ESG and Third-Party Risk Management

ESG FUNDAMENTALS AND YOUR THIRD-PARTY RISK MANAGEMENT PROGRAM

venminder

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Corporate social responsibility (CSR) and environmental, social, and governance (ESG) are hot topics these days.

Every day we see headlines related to climate change, poverty, depletion of natural resources, pollution, modern slavery, racial and gender inequality, and armed conflicts or wars.

When it comes to the business world, the question is: How do these matters interact with third-party risk management?

The answer can be both surprisingly simple and incredibly complex. First, every organization that utilizes third parties to deliver products or services are responsible for the risks posed to thier organization and its customers as a result of any third party relationship. Those risks include the environmental, social, and governance risks within the supply chain. However the ability to identify those risk factors, let alone mitigate them, can be extremely challenging for even the most sophisticated organizations.

The first step in the process is to have a firm understanding of the issues, how and where they occur, and the industries that are most vulnerable to environmental, social, and governance risks.

5 QUESTIONS TO CONSIDER:

1. What are the key issues and concerns addressed through CSR and ESG?
2. Are regulators responding to these concerns?
3. How can CSR and ESG affect corporate sustainability?
4. What is the role of third-party vendors within CSR and ESG topics?
5. How should my third-party risk management framework address these risks and issues?

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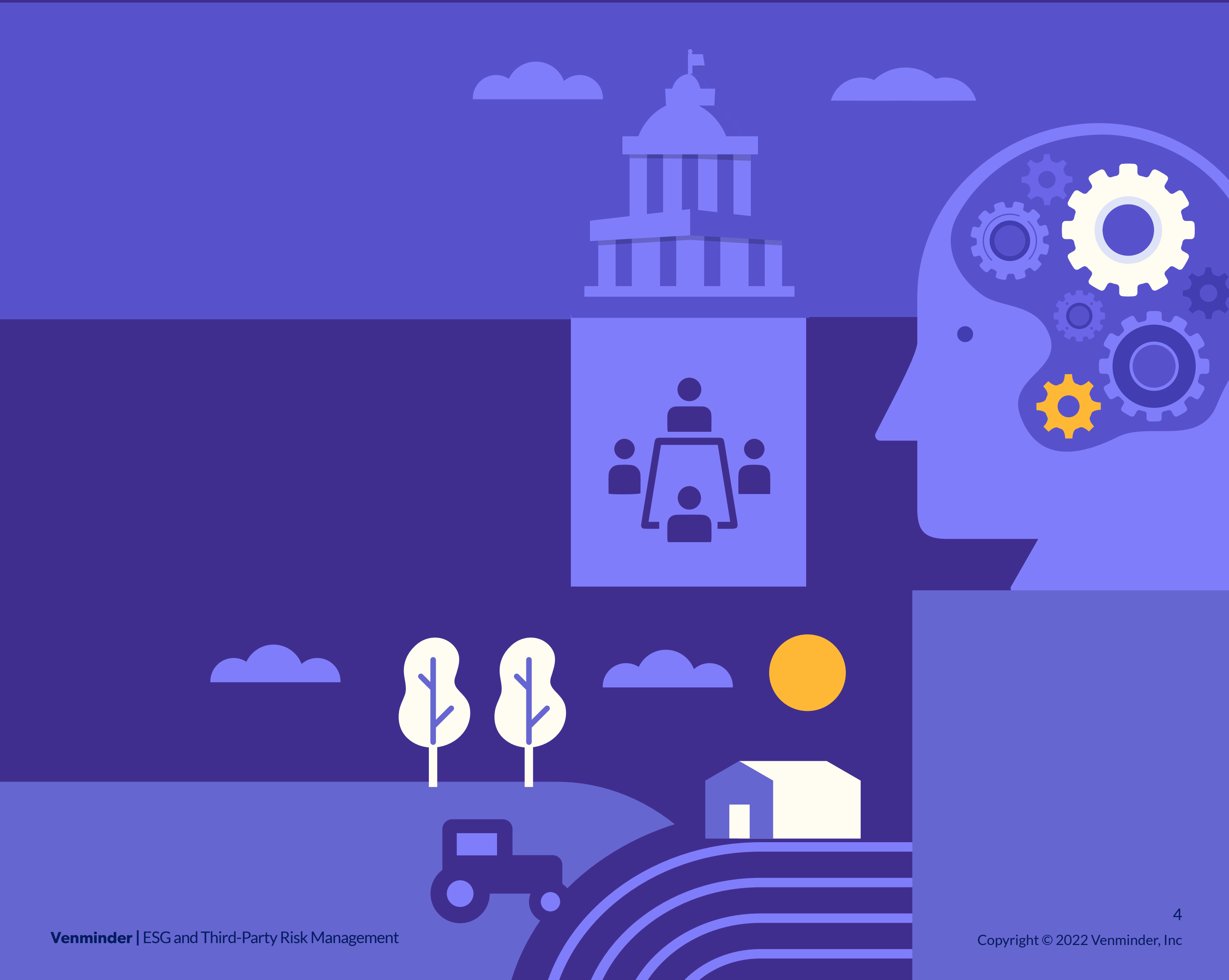
Section 1

Understanding Corporate Social Responsibility (CSR) and Environmental, Social, and Governance (ESG)



To begin, it's important to define and understand some core concepts related to CSR and ESG. These two ideas can function together, but each has its *own objectives*.

Historically, many businesses have prioritized profits over ethical issues, but the history of CSR and ESG has spanned thousands of years.

This section will cover the basics of CSR and ESG, while also describing the value they can bring to your business. If you're still in the early stages of building a CSR or ESG program, it might be difficult to understand how these issues can play out in the real world. Within this section, you'll find an example of how the clothing industry can have immense impacts to people and the planet.

There are no easy answers to these problems, but business leaders should begin to evaluate their stance on certain issues, especially as they pertain to their organization's sustainability.

What Is CSR and ESG?

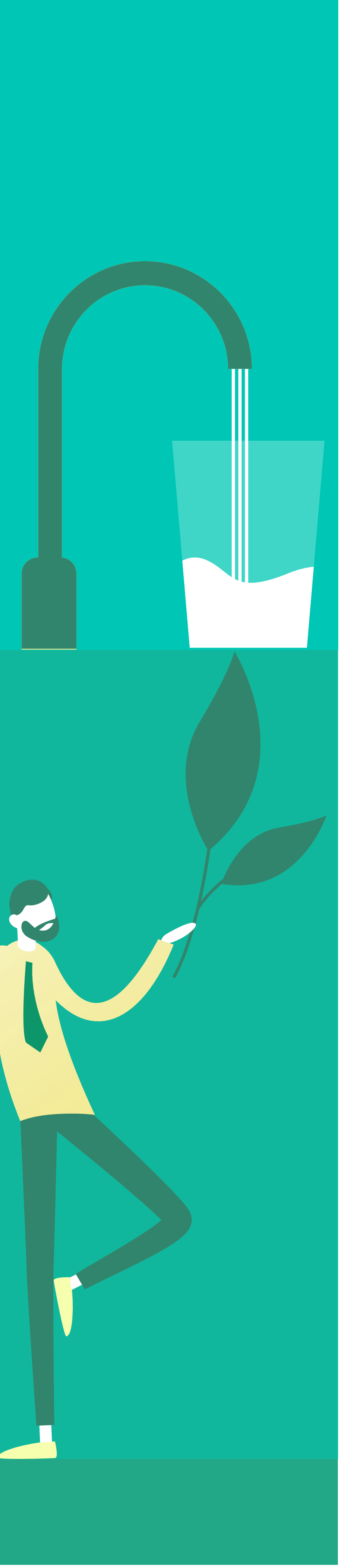
The International Organization for Standardization (ISO), a standard setting body, defines CSR as, "The responsibility of an organization for the impacts of its decisions and activities on society and the environment, resulting in ethical behavior and transparency which contributes to sustainable development, including the health and well-being of society; takes into account the expectations of stakeholders; complies with current laws and is consistent with international standards of behavior; and is integrated throughout the organization and implemented in its relations."

At a high level, all CSR and ESG programs are built on the idea that a business undertakes actions intended to positively impact the environment and society.

And generally, those actions include a commitment from the organization to incorporate CSR into their decisions and strategy, with many organizations setting specific goals and objectives related to their promise. In the case of ESG, a more formalized approach, the goals and objectives are paired with metrics to measure progress. In addition, ESG metrics and measures are meant to be reported to the public.

Despite the nuanced differences between CSR and ESG, both have foundations based on the principle of sustainability.

Let's take a deeper dive into sustainability, CSR, and ESG.



Sustainability

Sustainability can be simply defined as the ability to be maintained at a specific rate or level. To put it simply, how long can an organization run its operations in the same way they do today? Over the past decades, sustainability has been further defined as meeting our own needs without harming people or the planet and compromising future generations' ability to meet their needs. In addition to natural resources, everyone must also have social and economic resources to meet their needs.

The current model of sustainability embodies three distinct components:

Environmental:
Maintaining ecological integrity and balance of earth's natural systems, while natural resources, consumed by humans, are used at a rate where they can replenish themselves.

Economic:
Human beings worldwide can gain or maintain their independence and access the resources they require, financial and other, to meet their needs. Economic systems are intact and are available to everyone, such as secure sources of work and livelihood. And, they have access to enough resources to keep their families and communities healthy and secure.

Social:
Universal human rights and necessities are attainable by all people. Communities have ethical and just leaders who ensure personal, labor, and cultural rights are respected. Legal justice is applied equally and all people are free from discrimination.

CSR

CSR is generally considered a self-structured and controlled business management concept that can help an organization be accountable to its employees, investors, customers, and the public.

It's primarily designed to contribute to societal goals of a charitable, philanthropic, volunteer-oriented, or influential nature by engaging in, or supporting, social or environmental causes and ethically-oriented practices.

Keep in mind that CSR is a broadly defined term and can take many forms depending on the industry or geography. In China, for example, CSR may be recognized as making high-quality and safe products. Whereas, in Germany, it may mean creating good jobs. In South Africa, it may be an organization's contributions to social needs such as healthcare and education.

And, the United States (U.S.) and European Union (EU) are very broad ranging in their interpretation – it tends to include everything from the treatment of the environment to fair working conditions, diversity, and inclusion, to ethical corporate behavior.

ESG

ESG takes CSR to the next level. ESG can be defined as translating CSR issues into reportable factors using metrics that objectively measure and report an organization's status and progress.

ESG data attempts to measure the intangible assets within an organization and covers a broad spectrum of issues traditionally excluded from financial analysis. These reports are often used by investors to screen potential investments and evaluate an organization's operations.

The investment community has embraced the theory that an organization's valuation is incomplete unless its social capital and sustainability are included in the calculation.

Triple Bottom Line (TBL)
ESG is also closely aligned to a financial theory called the Triple Bottom Line. TBL theory suggests that instead of one bottom line, there should be three: profit, people, and the planet. Organizations should place equal focus on social issues, environmental concerns, and profits. Investors are also looking at the triple bottom line through ESG reporting to identify potential financial risks not traditionally measured.

