.S. securities law.

Another distinction is that RobecoSAM is the "only ranking assessment out there that is third-party audited," Dornau said. Each year, Deloitte conducts a full audit on RobecoSAM's processes and selected audits on certain companies—for example, how they were assessed, how the questionnaire process works. "We have to defend our decision making on a very detailed level," he said.

But with so many ESG reporting initiatives to choose from, companies that have never participated in RobecoSAM's CSA may still be wondering if it's worth the effort. The process, after all, can be quite time-consuming and requires a strategic, coordinated approach among departments.

Such obstacles can be reduced, however, by having a strategy in place. Typically, the sustainability or CSR group within the company will head the initiative, said Louis Coppola, co-founder and executive vice president at the G&A Institute.

Additionally, it's helpful to engage subject matter experts within different divisions in the company, Coppola said. For example, if the company's initiatives concern innovation, consider engaging with someone from research and development; financial information, the chief financial officer or investor relations; social issues or employee issues, human resources.

Deciding whether to participate in the CSA is not an easy decision, but just going through a self-review of the questions in the CSA can be valuable, Harvey said. "In the end, hopefully, you get better at these things, and you get better at tracking and measuring them, and you have some interesting and satisfactory results." ■

Integrating ESG into due diligence

Authored by **Brian Alster**, General Manager of Third Party Risk Management and compliance, Dun & Bradstreet.

INTRODUCTION

Global corporations have long had to worry about risks in their supply chain, and now a new risk is clamoring for attention: better oversight of environmental, social, and governance (ESG) issues.

In truth, businesses have always paid at least some attention to ESG concerns among their suppliers. Within the last 10 years, however, demand for better oversight of ESG has soared—among shareholders, consumers, regulators, and even other business partners. Moreover, the ability of those groups to press their demands has vastly improved thanks to social media.

That greater attention has led to the rise of "non-financial reporting" from businesses and other large organizations, sometimes required by law (the European Union already has rules for ESG disclosures), and other times simply a best practice companies undertake voluntarily.

Several bodies, such as the Sustainability Accounting Standards Board or the International Integrated Reporting Council, already publish frameworks to guide ESG disclosures.

This is not a theoretical, nice-to-have capability. In a D&B Sentiment Report from February, which surveyed more than 600 procurement and compliance professionals in both the United States and United Kingdom, respondents ranked ESG as the second most important issue they expect to face in the next six months (placing only behind customer due diligence). Fifty-one percent said the need for more data, so they can find and verify identities, was their top ESG concern.

All that brings us to this point: businesses still need a method to extract that ESG information about their suppliers and related third parties. They need to modify the due diligence procedures they already have to this new challenge, so the company can assure that its use of third parties aligns with its own ESG goals and the priorities of its stakeholders.

So how does a compliance function do that?

> Businesses have always paid at least some attention to ESG concerns among their suppliers. Within the last 10 years, however, demand for better oversight of ESG has soared.

Part I. The rise ESG risks, disclosures, and demands

TTo perform due diligence for ESG issues effectively, a compliance officer must first understand all the issues that "ESG" might entail. That is not easy, because ESG is a broad term. It could include any or all of the following:

- Conflict minerals that might be used in your supply chain;
- Human trafficking or forced labor;
- Fair labor standards, such as equal pay across gender or racial lines;
- Greenhouse gas emissions;
- Environmental pollution, including items such as micro-

plastics;

- Energy use, and the portion of renewable energy the firm uses;
- Corporate political contributions;
- Conflicts of interest in choice of board members or business partners.

Various laws around the world require at least some disclosure of ESG issues. For example, the U.K. Modern Slavery Act requires firms working in Britain to disclose what steps they are taking (including no steps at all) to eradicate slave labor in their supply chains. A similar state law exists for businesses working the state of California. U.S. publicly traded companies are supposed to comply with the Conflict Minerals Rule, which requires disclosure of certain four conflict minerals that might be in their supply chain.

The European Union also began requiring firms to publish sustainability reports starting in 2018. Those reports require large firms working in Europe to disclose a host of items related to diversity on corporate boards, respect for human rights, environmental consequences of their operations, and more. Beyond regulatory requirements around ESG is the threat of pressure from institutional investors and non-governmental organizations, who will needle companies to improve their performance on ESG issues anyway.

For example, the Corporate Human Rights Benchmark (CHRB) is an annual listing of 100 large companies around the world, ranking them according to how they perform on many ESG issues. Institutional investors attuned to ESG issues (who have an estimated $12 trillion under management) can then use that benchmarking information to pressure specific companies to change their operations.

