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Where to start on your ESG journey

An e-Book publication sponsored by SAI360
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Experts: Where to start on your ESG journey

ESG directors from Tenneco and Amneal Pharmaceuticals shared best practices for businesses broaching the initial phases of environmental, social, and governance reporting at CW's virtual summit.

BY KYLE BRASSEUR, COMPLIANCE WEEK

Initiating your company's commitment to reporting its environmental, social, and governance (ESG) metrics can prove a daunting task. But keep in mind: It's a marathon, not a sprint.

"You don't have to be perfect on Day 1," said Emily Parlapiano, director of ESG programs and reporting at Amneal Pharmaceuticals. "Your suppliers and stakeholders want to see progress."

Parlapiano spoke as part of a panel on developing ESG programs at Compliance Week's virtual ESG Summit held in September. She was joined by Adrian Khouri, global director of ESG at automotive components manufacturer Tenneco, in discussing best practices for businesses broaching the initial phases of ESG reporting and how to prepare for the potential of regulatory disclosure requirements.

If your company is at this stage—perhaps bracing for the climate-related disclosure rule proposal put forward by the Securities and Exchange Commission (SEC) in March—the presenters offered a roadmap (at left) for getting your ESG efforts off the ground.

Best practices for each milestone are explored further below.

Transparency and annual reporting: "Start by identifying all the things your company is doing on ESG and build a baseline," said Khouri. "That will give you an indication of how mature your program is today. Most likely you're doing a lot already."

At Tenneco, Khouri said, European customers began pressuring the company regarding its ESG standing in 2016. The business put together its first report not tied to any particular framework and built on its findings year-over-year before ultimately adopting the Global Reporting Initiative (GRI) standard in 2019.

"It got people discussing [ESG] and trying to understand what it was we were trying to do and where to go from there," said Khouri of the company's early efforts.

Parlapiano advised engaging with investors to discuss the areas of ESG most important to them. She also spoke to the benefit of external gap assessments, which Amneal had done before it issued its first report. Determining where your company's strengths and weaknesses lie can help establish early focus areas.

"You're going to have a great starting point, but you have to dig past some of those layers before you can get that first report out the door," she said. "... Where you are on the journey today shapes how you're going to get to where you want to go going forward."

Peer benchmarking: Where are your competitors in their ESG journeys? Have any of them experienced public success or failure you can learn from?

"When we did peer benchmarking specifically in automotive, we were surprised how many of our peers were still in the beginning of their journey," said Khouri. "We thought for sure many would be advanced, if not in the middle. A lot of them were either not reporting at all or just starting."

From this exercise, your company can set realistic expectations of where it wants to be to keep pace with the competitive landscape.

Materiality assessment: "Understanding the materiality drivers for your industry or industries, depending on how your company is structured, is helpful," said Parlapiano. The Sustainability Accounting Standards Board (SASB) offers a materiality map that provides guidance for 77 different industries.

Khouri shared Tenneco used a third party to conduct a materiality assessment in addition to interviewing top leaders and reviewing customer/investor requirements and expectations before mapping out its most significant ESG areas.

"Having something at the bottom doesn't mean it's not important and you stop doing it, but it helps you focus on the top tier," he said. "Those are the items you need to set public goals on."

External materiality assessments also add credibility, Parlapiano noted.

Strategy framework: You know what your peers are doing, you know what's important to the company and its investors—now is when you build out your strategy.

"What does ESG mean for us?" said Khouri. "What are we trying to achieve?"

ESG means different things for different companies, noted Parlapiano, but "there's also some fundamental truths about what ESG is and how and who ESG is serving—the stakeholders involved in your business."

Particularly for compliance professionals, serving shareholders is a natural strategic goal to build around, she said.

Goal setting/resetting: During the peer benchmarking stage, you might note some of the milestones your competitors are striving toward. Their goals can help shape your own.

"Do you want to be with the group where you're just managing expectations, or do you want to compete or lead?" said Khouri. "It doesn't happen overnight; you have to go through it step-by-step and build your goals for the long term to move the needle on this."

"[ESG] is about the people. This is not about the processes, procedures, or requirements."

Adrian Khouri, Global Director of ESG, Tenneco

If you're setting carbon-neutral or net-zero deadlines, be realistic, he added. "Put something out there that is achievable but not too easy," he said.

Implementing and measuring: This is the most important step because "it's not in your hands anymore," said Khouri. "You have to depend on your cross-functional teams ... they will be the ones doing the work and implementing the initiatives."

Legal, human resources, operations, and other departments each have a part to play. At Tenneco, Khouri said the company set up a dashboard to track how it was progressing on its key performance indicators on a quarterly basis.

"We didn't wait until the annual report to find out how we did," he said.

Improvement and adjustment: ESG reporting is a cycle, as evidenced by the arrow in the roadmap image. Going through these steps each year will help ensure a business is tailoring its objectives to continue to serve the most important piece of the puzzle.

