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.

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/.

## 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 |

## 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 healthy 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.

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.

## 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

## Interested in learning more about aligning Ethics and Compliance with ESG?

## Let's start a conversation.

## Our unified approach to risk sets us apart

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