CSR & ESG Throughout History

Societal expectations of business have evolved dramatically over the past several decades, but that doesn't mean the idea that trade and commerce can benefit society is new. In fact, this notion goes back thousands of years, and it has been traditionally rooted in religious belief. In Christianity, one should seek to avoid business practices that are sinful or unholy. Islam forbids charging interest on loans, and Judaism advocates financial investments to drive social good.

Here are a few more historical examples where **both investors and the public** expressed the expectation that profit should not come at the expense of people or the planet.

1758

In Philadelphia, the Quaker leadership forbade their members from profiting from the slave trade. **The Quakers determined that slave trading was unethical; thus, no one should profit from it.** This is recognized as the first time the term "socially responsible" was used in investing.

1872

John Wesley of the Methodist Church gave a sermon titled "The Use of Money," where he identified firearms, liquor, and tobacco as "sin stocks." Wesley said: **"We ought to gain all we can gain, but this it is certain we ought not to do; we ought not to gain money at the expense of life, nor at the expense of our health."**

1968

The first non-religious approach to socially responsible investing happened back during the unrest with Vietnam War, the Civil Rights movement and the attention around equality for women. **One specific example is shareholders requesting that Dow Chemical stop the production of napalm.**

1988

Anti-Apartheid investors reviewed **$625 billion of investments and excluded South African businesses and projects.**

**Sources: sgENGAGE, TCIWealth and Bailard*

Differences Between CSR and ESG

Without the foundation of CSR, ESG wouldn't be possible, but the two shouldn't be used interchangeably. While CSR intends to make a business accountable, ESG benchmarks make its efforts measurable. CSR activities and standards vary tremendously between businesses and industries, and there is a lack of comparable metrics. ESG activity, on the other hand, is quantifiable using metrics and reporting.

The Business Value of CSR and ESG

The notion that an organization should act in a way that doesn't harm people and the planet hasn't always been a popular one. For years, successful businesses were measured by how much their shareholder value increased or by their profits. Yet, today, many shareholders, employees, investors, and the community demand that organizations conscientiously minimize negative impacts to people and the planet resulting from their operations.

Many studies demonstrate that CSR and ESG programs can positively impact an organization's finances, employee engagement, investor opinion, and even creditworthiness. However, that doesn't mean that all organizations are ready to go all in with sustainability goals or commitments. Some organizations turn to CSR or ESG only after an adverse event has damaged their brand or bottom line. Regardless of why organizations commit to CSR or ESG, the court of public opinion

harshly judges the actions or inactions of every major organization and corporation. According to our calculations done with data from ZDNet, Sprout Social, and the White House Office of Consumer Affairs, in these days of social media, an organization with a negative reputation is more than nine times as likely to be the subject of a social media post than a peer with a good reputation.

While improvements to the bottom line are essential, doing the right thing is equally important for many organizations, but not always for the most obvious reasons. Being "good" for the sake of being good is not the whole story. To run a "good" and profitable business, you must be IN BUSINESS. That is where the idea of sustainability really comes into play.

> **Organizations are waking to the reality that there will be no business without responsible treatment of the earth and its people.**

EXAMPLE

Growing and selling agricultural products necessitates an appropriate climate, nutrient-rich soil, enough water, and people to cultivate and harvest the crops. Farming practices that ruin soil quality, pollute the water, or use pesticides that kill pollinating bees will drastically limit future crop production and quality.

Imagine you're a lumber manufacturer. You need healthy forests that are constantly replenished both now and in the future, or you'll literally have no product to sell.

Sacrificing what you need tomorrow to get all you can today is shortsighted and not the way to build a long-lasting and profitable business.

That is why many organizations are choosing sustainability over outright profit. It's the best plan to ensure the viability and success of their organization in the future.

CSR and ESG in the Real World

Now that you have learned the basics of sustainability, CSR, and ESG, you can apply your understanding to the following example. Let's look at the product cotton and place it center stage in a fictional story about a large corporation experiencing real-world issues.

STORY

The $5.00 T-Shirt and the Uncomfortable Side of Cotton

Our story begins with cotton. Virtually everyone has something made from cotton. Unfortunately, many of us never think about how cotton is grown or finished into fabrics and other materials.

Yet, it's around us every day in clothing, shoes, baby products, personal hygiene products, household goods, bandages, and medical dressings. Cotton is also used as an industrial material in tires, mattresses, tents, and even the space shuttle.

Cotton is the most common textile fiber in the world. It's natural, breathable, comfortable, and known for its durability.

Approximately half of all textiles in the world are cotton. According to UL (ul.com), cotton is so popular that **20 million tons of cotton are produced in approximately 90 countries each year, providing income for over 250 million people worldwide.**

The average per person consumption of cotton equals about **42 square meters (or about 450 sq ft) per year.** That is about the same size as a small apartment.

Thus, cotton is literally "the fabric of our lives." **But, all that lovely and "natural" cotton has a darker side that can be problematic from a sustainability perspective.**

Water Use

Cotton is a highly water-intensive crop. On average, making one kilogram of cotton takes 10,000 liters of water. So, to make one t-shirt, it takes about 2,700 liters of water, which is about the same amount of water the average human might drink in three years.

Cotton cultivation uses so much water that the world's fourth-largest lake, the Aral Sea, has all but vanished due to diverted water used for cotton farming. Not only did the lake dry up, but as it did, the water salinity increased, decimating the once thriving fisheries that fed and nourished the local population. In addition, the blowing dust from the lakebed was so contaminated with fertilizer and pesticides that it became a severe health hazard. Without water, the lake bed was a dry and dusty bowl.

1 kilogram
of cotton
takes
10,000 liters
of water

The winds came and caused terrible dust storms, which spread the contaminated dust onto food and other agricultural fields. The dust degraded the soil to such a degree that those crops needed to be flushed with yet more and more water.

Pesticide Use

Cotton production represents 2.5% of the world's cultivated land yet accounts for 24% of global insecticide and 11% global pesticide use.

Cotton is the most pesticide-intensive crop in the world. The chemicals and fertilizers used to grow cotton are known for the damage they cause to plants and waterways, reducing biodiversity both in and near the cotton fields. The chemicals used seriously threaten the health of farmworkers and adjacent communities. They also contaminate lakes, rivers, aquifers, and wetlands, causing even more damage to the local ecosystem and threatening the health of natural vegetation, wildlife, and human beings.

Typical commercial cotton farming also severely degrades soil quality. Cotton demands so much water that soil salinization increases, causing other crops to struggle or fail if cultivated where cotton has been grown. While the global area for producing cotton has remained relatively constant over the last 70 years, production has dropped significantly because the soil is so depleted. And, when the soil can no longer sustain the crop, the cotton growers expand the fields, further destroying already vulnerable habitats and ecosystems.

Cotton accounts for
24%
of global
insecticide use

Now that you've learned more about the cotton industry, it's time to meet Pat Crawford, the fictional CEO of a big-box retailer. Pat is responsible for thousands of stores that sell household products and goods, affordable clothing, electronics, and food. Most of their customers are families with young children, young working adults, and the elderly. The store brand is all about enjoying "great products for a good price."

Pat's organization is known for its affordable, yet stylish, clothing. Four times a year, the organization has a promotion featuring $5.00 t-shirts, which has been very successful. Sales data indicate that sales in all product categories are up 5%-12% during these promotions.

So, why might Pat be concerned about current cotton cultivation practices and the decreasing production rates?

- Twenty-six percent (26%) of their sales and 14% of their year-over-year growth is attributed to apparel
- Cotton is used in 95% of all the clothing they sell
- The global demand for cotton is increasing and production is decreasing

Apparel is a huge part of Pat's business, and cotton is the core fiber in the clothing. If less cotton were available, the prices of their apparel would increase. Pat knows the organization can pass some of the increased cost to the customer. Still, they'll see far less profit from clothing sales. What if the cotton harvests become smaller and smaller each year? How can they maintain that segment of their business? Regrettably, the apparel segment has given Pat more to worry about than sales and profit.

Recently, the organization and two of its primary competitors have been in the news for purchasing cotton harvested by children for no pay. These children were forbidden to go to school or see their families during harvest. In addition, several children were found to have severe respiratory health issues from the pesticides used on the cotton.

This public relations crisis has forced Pat to learn more about farming, harvesting cotton, and producing finished textiles. Pat discovered that many communities engaged with cotton production are experiencing severe health impacts.

Cotton accounts for

11%

of global **pesticide** use

In several cotton-producing regions, agrochemical pollution has become so bad that people no longer have access to clean drinking water or locally grown food to eat.

As a result, many workers are in poor health. In addition, the whole region has been impacted as workers begin to migrate to other communities searching for less dangerous work. Worst of all, this work is often forced upon women and children, some as young as four years old. They can be subject to long hours without food and rest, and with no pay.

As the CEO, Pat is exceptionally concerned about the environmental and human impacts of cotton production. Pat is outraged to hear about the abusive work practices and child labor. At the same time, Pat is also apprehensive about the future of the organization's apparel segment, a significant contributor to the bottom line. After all, the organization employs almost 200,000 people.

What might happen if the products sold in the organization's stores became more expensive and therefore less profitable? What if the brand went from "family favorite" to "worst of the worst"? In that case, its workers might lose their jobs, impacting hundreds of families and their communities. Furthermore, Pat knows the organization's brand is at risk if it continues business as usual.

Pat and the organization are now asking some hard questions, such as:

1. How did this happen and how can we stop it?
2. What is the true cost of a $5.00 t-shirt?
3. Is it worth it?

Suppose Pat and the organization want to implement CSR or ESG practices related to their apparel products. In that case, the organization can't realistically expect the same growth or profits related to cotton clothing. While the cost of cotton is low now, and profits are good, the devastating impacts on many people and the planet are too high. Pat knows there is work to be done. However, just how does an organization balance the needs of the business with the needs of people and the planet?

There are no quick and easy answers. Pat must collaborate with internal and external stakeholders to chart a new plan as the organization's current practices regarding cotton are not sustainable.

Fortunately, both Pat and the organization are fictional. **Unfortunately, scenarios like this are entirely too real.** Organizations everywhere are starting to examine how those environmental and social risks occur in their supply chains and what can be done to manage them. This is no easy task, as the complexity of global supply chains and international commerce enable unscrupulous players to integrate into the market and often go undetected. And, differences in environmental standards and human rights vary dramatically by country. Even organizations with the best intentions and solid reputations can find themselves entangled in human rights abuses or labeled as polluters. This is how many organizations begin their journeys with CSR and ESG.