"This (ESG) is about the people," Khouri said. "This is not about the processes, procedures, or requirements. It's about the people—inspiring the people, collaborating cross-functionally, getting that momentum. That will help you move a lot faster." ■

ESG: Adapting businesses should look beyond what is financially material

ESG is comprised of just three words, but it represents much more regarding how businesses can operate efficiently, ethically, and more financially sound.

BY JEFF DALE, COMPLIANCE WEEK

The vice president of internal audit and enterprise risk at aerospace giant Lockheed Martin explained how businesses must form resilience as they prepare for future risks regarding environmental, social, and governance during a session at Compliance Week's virtual ESG Summit.

Christopher Geiger broke down ESG into an easily digestible wheel, designating what to keep in mind when thinking of issues in each space.

Environmental, as many would expect, covered climate-related elements, including carbon, energy, water, waste, and circularity. Diversity and inclusion, workplace safety, data privacy and protection, and customers and community fell under social. Governance claimed ethical business practices, board structure, disclosures and reporting, and executive compensation.

While ESG is comprised of just three words, it represents a lot more, encompassing many aspects of how businesses can operate efficiently, ethically, and more financially sound.

"Sometimes you have to take out some of the buzzwords that cause people to lock in to certain thinking and open it up," Geiger said. "One way to do that is to call it strategic nonfinancial materiality."

It's important to think of sustainability initiatives in terms of strategic nonfinancial materiality when it comes to what Geiger termed as the "tragedy of the commons," a popular term in environmental science.

"When we come across something we can use with no associated cost, we historically 100 percent of the time overuse and mismanage it," Geiger said. "If something is common, we manage to mess it up."

Examples of this include the atmosphere, oceans, and low earth orbit, according to Geiger.

Geiger said prudent corporations can innovate their thinking by getting ahead of an issue and "band[ing] together with industry [or] with other people who use those commons."

One way to think about this, Geiger said, is the term "double materiality," which is often associated with the European Union's Nonfinancial Reporting Directive. Double materiality calls for companies to consider their impact on society and the environment in addition to how sustainability issues affect the company.

"In the United States," Geiger said, "… I think we're very well focused on financial materiality."

Also worth considering is "dynamic materiality," Geiger noted, a term utilized by the World Economic Forum that encourages companies to track certain factors year-over-year that might not be material now but could be in the future as the environment changes rapidly.

"These are dynamically material risks. You may still not

know anything about them, but it is important to track them potentially as emerging risks," he said. "So, innovate how you look at not just what's a snapshot material now but what are those things that are likely to be material soon."

Regarding social, Geiger suggested contemplating news stories over the last few years that have changed how we deal with employees as an example.

"They didn't happen in a continuity," he said. "One day you weren't talking about it, the next day it was on the front page and didn't go off. Those are dynamically material things that drastically change, and you should be able to look for them."

The Securities and Exchange Commission's (SEC) proposed climate-related disclosure rule released in March puts forward a similar process, asking companies "to report items that aren't financially material but are risks nonetheless," Geiger noted.

"This is new, and it's going to affect the assurance functions," including internal audit, enterprise risk management, and trade compliance, he said. "Assurance functions rely on governance and rules, and as we do this, we are going to expand that governance. When you do, you can expand assurance."

Under the SEC's proposal, assurance—first limited, then reasonable—is required for Scope 1 and 2 greenhouse gas emissions disclosures outside of the financial statements for accelerated and large accelerated filers. There is no initial attestation requirement for Scope 3 disclosures, which are also subject to a safe harbor provision for affected registrants.

Regarding internal audit, Geiger said, "Maybe we can apply more automation [and] more data analytics to those areas. There is going to be more governance and rigor applied. Maybe more of our creative aspects and our more human and complex audits can go to other places because if greenhouse gas emissions are going to be extremely rigorized, similar to financials, maybe that can be a robotic process automation." ■

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WHITEPAPER

Hidden Opportunities of Aligning Ethics and Compliance with ESG

A robust, well-articulated ESG program is rapidly becoming table stakes for investors, placing ESG squarely on the board agenda. As boards grapple with how to best embody, valuate, and disclose ESG values and initiatives, a host of opportunities are emerging for ethics and compliance leaders to add value and increase professional visibility.

ESG is rapidly evolving from grass-roots activism into a top down, board-driven mandate. It's no mystery why, given that ESG assets make up a third of total global assets under management and are expected to surpass $50 trillion by 2025[1]. ESG investing (also known as "impact investing") was born of a growing awareness that long-term financial performance of businesses is inextricably intertwined with environmental, social, and governance factors. It has gained considerable traction as research suggests that companies with high ESG ratings tend to outperform their counterparts.

