Rules to Receive CPE Credit

By attending today's session, you are eligible to receive 1 CPE Credit per the following guidelines:

In order to receive this credit, the following items MUST be completed:

- ✓ Each person wishing to receive CPE Credit must log into the session individually with their credentials
- ✓ You MUST answer ALL of the polling questions throughout the presentation
- ✓ You MUST be in attendance for the entire live session
- ✓ You MUST complete the follow-up survey regarding the session

venminder

venminder

Vendor ESG Oversight

What It Is and What You Need to Know for Third-Party Risk Management

PRESENTED BY
Hilary Jewhurst

Head of Third-Party Risk Education & Advocacy
Venminder

January 25, 2022

Session Agenda

1

What ESG and sustainability are, CSR vs. ESG and the Triple Bottom Line theory

2

Associated risks and regulations in the United States and abroad

3

What you need to know for third-party risk management

4

Best practices

What Is Environmental, Social and Governance

ESG refer to the set of standards and metrics to screen potential investments and evaluate an organization's operations.

ESG considerations cover a broad spectrum of issues that have traditionally been excluded from financial analysis:

- Environmental measures consider how an organization performs as a steward of nature
- Social measures examine how it manages relationships with employees, suppliers, customers and the communities they operate
- Governance deals with an organization's leadership, executive pay, audits, internal controls and shareholder rights

venminder

Corporate Social Responsibility (CSR) vs. Environmental, Social and Governance (ESG)

CSR Values

- Self-structured and controlled business management concept
- 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
- Broadly defined – no standard

ESG Actions

- ESG can be seen 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
- Reports are often used by investors to screen potential investments and evaluate an organization's operations

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.

What We Say (CSR) and What We Do (ESG)

Corporate Social Responsibility

- Healthy Planet
- Gender Equality
- Community Outreach & Volunteering
- Running an Ethical Business

Environment, Social and Governance

Carbon Footprint Reduction
- Produce a Greenhouse Gas Emission report
- Reduction of emissions

Gender Pay Equality
- Percentage of the basic salary
- Percentage of men to women in each employee category and area of operations

Community Reinvestment
- Percentage of monetary contributions
- Percentage of time contributions (paid staff volunteering)

Anti-Corruption
- Percentage of governance body members
- Percentage of employees and partners trained

venminder

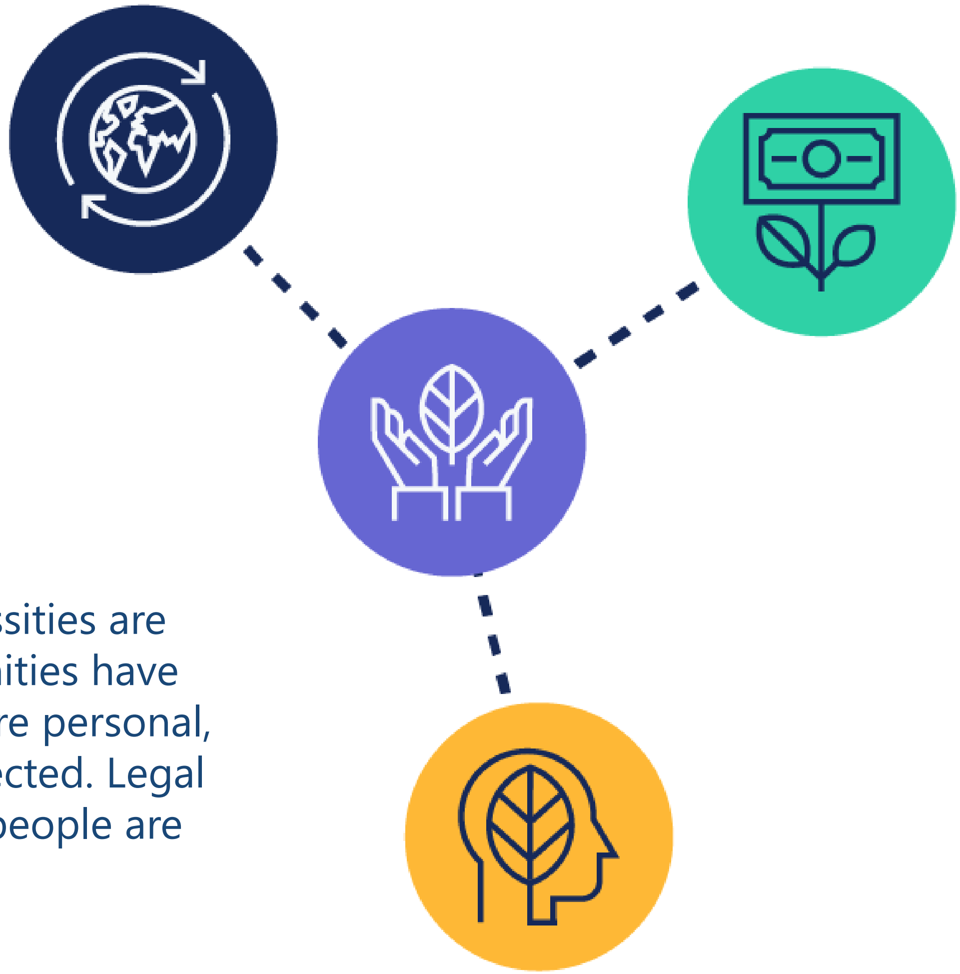
The Shared Foundation Between ESG and CSR