Section 2

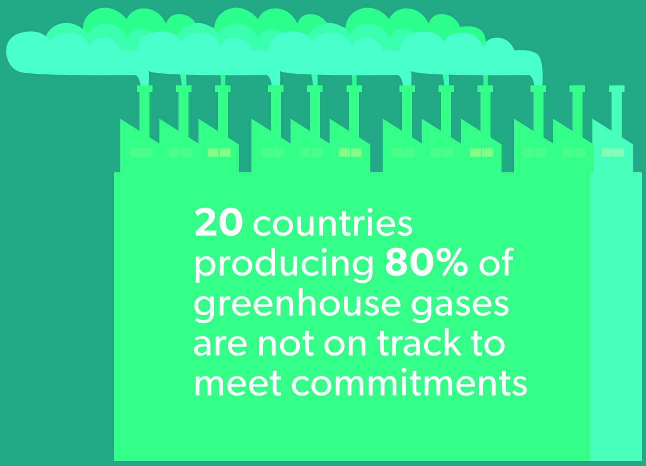
Distinguishing CSR and ESG Issues – *Climate Change, Modern Slavery, and Applicable Regulations*

Identifying specific issues to be addressed, and the measures taken to address them, is essential in any corporate social responsibility (CSR) and environmental, social, and governance (ESG) program. Learning the fundamental concepts of these issues is a practical first step. This section will cover the most identified issues that need to be addressed through CSR and measured through ESG, as well as some high-risk countries and industries.

First, it's helpful to realize that there is no comprehensive list of CSR or ESG factors and issues. Many problems are interconnected, so many subjects don't fit into a single category. The information in this section is designed to provide guidance and illustrate concepts of CSR and ESG. However, it's essential to remember that CSR is used to communicate what an organization does to make its organization accountable, while ESG uses specific benchmarks to make those efforts measurable. Look for examples throughout this section that show a CSR objective versus an ESG metric.

STATS

Carbon emissions reporting is mandatory for certain organizations and is a key component of ESG reporting



Most G20 countries have some kind of mandatory emissions reporting regulation. **These 20 countries, which together produce 80% of the world's greenhouse gases, are not currently on track to meet the commitments they made in the Paris Agreement**.

Since 2009, the United States has required facilities emitting at least 25,000 metric tons or more of carbon dioxide to report their greenhouse gas emissions to the Environmental Protection Agency every year. Together those facilities account for about 3 billion metric tons CO_2e, which is about half of total U.S. emissions.

*Source: UL (www.UL.com)

3 CSR Issue Categories with ESG Dimensions of Measurement and Reporting

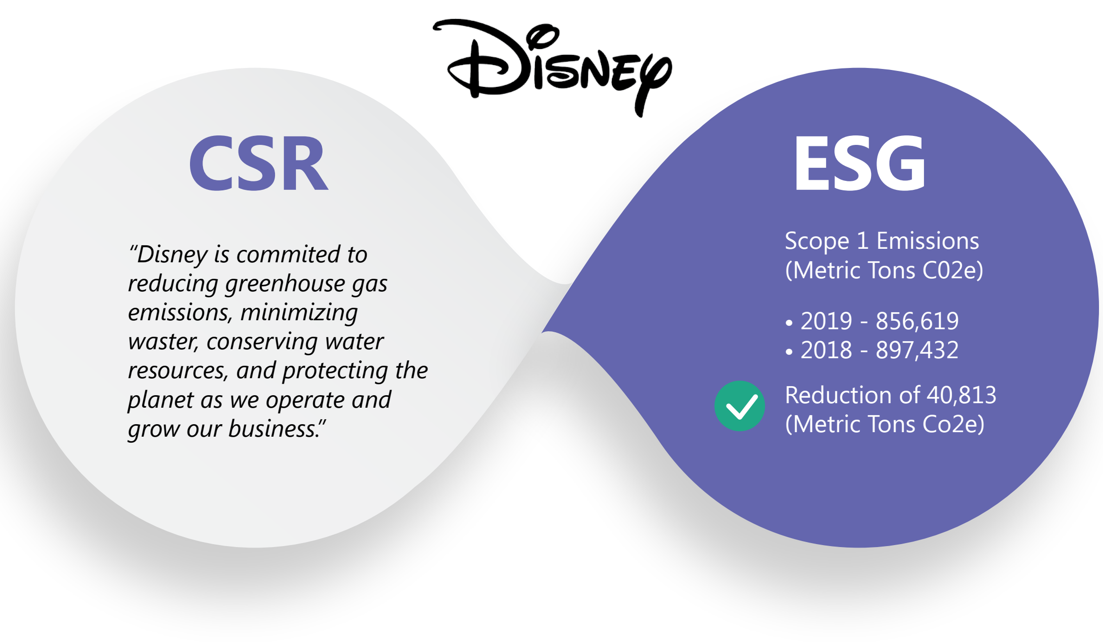
When developing a CSR program, it's important to address the three areas of ESG impacts. Not only will these issues need to be identified within the program, but there should also be an established set of metrics used to report them. These metrics will vary for each organization, so read through some of the suggested questions below to help guide your program.

Environmental Issues

These are issues related to the treatment of the earth and the use of its natural resources. Environmental impacts from an organization's operations, vendors, and subcontractors are in scope. Additionally, the lifecycle of the products must be considered from production, packaging, transportation, distribution, use, and end of use recycling or disposal.

Environmental metrics measure an organization's energy use, waste, pollution, natural resource conservation, and treatment of animals. The criteria can also aid the assessment of environmental risks an organization might face and how the organization is managing those risks.

Check out the environmental chart from the Walt Disney Organization which correlates its CSR goals with ESG metrics:



***Source: Walt Disney Company CSR Report**

EXAMPLES

Environmental Impacts

- Air pollution
- Biodiversity
- Carbon emissions
- Clean energy use and technology
- Climate change
- Deforestation
- Energy efficiency
- Mining and minerals
- Ocean conservation
- Recycling and reuse
- Waste prevention and management
- Water conservation and scarcity
- Water pollution

Environmental Considerations

- Does the organization own contaminated land?
- How does it dispose of hazardous waste and manage toxic emissions?
- Does it comply with government environmental regulations?

Social Issues

These issues are related to the consideration and treatment of people. This includes employees of both the organization and its vendors and subcontractors as well as customers, the community, and people worldwide. Social metrics measure the organization's business relationships.

EXAMPLES

Social Issues

- Modern slavery and human trafficking
- Diversity, equity, and inclusion
- Employee relations
- Gender equality and equity
- Customer service and satisfaction
- Data rights protection and privacy
- Human rights
- Health and wellbeing
- Community impact and relations
- Education
- Labor practices

Social Considerations

- Do the organization's suppliers share their values?
- Does it give back to the local community either by donating profits or encouraging employee volunteer work?
- What benefits do they provide their employees?
- Do the organization's working conditions show high regard for its employees' health and safety?
- Are other stakeholders' interests considered?

The social issues above are serious and deserve awareness and action. **Special attention must be given to modern slavery and human trafficking,** both of which are rampant and hard to detect. These forced labor practices are regularly obscured by complex supply chains, multiple subcontracting relationships, and unscrupulous third parties.

Governments worldwide are undertaking measures to stop these practices through regulation, monitoring, and law enforcement. Still, it's the responsibility of businesses to detect and mitigate these practices in their supply chains. We will expand on modern slavery in the section dedicated to Risks, Regulations, and Reporting on page 23.

Here's a real-world example of CSR goals and ESG metrics within the social category:

HERSHEY'S

CSR

"Hershey does not tolerate child labor within our supply chain and is working to eliminate it from occurring within cocoa communities."

ESG

Children monitored*

2019	**68,988**
2018	**33,956**

Children identified doing inappropriate work and in remediation*

**We continue to expand our CLMRS program to cover a greater portion of our supply chain, year over year. The current increases in children monitored and children identified doing inappropriate work is reflective of the continued growth of the program.*

***Source: Hershey Sustainability Report 2019**

Governance Issues

The below issues represent how organizations are managed at the highest level and include moral and ethical standards. Governance also speaks to the management mechanisms and tools that hold people accountable and includes these areas:

Governance Issues

- Board structure and composition
- Codes of conduct
- Organization purpose, strategy, and accountability
- Corporate governance
- Corruption and bribery
- Crisis management and resiliency
- Data and privacy management
- Executive compensation
- Gender pay gap
- Policy influence and political contributions
- Corporate social responsibility
- Risk management
- Supplier codes of conduct and ethics
- Supply chain awareness and risk management
- Supply chain integration of ESG
- Tax strategy, reporting, and governance

Governance Considerations

- Does the organization pay fair taxes?
- How does it manage risk?
- What is the executive compensation like?
- Does it respect the rights of investors and other stakeholders?
- Does the organization prevent and avoid bribery and corruption?
- What is the structure and diversity of the board?
- What political donations do they make, and do they utilize lobbyists to gain political influence?
- How do they manage gender diversity and equity in the workplace?
- Are the advertising and marketing truthful and in the best interest of the consumer?

CSR and ESG Risks, Regulations, and Reporting

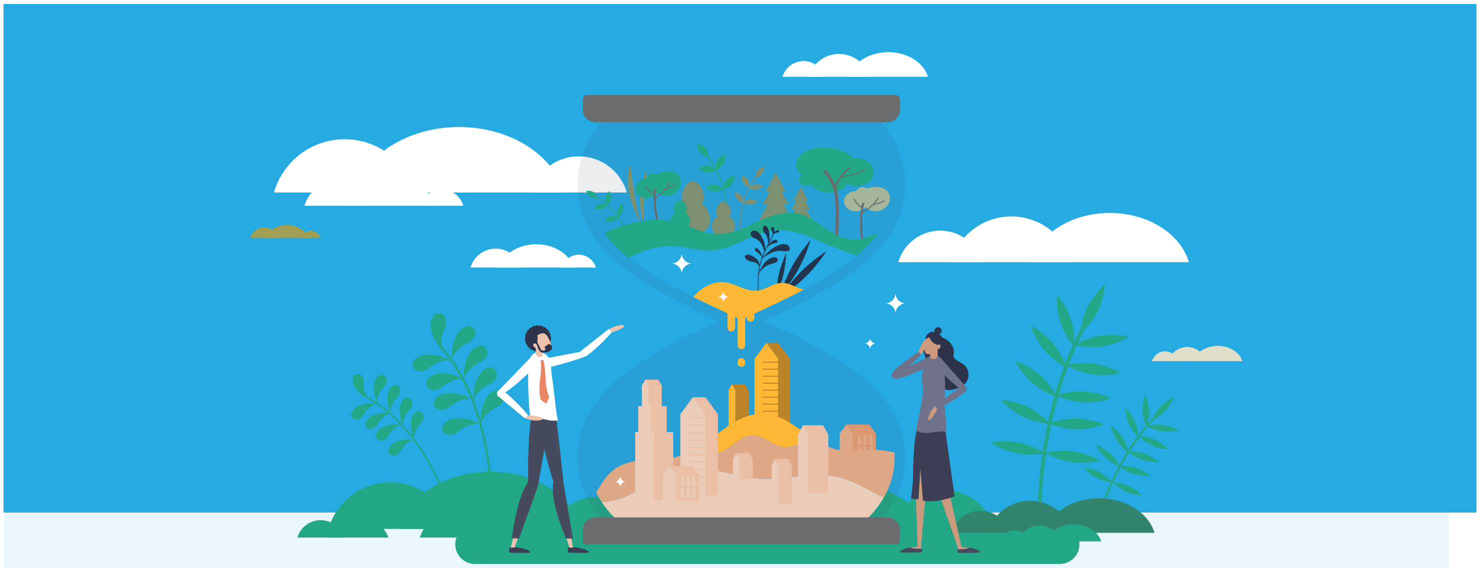
There are many risks and issues to consider in the broad spectrum of CSR and ESG. However, two problems are gaining the most attention worldwide and are closely intertwined: **climate change and modern slavery.**

> **It's no coincidence that these two issues are (or should be) at the forefront of any CSR or ESG discussion. Climate change isn't just a CSR or ESG factor. It's now considered a systemic risk to the financial sector and worldwide economies.**
>
> **Also, modern slavery is the greatest moral crisis of our time. Both the public and private sectors are demanding swift and measurable action to mitigate these risks.**

What is systemic risk?

