ecovadis

EU Policy Recommendations for Sustainable Supply Chains

A Discussion Paper

V2.0 - May 2021

The European Union at a Crossroads in 2020

The European Green Deal Investment Plan, also referred to as the Sustainable Europe Investment Plan, was adopted by the European Commission (EC) in January 2020 to drive the green transition. Its objective is to mobilize at least €1 trillion ($1.1 trillion) in sustainable investments within the next 10 years. To help the EU deliver on the European Green Deal, the EC will face decisions of immense consequences over the next 12-18 months.

Specifically, this decision-making will center around the following policies:

- Mandatory human rights and environmental due diligence legislation[1];
- Taxonomy Regulation[2];
- Carbon Border Adjustment Mechanism;
- Non-Financial Reporting Directive[3].

Global Supply Chains Are a Key Part of a Responsible European Economy

With these policies, the EC shows that it is fully aware that supply chains are a key component of a responsible economy and that imposing sustainability requirements on European companies alone will not be effective if their global supply chains are not taken into account. In a global economy, policies need to go beyond the EU market and supply chain issues have to be taken into account when designing policy frameworks.

In doing so, the EC is supporting a movement already launched by the EU's leading companies, who have already identified supply chains as a key piece of their sustainability strategy, and ultimately, as a key opportunity for value creation.

We are presenting ten recommendations in this paper to advocate for a more practical inclusion of supply chain issues in EU policies.

EcoVadis' Contribution to the Discussion

This discussion paper is intended for the consideration of the EC, and other stakeholders, as proposals are developed on these initiatives.
Given our position in the market as a value chain sustainability ratings and intelligence provider, and our broad community of stakeholders, we believe EcoVadis is a unique observer of the current corporate practices and market dynamics, and that we have extensive data and experience to share, including the following:

- **Insight into the immense opportunity for positive impact from well-executed sustainable procurement programs - both within Europe and beyond.**
  We support close to 500 multinational companies in their programs to mitigate social and environmental issues within their supply chains, and know what best practices and key success factors are necessary to implement successful sustainable procurement programs and supply chain due diligence.
- **Data on corporate sustainability practices across the globe.**
  We regularly publish reports and whitepapers detailing our findings and observations. The latest edition of our Business Sustainability Risk and Performance Index 2020, for instance, analyses a five-year trajectory (2015-2019) and is now based on close to 65,000 sustainability ratings across more than 100 countries and over 180 industries.
- **Unique expertise in the field of sustainability performance of small and medium-sized enterprises (SMEs) backed by significant data sets.**
  Our experience is not limited to large companies. We have rated more than 50,000 SMEs since 2008, which comprise the majority of all the companies we rate.

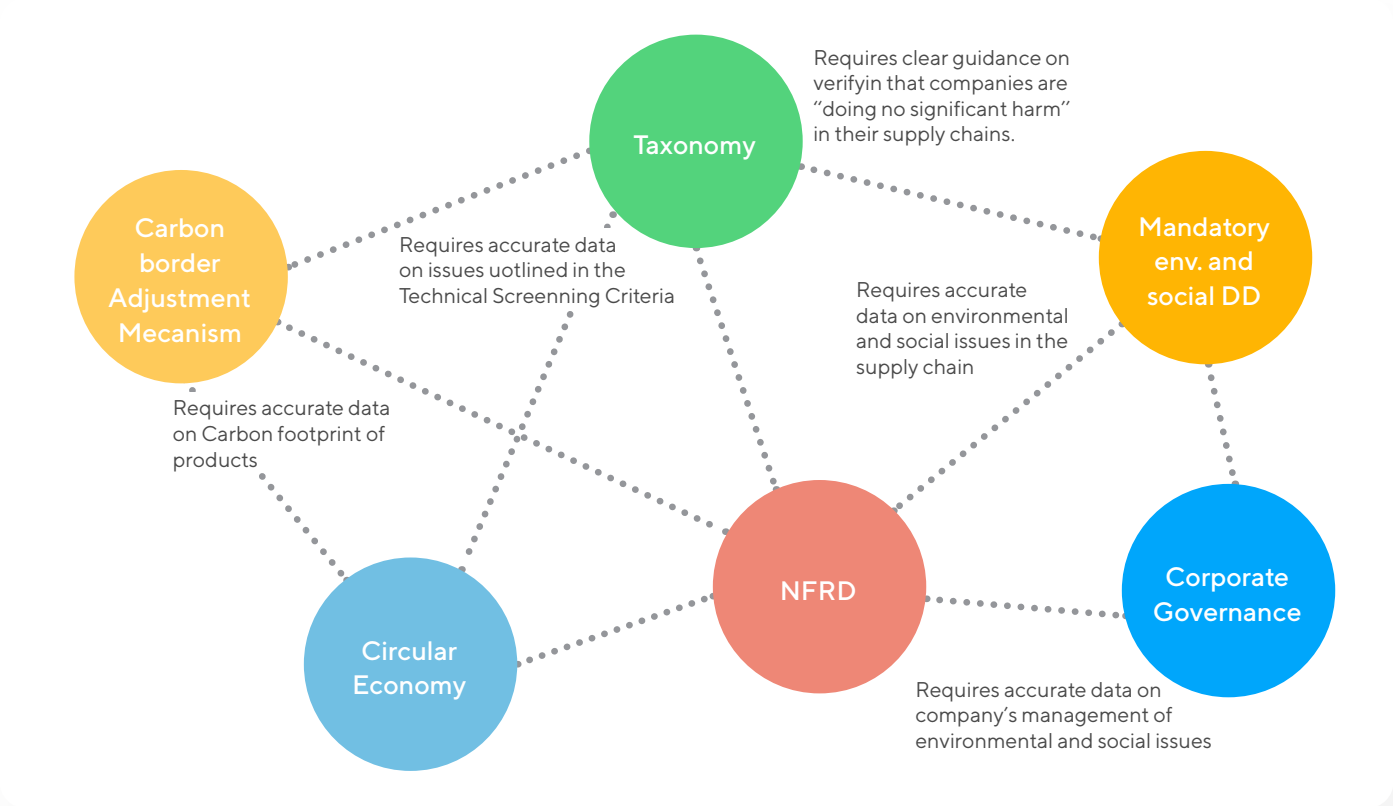
1 Currently included in the Sustainable corporate governance initiative.
2 Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088
3 Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups

