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eBOOK

5 ESG Regulatory Lessons that Tell Us What to Watch in 2024.

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Table of Contents

ETHIXBASE360

Executive Summary 3

Introduction: The ESG Model Evolves 4

Lesson #1: From Voluntary to Mandatory 5

Lesson #2: Reputational Risks 6

Lesson #3: UBO Challenges 7

Lesson #4: Integrated Regulations 8

Lesson #5: Surge in Regulations 9

Conclusion: How Ethixbase360 Can Help You 10

About Ethixbase360 11

References 12

Executive Summary

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Geopolitical turbulence in Eastern Europe and the Middle East is causing a lot of uncertainty in the business world. But it also brings home the message to corporates and supply chains the world over that they need a solid foundation for their operations now more than ever. Unlike politics, their business infrastructure is well within their control.

In the environment, social, and governance (ESG) arena, the regulatory landscape has shifted to make what used to be voluntary increasingly mandatory. From Germany to Canada, a spate of regulations that either took effect or were enacted in 2023 mandate environment, social, and governance reporting and disclosures.

Controversies pertaining to modern slavery and forced labor in various parts of the world continue to drive consumers, investors, and the public to demand corporate transparency and accountability, which in turn pressure companies to implement processes or pressures companies to institute best-in-class programs?

New developments in the European Union are pushing the convergence of “E” and “S” in ESG regulations. This is apparent in the EU’s Corporate Sustainability Reporting Directive (CSRD), which took effect last year, as well as the Corporate Sustainable Due Diligence Directive (CSDDD), which advanced at the European Parliament and Council in late 2023.

This e-book highlights some of the most important changes in the ESG regulatory landscape recently. They offer a glimpse – and a heads-up – of what you can expect in 2024 and beyond.

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Introduction: The ESG Model Evolves

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The seminal report "Who Cares Wins,"[1] published by the UN Global Compact in 2004, offers a list of recommendations for financial institutions, corporations, stock exchanges, regulators, and other stakeholders to consider ESG factors in their actions for "better investment markets and sustainable societies."

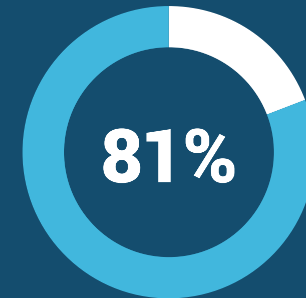
It was the first document to formalize the term ESG. The initiative persuaded thousands of organizations worldwide to align their operations with principled standards in the areas of human rights, labor rights, environment, and anticorruption and antibribery practices. It became the basis of voluntary ESG reporting and related initiatives by companies covering a wide array of concerns, from helping mitigate climate change to promoting sustainable manufacturing to improving labor standards.

The UN Global Compact's ESG model and the movement it spawned have evolved in the past two decades and continue to do so. In particular, the "S" in ESG gained a strong foothold, thanks to modern slavery and forced labor laws introduced in many countries.

As the movement grows, criticisms and backlash are inevitable. They mostly stem from inconsistencies in ESG reporting and discrepancies between what companies claim to do versus what they actually do. Critics decry businesses claiming to be sustainable more than they are as guilty of greenwashing, while those who promise to do more but have no wherewithal to fulfill it are guilty of greenwishing.[2]

The movement has been politicized over the years. In the U.S., the absence of a federal ESG framework has resulted in a political divide between states with pro-ESG legislations and those with anti-ESG laws.[3]

For all the ups and downs in the ESG movement, recent developments offer important lessons for corporates and their value chains. Let's take a look at five areas that are likely to shape the ESG regulatory landscape in the next few years.



of companies attribute **progress on their sustainability work** to participate in the Global Compact.

SOURCE: UN Global Compact Annual Implementation Survey

20,000 +

COMPANIES &

3,800+

NON-BUSINESS PARTICIPANTS AND COUNTING

Our participants represent nearly every industry sector and size, and come equally from developed and developing countries.

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New regulations that took effect in 2023 signal a definitive move from voluntary ESG reporting to mandatory compliance.

Europe's reputation as a leader in the global ESG movement was cemented by important milestones indicating that the days of optional ESG implementation are over. Germany's Lieferkettengesetz (LkSG), which took effect in January 2023, raised the bar in the fight against unethical global supply chains.[4]

Also known as the German Supply Chain Due Diligence Act, it mandates companies doing business in Germany to perform due diligence on human rights, including preventing and mitigating any violations, within their supply chains.