Systemic risk describes an event that can spark a major collapse in a specific industry or the broader economy.

A World Bank 2018 Groundswell - Preparing for Internal Climate Migration report notes that if sufficient climate action isn't taken, more than 140 million people may be displaced by the impacts of climate change by 2050. Previous research conducted by the International Labor Organization and the International Organization for Migration has also established a clear link between risky migration and various forms of exploitation, including trafficking, debt bondage, and forced labor.



Let's examine both climate change and modern slavery risks in more detail:

Climate Change

Most of us are already aware of the debate surrounding climate change, including the claims that it's a hoax or bad science. We won't jump in that particular rabbit hole here, but we'll instead look at climate change's current and future term impacts as noted by scholars, scientists, and financial experts. **Under their current estimates, the overall social, environmental, and economic impacts of climate change could rise to cataclysmic levels much sooner than most realize.**

NASA's definition of climate change describes it as: "*a broad range of global phenomena created predominantly by burning fossil fuels, which add heat-trapping gases to Earth's atmosphere. These phenomena include the increased temperature trends described by global warming, but also encompass changes such as sea-level rise, ice mass loss in Greenland, Antarctica, the Arctic, and mountain glaciers worldwide; shifts in flower/ plant blooming and extreme weather events.*"

Experts agree that the world is at risk of irreversible climate change as early as 2030, unless greenhouse gases resulting from human activity are drastically reduced. Many are alarmed by this prediction for different reasons. Water scarcity, low food production, displaced people, and more frequent and intense natural disasters like hurricanes, floods, and winter storms are all obvious causes for alarms.

What about the financial impacts? Financial risk analysts and economic experts worldwide agree that the potential for severe disruption to the real economy resulting from climate change is significant.

Failure to materially address climate change will cause catastrophic environmental, social, and financial impacts to everyone and everywhere on the planet.

To understand the financial impacts results from the climate change, one must examine the ways the financial system can be impacted:

Physical risks

These are associated with frequent and severe weather events and long-lasting environmental changes. Using the mortgage industry as an example, let's explore the risks and potential financial impacts.

1. **Loss of physical assets.**
Natural disasters such as hurricanes, floods, or wildfires can cause the complete destruction of physical assets like homes or businesses.

2. **Mortgage defaults from lack of insurance coverage.**
The property damage from rising sea levels and flooding may not always be insured and can therefore result in mortgage defaults. Government-sponsored lender, Fannie Mae, discovered that mortgage defaults are more common in areas outside of FEMA flood zones, where flood insurance isn't required. Flood insurance polices have been in a steady decline over the years and homeowners in the west have been subject to increasing premiums and decreasing coverage in fire-prone areas. Homeowners often find themselves with insufficient coverage and are left with mortgage defaults as their only option. Finally, it's not uncommon for property values to decline when they're located in areas affected by natural disasters. This decline can be so steep that the lender won't be made whole, even if the property is sold.

3. **Forbearance rates increase (which decrease lender's liquidity).**
Forbearance and payment relief are often provided to homeowners who have federally backed mortgages and live in areas affected by natural disasters. These homeowners can be eligible to suspend or reduce their mortgage for up to a full year, during which they won't acquire late fees and are protected from foreclosures.

4. **Prepayment.**
Disaster insurance can be used to pay down a mortgage after an extreme weather event. When a mortgage is prepaid, the principal value of the underlying security is reduced, as is the mortgage value for holders of mortgage-backed securities.

5. **Securitization.**
Mortgages that can be securitized after natural disasters are more likely to be approved by mortgage originators. Securitizing risky mortgages can allow mortgage originators to transfer climate-related risks to the secondary market. This is especially true of local lenders who may have a better understanding of these risks and are familiar with the local market. This is what occurred with subprime mortgages leading up to the 2008 financial crisis. In that case, lenders were involved in an originate-to-distribute model of lending which freed them from the risks and allowed them to keep the fees.

Transitional risks

These are risks related to the decarbonizing of financial markets. According to EconoFact, moving towards a greener economy with less pollution may cause significant shifts in asset values or higher costs of doing business for some sectors of the economy.

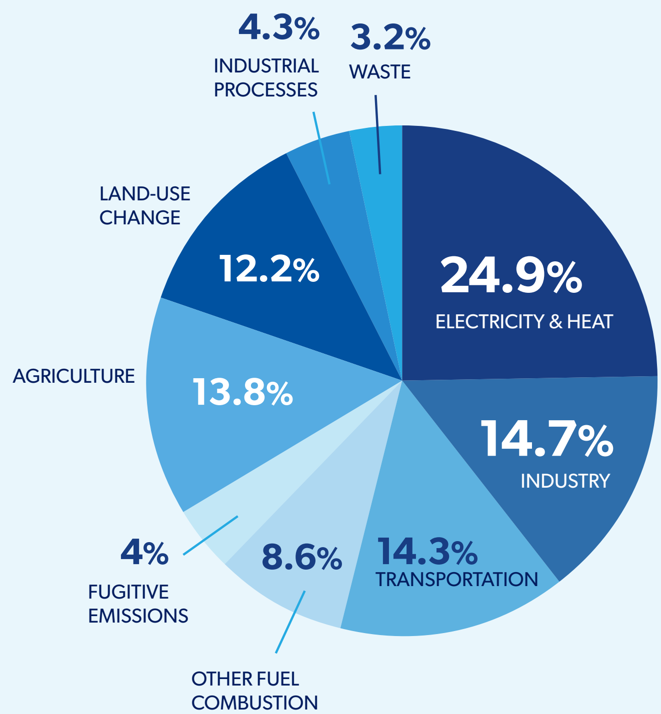
These risks can also affect the economy as a whole, especially if the transition is abrupt and poorly designed. Let's look at two industry examples:

1. **Energy:**
   If global policies were to align with the Paris Agreement, this would result in a ban on 2/3 of the world's known fossil fuel reserves, according to Financial Times, Bank of England, and EcoWatch. This would affect the value of investments that are held by banks and insurance organizations within the oil, gas, and coal industries.

2. **Coal:**
   According to Center for Climate Solutions, 40% of global CO2 emissions are still attributed to coal. The U.S. has moved away from building coal-fired power plants, in favor of cleaner power plants that produce cheaper electricity. Many large banks have also pledged that they won't provide funding for new coal facilities. This has resulted in underperforming share prices of U.S. coal mining organizations, compared to organizations that have clean energy assets. However, the increasing coal consumption in China may increase the costs of these share prices. It's difficult to value coal stocks, as the demand and opinion of coal fluctuates.

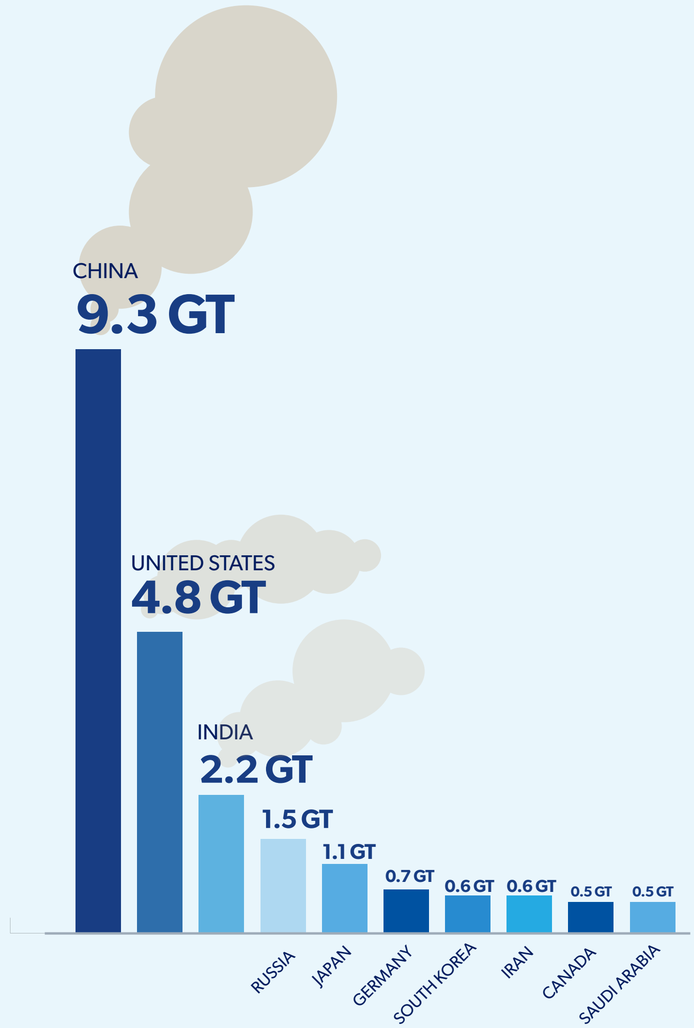
Industries with the Highest Climate Change Risks

According to the Environmental Protection Agency, the following industries have the highest climate change risks.



Largest Emitters of Carbon Dioxide

According to Energy Education of University of Calgary, these are the countries that are the largest emitters of carbon dioxide:



Carbon-sensitive assets that are tied to the utilities, energy, transportation, industrial, and other sectors could lose value depending on a couple of factors. The first one being whether governments and lawmakers take the necessary steps to reduce carbon in the economy.

The second is whether new developments in technology can make this transition more financially appealing. According to Center for American Progress, Adam Tooze, a professor at Columbia University, estimates that **as much as one-third of all equity and fixed income assets are tied to carbon-sensitive industries.**

Financial institutions are under the most pressure to disclose carbon use and reduction goals. Ironically, financial institutions are exposed to the physical and transition risks of climate change.