As a result, companies are moving beyond "check the box" ESG disclosures, to instead build out substantive ESG programs, identify appropriate quantitative and qualitative metrics to measure and validate their ESG initiatives, and distinguish themselves with "AAA" ESG ratings. Corporations are devoting significant capital, time, and resources to embedding environmental, social and governance factors into their business strategies and preparing annual ESG disclosures.

Because ethics and compliance is so tightly woven into the social and governance elements of ESG, ethics and compliance officers are uniquely poised to support this broader effort in a number of ways.

THE OVERLAP BETWEEN E&C AND ESG

While ESG is strongly associated with environmental initiatives such as lowering carbon footprint, social and governance factors have achieved equal prominence. "Social" and "governance" define a company's corporate citizen persona—or how it behaves—which is the heart and soul of ethics and compliance and, increasingly, a key factor in market valuation.

Ensuring a company behaves responsibly and ethically is both the mission of a Chief Ethics and Compliance Officer and the purpose of an ESG program. CECOs therefore have oversight of much of the infrastructure that supports social responsibility and prevents corruption, such as internal controls, Code of Conduct and policies, workplace health and safety, data protection and privacy, whistleblower hotlines, workforce training, and prevention of fraud, bribery and money laundering.

Ethics and compliance is mission critical because it is the reputational guardian of the company, the first line of defense against ethical fading. Thanks in large part to the lightning speed of today's news cycle and the instantaneous impact of social media, corporate malfeasance scandals can have massive immediate impact on reputation and by extension valuation. It's not unusual for news of bad corporate behavior to be accompanied by an immediate 20-30% drop in market cap. For a $3 billion company, that can equate to a one-day loss of $1 billion.

WHY SHOULD CECOS ALIGN WITH ESG?

It's early days for ESG, relatively speaking, and best practices for building, quantifying, and disclosing ESG programs are rapidly evolving. As companies move towards transparency and begin walking the talk by aligning corporate culture to the stated ESG values, the historical function of E&C rolls up naturally to support these efforts. Opportunities abound for ethics and compliance leaders who join the challenge to improve their company's ESG report card:

Board visibility: Boards have come to recognize that robust ESG programs not only attract investors, but also offer a framework to mitigate business risk and future proof the company. Boards are now dedicating agenda time to embedding ESG into company strategy and risk mitigation. As a result, the head or coordinator of a company's ESG program often reports to the board.

More funding: A traditional ethics and compliance framework is often insufficient to meet the broader mandate of ESG. The top accounting and consulting firms are investing in building capability and capacity for ESG advisory services, and CECOs should be doing likewise internally. By tying ethics and compliance programming to ESG, E&C officers can tap into a bigger budget pool.

Organizational clout: ESG planning and disclosure requires holistic engagement across the organization. By ensuring ethics and compliance is a strong complement of, and contributor to, the high-visibility high-value ESG initiative, CECOs can break organizational silos and increase the intrinsic value of ethics and compliance (and their roles) in the process.

HOW TO ALIGN ETHICS AND COMPLIANCE WITH ESG

This basic roadmap for aligning ethics and compliance with broader ESG initiatives can increase the impact of your organization's ESG profile—and potentially uncover some professional development opportunities along the way.

1. FAMILIARIZE YOURSELF WITH ESG STANDARDS AND FRAMEWORKS

ESG standards and frameworks are used by organizations to map out and disclose their ESG programs, and by investors and ratings agencies to assess the sustainability of a company. At least a dozen ESG frameworks are currently in use, each with its own taxonomy of sustainable ESG topics and activities. There is quite a bit of overlap between these frameworks, so efforts are underway globally to consolidate them.

There is no mandated format for ESG disclosures, although organizations are coalescing around five notable reporting frameworks: SASB, TFCD, GRI, CDP, and the UN's SDGs. We've described each briefly in the table below. Whether your company aligns ESG reporting with one of these frameworks or reports against a customized set of ESG standards and goals, this is a good starting point to learn your organization's ESG lexicon and narrow down the areas of ESG that management has deemed material to the organization.

PRIMARY ESG REPORTING FRAMEWORKS	
SASB (Sustainability Accounting Standards Board)	Sector-specific guidance across five dimensions of ESG sustainability including environment, social capital, human capital, business model, leadership, and governance. Disclosures appeal to investor-focused audience.
TFCD (Taskforce on Climate-Related Financial Disclosure)	Principles-based recommendations for managing and reporting on climate risk. Disclosures appeal to investor-focused audience.
GRI (Global Reporting Initiative	Most commonly used framework among all industries to disclose impacts on the environment, the economy, and society. Intended for broad stakeholder audience.
CDP (Carbon Disclosure Project)	Environmental standards pertaining to GHG emissions, water use and forestry. Intended for broad stakeholder audience.
UN SDGs (United Nation's 17 Sustainable Development Goals)	Goals designed to build a plan of action for inclusive growth. Important to investors who are signatories of the UN's Principals for Responsible Investing