Across all of this ESG landscape, a company's responsibility for disclosure and better performance extends through its supply chain. In much the same way that anti-corruption laws hold companies responsible for third parties taking corrupt actions on their behalf, ESG regulations hold companies responsible for the behavior of their suppliers. To meet those ESG obligations, then, companies must exercise stronger ESG governance over their supply chain. The first step to achieving that capability is due diligence that can collect the necessary information from your supply chain, so your organization knows what its ESG risks are and how to respond to them.

Part II. Redesign due diligence to incorporate ESG concerns

The good news is that due diligence itself is nothing new to large firms. They have had to exercise risk-based due diligence over their third parties for years to comply with anti-corruption laws, and the basic practices to perform due diligence are not much different for ESG issues. The "muscle memory" in a company's existing compliance program can be expanded to encompass these new issues too.

First, select an ESG risk framework that can guide your organization about what information to seek from suppliers. That framework should align with the company's values and commitment to ESG concerns, and address any specific ESG disclosures that regulations might require your company to make.

Businesses have numerous frameworks or sets of standards they might use. For example, the Sustainability Accounting Standards Board publishes ESG disclosure standards for 11 business sectors. The Organization for Economic Cooperation and Development published its Due Diligence Guidance for Responsible Business Conduct in 2018. The Global Reporting Initiative has published ESG standards for more than 20 years. Once your organization decides on a framework to use, it must decide what information from or about third parties would satisfy those disclosure criteria, and demonstrate that your business has performed adequate due diligence.

For example, a retail business that sources its products to manufacturers in emerging markets will have high concerns about sweatshops and pay equity; environmental pollution; and perhaps concerns about conflicts of interest among suppliers and sub-suppliers. In that case, the retailer will need a mix of attestations and certifications from its suppliers about those issues, plus independent corroboration from objective third parties.

ESG frameworks will detail exactly what data the retailer should find. Do all its suppliers have policies against fair pay, and in favor of pay equity across gender and racial lines? Do those suppliers push those policies to sub-suppliers? Do the suppliers have hotlines employees can use, and so forth? Does the supplier have a history of environmental infractions? And so forth.

Those criteria can guide our hypothetical retailer, or any other business, as it crafts the due diligence questions it wants to answer. And as compliance programs have done for anti-corruption due diligence for years — the most common tactics will be attestations from your third parties, plus cross-checking of those answers against databases of adverse media reports, ownership directors, regulatory infractions, and the like.

That said, your organization should also consider changes to contract language and employee workflows that might be necessary to obtain ESG data from your suppliers. For example, any contracts with suppliers should include language forcing them to provide necessary information, and include possible penalties for violating your ESG expectations. Compliance officers might need to work with their procurement functions to ensure those new ESG objectives are included in your company's sourcing procedures.

Moreover, compliance officers also need to anticipate training and communication needs that might arise while explaining these changes to employees and third parties. As with so much else in corporate compliance, swift, unexplained changes can breed resentment and confusion. Employees and suppliers need to know why ESG due diligence is now happening, and how non-compliance might affect their relationships with the company.

Part III. Putting ESG due diligence data to use

Once your firm had ESG due diligence procedures in place and begins collecting that data, then comes the task of putting that information to work.

First, that data will likely give mixed results: some third parties scoring well, others not. Again, as with anti-corruption due diligence for third parties, compliance officers will then need to consider additional oversight procedures for high-risk suppliers. That could be anything from demands for more extensive documentation, to conducting follow-up checks more often, to stiffer penalties for non-compliance. (Ongoing monitoring and re-assessment of ESG risks will also be crucial.)

Second, companies would do well to tie their ESG policies and data into procurement functions. For example, the company could prohibit onboarding of prospective suppliers that fail to meet certain ESG criteria, or insist on additional ESG due diligence checks for suppliers in certain high-risk regions. The more these policies can be embedded and automated into procurement procedures, the less burden ESG compliance will impose on business operations.

Third, in many instances ESG due diligence and oversight will result in the company publishing some sort of sustainability report: either actual reports (as required under EU rules) or ESG disclosures included in corporate reports (such as the Management Discussion & Analysis section of securities filings). In that case, the compliance and procurement functions should consult with the organization's external reporting function, to see whether ESG data should be tied to disclosure controls and procedures.