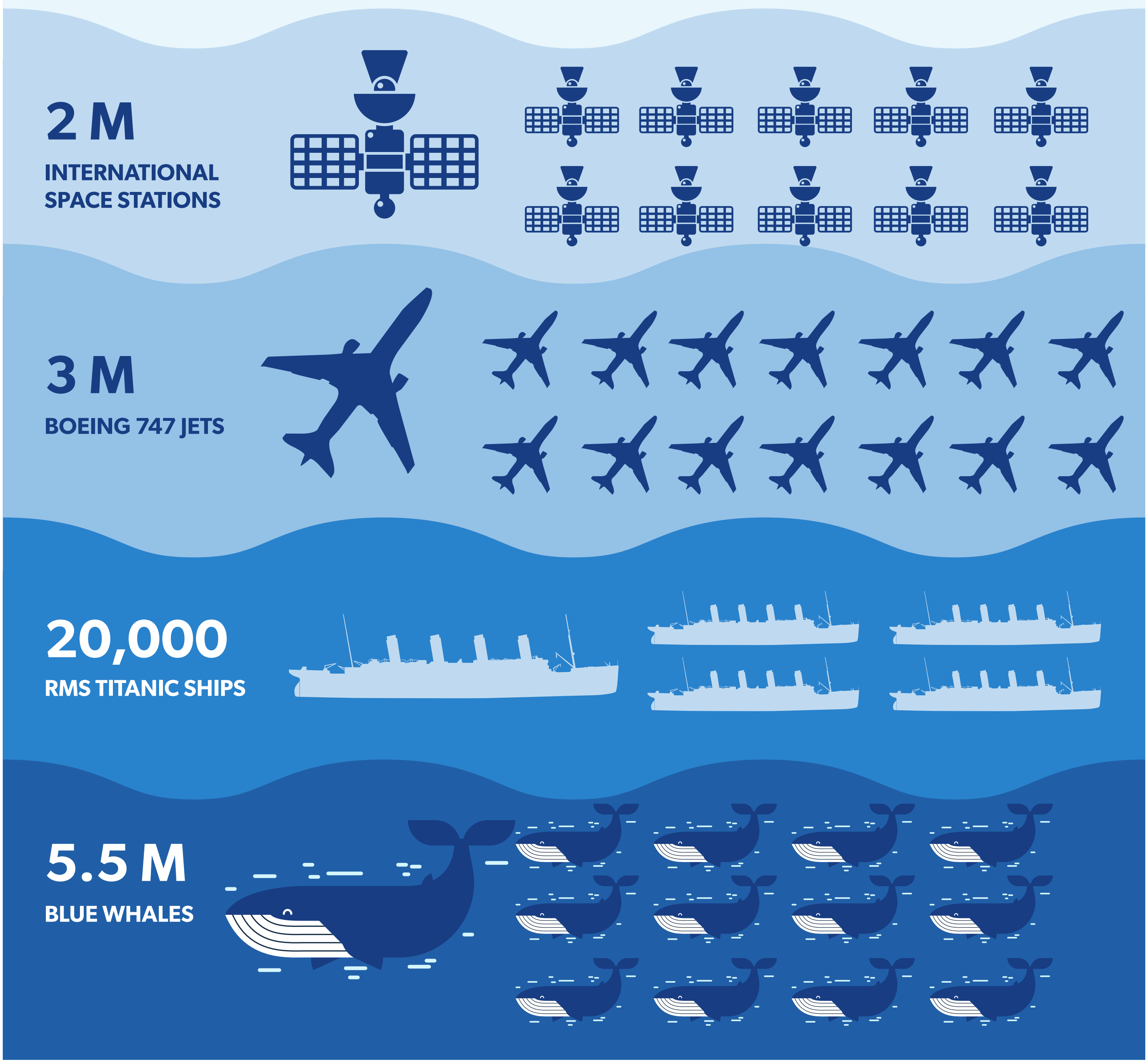
Still, they're also actively exacerbating those risks by providing substantial financing to activities that intensify climate change. The six largest Wall Street banks in the United States committed more than $700 billion toward fossil fuel financing from 2016 to 2018.

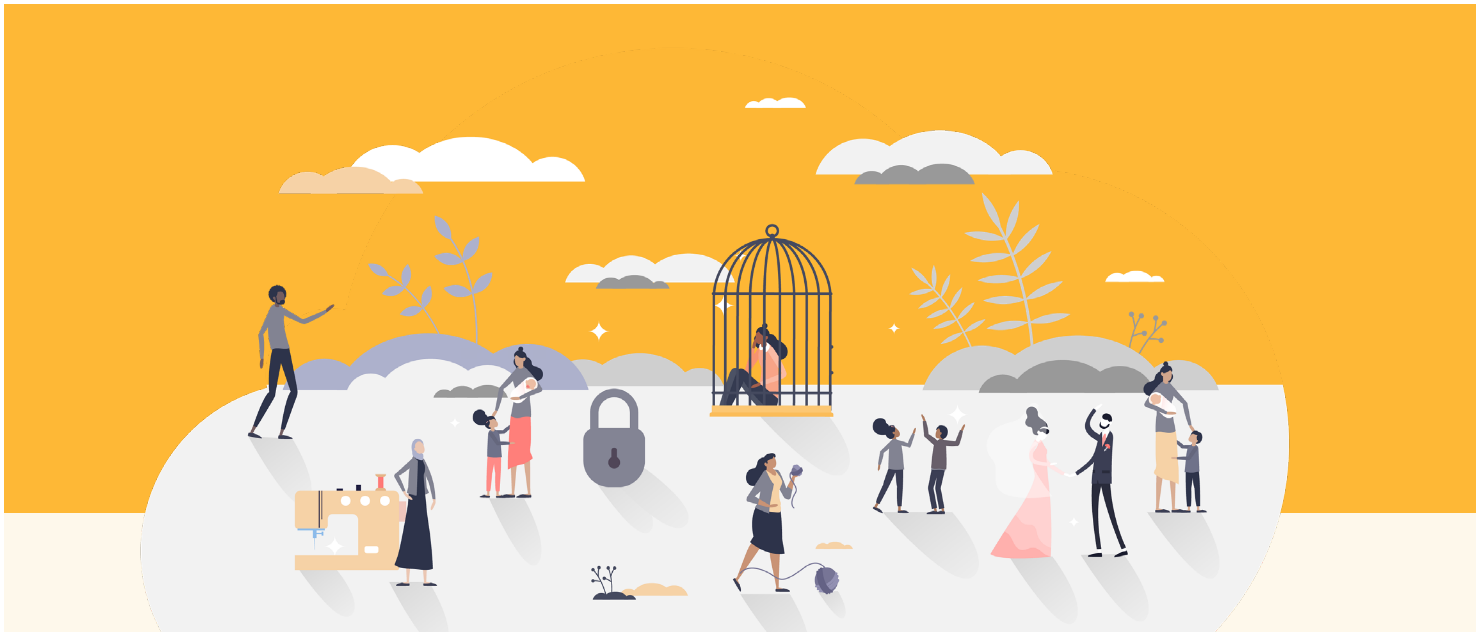
1 GIGATON

Measurements are in gigatons (one GT = 1,000,000,000 tons) which are often used when discussing human carbon dioxide emissions, according to Energy Education of University of Calgary.

A gigaton is roughly the mass of all land mammals (other than humans) in the world.

One gigaton is also equivalent to:





Modern Slavery and Human Trafficking

The International Labor Organization recently estimated that over 40.3 million people live in some form of slavery today, which is more today than any other point in human history. Women and children are particularly vulnerable, making up 71% of enslaved people.

Children alone account for 25% of those enslaved, which amounts to approximately 10 million living in slavery worldwide.

Modern slavery is a profitable business, estimated at $150 billion annually. It's very prevalent in worldwide supply chains that include raw materials, manufacturing, and construction. However, it's often obscured by the complexities within those supply chains, multiple subcontracting relationships, and corrupt third parties.

The U.S. State Department uses the terms "modern slavery," "trafficking in persons," and "human trafficking" to reference many different acts. These can include recruiting, harboring, transporting, providing, or obtaining a person for forced labor or commercial sex acts through the use of force, fraud, or coercion.

The following are different types of modern slavery and human trafficking:

1. **Slavery by Descent or Chattel Slavery**
   In chattel slavery, the enslaved person is considered another person's property and can be bought and sold. Historically, this type of slavery stemmed from conquest or slave raiding, both practices that were common in the Atlantic slave trade.

2. **Bonded Labor**
   Most types of modern slavery fall under the bonded labor category.

Victims of bonded labor are forced to work in order to repay a debt and cannot leave until they do so. Workers are often trapped by debt by being pressured to pay recruitment fees and signing contracts they don't understand, only to receive meager wages. The employer then claims that the wages are needed to repay debts, food, and accommodations, thereby trapping the enslaved person in an endless cycle.

3. **Domestic Servitude**
Maids, nannies, and other household help may actually be victims of domestic servitude if their employer prevents them from leaving by confiscating their travel papers. Migrant workers and other individuals living abroad are especially vulnerable to this type of slavery. A common practice in some recruiting agencies involves deception to trick workers into moving abroad where their employer will seize their travel and ID documents. These workers often face language barriers and are fearful of immigration officials.

4. **Forced Labor**
Victims of forced labor are often threatened with violence and receive no pay. They're treated as property and exploited to create commercial products. Forced labor is used to produce many products in our global supply chains and is especially prevalent in the fishing, textile, construction mineral, and agriculture industries. It's important to realize that forced labor isn't limited to the private and commercial sector. According to the International Labour Organization, at least 2.2 million people are victims of forced servitude, many of whom within state and rebel governments. State prisons, convict leasing programs, and military or rebel armed forces have all been intertwined with forced labor. Children aren't exempt either, as they're often kidnapped and forced to become soldiers.

5. **Sex Trafficking:**
The commercial sex industry can cross the line into sex trafficking when women, children, or men are forced into it and held against their will by fraud or coercion. Victims can be involved in pornography, prostitution, and escort or hostess services.

6. **Child Labor**
This can include street crime like begging or pickpocketing, drug trafficking, or cannabis cultivation. Children can also be victims of any other type of modern slavery like domestic servitude, sex trafficking, and forced labor.

7. **Forced Marriage**
Family members are often the perpetrators of forced marriage, selling their female or child relatives into marriage to repay a debt or as a trade for goods.

Modern Slavery High-Risk Industries and Geographies

Now that you have a better understanding of modern slavery and its various forms, let's review the industries where it's most prevalent.

According to the Modern Slavery Index and SAI Global, here's a list of industries that are most at risk for modern slavery:

- Domestic work, cleaning services, and janitorial
- Agriculture
- Manufacturing
- Construction
- Fishing and seafood
- Clothing and textiles
- Tourism and hospitality
- Mineral and metal mining
- Consumer goods
- Sex industry

According to Walk Free Orgnization, these are the top 10 countries with the highest prevalence of modern slavery:

1. North Korea
2. Eritrea
3. Burundi
4. The Central African Republic
5. Afghanistan
6. Mauritania
7. South Sudan
8. Pakistan
9. Cambodia
10. Iran

Modern slavery isn't only a concern from an industry perspective, but also from an import perspective. According to the Global Slavery Index, among G20 countries, the United States is the world's largest importer of goods at risk of being produced through modern slavery. Following the U.S. is Japan, Germany, the United Kingdom, and France.