The European Union's Corporate Sustainability Reporting Directive (CSRD) requires all large and listed EU and non-EU companies doing business in the region to file annual sustainability reports. The directive took effect in 2023, but EU lawmakers agreed to delay sector-specific ESG corporate disclosures for the oil, mining, and energy industries until June 2026 to give companies more time to comply.[5] CSRD elevates sustainability reporting to the same level of rigor as financial reporting in terms of accountability and "auditability."[6]

Outside of Europe, Canada's groundbreaking modern slavery law made waves when it passed in May 2023. The law provides supply-chain transparency by requiring public and private entities to submit annual reports showing that they are not using forced labor or child labor.[7]

While these new regulations are a step in the right direction, critics point to the need to strengthen due diligence requirements and compliance enforcement. It's not enough to mandate reporting. Companies must also show accountability.

In Australia, the Attorney General's review of the first three years of the country's Modern Slavery Act 2018 included 30 recommendations that will toughen the law. The goal is to align the law with recent global trends in human rights due diligence and supply-chain transparency.[8]

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Persistent modern slavery issues worldwide emphasize how critical reputational risks are for companies.

Despite advances in fighting modern slavery, it remains an endemic problem that requires continuous vigilance and commitment by stakeholders. The total number of people trapped in modern slavery has risen from 40.3 million in 2016 to 49.6 million in 2021, according to the International Labor Organization. The figure is the most recent estimate available of forced labor and forced marriage victims combined.[9]

The message hit home last year in controversies from China to Kenya and other places in between. For corporates, the lesson is clear – all it takes is one unethical third party in the supply chain to damage a company's brand and reputation.

China Labor Watch found serious labor rights violations in the Chengu factory of Foxconn, a major Apple supplier, after it investigated the factory from June to July 2023. Some of the findings include forced overtime, widespread workplace bullying and sexual harassment, and discrimination in the hiring process based on gender, ethnicity, and religion.[10]

Kenya's Parliament is investigating alleged sexual abuse of workers in a tea farm that supplies some of the UK's biggest brands. Lawmakers ordered the inquiry after the BBC reported the abuse in Feb. 2023.[11]

In the United States, the U.S. Department of Labor investigated Perdue Farms and Tyson Foods in September 2023 regarding the hiring of migrant children as young as 13 to clean their plants. The investigation is part of the federal government's crackdown on illegal child labor in the country.[12]

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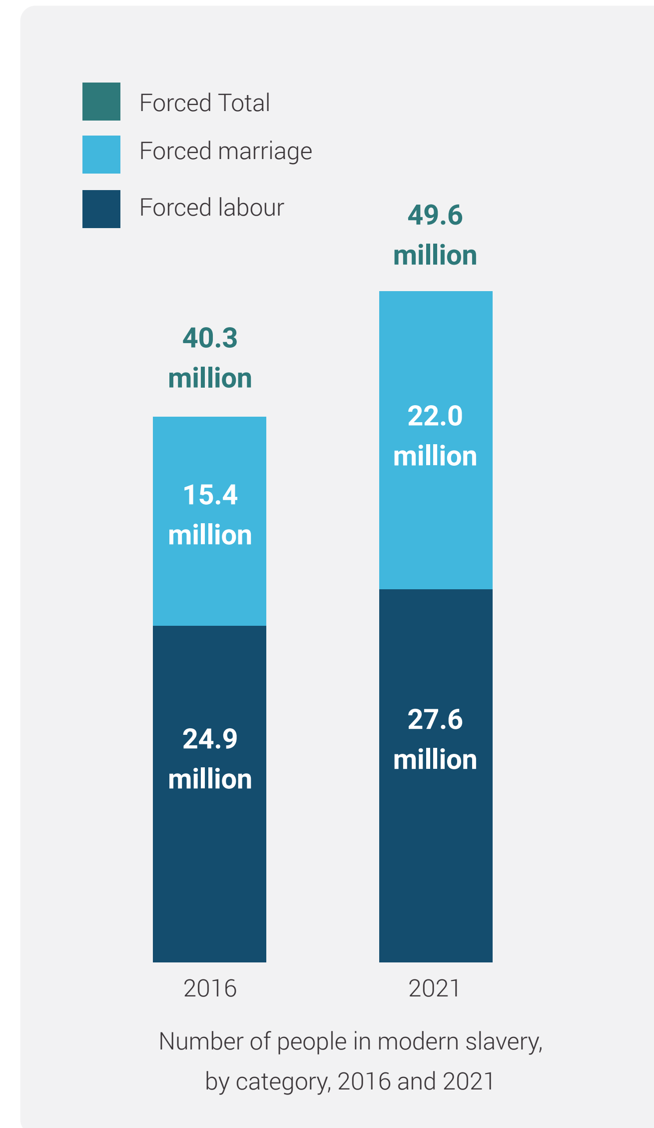

Number of people in modern slavery, by category, 2016 and 2021

Lesson #3: UBO Challenges

The expansion of the U.S., UK, and European Union's lists of blocked persons and entities under their sanctions against Russia is highlighting the importance of due diligence into UBOs.