- Both ESG and CSR have a shared foundation based on **sustainability.**
- **Sustainability** can best be defined as meeting our own needs without harming people or the planet and without compromising the ability of future generations to meet their own needs. In addition to natural resources, we also need social and economic resources.

The 3 Aspects of Sustainability

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.



Financial

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

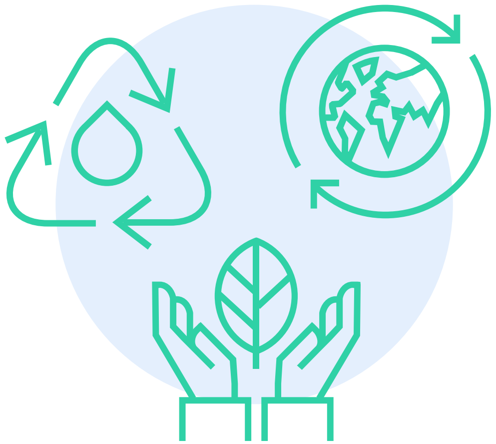
Universal human rights and necessities are attainable by all people. Communities have ethical and just leaders who ensure personal, labor and cultural rights are respected. Legal justice is applied equally, and all people are free from discrimination.

How the Triple Bottom Line (TBL) Relates to ESG

ESG is closely aligned to a financial theory called the Triple Bottom Line.

TBL theory suggests that instead of one bottom line, there should be three:

People



Planet

Profit

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.

ESG Environmental Issues and Considerations

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.

Examples

- Air pollution
- Biodiversity
- Carbon emissions
- Clean energy use and technology
- Climate change
- Deforestation
- Energy efficiency
- Mining and minerals
- Ocean conservation

Sample 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?

ESG Social Issues and Considerations

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

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

Sample Considerations

- Do the organization's suppliers share their values?
- Does the organization 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?

venminder

ESG Governance Issues and Considerations

Governance Issues	Examples	Sample Considerations
• These 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.	• Board structure and composition • Codes of conduct • Corporate governance • Crisis management and resiliency • Executive compensation • Gender pay gap • Policy influence and political contributions • Risk management • Supplier codes of conduct and ethics • Corporate social responsibility • Tax strategy, reporting and governance • Corruption and bribery • Data and privacy management	• How does it manage risk? • What is the executive compensation like? • Does the organization prevent and avoid bribery and corruption? • 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?

venminder

Poll Question

Does your organization currently have a CSR or ESG program?

a. Yes
b. No, but one is in the works
c. No
d. Not sure

Climate Change

- Climate change isn't just a CSR or ESG factor. It's now considered a **systemic risk** to the financial sector and worldwide economies. Systemic risk describes an event that can spark a major collapse in a specific industry or the broader economy.
- Financial risk analysts and economic experts worldwide agree that the potential for severe disruption to the real economy resulting from climate change is significant.

venminder

Climate Change (Continued)

Physical Risks

These are associated with frequent and severe weather events and long-lasting environmental changes:

- Destruction of assets, displaced people and workforce migration, water scarcity and lower food production
- More frequent and intense natural disasters like hurricanes, floods and winter storms

Transition Risks

These are related to the decarbonizing of financial markets:

- Carbon-sensitive assets that are tied to the utilities, energy, transportation, industrial and other sectors could lose value
- As much as *one-third of all equity and fixed income assets are tied to carbon-sensitive industries

** Source: Center for American Progress, Adam Tooze, Columbia University*

Modern Slavery (Forced Labor 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. Modern slavery is:

- A profitable business, estimated at $150 billion annually
- Very prevalent in worldwide supply chains that include raw materials, manufacturing and construction
- Often obscured by the complexities within those supply chains, multiple subcontracting relationships and corrupt third parties
- According to the U.S. State Department, it’s termed as “modern slavery,” “trafficking in persons” and “human trafficking” to reference many different acts (e.g., recruiting, harboring, transporting, providing or obtaining a person for forced labor or commercial sex acts using force, fraud or coercion)

Modern Slavery (Forced Labor and Human Trafficking)

Women and children are particularly vulnerable, making up 71% of enslaved people

- **Slavery by Descent or Chattel Slavery:** In chattel slavery, the enslaved person is considered another person's property and can be bought and sold.
- **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.
- **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.
- **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.
- **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.
- **Child Labor:** This can include street crime like begging or pickpocketing, drug trafficking or cannabis cultivation or any other type of modern slavery including domestic servitude, forced labor and chattel slavery.
- **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.

Regulatory Environment in the United States

- **In the United States, there are currently no mandatory ESG disclosures at the federal level**, although the SEC requires all public companies to disclose information that may be material to investors, including information on ESG-related risks
- SEC agency expects public companies to disclose material information about climate change in their SEC filings under existing disclosure rules
- Existing disclosure standards are applicable to climate change are largely based on principles of materiality and thus provide significant discretion to company management

Regulatory Examples/Environment Abroad

The European Union

- **Sustainable Finance Disclosure Regulation ("SFDR")** requires certain asset managers and Financial Advisers to make environmental, social and governance disclosures to potential and current investors.
- **Due Diligence for EU businesses** to address the risk of forced labor in their operations and supply chains" (the Guidance)
- **Proposed: EU Forced Labor Import Ban**

**This list is not all inclusive*

The United Kingdom

- **SFDR "Double Materiality" disclosures** will come into force in June 2022 and applies to any UK financial institutions operating in the EU or transacting with EU-based clients
- **Task Force on Climate Related Financial Disclosures** (TCFD)
- **Sustainable Disclosure Requirement** (SDR) Sustainable Finance regulations to be expanded in 2022, will make ESG reporting mandatory for all private UK companies and limited liability partnerships with more than 500 employees and turnover greater than £500m, along with all publicly quoted UK companies
- **Section 54 (Transparency in Supply Chains) of the Modern Slavery Act 2015**

venminder

Density of ESG Laws and Regulations by Country

Source: Climate Change Laws of the World (climate-laws.org)

venminder

Poll Question

Does your organization consider ESG factors as part of vendor management?

a. We're looking into it, but it's not yet part of our process
b. We consider ESG as part of our vendor vetting
c. Not applicable
d. Not sure
e. I'm first hearing about this now

venminder

Hard Law vs. Soft Law

- **Hard law** refers to existing regulations. Many countries have passed legislation requiring an organization's disclosure on human rights, environmental protection and labor practices within its supply chain.
- Current laws and standards specific to these issues are still limited.
- Alternatively, **soft law** is related to the voluntary adherence to ethical standards and norms.
- These aren't enforceable by law but generally agreed upon across member entities such as the Geneva Convention, World Health Organization and the Kyoto Protocol.

Investor Pressure

By some estimates, over 90% of U.S. equities by market capitalization are exposed to material financial impact from climate change.
(SEC, Commissioner Lee, August 2020)

- ESG reporting has historically been voluntary, ad-hoc and focused on communicating aspirations while providing some data to support or help tell the story around those aspirations
- More broadly, investors have also advocated for companies to embrace and report on ESG
- Companies are responding; over 90% of the S&P 500 Companies and 70% of the Russell 1000 Index companies published sustainability reports in 2020. (*Corporate Compliance Insights, Jan 04, 2022*)

ESG Ratings

- These formal ratings established through external third-party firms measure an organization's exposure to ESG risks and its performance related to those issues
- 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

Third-Party Risk Management and ESG Considerations

- Third-party risk management has an important role to play in your organization's ESG initiative and reporting
- ESG maturity varies greatly across organizations and their third parties
- ESG regulations, requirements and expectations are rapidly evolving
- Rushed or poorly planned integration of ESG into TPRM will only result in rework, frustration and wasted resources (time, money)
- Not suitable for a "just do it" project

TPRM cannot scope, plan, integrate or execute third-party risk ESG alone. Cross-functional collaboration and communication is imperative.