Regulations vs. "Soft Law"

CSR and ESG issues still lack a comprehensive regulatory structure, but it's important to understand what currently exists in regards to current laws and unenforceable guidelines.

Regulations (Hard Law)

Considering the enormous impacts of climate change and modern slavery risks, it's easy to understand why there is increasing pressure on organizations to disclose their exposure to and their mitigation plans for these risks.

Who is applying that pressure? If you assumed it was the regulators, you'd only be partially correct. From a legal and regulatory standpoint, according to the Global Slavery Index, the California Transparency in Supply Chains Act, EU Directive 2014/95/EU, NSW – Modern Slavery Act 2018 No 30, UK – Modern Slavery Act 2018 No 30, LAW No. 2017-399 and Child Labor Duty of Care Act, there has been legislation adopted in the U.S., EU, Australia, United Kingdom (U.K.), France and the Netherlands that requires large multi-national corporations to monitor and report on certain forms of human rights abuse in their supply chains and on their policy and practice concerning environmental protection, labor practices, business ethics, and diversity.

Climate change and modern slavery laws are still somewhat limited. The laws requiring an organization to disclose their exposure to these matters, and other CSR and ESG factors, are low in number compared to the issues themselves.

However, things are changing rapidly as governments of G7 countries and organizing bodies such as the United Nations push towards standardized and mandatory reporting.

As it relates to climate change, several countries have proposed legislation that hasn't yet become law as of June 2022. Other jurisdictions, such as the U.S. and the EU, have legislation that could cover climate change disclosure, but require more specificity to become actionable. Both the U.S. and the EU consider climate change risk as material in non-financial reporting.

In the U.S., the Securities and Exchange Commission (SEC) has made efforts in addressing climate change, most notably in the requirement for all public organizations to include material risk in 10-K reports. Materiality is typically defined as information that could affect the decision making of an informed investor. However, many stakeholders are challenging the traditional definition of materiality in the climate context since most investors take a relatively short-term view of the market. More stakeholders are now considering the long-term financial viability of organizations and are including climate change risks in that evaluation. The SEC also proposed rules changes on climate change disclosures in March 2022. In particular, the rules would require that registrants disclose information about their direct greenhouse gas emissions as well as emissions from upstream and downstream activities.

The Non-Financial Reporting Directive (NFRD) applies to large public-interest organizations with more than 500 employees in the EU This covers approximately 11,700 large organizations and groups who are required to report on the following issues:

- Environmental matters
- Social matters and treatment of employees
- Respect for human rights
- Anti-corruption and bribery
- Diversity on organization boards (in terms of age, gender, educational and professional background)

In April 2021, the European Commission adopted a proposal for a Corporate Sustainability Reporting Directive (CSRD), which would amend the existing reporting requirements of the NFRD.

The proposal will do the following:

1. *Extend the scope to all large organizations and all organizations listed on regulated markets (except listed micro-enterprises)*
2. *Require the audit (assurance) of reported information*
3. *Introduce more detailed reporting rules and a requirement to report according to mandatory EU sustainability reporting standards*

Australia passed its Modern Slavery Act in 2018, and the U.K. passed its Modern Slavery Act in 2015. As with climate change disclosure, several other countries are currently navigating new modern slavery laws through their legislative paths. Both Australia and the U.K.'s Modern Slavery Acts share a common requirement for organizations of a specific size, industry, or status to provide an annual Modern Slavery Statement.

What a Modern Slavery Statement Is

A Modern Slavery Statement is a formal document created by organizations to publicly note their action to ensure that their business and supply chains are slavery-free. There are specific guidelines and required content for these documents and the statement must be renewed each year. The modern slavery documents must be contained within the organization website, and for countries that require it, in a designated public depository.

Soft Law

You might be thinking that since the laws related to climate change and modern slavery disclosure are relatively new, how is it that so many organizations are already providing these disclosures? The answer lies in something referred to as "soft law." **Soft law** refers to rules that are neither strictly binding in nature nor completely lacking legal significance. In international law, soft law refers to guidelines, policy declarations, or codes of conduct that set standards of conduct. However, they are not directly enforceable. Soft laws often represent the acceptable norms of a civilized society. For example, the United Nations works on soft law principles, where members willingly commit to a certain standard of conduct.

Soft law is prevalent in the international law environment as it can be the first step in a process, eventually leading to the conclusion of a multilateral treaty. Or, because they provide the detailed rules and technical standards required for the implementation of a treaty that will contain hard law instruments and enforcements. There are many soft law bodies, including the Geneva Convention, the World Health Organization, and the Paris Agreement.

International bodies and non-governmental organizations typically utilize soft law as the mechanism to gain consensus and agreement across a wide variety of stakeholders.

ESG Ratings

Compliance with ESG disclosure and reporting can be incentivized by hard law (regulations) or soft law (standards and common codes of conduct). However, there is also another driving motivation for organizations and organizations to provide transparency through reporting: **the rise of ESG ratings.**

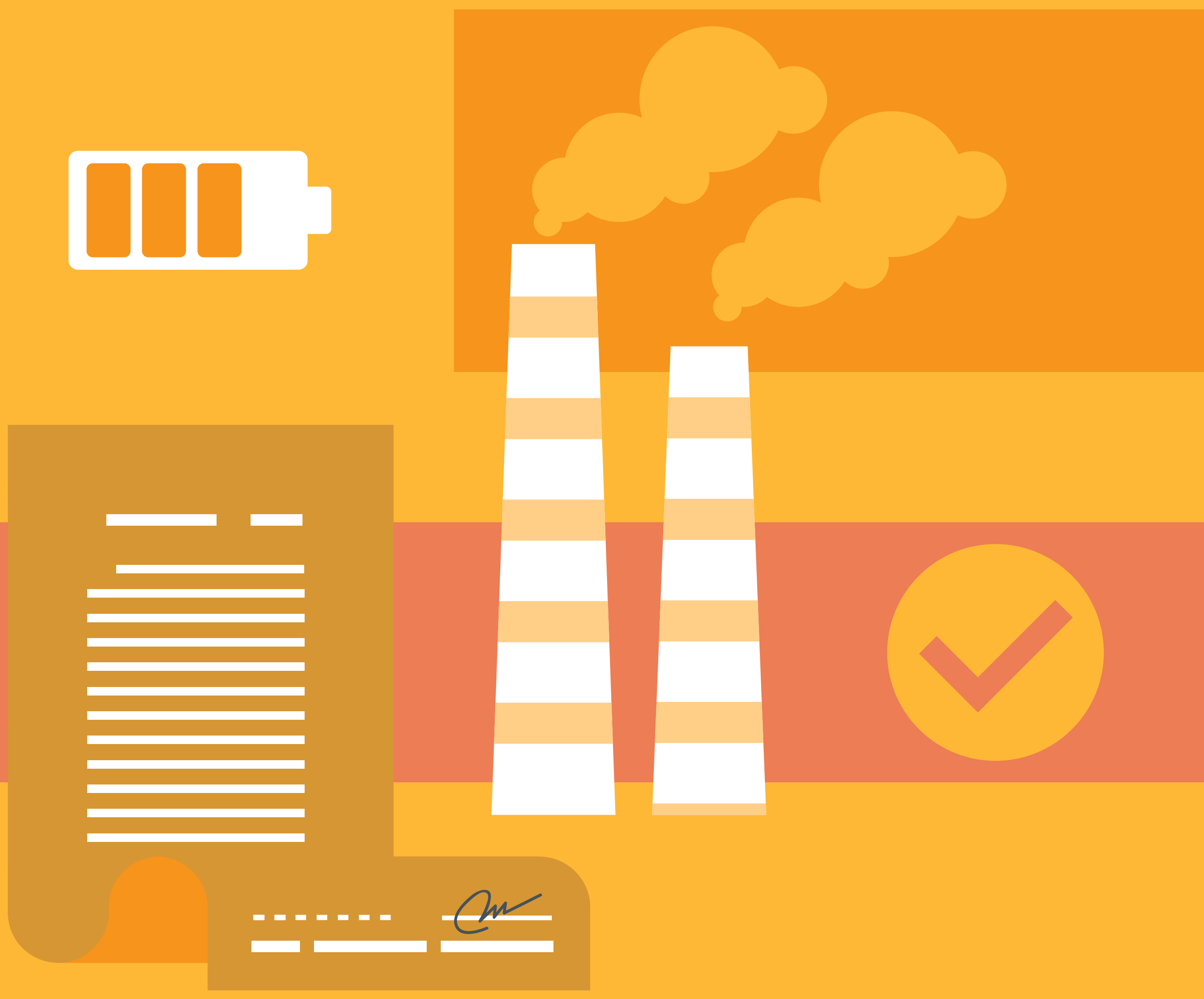
Over the past decade, firms dedicated to rating an organization's ESG activities have appeared in record numbers. These ratings are similar to a credit score that communicates a consumer's ability to pay back debt or a bond rating which provides context for an issuer's ability to meet financial commitments and avoid default.

An **ESG risk score** gauges an organization's performance on ESG issues and exposure to ESG-related risks. They're calculated against ESG metrics and may be expressed on a number scale or through a letter ranking system. Investors and stakeholders review these scores as part of the decision-making process. When investors and fund managers compare one or more organization's ESG ratings, it seems reasonable that they would prefer the vendor with the least risk.

While there are many ESG rating firms, there are just as many scoring methods. Regardless of the scoring mechanisms, these ratings are effective data points in the decision-making process. Still, the need to standardize these rating systems is a hot topic. Regulators have cited the lack of uniformity among the various rating methodologies as a barrier to implementing more regulations.

Section 3

Change Management Scope for Vendor CSR and ESG



If you've read the last two sections of this whitepaper and are interested in incorporating these requirements into your third-party risk management program, read on to learn more.

As organizations develop and publicize their commitments to corporate social responsibility (CSR) and environmental, social, and governance (ESG), those requirements inevitably must extend to their vendors. If you consider the prevalence of outsourcing, this makes sense. Let's imagine that like most companies, your organization uses vendors to directly or indirectly provide 60%-80% of your products and services. To leave your vendors out of the equation is like looking at only 20%-40% of the risk.

From a regulatory standpoint, the message is clear, while you can outsource a service or product, you can't outsource the risk. In other words, an organization owns the CSR and ESG risks that are related to its use of vendors.

Incorporating Your Organization's CSR and ESG Into Your Third-Party Risk Management Framework: Where to Start

It may sound simple, but the best place to start is **determining if your organization has an actual CSR or ESG reporting commitment.** You may be aware of such efforts, but are unsure how formalized they are.

An excellent first step, in this case, is working directly with your public relations or marketing department. Since this team is typically responsible for creating external-facing communications, they're usually the best place to start.

7 QUESTIONS TO ASK

1. Do we have a CSR policy?
2. Do we have CSR or ESG goals or commitments?
3. How are those commitments expressed and measured? Do we use specific metrics?
4. Do we report our CSR and ESG progress?
5. Who is the audience for the reporting?
6. What is the format for the reporting? An annual report, 10-K, CSR report, etc.?
7. How frequent is the reporting?