CONCLUSION

Without question, ESG concerns are here to stay in the world of corporate oversight. Regulatory demands are increasing, and more fundamentally, the public now expects corporations to engage more fully in ESG issues — from fair labor, to climate change, to pay equity, and much more. Organizations must exercise more oversight over their supply chain, period. That means more due diligence.

"More" due diligence, however, only means an expansion of the due diligence organizations already do; not a re-invention of the wheel. Businesses need to find ESG risk and disclosure frameworks, incorporate those issues into their due diligence and procurement policies, and then respond to suppliers' ESG behavior accordingly.

Ultimately, that work also means reporting: either in sustainability reports, ESG regulatory disclosures, or just an enhanced ability to engage with NGOs, consumers, and business partners concerned about ESG issues — and an organization more responsive to its stakeholders always fares better over the long term. ■

BRIAN ALSTER, DUN & BRADSTREET


Alster

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Brian has been with Dun & Bradstreet for eight years, and has also held various leadership roles in D&B's Strategic Sales organization. Prior to joining D&B, Brian spent almost 20 years in the Financial Services industry. Most recently Brian worked for JPMorgan Chase is the Small Business Card division, leading both Customer Analytics and New Account Acquisition efforts across all marketing channels.

Prior to joining Chase, Brian spent 12 years at MBNA America and Bank of America, working in various consumer risk and marketing leadership roles in multiple lines of business, including consumer card, mortgage, and unsecured lines of credit.

How DICK's Sporting Goods manages responsible sourcing

A successful sourcing program is about more than conducting audits and taking corrective action, writes **Jaclyn Jaeger**: It's about executing an enterprise-wide risk strategy.

Mandatory vendor compliance programs are becoming less unusual these days, encouraged by an increasing number of companies looking to improve both their supply chains and supply-chain transparency.

One company that is requiring suppliers to show environmental sustainability and financial integrity, in addition to ensuring workers' safety, health, and wages, is U.S.-based omni-channel retail company DICK's Sporting Goods, which operates in more than 700 locations across the United States. In a recent Compliance Week Webinar, sponsored by global trade software provider Amber Road, Chris Bereznay, DICK's director of global ethics and compliance, shared how to go about building a responsible sourcing program for suppliers and factories with an eye toward long-term success.

A successful responsible sourcing program is not just about conducting audits and taking corrective action. "What you really need is a holistic strategy that addresses risk at various levels," Bereznay said.

A key part of a holistic strategy is to assist vendors in practicing self-governance. "In a perfect world, you'd have this cascading level of responsibility," Bereznay said, in which all of an organization's vendors would audit their own factories. It's an approach that's starting to gain momentum. "We are definitely moving forward in this direction, because we believe it's the only sustainable way to move things forward," he said.

At the factory level, you must "trust but verify," Bereznay continued. Factory-level assessments are a part of managing these risks.

Other ways to improve responsible sourcing at the factory level, he said, include:

- Accepting shared audits from other reputable brands or companies: "A lot of factories go through audit fatigue," he noted.
- Conducting training in capacity-building: "It's really important to help these folks understand how to solve these issues. Can you help them get to the root cause to better understand what's driving an issue?"
- Asking your factories to take more ownership over the process: "Every factory we meet with now, we have discussions around what they're doing to manage their own compliance matters. Do they have a Code of Conduct? Do they have a certified or designated compliance manager? Do they have an effective grievance system in place or worker management committee?

Building a holistic social responsible program means everyone—from senior leadership down to the business units, and vendors down to the factories—has an active role to play. In addition to the compliance department, other key players may include production and sourcing partners; merchandising groups, if you're a retail company; supply chain logistics; and legal and internal audit, who can be great partners in helping to vet and validate the program, Bereznay said.

When building your social responsibility program, or looking to improve it, be sure to include either the audit committee of the board of directors or an executive compliance committee, who can review the program. In other words, "gain support for your plan, in advance," Bereznay said. That will go a long way toward building momentum for the program and getting senior-level buy-in, which is another important component of an effective responsible sourcing program.

Above all, don't lose sight of why responsible sourcing is necessary in the first place and the impact it has on brand value. If the company is struggling to manage its responsible sourcing program, because it's not efficient or effective, "those numbers can be astronomical," Bereznay stressed.

NGO collaboration

It's also important to partner with NGOs, so that they too become the eyes and ears of your vendors and factories. "It's really important to not be afraid of these groups; some folks shy away from engaging with the NGO community," Bereznay said. "Personally, I've found them to be extremely helpful."