Incorporating ESG Into Your TPRM Framework

Begin with these 8 questions:

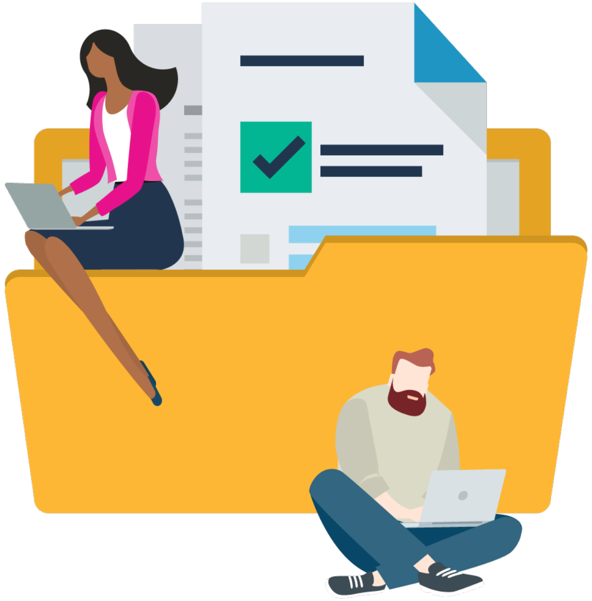
1. What is your organization's commitment to ESG?
2. Who owns ESG at your organization?
3. Who is the subject matter expert on ESG (internal or external)?
4. Is there a committee or working group for ESG?
5. Is the organizational focus on transparency and reporting or are we also setting goals? What is the current objective?
6. Is third-party risk management currently in scope for ESG?
7. How will we determine which third parties will be in scope for ESG? Will we select based on risk profile, product or service or spend ?
8. What is the expected timeframe for third-party ESG compliance?

venminder

Third-Party ESG – Getting Started

As the regulatory landscape and investor expectations continue to evolve TPRM programs can focus on the basics:

1. Does the third party have any ESG reporting?
2. Does the third party have a Modern Slavery (Forced Labor, Human Trafficking) statement?



The approach: Using a simple ESG questionnaire, survey your critical and high-risk vendors first.

You do not need to be a subject matter expert (SME) to determine:

- If the organization has an ESG program in place
- If the organization has any documented ESG goals
- If organization is doing ESG reporting
- If the organization has a modern slavery statement
- Is the organization making progress on their goals

venminder

ESG as Due Diligence

- As another type of third-party risk, ESG risk questions should be included in the inherent risk questionnaire. Therefore, your organization needs to have enough ESG maturity to determine the scope, impacts and risk handling for ESG issues.

- Ultimately, ESG will become another component of due diligence and depending on your organization's ESG goals, you may need to engage a SME to determine what ESG controls are required, how those controls are evidences and to review third-party provided information.

venminder

Other ESG Vendor Risk Lifecycle Considerations

- Your systems and workflows will require updating to include third party ESG requirements
- Governance documentation, such as policy and program documents, will need to updated to reflect the inclusion of ESG
- Standard contract terms may need to be adjusted to reflect ESG reporting requirements
- Ongoing risk monitoring will need to consider ESG as a risk factor
- Your third parties will need plenty of communication, education and realistic timeframes to work towards compliance
- If not a contract requirement, know how third party noncompliance will be addressed
- Third party ESG reporting metrics should be included in board and senior leadership reporting

venminder

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 Tips:

- Be sensitive to the change management required and how it might affect your current vendors, especially if it means they new data to collect and reports to issue
- To ensure a successful transition for your vendors, clear and constant communication is paramount
- Longer compliance time frames (6 months to a year) are recommended

venminder

Poll Question

For due diligence and vendor risk reviews, our subject matter experts are:

a. Spread out across multiple departments, but not TPRM
b. TPRM only
c. A mix of different departments and TPRM
d. Some internal and some external
e. All external
f. Not sure

venminder

Best Practices

- Understand your organizational goals around ESG first
- Collaborate to identify the specific goals and requirements for third-party ESG
- Determine which third parties are in scope for ESG
- Survey your third parties first to get a baseline on ESG reporting and Modern Slavery Statements
- Consider and plan for how ESG will be integrated into your TPRM framework, documents, processes and reporting
- Get educated and insist on access to a ESG subject matter expert
- Set realistic expectations around integration timelines
- Provide your third parties with education, communication and ample time to meet compliance requirements
- Be prepared for changes as regulations and expectations evolve

Post a Question:

www.thirdpartythinktank.com

THIRD PARTY thinktank
A Community for Risk Professionals

Questions & Answers

Email Us:

resources@venminder.com

Follow Us:

@venminder

venminder

Also Join Us At
Our Upcoming Webinars:

FEBRUARY 8, 2022
State of Third-Party Risk Management 2022

Click here to view our Webinars Page.

venminder

Thank You

venminder