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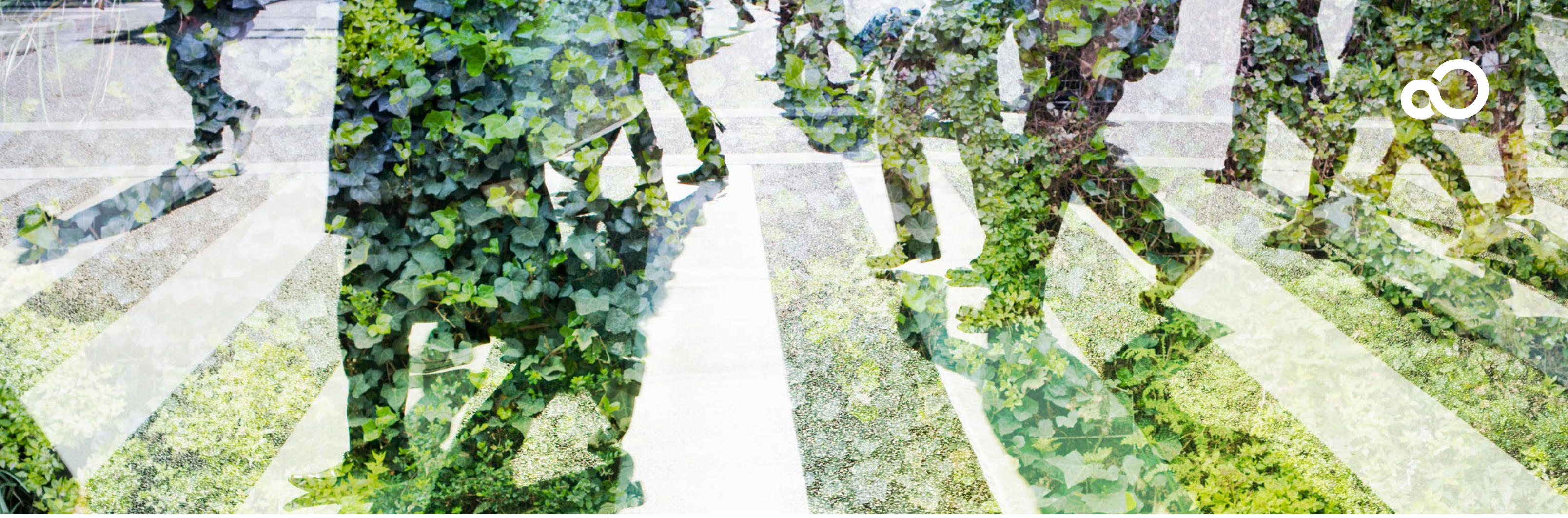

2. MAP YOUR E&C PROGRAM TO YOUR COMPANY'S PUBLICLY STATED ESG PRIORITIES

The best place to determine how your E&C initiatives map to the company's ESG goals and initiatives is by reviewing your company's ESG-related disclosures. These are usually published annually and have titles like ESG Report, Sustainability Report, or Corporate Responsibility Report. Many companies have standalone corporate responsibility or corporate sustainability websites where they publish descriptions of ESG initiatives and share PDFs of annual reports; some even embed interactive ESG reports directly into those sites. Companies farther along the ESG disclosure maturity curve include materiality matrices and impact assessments to rank and quantify the importance of specific ESG initiatives to the company's sustainability and financial performance. Companies that don't yet publish annual ESG reports usually at least discuss certain ESG issues within the narratives of annual 10Ks or proxy statements.

You should also take a look at what ESG ratings agencies are saying about your company's overall ESG profile. ESG ratings are offered by agencies and analysts to measure a company's resilience to environmental, social, and governance risks and are fashioned after the bond-rating style, for example from "leader" (AAA, AA), "average" (A, BBB, BB) to "laggard" (B through CCC). The dominant ESG rating providers are MSCI and Sustainalytics; to a smaller subset of the corporate population Bloomberg, Moody's, S&P, ISS and Fitch also provide them.

Once you identify the priority ESG issues and goals of your organization that also fall under the umbrella of ethics and compliance, and you've reviewed ESG ratings for areas of strength and weakness, ask yourself a few important questions:

- How closely does my E&C program align with and support key ESG program goals?
- Where can ethics and compliance add value to my company's ESG initiatives?
- Are there areas where E&C is contributing meaningfully to ESG-related initiatives, but management has failed to notice or mention in ESG disclosures?
- Have ESG ratings agencies noted areas of weakness related to ethics and compliance?
- Is my department getting appropriate recognition for adding value to ESG?

The answers to these questions will help you fill in any gaps and ensure the full value of your E&C program is recognized by management and the board.