By building and nurturing relationships with NGOs, these groups will reach out to you directly when they discover an issue in a factory or with a vendor that you're using. The benefit in that is that you can "get ahead of an issue before it gathers too much momentum," Bereznay said. "It's also nice to find out about those issues before they make the headlines."

Which NGO to reach out to as it relates to a responsible sourcing program depends on the industry. In the retail industry, for example, the Fair Labor Association, whose mission is to promote adherence to international and national labor laws, has published ten "Principles of Fair Labor and Responsible Sourcing," which serves as a helpful framework. Other NGOs in the retail industry include the International Labour Organization (ILO) and the Better Work program, a partnership between ILO and the International Finance corporation to improve labor standards in global supply chains.

Doing more with less

During the Webinar, Bereznay also shared how to do more with less as it relates to a social responsible program. "If you really want to focus your resources where they're needed the most, where you can have the most impact … segmentation definitely has to be a part of your strategy," he said.

With segmentation, the idea is to focus your time and energy on your top strategic suppliers, which means you first need to identify who those suppliers are. It doesn't make sense to spend time and energy showing vendors how to self-govern, unless they're a top strategic supplier to the company—for example, a vendor that the company has invested millions in, and you know they're going to be around for a few years.

In the middle are those suppliers that may need some oversight and auditing, maybe once a year. The lowest tier of suppliers is the fillers. For this tier, it may not make sense to audit under a certain threshold, because you simply don't have enough influence over them. "I've had factories that I've gone into that have said, 'No, I'm not going to fix that. You're not a big enough part of my business,'" Bereznay said.

Leveraging technology is another way to do more with less by eliminating redundant processes and unnecessary administrative work. For example, technology solutions like those offered by Amber Road can push alerts to suppliers, alerting them when it's time to update their corrective action plans. "Make them responsible for their own compliance checks and balances," said Chery Layne, customer success director at Amber Road.

Technology solutions can also alert third-party auditors when their audits are due. For example, Amber Road solution digitally integrates the information it receives from third-party auditing firms or internal auditors, and that information is then shared in real-time with all parties who have access to it.

"We wouldn't be able to manage this whole process with the team that we do without a solid technology process," Bereznay said. DICK's uses technology to generate management reporting that allows for "one version of the truth."

The system is used to schedule and assign both internal and external audits, for example. The company's factories can also log in and update the system with their responses to corrective actions, so that DICK's can track and manage all corrective action plans from beginning to completion.

Management reports then get communicated to the executive compliance committee and audit committee throughout the year, Bereznay explained. "That data also helps to feed our scorecard system, which is combined with quality, delivery, and other key components to managing production," he said.

Technology can also help trace products back to their origin, which is important given that factories with poor or illegal working conditions is a high compliance risk in the retail industry. "A lot of times, manufacturers or brands are just unaware," Bereznay said. If DICK's were to discover that one of its imported products was being produced in a factory that used forced labor, for example, "we would have to put resources toward identifying where and when that product was being produced, attempt to isolate it, and then potentially remove it from the marketplace," he said.

The need has never been greater to implement a holistic responsible sourcing program. Industries and individual companies that move toward that goal will not only achieve greater transparency and traceability throughout their supply chains, but also build stakeholder trust and, consequently, brand value and long-term growth. ■

10 Principles of Fair Labor and Responsible Sourcing

1	**WORKPLACE STANDARDS:** Company affiliate establishes and commits to clear standards.
2	**RESPONSIBILITY AND HEAD OFFICE/REGIONAL TRAINING:** Company affiliate identifies and trains specific staff responsible for implementing workplace standards and provides training to all head office and regional staff.
3	**SUPPLIER TRAINING:** Company affiliate obtains commitment and trains relevant supplier management on workplace standards and tracks effectiveness of supplier workforce training.
4	**FUNCTIONING GRIEVANCE MECHANISMS:** Company affiliate ensures workers have access to functioning grievance mechanisms, which include multiple reporting channels of which at least one is confidential.
5	**MONITORING:** Company affiliate conducts workplace standards compliance monitoring.
6	**COLLECTION AND MANAGEMENT OF COMPLIANCE INFORMATION:** Company affiliate collects, manages, and analyzes workplace standards compliance information.
7	**TIMELY AND PREVENTATIVE REMEDIATION:** Company affiliate works with suppliers to remediate in a timely way and preventative manner.
8	**RESPONSIBLE PURCHASING PRACTICES:** Company affiliate aligns planning and purchasing practices with commitment to workplace standards.
9	**CONSULTATION WITH CIVIL SOCIETY:** Company affiliate identifies, researches, and engages with relevant labor non-governmental organizations, trade unions, and other civil society institutions.
10	**VERIFICATION REQUIREMENTS:** Company affiliate meets FLA verification and program requirements.