From day one, we have advocated for placing more emphasis on supply chains when reviewing a company's sustainability performance. This is because supply chains remain a significant blind spot for most companies, as evidenced by the data included in the following pages. Working with global supply chains also means that our network represents a wide spectrum of companies from across the globe: It includes both large publicly listed companies and SMEs. This provides us with rare data and insights into the maturity and performance of a huge share of the global market that are often lacking in research and market analysis.

We have chosen to comment on these four policy initiatives jointly to highlight the many synergies and interconnections between them. This also represents our belief that they should ultimately be considered as a whole and simply cannot be designed individually.

This policy framework needs to be carefully orchestrated to create the sound and meaningful foundation we need to ensure the success of the EU Green Deal, or else we run the risk of generating a new layer of bureaucracy.

This, however, raises an even more important question on what overarching social and economic vision should underpin those major initiatives. The EU should continue to define and, most importantly, communicate its vision of a sustainable economy to ensure its policies will drive the European economy toward a common goal.



What is the underlying economic and societal vision underpinning those legislative initiatives?

Summary: Ten Recommendations for Sustainable Supply Chains

Mandatory Environmental and Human Rights Due Diligence Legislation

Policy Recommendations

1. Extend due diligence requirements to all companies with more than 250 employees, unless they can demonstrate their spend volume falls under a specified threshold.

- 9% of all Small companies rated by EcoVadis had negative environmental or social issues in their supply chains, showing that even smaller companies need to address these risks through a robust due diligence approach.
- A company's spend volume is a better indicator of exposure to supply chain sustainability risks than its number of employees. If companies can demonstrate that they have little to no procurement activity by disclosing to national authorities that their spend volume falls under a specified threshold, they should be exempted from mandatory due diligence requirements.

2. Include requirements for companies to implement effective grievance mechanisms to address complaints from their stakeholders regarding environmental and human rights issues.

- The EU Parliament Committee on Legal Affairs has already recommended to requiring companies to implement a grievance mechanism for stakeholders to voice concerns regarding human rights, environmental and governance risks.
- Grievance mechanisms can help to improve the dialogue, de-escalate tensions and identify solutions more quickly. We recommend considering some key elements to ensure the company-led grievance mechanism is effective.

3. Include requirements for boards of directors to report on how they have integrated environmental and social issues in the supply chain within their company's long term strategy.

- Boards are increasingly adding sustainability topics to their agendas (e.g., 43% of SBF 80 companies had a CSR committee at board level in 2020, compared to 35% in 2019), but it is unclear whether these include a focus on supply chain topics.
- 13% of sustainability professionals surveyed in the EcoVadis & NYU 2019 Barometer still cite the lack of executive and board engagement as an obstacle to the roll-out of their sustainable procurement strategy.

4. Review the public procurement directive to ensure it holds public procurement to the same environmental and human rights due diligence standards as the private sector.

- Public pocurement in the EU represents an estimated €2,000 billion annually and represents an enormous opportunity for impact by favoring suppliers with sustainable practices and accelerating the transition toward a more responsible economy.

Best Practice Recommendations

5. Buying organizations should engage in the capacity building of their suppliers on environmental and social issues. This would help drive continuous improvements among suppliers and prevent due diligence approaches focusing solely on "tick-the-box" compliance.

- 47.1% of suppliers rated by EcoVadis still fall in the 25-44 score range (medium risk) and would be left behind if buying organizations disengaged.
- In 2019, only 19% of all Large companies rated by EcoVadis had implemented capacity-building programs (e.g., setting corrective action plans, providing training) to help their suppliers improve.

6. Develop collaborative and industry-wide due diligence initiatives in order to synergize due diligence efforts and accelerate positive impacts.

- An internal EcoVadis study compared the improvement of suppliers engaged by a major sector initiative versus suppliers engaged by individual buying organizations. The study found that, on average, the sector initiative's suppliers have improved their EcoVadis score on average by over 50% since their first rating compared to the EcoVadis network average.
- These results are aligned with the findings of a recent study conducted by Adelphi and EY on behalf of the German Ministry of Labor and Social Affairs on the consideration of human rights in global supply chains, which concluded that sectors that have implemented strong sector initiatives were more advanced than others in addressing human rights in their supply chains.