Keep in mind as you go through this exercise that the form and substance of ESG disclosures still vary widely from company to company. It can therefore be very illuminating to read ESG disclosures of peer companies within your industry, or even in completely unrelated industries. You'll find a broad array of E&C topics and initiatives that companies consider integral to their ESG programs, and perhaps uncover additional ways for E&C to add value to your organization's ESG efforts. We've linked to examples of robust corporate ESG reports across a variety of industries in Appendix 1 of this paper.

3. JOIN OR START YOUR COMPANY'S CORPORATE SUSTAINABILITY OR ESG COMMITTEE

If you haven't been part of the ESG conversation at your company, it's time to pull up a chair.

Aggregating ESG data for annual reporting is an all-consuming effort that extends across many facets of an organization. Corporate boards everywhere are debating the appropriate balance between profit, planet, and people. As companies build reporting mechanisms to articulate that balance, Chief Ethics and Compliance Officers are uniquely qualified to add considerable value to the process, which could bring unprecedented visibility to E&C leadership roles.

Companies that embed ESG into business strategy are centralizing ESG oversight by establishing stand-alone committees that assign executive accountability for managing ESG risks and progressing toward ESG goals. If your company already has an ESG committee or team, make sure you are a part of it. Joining the team responsible for ESG planning and reporting gives CECOs an opportunity to break operational silos and collaborate across the organization with C-suite peers who have oversight of other ESG domains, including finance, audit, human resources, DE&I, risk (including cyber), supply chain management, facilities management, and information technology.

If your company is just beginning its ESG journey—and if you have the bandwidth—offer to lead the charge. ESG committees are often led by either the General Counsel or the CECO, and they often report to the board which brings additional visibility and organizational clout to the role.

4. CONTRIBUTE TO YOUR COMPANY'S ESG REPORTING AND CERTIFICATION PROCESSES

As companies mature beyond mere "greenwashing" into walking the talk through robust sustainability practices, ESG disclosures are maturing in parallel. Over 95% of the S&P 500 and over 80% of the Russell 1000[2] are now publishing reports in some form or fashion that articulate meaningful and quantifiable progress towards corporate sustainability and positive societal impact. These can be titled ESG Reports, Corporate Social Responsibility Reports, or Sustainability Reports. Regardless of the title or format, compelling narratives about climate change oversight and risk management are increasingly important to earning high scores from ESG rating agencies and to attracting investors, customers, and prospective employees.

The work of highlighting and quantifying ESG programs and accomplishments across the organization expends considerable time and resources. CECOs are ideally situated to coordinate that reporting because of the strong overlap of their roles with the "S" and the "G" components of ESG. Whether you spearhead the reporting effort or not, any contributions you can make to gathering data or telling the story will be appreciated—particularly if you can identify ESG "wins" within your ethics and compliance program that the ESG reporting team hadn't considered or wasn't aware of.

You could also offer to research emerging best practices in ESG disclosures. There are a number of useful ESG reporting guides available and we have provided links to several in Appendix 2 of this paper.

5. ENSURE ETHICS AND COMPLIANCE TRAINING MODULES REINFORCE ESG MESSAGING AND INITIATIVES

Workforce training should nurture behaviors that support ESG social and governance goals such as creating safe, respectful, and heaalthy workplaces; preventing fraud and corruption; encouraging inclusive cultures; and strengthening data privacy and information security.

The context of workforce training has changed as organizations become mindful of protecting their corporate citizen personas and seek to do what is right, versus just stay out of trouble. Training scenarios are being rejigged to talk about ethics and compliance obligations in language that is more broadly understood, to explain social impact of wrongdoing, and to reflect authentic corporate culture and workflows. In other words, ESG-aligned workforce training embodies the human impact of ethics and compliance.

For example, if your company has identified an inclusive culture as important to workforce retention, unconscious bias and sexual harassment training can be an important means of achieving that goal. If the prevention of human trafficking is a social cause your company champions in social responsibility disclosures, then anti-bribery training should include scenarios that illustrate the negative social impact of putting money into the wrong hands.

6. ALIGN CODE OF CONDUCT WITH YOUR COMPANY'S CORE VALUES

Code of Conduct is another ethics and compliance domain that should be aligned with ESG. Many companies still utilize rules-based documents that were prepared by lawyers to defend against lawsuits or regulatory investigations by demonstrating that the company does not condone, and in fact prohibits, illegal activities.

Stakeholders (including employees) are becoming increasingly vocal in their demands that corporations take a leadership role in areas like social injustice which is traditionally the domain of governing and legislative institutions. In the face of these social pressures, we are witnessing the emergence of "stakeholder capitalism," which is forcing a maturing of Code of Conduct from a rules-based paradigm to one that is values-based.

Adopting a values-based approach to Code of Conduct, and restructuring employee training accordingly, helps to cultivate a culture and reinforce workforce behaviors aligned to company values. At the same time, alignment between Code of Conduct and values demonstrates to all stakeholders that Code of Conduct is integral to how the corporation conducts itself and is not merely a means of risk-avoidance.