It's never easy to find out the ultimate beneficial owner (UBO). It's gotten harder when the U.S. and the U.K. expanded their lists of sanctions against Russia.13 The European Union's sanctions have been in place since 2014, following Russia's annexation of Crimea, but the measures have grown recently in light of Russian aggression in Ukraine.[14]

In the same vein, the U.S. and the U.K. imposed sanctions against Hamas and its backers in Iran and Lebanon after Hamas attacked Israel in October 2023. The ban prevents companies in the U.S. and U.K. from doing business with targeted people and entities.[15]

Corporates should remember the U.S. Office of Foreign Assets Control's 50% Rule when it comes to UBO. Under the rule, any entities owned 50% or more, directly or indirectly, in the aggregate by one of more blocked persons are considered blocked.[16]

Businesses can't claim to be unknowingly dealing with blocked entities. Regulators expect companies to perform appropriate due diligence to identify, mitigate, and remediate UBO risks throughout their supply chains.

Lesson #4: Integrated Regulations

The convergence of "E" and "S" in future ESG regulations is likely considering the example set by the European Union's recent directives and Germany's LkSG.

The EU's Corporate Sustainable Due Diligence Directive, informally approved late last year by the European Parliament and European Council negotiators, is unique because it covers both climate protection and human rights in one legislation. CSDDD mandates companies to integrate their human rights and environmental impacts into their management systems.[17]

Like CSDDD, the EU's CSRD requires companies to be transparent about their environmental and social impacts. The two directives complement each other. CSRD provides a framework for ESG reporting, while CSDDD aims to ensure that companies take concrete actions to implement their ESG policies. They both require reports, but they have different approaches to their requirements.

Although LkSG is known primarily for its human rights requirements, it also includes an environmental-protection component. It requires businesses to prevent health and environmental hazards based on the terms of two international conventions: the Minimata Convention on Mercury and the Stockholm Convention on Persistent Organic Pollutants.

This law is a historic breakthrough. **Companies are now responsible for potential abuses in their value chain**

Lesson #5: Surge in Regulations

Corporates need better strategies and processes to manage the surge in regulatory reporting requirements across borders.

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The surge in ESG regulations across jurisdictions makes it clear that corporate transparency is no longer a nice option but a must-have. In the face of 600 overlapping ESG standards,[18] the release of two new standards meant to provide a global baseline was welcome news.

The International Sustainability Standards Board's (ISSB) first two Sustainability Disclosure Standards (IFRS S1 and IFRS S2) were announced last year and took effect in January 2024.[19]

Although the ISSB standards are voluntary, 140 jurisdictions are expected to use them. They will help boost public confidence in company ESG disclosures by providing clarity and consistency in reporting. Companies with multiple reporting obligations in different jurisdictions can use the ISSB standards as a tool to foster transparency and accountability throughout their value chains.

The launch of the ISSB and these forthcoming standards come at a critical time with the lack of relevant, **decision-useful climate information is increasingly seen as a barrier in the transition to a green economy.**

Conclusion: How Ethixbase360 Can Help You

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As more jurisdictions mandate value chain transparency via ESG due diligence and reporting, your compliance burden will also grow. It behooves you and your supply chain to embrace ESG regulations and standards not only for compliance but as a core strategy in increasing your brand's value and developing future growth.

You can no longer rely on manual due diligence processes and homegrown risk-management systems for the kind of ESG transparency demanded by regulators, investors, consumers, and other stakeholders.

A purpose-built third-party risk management platform such as Ethixbase360 can help you navigate the regulatory landscape as it evolves from voluntary to mandatory. The highly configurable platform provides proportionate risk-based due diligence to help you identify, manage, and mitigate third-party risks along with regulation specific supply chain risk assessment questionnaires to aid in mandated reporting. It was designed to help elevate the ethical standards of your company and entire supply chain by facilitating and accelerating compliance.

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About Ethixbase360

Ethixbase360 is a value chain sustainability solutions business that delivers robust technology and data analytics to assist corporations and third parties in creating and maintaining sustainable business practices. We create the most intuitive, robust, and configurable platform to help firms globally elevate their third-party supply chain in the areas of anti-corruption, human rights, environment, and labor. **Contact us today for more information.**

Website | **LinkedIn**

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