Carbon Border Adjustment Mechanism (CBAM)

Policy Recommendations

7. Base the CBAM on products' actual emission data whenever possible, and refer to industry averages only when importers are not able to provide product-level carbon data.

- Taxes should be reduced or even waived if a supplier of goods is able to demonstrate that their product has a carbon footprint that is comparable to or even lower than the European average. This will allow the CBAM to reward advanced suppliers outside the EU who have succeeded in decreasing their products' carbon intensity.

Corporate Sustainability Reporting Directive(CSRD)

Policy Recommendations

8. Introduce requirements to report on specific leading and lagging indicators on supply chain issues. Clear reporting from companies will improve their ability to transparently and efficiently address environmental and social issues in their supply chains.

- The main reporting standards, such as the GRI, SASB, or the World Economic Forum's "Stakeholder Capitalism Metrics", typically refer to supply chain issues indirectly, by recommending that the disclosing company includes environmental and social impacts in the supply chain "when material". This leads to companies consistently underestimating the materiality of supply chain issues. We recommend making these supply chain indicators mandatory.

Taxonomy Regulation

Policy Recommendations

9. Include supply chain impacts in the "Do No Significant Harm" Technical Screening Criteria of the six environmental objectives for the sectors that rely on complex supply chains.

- In 2019 about 72% of the most environmentally advanced companies (Environment theme score above or equal to 60/100) achieved a Sustainable Procurement theme score of 50 or less, showing they were significantly less advanced on their supply chain management strategy.

10. Require concrete due diligence actions, including in the supply chain, to demonstrate compliance with the minimum social safeguards.

- In 2019 about 30% of the most environmentally advanced companies (Environment theme score above or equal to 60/100) achieved a Labor & Human Rights theme score of 50 or less, showing they still had significant improvement areas in their management of social issues.

** The Non-Financial Reporting Directive (CSRD)*

Mandatory Environmental and Human Rights Due Diligence Legislation

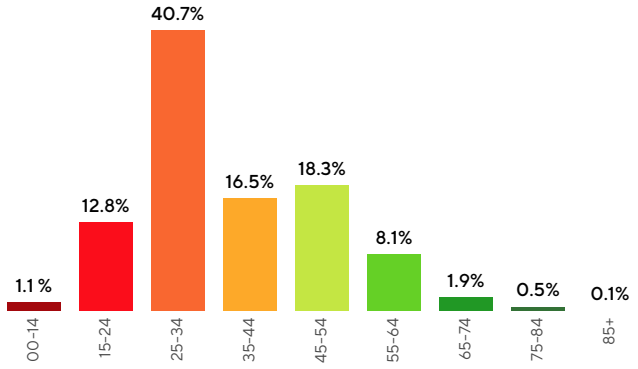
The ambition of the new responsible economy is to offer the best products and services to consumers while guaranteeing responsible and sustainable means of production and delivery all along the value chain. Tracking social and environmental data along the supply chain and integrating this information into each procurement transaction helps to empower consumers to make a conscious decisions about the environmental and social aspect of their purchases.

New technologies are bringing promising perspectives. Countless solutions are emerging to help companies make their supply chains more transparent, including using smartphones to poll workers about their well-being at work, drones to help fight deforestation, blockchain transactions to certify the origins of food and artificial intelligence-based social ratings. Some leading multinational companies, have paved the way in the last decade for sustainable procurement and their progress in implementing social, environmental and ethical due diligence has encouraged other companies to follow suit: EcoVadis & NYU 2019 Barometer on Sustainable Procurement highlights that commitment to sustainable procurement has increased over the past three years for 81% of the 200 surveyed companies.

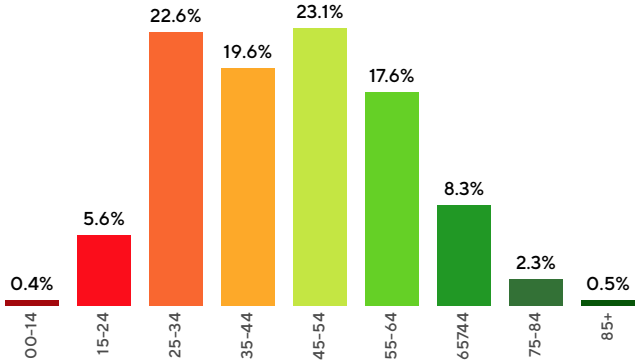
The same study found that 66% of procurement organizations cite regulatory compliance as a critically important aspect of their sustainable procurement programs, showing that the EU mandatory due diligence legislation is an opportunity to significantly increase the adoption of existing best practices and nurture transparency throughout their value chain.

It is true that, apart from these industry leaders, the majority of companies have been slow to address environmental and social risks in their supply chains through a formalized and structured approach. Data from the EcoVadis database shows that companies typically perform better on Environment and Labor & Human Rights themes, which cover impacts from direct operations, and are still lagging behind on the Sustainable Procurement theme, which looks at how companies manage environmental and social impacts from their supply chains. There is still room for significant improvement.