7. EXTEND THE REACH OF YOUR ETHICS AND COMPLIANCE PROGRAM TO THIRD PARTIES

For a long time, companies could safely claim ignorance of the behavior of their third parties, but no longer. Technology has enabled communication and connection like never before, and the pandemic starkly illustrated how interconnected and vulnerable our global economic ecosystem is. As a result, companies are increasingly being held to account for the ethical behavior of third parties, including those on either end of their supply chains: Are suppliers ethically sourcing their raw materials? Are their work environments safe, healthy, and humane? Are distributors selling parts or finished products to enemy states or other bad actors?

ESG investors and other stakeholders are beginning to take the stance that a company's environmental, social and governance footprint extends outside its own walls. In other words, any given company is assumed to be part of an "extended enterprise" that includes suppliers, distributors, contractors, and business partners. Third parties have landed on the board agenda as well, as boards are now keeping a close eye on supply chain management thanks to the pandemic.

In the current business environment, companies will have to find a way to know their third parties better and ensure that the ethics and compliance practices of their supply chain partners are aligned with their own. Fortunately, cloud-based applications are tech-enabling the extension of key tools of the E&C program—such as Supplier Code of Conduct and employee training—to third parties. Companies can finally take concrete action to help third parties do the right thing.

HOW CAN WE HELP YOU?

Investors have come to view a robust ESG program as a key predictor of long-term growth and profitability. As guardians of corporate reputation and market valuation, ethics and compliance executives need to be closely aligned with internal ESG teams. To learn more about how to execute the roadmap in this white paper, reach out to connect with our team: **Speak with a Training & Ethics Learning Expert – SAI360.**

APPENDIX 1: SAMPLE CORPORATE ESG REPORTS

Kraft Heinz Company 2021 ESG Report

Whirlpool 2021 Sustainability Report

Boeing 2021 Sustainability Report

Shell Sustainability Report 2021

Apple's 2021 ESG Report

Victoria's Secret & Co 2021 ESG Report

Pfizer 2021 Environmental, Social and Governance Report

APPENDIX 2: ESG DISCLOSURE GUIDES

Sustainable Stock Exchanges Initiative: Model Guidance for Reporting ESG Information to Investors

Nasdaq: ESG Reporting Guide 2.0

NYSE: Best Practices for Sustainability Reporting

[1] "ESG May Surpass $41 Trillion Assets in 2022, But Not Without Challenges, Finds Bloomberg Intelligence." Bloomberg.com. Bloomberg, January 24, 2022. https://www.bloomberg.com/company/press/esg-may-surpass-41-trillion-assets-in-2022-but-not-without-challenges-finds-bloomberg-intelligence/.

[2] Threlfall, Richard, Adrian King, Wim Bartels, and Jennifer Shulman. "The time has come: The KPMG Survey of Sustainability Reporting 2020." KPMG, December 2020. https://assets.kpmg/content/dam/kpmg/be/pdf/2020/12/The_Time_Has_Come_KPMG_Survey_of_Sustainability_Reporting_2020.pdf.

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Holistic approach to supply chain risk an 'investment differentiator'

Mapping supply chains has become an increased point of emphasis from a governance and regulatory perspective. It can also be an opportunity.

BY JEFF DALE, COMPLIANCE WEEK

Two experts explained how the C-suite as a whole—not just compliance officers—should be focused on the holistic approach to supply chain risk management during a session at Compliance Week's virtual ESG Summit.

Alexis Huseby, vice president and research analyst of environmental, social, and governance at Lazard Asset Management, described the holistic approach to supply chain risk management as asking the question, "Your peers are paying attention to this—are you?" She said this approach could be an "investment differentiator imperative going forward."

Without buy-in from asset managers and corporations they own, a shift in the sustainability space is unlikely, said Huseby.

"The combination of sustainability and financial markets is where some very interesting change can be driven," she said.

Since the onset of the Covid-19 pandemic and Russia's invasion of Ukraine, supply chain risks have increased exponentially, which makes mapping the supply chain more significant as business is conducted at a faster pace.

"Up until two years ago, compliance officers saw supply chain as a pretty smooth thing," said Frank Meehan, managing director of ESG and climate at software provider FiscalNote. "Things took care of themselves. … There really wasn't a sense of disruption on supply chain as there is now. Now, everything has completely changed."

Mapping the supply chain has also become an increased point of emphasis from a governance and regulatory perspective.

"We do see new proposed rules coming out of the European Union regarding forced labor. I think that's going to require more data," Huseby said. "We see the United States already has bans in place on certain geographic regions of the world—that requires more data and reporting."

In the United States, the Uyghur Forced Labor Prevention Act took effect in June and bans any goods mined, produced, or manufactured in whole or in part in the Xinjiang Uyghur Autonomous Region of China from entering the country.

Going forward, Huseby said with businesses moving toward a "shorter timeline for supply chain management," having proper best practices and benchmarking becomes imperative.