Source: Fair Labor Association

More are tackling ESG disclosure as a business

A debate about ESG issues came to the forefront when the Department of Labor downgraded the economic relevance of ESG investments—just as companies and investors gathered at an event to discuss their importance. **Jaclyn Jaeger** reports.

An impassioned debate about environmental, social, and governance (ESG) issues took center stage in April, when the Department of Labor downgraded the economic relevance of ESG investments—just as companies and investors gathered at an event to discuss their importance.

On April 23, 2017, the Department of Labor published guidance cautioning financial managers that investments based on ESG factors may not always be a "prudent choice." Specifically, the Labor Department said, fiduciaries of private-sector employee benefit plans covered by the Employee Retirement Income Security Act (ERISA) "must not too readily treat ESG factors as economically relevant to the particular investment choices at issue when making a decision."

"Rather, ERISA fiduciaries must always put first the economic interests of the plan in providing retirement benefits," the guidance stated. "A fiduciary's evaluation of the economics of an investment should be focused on financial factors that have a material effect on the return and risk of an investment." The Trump administration guidance is distinct from the Obama administration, which encouraged plan fiduciaries to consider ESG factors in their investment decisions.

For many investors and forward-thinking companies that see ESG risk and opportunities as being material to long-term financial performance, the guidance doesn't make sense. "I think it's concerning and confusing," said Jamie Martin, executive director in Morgan Stanley's Global Sustainable Finance group, speaking on a panel in April at Ceres Conference 2018 in Boston.

The literal bottom line for companies is that global sustainability challenges—like climate change, the growing scarcity of natural resources, poverty, human rights abuses, and more—are factors that affect economies and, thus, are material issues that companies must think about. For companies that depend heavily on natural resources, for example, it's difficult to understand how looking at the utilization of resources is not relevant to the long-term success of the business.

"Environmental, social, governance factors drive the long-term success of businesses," said David Blood, co-founder and senior partner of Generation Investment Management, an asset management firm with more than $18 billion under management. "I'm disappointed that the administration has taken a different point of view."

Many in the United States still question whether ESG practices are a business initiative, or a political one. "We have to keep going back to the business case why this is relevant," Blood added.

Also, sustainability investing rose in 2017—more than $8 trillion under management in the United States was screened by investment firms using ESG criteria, a number grew by 33 percent since 2014, according to the U.S. Sustainable Investing Forum.

In response, an increasing number of companies are keeping investors apprised of their sustainability efforts. According to a recent report conducted by non-profit sustainability organization Ceres, 43 percent of the close-to 600 companies that were analyzed proactively inform investors about their sustainability efforts.

Companies' level of engagement varies by sector. Industrial companies, for example, engage investors on both sustainable business risks and opportunities. Sixteen companies in the industrial sector indicated they "present sustainability as a business driver for product innovation, driving investment in new technologies that reduce greenhouse gas emissions and energy and water use," the Ceres report stated.

Ceres also found that investor activism is driving changes in the oil and gas sector. In this sector, 23 oil and gas companies disclosed sustainability information in their annual financial filings, and 52 percent informed investors about their sustainability efforts.

Investment giant factoring in ESG

In January 2018, BlackRock CEO Larry Fink, whose firm manages $6.2 trillion in assets, issued an open letter to the CEOs of all publicly traded companies, in which he warned that BlackRock will be asking officers and directors some tough questions around how they integrate ESG principles into their long-term strategy and management.

"I want to reiterate our request, outlined in past letters, that you publicly articulate your company's strategic framework for long-term value creation and explicitly affirm that it has been reviewed by your board of directors," Fink wrote. "This demonstrates to investors that your board is engaged with the strategic direction of the company. When we meet with directors, we also expect them to describe the board process for overseeing your strategy."

"A company's ability to manage environmental, social, and governance matters demonstrates the leadership and good governance that is so essential to sustainable growth, which is why we are increasingly integrating these issues into our investment process," Fink added. To further emphasize its commitment to this approach, BlackRock released its first set of questions it will ask senior management and board members concerning human capital management.