Score Distribution (SUP)



Score Distribution (ENV)



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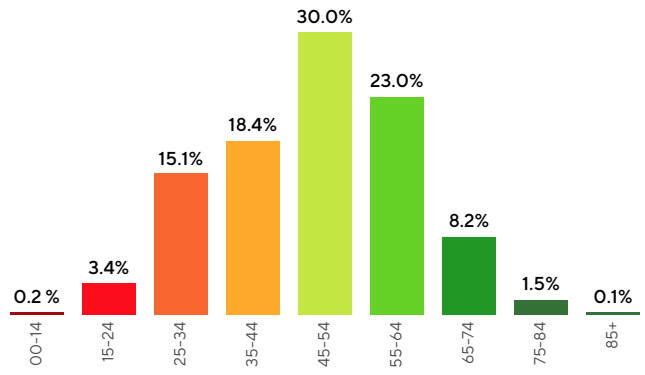


Distribution of EcoVadis scores (January 2019 to October 2020, covers over 33,400 companies)

The due diligence directive is an opportunity to standardize due diligence best practices, based on the trial-and-error experience of leading companies, to build the foundation for a more responsible and regulated globalization, and to ultimately secure global value chains to protect the interests of consumers and investors.

EcoVadis' recommendations are based on the best practices that have made the difference in our customers' due diligence programs.

Our experience working with more than 500 multinational companies on environmental and social issues in their supply chains shows that going beyond Tier-1 suppliers remains a major challenge. Lack of transparency into the further tiers of the chain and difficulties in accessing reliable data remain significant obstacles in conducting upstream due diligence.

Increasing the implementation of robust due diligence programs will allow us to cascade due diligence best practices up the supply chain. We believe that combining technology and expertise is the way to overcome these challenges and to achieve transparent and responsible supply chains.

1. Recommendation: Extend due diligence requirements to all companies with more than 250 employees, unless they can demonstrate their spend volume is under a specified threshold.

We believe that the mandatory due diligence directive should have a wide application scope if it wants to have a real impact on business and supply chains. Restricting the due diligence requirements to large companies with a high revenue or a large workforce will lead to a limited approach, since significant sustainability risks also exist in the supply chains of smaller companies. Between 2019 and 2020, EcoVadis rated 12,500 companies with less than 100 employees: of these rated companies, we identified negative environmental or social issues in the supply chains for 9%.

Rather than criteria like a company's revenue or number of employees, the most telling indicator when it comes to supply chain risks is the extent to which the company has externalized its activities, which can be found in small and large companies alike. This degree of externalization can be grasped by looking at how much the company has spent on procurement, known as the "spend" volume. By focusing only on criteria like a high revenue or a large number of employees, the directive may miss companies who have externalized most of their environmental and social risks, and rely on a large supply chain for their core business.

As a result, we recommend extending due diligence requirements to any company with more than 250 employees, unless they can demonstrate that their procurement activity is insignificant. We recommend defining a minimum threshold for spend volumes: A company would be exempted from the mandatory due diligence requirements if they can demonstrate to national authorities that their spend is below that threshold.

Companies with little procurement activities also typically have less leverage on their suppliers, which means that risk mitigation steps from them will be less effective than those of large buying organizations, and that impacts of their due diligence approach may be limited in practice.

Finally, we recommend that due diligence remains voluntary for companies with less than 250 employees.

> **2. Recommendation:** Require companies to implement effective grievance mechanisms to address complaints from the company's stakeholders regarding environmental and human rights issues.

In Article 9 of its draft report with recommendations to the Commission on corporate due diligence and corporate accountability, the EU Parliament Committee on Legal Affairs included a requirement for companies to implement a grievance mechanism for stakeholders to voice concerns regarding human rights, environmental and governance risks. We welcome the reference to grievance mechanisms, which is also a key recommendation of the OECD Guidelines for multinational enterprises. These mechanisms are still not a common practice for corporations, which are often concerned about their legal ramifications and reluctant to open what is seen as a Pandora's box. Business-led grievance mechanisms also present significant practical challenges: the channels are often not well communicated, workers and other stakeholders are not always literate and able to log a complaint, or they can be afraid of losing their jobs or visas. Companies need to consider this from the outset for the mechanism to be effective, and there needs to be, at a minimum, worker involvement in the design, multi-lingual tools available and NGO collaboration throughout the process. Finally, grievance mechanisms cannot lead to an obstruction of access to judicial remedy, for instance by making workers waive legal rights after company-level remedy provision.

We see grievance mechanisms as important pieces of due diligence systems, but also strongly believe that this can by no means replace judicial remedies. Any non-judicial remedy works only if it is supported by effective judicial options.

If done right, however, grievance mechanisms and the resulting mediation process are a unique opportunity to engage in a dialogue and create trust with stakeholders, especially in earlier stages, to prevent an escalation of issues.

> **3. Recommendation:** Include requirements for boards of directors to report on how they have integrated environmental and social issues in the supply chain into their company's long term strategy.

Sustainability issues, including those in the supply chain, should be fully integrated in the company's strategy, and this should be reflected in its corporate governance and agenda.

A recent EY study on corporate governance shows that boards increasingly add sustainability topics to their agendas (e.g., 43% of SBF 80 had a CSR committee at board level in 2020 compared to 35% in 2019), but it is unclear whether these include a focus on supply chain topics, which is where companies' main environmental and social footprints are located. 13% of sustainability professionals surveyed in the EcoVadis & NYU 2019 Barometer still cite the lack of executive and board engagement as an obstacle to the roll-out of their sustainable procurement strategy.

Procurement functions cannot be the only function driving the company's sustainability strategy in the supply chain, and companies need strong commitments and prioritization of these topics at top management and board level.