"It's all about data," said Meehan, who added companies "can't be looking at data that's six to eight months old. … You absolutely have to be looking at it from a real-time perspective."

Internal data is paramount under these circumstances, along with understanding risk in a supply chain "even before the supplier does," Meehan noted.

"When I'm looking at the supply chain management of a company … I'm really looking for supply chain mapping. I'm looking for all the reporting from the get-go," Huseby said. "I'm looking if they have a methodological and clear process in place for mapping suppliers and organizing those suppliers into tiers."

Huseby added companies have created extra transparency by publicly releasing all their Tier 1 suppliers and implementing ESG language into contracts and know your supplier practices. Scorecards and proper risk audits can also help, she said.

"There are a lot of qualitative things you can do in addition to the quantitative data gathering … that allows resilience in the face of future disruption," Huseby said.

Huseby also discussed issues from companies marketing sustainability initiatives, which often can be exaggerated.

"In many places, the chief marketing officer gets halved as being the head of sustainability. There is absolutely a level of marketing to it," Huseby said. "But the problem is it's very obvious to us when it's just marketing." ■

How Rite Aid is preparing to comply with SEC's climate disclosure rule

Amanda Patrick, Rite Aid's director of ESG/corporate sustainability, shared the retail pharmacy chain's sustainability journey so far and how it is readying to meet the SEC's potential disclosure mandate.

BY ADRIANNE APPEL, COMPLIANCE WEEK

Rite Aid is preparing to comply with the Securities and Exchange Commission's (SEC) climate-related disclosure rule, regardless of the timeline on when the proposed mandate might take effect, the retail pharmacy chain's director of environmental, social, and governance and corporate sustainability said during her opening keynote address at Compliance Week's virtual ESG Summit.

Since the SEC's controversial proposal was released in March, Rite Aid has embraced an "enterprise-level awareness" about the need to implement, document, and disclose ESG practices and policies, said Amanda Patrick as part of her fireside chat, titled "Moving the Needle on ESG Compliance."

Patrick advised risk professionals get involved "from Day 1" with their company's ESG compliance and disclosure programs. They should understand the ratings systems available and the metrics behind them.

"Get yourself a seat at the table so you can be part of the process," she said.

Rite Aid has experience under its wing, as it began disclosing annually its ESG milestones in June 2019.

Rite Aid's reporting, now released each July, was prompted by a 2018 shareholder proposal. Patrick, who had held various roles at Rite Aid since 2007, became its sustainability director in 2019, a new role for the company. She is responsible for shepherding its ESG efforts, including satisfying investor requirements and complying with the potential climate-related disclosure mandates of the SEC.

"In FY22, we continued to seek environmental and social sustainability opportunities consistent with our purpose, to help our customers achieve whole health for life, through cross-functional collaboration with key business partners and increased engagement with our board," said Rite Aid Chief Executive Heyward Donigan in the retailer's most recent ESG report. "… We remain committed to transparency around our ESG journey."

> "Get yourself a seat at the table so you can be part of the (ESG) process."
>
> Amanda Patrick, Director of ESG/Corporate Sustainability, Rite Aid

Starting point

Rite Aid created an ESG steering committee to guide its efforts, Patrick said.

The company decided to go with a risk-based approach and used the frameworks created in 2017 by the Financial

Amanda Patrick kicked off CW's virtual ESG Summit held in September with a candid discussion on Rite Aid's achievements and remaining goals in the sustainability space.

Stability Board's Task Force on Climate-Related Financial Disclosures (TCFD) for guidance, Patrick said.

"We were looking to report through a risk-based, investor lens," she said. After getting sign-off from its institutional investors—including BlackRock and State Street—Rite Aid, led by Patrick, the steering committee, and its board, got to work.

Rite Aid began by conducting internal interviews and analysis to determine "where we were," in terms of what ESG activities the company already had underway and what still needed to be done, Patrick said.

Over the last four years, the company's annual reports have shifted from voluntary disclosure to being mandatory, Patrick said.

Rite Aid altered the overall structure of its ESG governance from that of investor relations to being handled by the chief legal officer, she said.

Rite Aid further strengthened its governance around ESG, giving oversight to three of the four committees of the board, including the auditing committee, which focuses on climate impacts. The compensation committee has oversight over diversity, equity, and inclusion. The nominating and governance committee review the annual reports, in addition to management, before they are released, Patrick said.

"Strengthening that governance piece has been key," Patrick said. "They are all working independently but together."

The company's disclosures are also guided by the Sustainability Accounting Standards Board (SASB), a nonprofit founded in 2011 to assist companies as they take steps toward sustainability. The organization's popular materiality map reveals how general sustainability issues manifest across 77 industries. Rite Aid used the standards SASB identified for a retail pharmacy, in addition to drawing some topics from SASB's standards for food retailers and distributors, multiline and specialty retailers, and distribution, Patrick said.