CSR Program Doesn't Exist

What if your organization doesn't have a formal CSR program? You may be the first one to raise the issue. If this is the case, you must have the right stakeholders at the table for any discussions.

STAKEHOLDERS THAT SHOULD BE INCLUDED

- Legal
- Public relations and/or marketing
- Procurement or sourcing
- Finance
- Compliance
- Enterprise risk
- Human resources *(employees are a significant group of stakeholders)*

As a vendor risk manager, your objective for that meeting should be to reinforce the message that both the organization and its vendors should operate under the same standards. You or your team are integral to the process and need a seat at the table.

BEST PRACTICE TIP

If your organization doesn't currently have a CSR or ESG program, or is starting to develop one, the most valuable contribution you can make as a vendor risk manager is to be engaged proactively instead of waiting for an eleventh-hour ruling requiring vendors to report. The sooner you connect with the CSR or ESG team, the more time you'll have to alter and test necessary vendor risk management processes and framework.

As a vendor manager, you must ensure that any CSR or ESG metrics the organization develops can be successfully extended into the vendor environment. Don't be tempted to rush this process, as poorly designed metrics result in poor quality reporting that negatively impacts the organization.

Finally, the organization must be well organized and fully committed to CSR or ESG before integrating vendors into the program.

CSR Program Exists

Suppose your organization is well on track and has a CSR program or is developing the CSR program to be rolled out shortly. From a vendor risk management standpoint, there are many things to consider, especially related to the activities and timing required to effectively implement CSR or ESG for your vendors. Taking the time to map the activities out will enable you to set expectations for the program stakeholders and the vendors.

Here are some considerations related to your vendor risk management processes and the addition of CSR or ESG requirements:

- How will third-party risk management provide data to the corporate CSR team for integration into the organization's CSR or ESG reporting?
- How will the addition of CSR or ESG requirements affect your existing third-party risk management policies and procedures or vendor code of conduct?
- What reviews and approvals are necessary to make changes?
- Which vendors will be in scope for CSR or ESG? Will you identify them by industry, product type, risk rating, or other?
- What questions related to CSR or ESG do you need to include on your inherent risk questionnaire and vendor due diligence questionnaires?
- What documentation will you request as evidence of CSR or ESG compliance?
- Are the vendors required to produce a report in addition to providing data?
- Who will be responsible for reviewing CSR or ESG due diligence documents and data? Is that expertise available in your current pool of subject matter experts?
- What vendor contract terms and conditions require alteration or amendment to reflect new CSR or ESG reporting requirements?
- How will the addition of the vendor CSR or ESG impact vendor risk management resources and timing?
- How and when will you notify the vendors of the new requirements. How much time will they have to comply?
- Will you offer vendor training or education materials relevant to the new requirement?
- Will there be a penalty for vendors who can't meet your requirement or will there be an incentive for vendors who do?

Third-Party Risk Management Considerations

Now that you're thinking about what needs to be done, it's an excellent time to look at those various third-party risk management considerations in more detail. Your organization must determine the suitable methodology to use. A combination of these methods below is acceptable but it must be consistent and reasonable.

Governance documentation
(policy, program, and procedures considerations)

The fundamental consideration here is that the addition of CSR or ESG to your vendor risk management process will require your foundational documents to be updated. If your policy outlines the risk elements that need to be considered in due diligence, you'll need to add CSR and ESG to that list. You'll also need to consider if adding CSR or ESG risk to your program impacts your procedure or program documents. If your program doesn't currently have a vendor code of conduct, you'll need to work with legal and compliance to create one.

Of course, changes to your policy generally require approval from senior leadership and the board. As such, you must determine when those policy changes will be reviewed and implemented, as well as the timing of any internal or external communication around those changes.

Identifying in-scope vendors for CSR and ESG

This process requires that you identify a repeatable, reportable, and documented approach to determine in-scope vendors. You have three options:

By industry or product type.
This method requires that third-party risk management has a comprehensive and updated listing of both industries and products at risk as well as the risk related to the country where product and services are produced.

By risk rating.
This method sets a threshold for vendors by risk rating. However, keep in mind that a vendor may have low compliance or information security risk, but have high ESG risk.

Screen all vendors.
This method utilizes questions on the internal inherent risk questionnaire. It assumes that the internal person completing the risk assessment has enough knowledge of their vendors' risks relating to country, industry, product or services, subcontractors, and supply chain.

Adding CSR or ESG-related questions to inherent risk assessment questionnaires, vendor due diligence questionnaire, other workflows, and contracts

Before incorporating additional CSR or ESG questions into your existing risk questionnaires, make sure you have identified the vendor data level necessary for evaluation and measurement

See the examples below:

VENDOR QUESTIONNAIRE SAMPLES

FACTOR	QUESTION	DESIRED ANSWER	EVIDENCE
CSR Example 1			
Diversity and Inclusion (D&I)	Does your organization commit to diversity and inclusion in the workplace?	YES	- Employee Handbook - Recruiting materials - Annual Report - ESG report - Form 10-K
	Do you report on D&I in the workplace?	YES	- Employee Handbook - Recruiting materials - Annual Report - ESG report - Form 10-K
ESG Example 2			
Diversity and Inclusion: **Board Representation**	What is the percentage of representation on an organization's board?	Any measurement Specific measurement	- Form 10-K - Annual Report - Board Profiles
Diversity and Inclusion: **Employee Category**	What is the percentage of representation by employee category?	Any measurement Specific measurement	- Form 10-K - Annual Report - Board Profiles
Diversity and Inclusion: **Employee Category**	What is the ratio of compensation by employee category (e.g., equal pay for equal work)?	Any measurement Specific measurement	- Form 10-K - Annual Report - Board Profiles

Example 1 asks for confirmation of CSR criteria while **Example 2** asks for specific ESG measurements. In the second example, you require that acceptable thresholds and targets be identified to measure vendor data against them. The second approach requires significantly more work and may not deliver more value.

Make sure you consider the value of additional data before incorporating it into your questionnaire and consider these questions:

- **How will you use that data?**
- **Will the data drive additional actions, and if so, what are they?**
- **Will the request for extra data cause bottlenecks or significantly slow the process?**
- **How will vendor data be reported?**

BEST PRACTICE TIP

Ensure that the data you're requesting from your vendors aligns with your organization's CSR or ESG commitments. For example, if your organization doesn't do carbon reporting, you shouldn't require your vendors to do it.

Incorporating CSR and ESG Into Third-Party Risk Management Workflows

There are a few best practices when it comes to your third-party risk management workflow:

1. Collect vendor ESG data using your existing third-party risk management processes, ideally while requesting other due diligence items. This is more efficient than having the vendor answer a separate questionnaire outside of the process.
2. Keep your workflows standardized to reduce the opportunity for error and extended response timing.
3. Ensure that any changes to your workflow are tested before they're deployed.

CSR and ESG Due Diligence Considerations

Due diligence reviews are intended to evaluate vendor controls against the risk. Incorporating CSR and ESG into that process will require these considerations:

- **Are the CSR or ESG risks clearly identified?**
- **What level of ESG risk requires due diligence?**
- **What specific vendor controls are necessary to manage those risks?**
- **What evidence of vendor controls is acceptable?**
- **Who will review and evaluate the vendor controls?**

CSR and ESG Contract Considerations and Sample Clauses

The vendor contract is your best way to protect the organization from risk, primarily when all the risks aren't known. Your legal department must draft the contract terms and conditions to ensure legality and enforceability. Over time, these clauses will likely evolve. Still, the contract should include contract language regarding modern slavery and general adherence to the organization's ESG principles.

Let's look at some examples of contract language directly from guidance relating to the Modern Slavery Act of 2015:

Identifying Modern Slavery -
The Supplier must take reasonable steps to identify, assess, and address risks of Modern Slavery practices in the operations and supply chains used in the provision of the Goods and/or Services.

Supplier Modern Slavery Plan -
Within one month of the Contract Start Date, the Supplier will prepare and implement a Modern Slavery Risk Management Plan in relation to its performance of this Contract and, if requested by the Customer, provide a copy of this plan to the Customer. The Modern Slavery Risk Management Plan should at a minimum detail:

(a) the Supplier's steps to identify and assess risks of Modern Slavery practices in the operations and supply chains used in the performance of the Contract;

(b) the Supplier's processes for addressing any Modern Slavery practices of which

it becomes aware in the operations and supply chains used in the performance of the Contract;

(c) the content and timing of training for Personnel about Modern Slavery, and

(d) the Grievance Mechanism/s available to Personnel

Recruiting Practices -
Without limiting clause ___, in performing the Contract, the Supplier must:

(a) not require Personnel to pay fees, charges, expenses, or financial obligations incurred in order for the Personnel to secure their employment or placement (Recruitment Fees), regardless of the manner, timing, or location of the imposition or collection of these Recruitment Fees;

(b) not destroy or exclusively possess, whether permanently or otherwise, the travel or identity documents of Personnel; and

(c) ensure Personnel can access a Grievance Mechanism to safely report any instances of Modern Slavery in the operations and supply chains used by the Supplier in its performance of this Contract.

Supplier Training -
The Supplier will ensure Personnel responsible for managing the operations and supply chains used in the performance of the Contract have undertaken suitable training to be able to identify and report Modern Slavery.

Sustainability and Business Ethics -
The ABC Organization conducts its business in accordance with the principle of sustainable development and adheres to internationally recognized fundamental standards for occupational health and safety, environmental protection, labor, and human rights as well as responsible corporate governance (hereinafter "ESG Standards"). The ABC Organization has described its understanding of the ESG Standards in the Supplier Code of Conduct.

The ABC Organization expects the Supplier to adhere to the ESG Standards. Furthermore, the ABC Organization calls upon the Supplier to ensure that all its temporary workers adhere to the ESG Standards likewise. The ABC Organization shall have the right to check adherence to the ESG Standards, either itself or through third parties that it commissions, with prior notice.

As a general guideline, the vendor contract should include ESG information under its right to audit clause. Additionally, the agreement should identify what would qualify as a breach of contract due to ESG requirements.

Many more contract clauses may be included depending on your specific industry or supply chain considerations.

Issue Reporting and Remediation -
If at any time the Supplier becomes aware of Modern Slavery practices in their operations and supply chains used in the performance of the Contract, the Supplier must as soon as reasonably practicable:

(a) take all reasonable action to address or remove these practices, including where relevant by addressing any practices of other entities in its supply chains; and

(b) take all reasonable steps to remediate any adverse impacts caused or contributed to by the Supplier from these practices in accordance with the Guiding Principles on Business and Human Rights.

Communication and Education

Once internal questions are answered and systems are updated, you'll need to engage your vendors.

Successful vendor engagement is dependent on communication, education and timing.

Vendor Communication – New vendors don't present the same challenges as existing vendors when it comes to significant process changes. After all, the new vendors don't know any difference. However, you'll need to be sensitive to the change management required and how it might affect your current vendors, especially if it means they have to collect new data. To ensure a successful transition for your vendors, clear and constant communication is paramount.