We therefore recommend that companies are required to disclose how the board has integrated environmental and social risks into the company's long term strategy, as outlined in the report by MEP Pascal Durand. This disclosure should cover the steps taken by the board to engage stakeholders in the mapping of risks and the definition of the strategy, for instance through the establishment of stakeholder committees. Disclosures should also specifically address if and to what extent worker representatives were consulted by the board.

> **4. Recommendation:** Review the public procurement directive to hold public procurement to the same environmental and human rights due diligence standards as the private sector.

We believe that public procurement should be held to the same due diligence standards as private procurement. Public procurement in the EU represents an estimated €2 trillion annually and represents an enormous opportunity for impact by favoring suppliers with sustainable practices and accelerating the transition toward a more responsible economy.

The integration of sustainability requirements in public tenders in the EU has been limited until now due to public procurement's historical preference for only integrating requirements related to the product or services. Due diligence, through its focus on a company's practices and performance, was long seen as incompatible with product-related screening processes.

It is time to review this approach, however, as sustainability needs to be approached holistically. Product sustainability and company sustainability go hand in hand and cannot be separated: A product cannot be considered sustainable if other company activities are tainted by environmental or social abuses.

Following some changes and clarifications made to the EU's Public Procurement Framework, including the inclusion of information related to the company's environmental management system in its European Single Procurement Document used in public procurement procedures, a wider redesign of public procurement rules is required at EU level in order to allow public buyers to fully integrate sustainability requirements in their requests for proposals (RFPs). A review of current rules had already been discussed, but the urgency of this review has increased with the current discussions on adopting a mandatory due diligence framework so that these rules can apply also to public procurement.

By reviewing Directive 2014/24/EU on public procurement and applying the same due diligence standards to the public sector, the EU has an opportunity to position itself as a role model and set the example on integrating sustainability factors into account in its procurement decisions.

Best Practices Recommendations

On top of these policy recommendations, we also wanted to share two recommendations on best practices that we encourage companies to adopt when designing their due diligence systems. Based on our experience, the practices outlined below are key in ensuring that the due diligence approach is geared towards true impact creation.

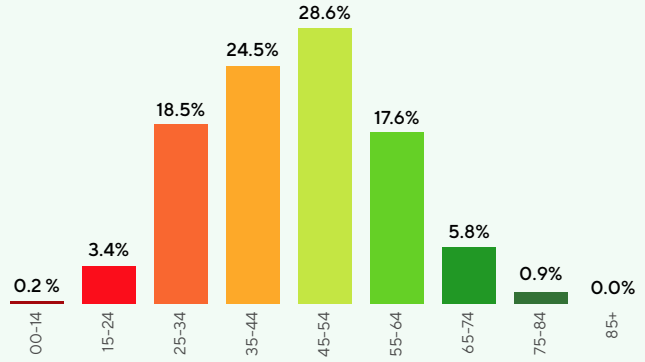
> **5. Recommendation:** Buying organizations should engage in the capacity building of their suppliers on environmental and social issues. This would help drive continuous improvements among suppliers and prevent due diligence approaches focusing on "tick-the-box" compliance.

Our experience shows that supplier capacity building is a key success factor in addressing environmental and social risks in the supply chain, and, ultimately, improving the environmental and social performance of all company stakeholders.

It can be tempting to approach supply chain due diligence from a compliance perspective by defining compliance thresholds and then screening the company's suppliers to identify whether they comply with these thresholds.

However, disengaging from "non-compliant" or "risky" suppliers is a missed opportunity to achieve positive environmental and social impact in the supply chain, which is achieved by focusing on continuous improvement of supplier performance.

Score Distribution (SUP)



Distribution of EcoVadis scores (January 2019 to October 2020, covers over 33,400 companies)

	CSR PERFORMANCE	LIKELY OUTCOME	
Best in Class ↑	85-100	OUTSTANDING	High Opportunity	• Structured and proactive CSR approach • Policies and tangible actions on major issues with detailed implementation information. • Comprehensive CSR Reporting on actions & performance indicators • Innovative practices and external recognition.
	65-84	ADVANCED	Medium Opportunity	• Structured and proactive CSR approach • Policies and tangible actions on major issues with detailed implementation information • Significant CSR Reporting on actions & performance indicators
	45-64	CONFIRMED	Engaged	• Structured and proactive CSR approach • Policies and tangible actions on major issues • Basic reporting on actions or performance indicators
	25-44	PARTIAL	Medium Risk	• Minimum structured CSR approach • Few policies or tangible actions on selected issues (reactive)
Increasing Risk ↓	0-24	NONE	High Risk	• No policies or tangible actions regarding CSR • Evidence in certain cases of misconduct (e.g. pollution corruption)

Almost half of the companies rated by EcoVadis in 2020 fell under the 44/100 score threshold, which represents high or medium risk. This shows that a due diligence approach based on compliance thresholds alone would leave a significant number of companies behind at a time where radical improvements in environmental and social practices are needed across the board.

Approaching due diligence from a punitive or compliance-based angle represents a missed opportunity to raise the bar and help low-performing companies, often SMEs, to improve their environmental and social practices. It also runs the risk of not sufficiently incentivizing "compliant" suppliers to improve and innovate further.