A big challenge has been determining which ESG ratings to use. There are a variety of systems and methodologies; Rite Aid asked its investors which rating agencies, from a regulatory perspective, it should pay attention to, Patrick said.

Her advice for others: Pick which rating agency is important and engage with stakeholders to ensure your ESG practices and reporting are aligned with that.

Rite Aid voluntarily released the results of a climate change questionnaire it submitted in 2021 to the CDP, a global nonprofit that measures how well corporations are doing on climate goals.

"It was an exercise in transparency," Patrick said. "Our peers had been reporting to CDP and had been for quite some time."

"It helped us set our baseline and understand our climate risk," Patrick continued. The company learned it had "work to do" around governance and risk, she said.

Moving forward

Rite Aid is pivoting again and now is preparing for the potential regulatory-driven disclosures that might be required by the SEC. The agency's proposed mandate is expected to face delays—first because of a technical glitch in the SEC's comment system, second from presumed legal challenges—but the information available now is enough to give companies lagging behind a good starting point.

"Now, you're going to have these regulators coming in and saying, 'Let's see the data and analysis,'" Patrick said.

The heaviest lift will be implementing new processes and controls for the company's finances; tracking climate impacts on official financial statements, including severe weather events; and aligning disclosures with the financial reporting periods, she said.

To really get a taste for what the SEC's rule will likely require, Rite Aid hired a consultant to walk it through a compliance gap assessment.

"It was worth every penny we spent," Patrick said. The assessment told Rite Aid what its next steps should be and gaps it needed to fill.

"If you don't have an expert internally, lean toward a good partner to get you set up and ready to go," Patrick said. ■

Shades of conflict minerals for SEC climate disclosure rule?

"It's like déjà vu all over again," said one expert of the SEC's latest controversial policy proposal.

BY AARON NICODEMUS, COMPLIANCE WEEK

The climate-related disclosure rule proposed by the Securities and Exchange Commission (SEC) will eventually pass but not before undergoing some changes, practitioners speaking at Compliance Week's virtual ESG Summit predicted.

Despite foreseeing changes and delays, speakers at the environmental, social, and governance event urged attendees to continue preparing for the SEC's potential mandate as if climate-related disclosures will be required for the 2023 fiscal year for large accelerated filers, as currently proposed.

"ESG is a process, not an outcome," said William Nelson, general counsel of the Investment Adviser Association. "If you wait to prepare until the rule is finalized, then you're too late."

Chris McClure, a partner at accounting firm Crowe, called ESG "an evolution of risks you have as an organization."

Compliance consultant Douglas Hileman compared the potential legal fight over the climate-related disclosure rule to another controversial SEC policy: the conflict minerals rule.

"There are a lot of parallels between the two," he said. "It's like déjà vu all over again."

The conflict minerals rule, adopted by the SEC in August 2012, requires companies to disclose information each calendar year on the source of tantalum, tin, gold, and tungsten used in their products. Those minerals are known to have funded violent conflict in the Democratic Republic of the Congo (DRC) and adjoining countries.

The National Association of Manufacturers, U.S. Chamber of Commerce, and Business Roundtable responded to the rule by filing a lawsuit in federal court, claiming forcing companies to disclose whether they sourced those metals from the DRC was an unconstitutional violation of their right to free speech. A U.S. appeals court ruled in 2014 that portions of the rule were indeed unconstitutional. The reconfigured rule took effect in 2017.

A fact sheet accompanying the SEC's climate-related rule indicated large accelerated filers would have to begin making climate-related disclosures for fiscal year 2023; accelerated filers and nonaccelerated filers for FY2024; and smaller reporting companies for FY2025.

It is likely a lawsuit would delay the rule's implementation. The Chamber of Commerce said in June the climate-related disclosure rule as currently crafted "exceed(s) the SEC's lawful authority and [is] vast and unprecedented in [its] scope, complexity, rigidity, and prescriptive particularity."

The SEC received thousands of comments expressing support and opposition to the rule.

Culled from those comments are main areas of concern for companies and trade groups: Scope 3 emissions and the rule's concept of materiality, said McClure.

Disclosing Scope 1 (direct) and Scope 2 (indirect but still in an entity's control, like energy use) greenhouse gas emissions hasn't drawn as much negative attention from commenters. Measuring and disclosing your organization's Scope 3 emissions, which are generated by a company's value and supply chain, is receiving more pushback, Nelson said.

Commenters opposed to disclosing their Scope 3 emissions have asked the SEC to delay implementation of that section of the rule so they have more time to prepare. It will be difficult to obtain accurate Scope 3 emissions data from all their partners and vendors, commenters said.

The rule would also define materiality when the aggregate dollar amount of the impact is greater than 1 percent of the related financial statement line item. This 1 percent "bright line" for line-by-line materiality has drawn a lot of concern from the business community, Nelson said. ■

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