Timeframe for Compliance – You'll need to consider what timeframe will be allowed for compliance. Will you expect compliance right away, six months, within a year? Truthfully you should be prepared to give your vendors a more extended timeframe – at least six months to a year. This is reasonable as the new ESG requirement may require your vendor to identify how that new data will be gathered internally and who will process and report that data.

The best time to communicate new CSR or ESG requirements is within the same timeframe that your organization announces its CSR initiatives. The public nature of those communications should signal your intentions. On the other hand, suppose your organization's program has already launched. In that case, the vendor communication should happen as soon as your internal process, and system changes are tested and complete. You should also reiterate the requirement at least quarterly leading up to the compliance date.

BEST PRACTICE TIP

Give your vendors a test period to ensure that the data is furnished correctly and errors related to vendor understanding can be remedied. For example, suppose you'd like your vendors to be fully compliant by January 1, 2023. In that case, you might suggest the fourth quarter of 2022 as a testing period. This gives the vendors plenty of time to make adjustments before they're required to comply. They should also provide you with actual data to ensure it is aligned to your reporting needs.

Communicating and Educating Your Vendor About CSR and ESG Expectations

The best way to ensure compliance with any new requirement is to provide the correct information and training related to the specific change. For example, suppose your organization has made diversity and inclusion a priority and has announced it publicly. Perhaps your organization provided a press release announcing the commitment or in the annual report or other external communication. Still, it's best not to assume that your vendors are aware of the change. Therefore, you want to make sure that your vendors have the best information possible **BEFORE** they attempt to gather and report the data.

Here are some communication and training suggestions:

- Draft a communication to the vendors, stating your organization's commitments and priorities
- Include a link or a copy of the organization statement
- Spell out the requirements and provide examples
- Clearly define the CSR or ESG metrics on which they must report
- Detail if there any specific formats necessary for the reporting
- Include a sample of a completed report
- Provide a template for the vendor reporting, if possible
- Identify the proposed timing for all vendors to reach compliance
- Describe any potential penalties for non-compliance
- Offer additional educational materials or webinars to provide details (for vendors and first-line vendor owners)
- Provide a contact name and email for vendor questions

This vendor communication should happen during the following intervals:

- The onset of the organization's CSR or ESG program
- Quarterly, reminding vendors of the timeline for compliance
- 60 days before any testing period begins
- 30 days before the compliance date
- 1 week before the compliance date

Communicating with the Vendor Owner/First Line of Business

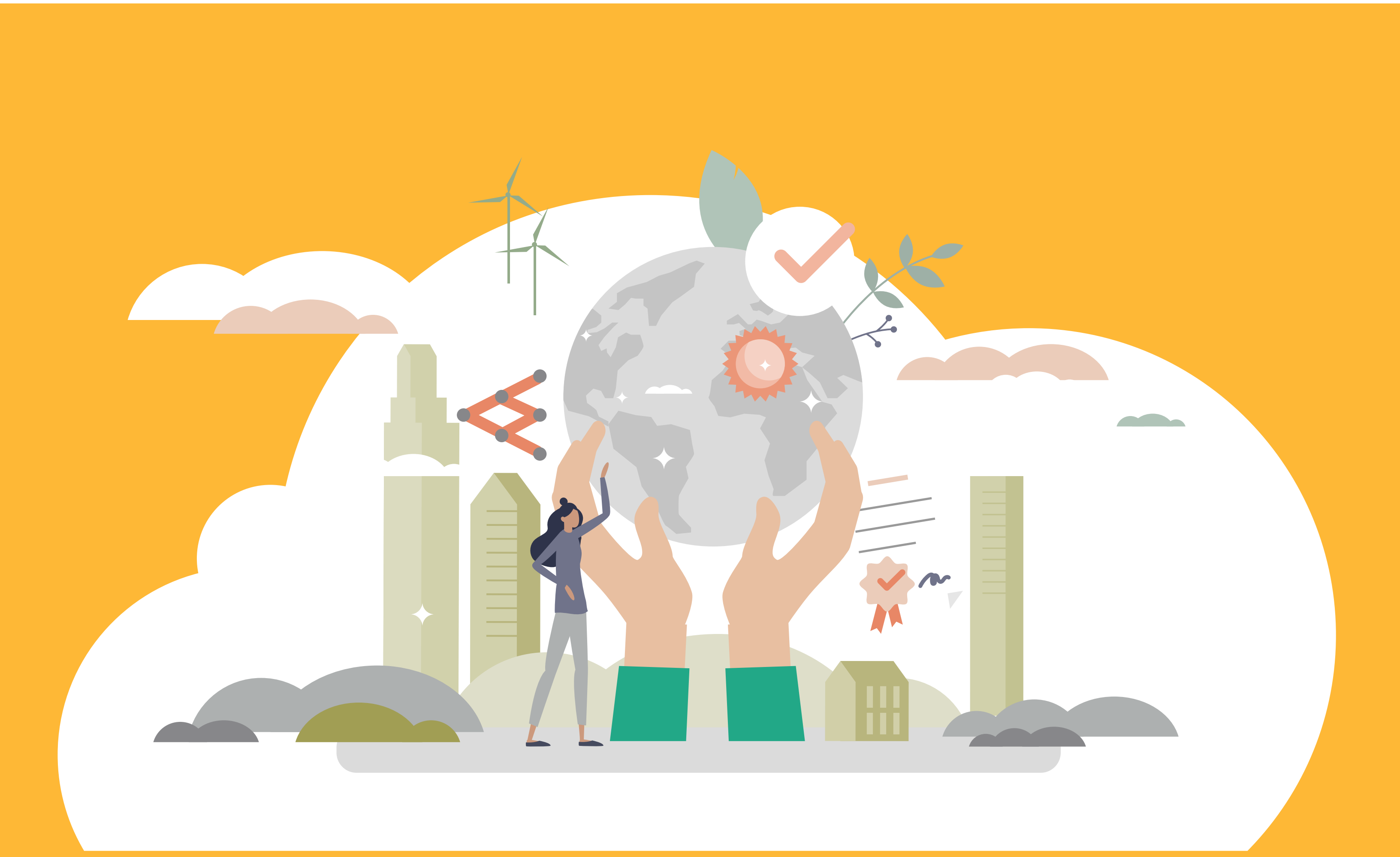
It's also recommended that you provide this information to the vendor owner/first line of business:

- A formal email to the vendor owner/first line (repeated at the same intervals as above)
- FAQ sheet
- A listing of all vendor communication dates
- A listing of any informational resources for the vendor

This vendor owner/first-line communication ought to occur in parallel with vendor communications. This will enable the first line vendor owner to speak confidentially about the new ESG reporting requirements and prevent any confusion down the line.

Refining CSR and ESG Within the Third-Party Risk Management Framework

Finally, once you've begun executing the new CSR or ESG requirements through your third-party risk management framework, take notice of any processes that need refining. You can add these to your continuous improvement program roadmap. You must also be careful of any resource challenges that arise, internal or external, resulting in unanticipated impacts due to the new requirements.



Additional Resources

If you desire to learn more about sustainability disclosure, reporting and remediation, here is a list of resources below:

Organization	Topic or Tool	Website
International Finance Corporation (World Bank)	*ESG Performance Standards*	https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/sustainability-at-ifc/policies-standards/performance-standards
International Labor Organization	*Labor Laws and Policy database*	https://www.ilo.org/global/statistics-and-databases/lang--en/index.htm
International Labor Organization	*Labor Standards*	https://www.ilo.org/global/standards/lang--en/index.htm
Know the Chain	*The KnowTheChain benchmarks aim to help organizations protect the well-being of workers by incentivizing organizations and identifying gaps in each sector evaluated.*	**2020-2021 Global Benchmarks:** https://knowthechain.org/benchmark/
Organization for Economic Co-operation & Development	*OECD Due Diligence Guidance for Responsible Business Conduct*	https://mneguidelines.oecd.org/duediligence/
Principles for Responsible Investment	*What are the Principles for Responsible Investment?*	https://www.unpri.org/pri/what-are-the-principles-for-responsible-investment
Responsible Sourcing Tool	*- Where Risk Enters Your Supply Chain* *- Where Risk Is Most Likely To Affect Your Supply Chain*	https://www.responsiblesourcingtool.org/
U.S. Department of Homeland Security	*Recognize the indicators of human trafficking and how to appropriately respond to possible cases*	https://www.dhs.gov/blue-campaign
U.S. Department of Labor	*List of Goods Produced by Child Labor or Forced Labor*	https://www.dol.gov/agencies/ilab/reports/child-labor/list-of-goods
U.S. Department of State	*Modern Slavery and Human Trafficking*	https://www.state.gov/policy-issues/human-trafficking/
United Nations	*Guiding Principles on Business and Human Rights*	https://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf
United Nations	**Global Compact:** *Guide to the 17 Sustainability Goals*	https://www.unglobalcompact.org/
Walk Free Organization	**The Globally Slavery Index:** *Modern Slavery and Human Trafficking*	https://www.globalslaveryindex.org/
World Economic Forum	***Measuring Stakeholder Capitalism:*** *Towards Common Metrics and Consistent Reporting of Sustainable Value Creation*	https://www.weforum.org/reports/measuring-stakeholder-capitalism-towards-common-metrics-and-consistent-reporting-of-sustainable-value-creation

***Disclaimer:**
Venminder doesn't explicitly endorse any of these organizations, but did find them very useful when researching and creating this whitepaper.

As we've learned, there is an *immediate need* to move away from current business practices that endanger people and the planet, not to mention the global financial system.

Without action today, the future of tomorrow is in peril.

Until now, the rise of CSR and ESG disclosure, reporting, and ratings have primarily been driven by conscientious investors, fund managers, non-governmental organizations, and individuals. However, governments and policymakers worldwide are under pressure to formalize desired business sustainability practices into actual laws.

Moreover, as organizations willingly commit to more sustainable business practices, vendors in the supply chain must also be scrutinized. Third-party risk management must be considered a key component in driving the transparency necessary to move toward sustainability throughout the supply chain.

It's important to understand sustainability and identify the change management necessary to successfully integrate CSR and ESG into your third-party risk management framework.

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About Venminder

Venminder is an industry recognized leader of third-party risk management solutions. Dedicated to third-party risk, the company is the go-to partner for software, high-quality assessments on vendor controls, certified subject-matter expertise, and education.

Venminder's platform provides a centralized location to execute a third-party risk management program. It enables users to store documentation, onboard a vendor, track contracts, manage SLAs, send and manage questionnaires, manage due diligence and oversight, complete risk assessments, create workflows, run reporting, and more.

Assessments performed by Venminder's qualified experts, including CISSPs, CPAs, financial risk analysts, paralegals, and more, are readily available in an online exchange library. The assessments enable customers to identify possible risks and understand areas of strength on their vendors' information security and privacy standards, SOC reports, financial viability, business continuity/disaster recovery preparedness, contractual standards, regulatory compliance, and more.