Instead, buying companies need to drive continuous sustainability improvement among their suppliers. This is achieved by first performing regular supplier assessments or audits to understand their current performance, but, most importantly, by then supporting them in addressing the identified improvement areas through capacity building. And this is what is still often missing from existing due diligence programs: In 2019, only 19% of all Large companies rated by EcoVadis had implemented capacity-building programs (e.g., setting corrective action plans, providing training) for their suppliers. Further assessments and audits can then be performed to confirm the supplier has closed its performance gap.

Due diligence programs should also include incentives and recognition for the supplier efforts, a practice still missing from most programs. In 2019, less than 2% of Large companies rated by EcoVadis provided incentives to performing suppliers (e.g., supplier awards, preferred supplier program, access to RFPs). Suppliers will be more reluctant to invest in sustainability programs if they do not see positive returns and an improvement in their buyer-supplier relationship.

Companies should devise due diligence programs with the aim of achieving positive environmental and social outcomes in their supply chains, by constantly raising the bar and helping their suppliers to improve, even and maybe most of all, the suppliers who are still lagging behind. This would also allow this due diligence initiative to be aligned with the EU's policy objectives for development.

6. Recommendation: Develop collaborative and industry-wide due diligence initiatives to synergize due diligence efforts and accelerate positive impacts.

We have seen numerous examples of collaborative approaches to due diligence across industries where collaboration has proven more impactful than individual efforts.

Industry-specific initiatives are one possible model that has proven effective in promoting collaboration. These national, regional or even sometimes global initiatives are usually created voluntarily by industry leaders to share best practices and industry-specific expertise on the sector's key issues, as well as due diligence costs and resources. These initiatives can leverage on existing trade associations or interest groups. Sector initiatives that go further than just shared commitments and define a common standard for assessing and auditing suppliers, and setting up common corrective action plans, have the opportunity to achieve significant economies of scale and results that individual companies could never obtain. Sector initiatives can allocate larger budgets to powerful due diligence and capability building tools.

A recent study conducted by Adelphi and EY on behalf of the German Ministry of Labor and Social Affairs on the consideration of human rights in global supply chains concluded that sectors that had implemented strong sector initiatives were more advanced than others in addressing human rights in their supply chains. The German chemicals sector in particular was cited as one of the most advanced sectors, with sector initiatives such as Chemie3, Responsible Care and Together for Sustainability (TfS) being instrumental in increasing the maturity of the whole industry regarding human rights due diligence.

The TfS initiative, for instance, has defined common assessment and on-site audit standards for their suppliers, and based on the results of these supplier assessments and on-site audits, has defined specific improvement topics for their suppliers. These topic-specific improvements are then addressed through a geography-specific training plan, sponsored by the 29 members of the TfS initiative, in a capability building effort that a single company could never even consider.

Responsible sourcing forums are another capability building tool in which TfS has invested. These supplier-focused events are dedicated to sharing both the sector initiative's sustainability goals and best practices and case studies with their key suppliers. This type of event helps to raise awareness among the supplier base and also conveys an important message to suppliers that they are seen as strategic partners of the industry initiative.

These capability building efforts have also translated into measurable results: over the years, suppliers rated as a part of the TfS initiative have improved their EcoVadis score on average by seven points since their first rating, compared to an average improvement of 3 points for the rest of the EcoVadis network.

In 2020, on average suppliers rated by EcoVadis for the TfS initiative performed better than the rest of the EcoVadis rated companies, with 1.2 point above the global average.

The German study concluded that other industries could learn a lot from the chemical industry's approach. Its final recommendations include replicating these industry initiatives, especially the harmonization of assessment standards, to other industries whenever possible.

Other sector initiatives have used their leverage to conduct supply chain due diligence beyond the first tier of suppliers, by collaborating with their Tier 1 suppliers so they could implement due diligence systems for their own suppliers and share results with the sector initiative. This allows the sector initiative to gain visibility over a larger portion of its supply chain rather than only the suppliers with whom they have a direct relationship.

Once again, this type of supplier collaboration in order to go beyond Tier 1 suppliers, is significantly easier when companies benefit from the entire sector initiative's leverage, and this remains a significant challenge for most individual companies.

Finally, another challenge that sector initiatives can successfully address is engaging suppliers with a dominant position on the market. In some industries, some suppliers of key materials or products are much larger than buying organizations. Buying organizations usually have little leverage to impose sustainability standards to this type of supplier, as these buyers represent only a minor portion of the supplier's revenue. It is only by joining forces that buying organizations gain leverage and bargaining power over some of their suppliers to request that they improve their sustainability practices.

Sector initiatives have demonstrated that combining the right tools and technology with industry expertise is a much more efficient way to improve traceability in the supply chain than trying to tackle the challenges individually. We recommend that the EC formally recommends the creation of sector initiative as a due diligence best practice. These initiatives, through their scale and resources, allow their members to give an institutional dimension to their due diligence program and, ultimately, to have an impact on an entire industry.

Conclusion

We call on the EC to establish a working group of recognized supply chain due diligence experts to advise policy makers, in order to ensure that the upcoming due diligence legislation takes existing best practices and challenges into account.

Finally, we also call for the EU to use its influence to ensure these standards are applied globally, including by taking a leadership role in the current discussions on the UN Binding Treaty on Business and Human Rights.