A recent client alert by law firm Womble Bond Dickinson highlights the magnitude of Fink's letter: "These actions are virtually 'quasi-regulatory' in nature, since BlackRock's assets under management (at $6.2 trillion) are larger than the GDP of many nations. In fact, if BlackRock were a country and its assets under management were the country's GDP, BlackRock would be the third largest economy on the planet—and that's a trading partner that is too large to be ignored."

Compliance risk

From a regulatory and compliance standpoint, the United States is not on the same page as other countries. France, for example, in 2015 became the first country to mandate climate change-related reporting for institutional investors. Article 173 of France's "Energy Transition for Green Growth Act" requires that French asset management firms and institutional investors disclose information on how they incorporate ESG—and particularly climate-related—criteria into their investment portfolios.

In the United States, investors and companies are collaborating to drive similar efforts. In June 2017, the Task Force on Climate-related Financial Disclosures (TCFD)—founded by former New York City Mayor Michael Bloomberg and established by the Financial Stability Board—developed voluntary recommendations on climate-related financial disclosures.

The Task Force structured its recommendations around four key themes: governance, strategy, risk management, and metrics and targets. The four overarching recommendations are supported by recommended disclosures that build out the framework with information that will help investors and others understand how reporting organizations assess climate-related risks and opportunities.

Since the recommendations were published, more than 237 companies with a combined market capitalization of over $6.3 trillion have publicly committed to support the TCFD. These companies represent a variety of industries—construction, consumer goods, energy, metals and mining, and transportation—across 29 countries. All of this is to demonstrate that there is a growing global push toward—not away from—more transparency around the quantity, quality, and availability of ESG-related disclosures.

Blood, who served as a member of the TCFD, said that in thinking about financial disclosures, it's more than just disclosing raw carbon statistics and the company's carbon footprint. Rather, it's how the company thinks about risk and opportunity and how that permeates through the company—starting with the board, how those efforts are supported by senior leadership, and how it's translated into business strategy.

For others interested in implementing its recommendations, the TCFD announced plans to launch a Web-based platform, the "TCFD Knowledge Hub," which will provide tools and other implementation resources, as well as references and links to other climate-related disclosure frameworks that have incorporated the TCFD recommendations. ■

COMPANIES IN ACTION

Below are examples of a few companies that actively engage their investor base, and how they do it.

Intel relies on consistent investor engagement to guide its strategic priorities. To reach a broad range of investors, companies should share their sustainability messages across a diverse group of engagement forums. In the opening statement to shareholders at Intel's 2017 Annual General Meeting, the company explained to investors how it integrates sustainability into strategies, management systems and goals across its supply chain. Throughout the year, Intel holds additional investor engagement sessions across the country to capture feedback on corporate responsibility practices. Intel's outreach team—a collaborative effort of the corporate responsibility, investor relations, and corporate governance teams—gathers feedback from leading ESG research firms and socially responsible investors on reporting practices and topical issues of concern. Intel's annual SEC filings describe how the company incorporates this investor feedback into its actions and plans.

Jacobs Engineering engages investors on its plans to tackle water scarcity in the United States. The rapid growth of Ceres' Investor Water Hub, which now includes more than 140 investors representing $20 trillion in assets under management, demonstrates increasing interest in the critical issue of water scarcity. At its 2016 Investor Day presentation, architecture firm Jacobs Engineering identified water as a high-growth area for its business practices due to increasing water scarcity and the United States' aging water infrastructure. In 2017, Jacobs Engineering announced it was acquiring CH2M, an engineering consultancy with expertise in water infrastructure, nuclear energy and environmental remediation. Jacobs' presentation to investors highlighted CH2M's leadership in wastewater treatment and desalination, which will help Jacobs grow its water services business, creating new opportunities in building smart urban infrastructure. Jones Lang LaSalle's investor engagement leads to increased CEO involvement and oversight for sustainability. Sustainable business leaders are defined by the strength of their management systems. Through its efforts to engage investors, JLL found that many of its shareholders were concerned about environmental sustainability issues, such as energy use and GHG emissions, as well as corporate sustainability innovation and thought leadership. This additional input, including feedback from clients and other stakeholders, helped lead the company to establish CEO and other executive oversight of the company's sustainability program. According to Jones Lang LaSalle, "embedding sustainability into its operations improves its investment returns to its investors and also helps attract sophisticated investors to LaSalle's investment platforms.

Source: Ceres

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