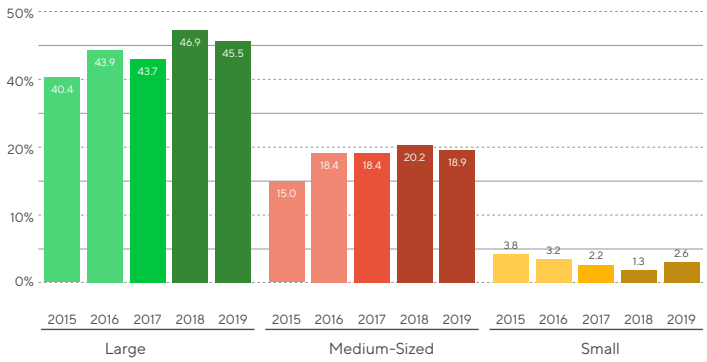
Carbon Border Adjustment Mechanism

7. Recommendation: Base the CBAM on products' actual emission data whenever possible and refer to industry averages only when importers are unable to provide product-level carbon data.

In an effort to become climate-neutral by 2050 and to prevent carbon leakage, the EC has suggested putting a carbon price on imports of certain goods from outside the EU with a new system called CBAM. EcoVadis welcomes this new mechanism, which will be an important step to avoid carbon leakage and ensure polluters pay for their emissions. However, it raises additional questions regarding the calculation method to determine the imported product's carbon footprint.

EcoVadis data indicates that product-level carbon data, or even producer-level carbon data, is currently not widely available. The EcoVadis 2020 Business Sustainability Risk & Performance Index, based on an analysis of over 65,000 sustainability ratings, shows that only 45.5% of large-sized companies were able to report on their entity's carbon emissions in 2019, and only 2% of them had Scope 3 data available. This does not even cover product-level information, for which reporting information is even more marginal - and these figures drop dramatically when looking at smaller-sized companies.

Porcentage of Companies Reporting on Co_2 Emissions by Company Size



Due to this lack of product-level data on carbon emissions, the CBAM will likely have to rely on industry averages in some areas. However, these averages are not a perfect solution either, as they are often obsolete and removed from reality. To achieve its objectives, the CBAM should be based, whenever possible, on carbon data specific to the imported product, so that taxes levied truly reflect the product's carbon footprint. We recommend that industry averages are used only if companies importing goods are not able to provide actual carbon emission data at the product-level. Taxes should be reduced or even waived if a supplier of goods is able to demonstrate that their product has a carbon footprint that is comparable to or even lower than the European average. This will prevent the CBAM from being perceived as unfair by advanced suppliers outside the EU who have succeeded over the years in improving their carbon management - and if they have not, it will provide concrete incentives for them to enhance their product-level reporting capabilities and provide more transparent information on their products' carbon footprints.

This will also incentivize buyers to source from suppliers who are serious about their carbon reporting and, ultimately, their carbon reduction plan, and could help buyers to select the best partners, no matter what country they are in. Leading companies are already engaging suppliers to tackle and report on carbon emissions in the supply chain, but the EU has an opportunity to significantly accelerate this movement. Whether they aspire to become net-zero or carbon positive, European companies will not be able to materialize their ambitions without buy-in from their suppliers. The large share of carbon emissions rooted in upstream processes, materials, and services makes it impossible to turn operations carbon neutral without supply chain action. Likewise, suppliers outside the EU, particularly SMEs, will not be able to improve their ability to report on the carbon intensity of their products without support from their buyers, who are in the best position to provide incentives for them to increase in maturity.

We are all in the same boat. Neither nationality nor a trade barrier is the path to success. Rather, we must embrace transparency and sustainable innovation. Trade tensions implied through the CBAM, which has at times been named as a protectionist move to protect European industry, could slow down the fight against climate. It is important that the CBAM is designed in a way that encourages companies globally to improve their carbon management. Global warming is a global problem that requires a global solution, not a solution where countries compete against each other.

Non-Financial Reporting Directive / Corporate Sustainability Reporting Directive

The NFRD is a strategic component of the EU Green Deal, because many other Green Deal policies, including the Taxonomy Regulation, the mandatory due diligence legislation and, potentially, the CBAM and the Circular Economy Action Plan, depend on the availability of reliable sustainability data. As this system operates on data, it is only as effective as the quality of the data available. The revision of the NFRD through the adoption of the Corporate Sustainability Reporting Directive is a real opportunity to introduce a much-needed alignment of reporting practices for EU companies and provide greater transparency in companies' sustainability performance and outcomes. As such, it should define key indicators companies should report on to improve the overall quality of supply chain sustainability data available to stakeholders. This will also allow companies to identify which indicators they should monitor to track the effectiveness of their sustainable procurement initiative.

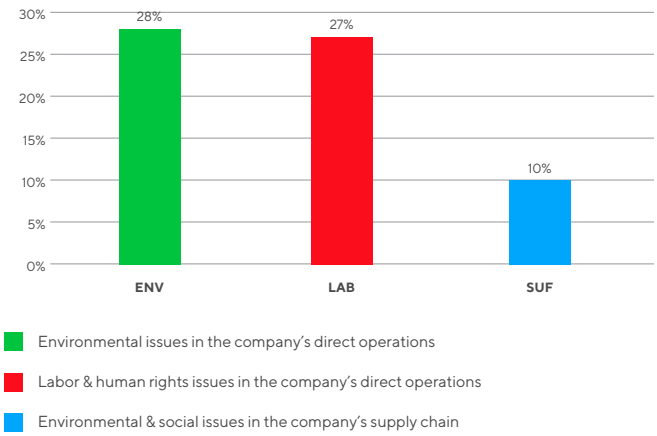
> **8. Recommendation:** Introduce requirements to report on specific leading and lagging indicators on supply chain issues. Clear reporting from companies will improve how transparently and efficiently they address environmental and social issues in their supply chains.

Supply chains often represent a blind spot in corporate sustainability programs. The EU trade deficit indicates that it still imports significantly more than it exports. In 2018, the EU imported 66% more goods from the BRICS countries (Brazil, Russia, India, China and South Africa) than it exported. The major part of a European company's environmental footprint is, therefore, usually located in its supply chain. Or example, 70 to 95% of a typical company's overall emissions are embodied in the supply chain (Scope 3).

The same is true for a company's social footprint: ILO studies regularly remind of us of the prevalence of child labor and human trafficking in global supply chains.

The first step in tackling these supply chain issues is, therefore, to increase transparency into companies' supply chains and sustainability practices of their suppliers. EcoVadis data confirms that companies report significantly less on environmental and social issues in their supply chain than on environmental and social issues in their own operations.

Companies rated by Ecovadis (2018-2019) with at least some reporting data available, by topic



EcoVadis rated companies with reporting data available, per topic (January 2018 to August 2019, covers 26,000 companies)

We, therefore, recommend introducing specific supply chain indicators in the mandatory reporting standards, which should include both leading and lagging indicators, as outlined below.

The main reporting standards such as the GRI, SASB, or the World Economic Forum's "Stakeholder Capitalism Metrics", typically refer to supply chain issues indirectly, by recommending the disclosing company include environmental and social impacts in the supply chain in its disclosures "when material". This approach has shown, however,

that companies consistently underestimate the materiality of supply chain issues, as indicated by the lack of data available on the topic in corporate disclosures. We therefore recommend going further and requiring companies covered by the scope of the NFRD to systematically report on specific indicators on supply chain management.

This will incentivize companies to systematically assess sustainability risks in their supply chain and report on the actions they have implemented and the results they have achieved.

We suggest including the indicators listed below, and also recommend to require disclosing companies to have their disclosures externally verified.

Leading indicators on the company's overall sustainable procurement strategy and management

Reporting should include, at a minimum, the following leading indicators:

- Percentage of high- and medium-risk Tier 1 suppliers screened on sustainability issues;
- Percentage of screened Tier 1 suppliers meeting sustainability screening thresholds;
- Percentage of screened Tier 1 suppliers covered by sustainability correction actions or capacity-building program.

Lagging indicators on the achieved outcomes and the effectiveness of the company's sustainable procurement program

Reporting should include, at a minimum, the following lagging indicators:

- Upstream Scope 3 GHG emissions;
- Percentage of Tier 1 suppliers considered at significant risk for human rights abuses;
- Percentage of Tier 1 suppliers with collective agreement on working conditions covering all workers.

Disclosing companies should also report on additional indicators regarding specific commodities relevant for their industry (e.g., paper, timber, palm oil, conflict minerals). The Supply Chains Transparency project, launched by Frank Bold, has published detailed recommendations on relevant indicators for some key sectors like garment, footwear, food and beverage, extractives and electronics.

Finally, we also recommend aligning the scope of application of the NFRD with the scope of the mandatory due diligence directive (see recommendation #1).

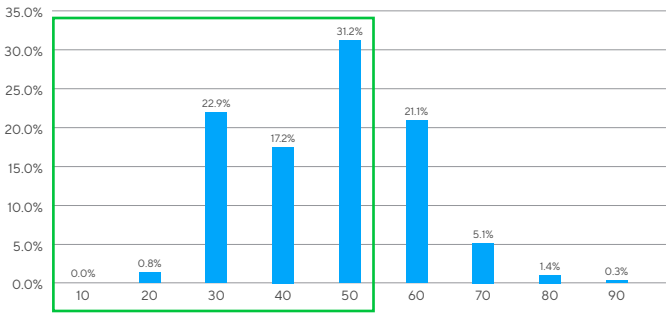
The past year has shown that the landscape of sustainability reporting standards is evolving quickly, with voluntary reporting standards building new coalitions and committing to more alignment. However, there is still no global governance of reporting standards. This is an important question that the EC will need to address sooner or later: How involved does it want to be in the definition of this new global governance?

Taxonomy Regulation

9. Recommendation: Include supply chain impacts in the "Do No Significant Harm" Technical Screening Criteria of the six environmental objectives for the sectors that rely on complex supply chains.

According to EcoVadis data, companies with advanced environmental practices do not necessarily have structured supply chain management practices: In 2019 about 72% of the most environmentally advanced companies (Environment theme score above or equal to 60/100) achieved a Sustainable Procurement theme score of 50 or less, showing they were significantly less advanced on their supply chain management strategy.

Performance on SUP theme of companies with solid enviromental performance (ENV theme score at 60)



EcoVadis rated companies who achieved at least 60/100 on the Environment theme (January-December 2019, covers over 6,000 companies)

This shows that even the most environmentally advanced companies may be failing to address environmental risks in their supply chains. If companies to review how their supply chains might be undermining or harming the environmental objectives outlined in the Taxonomy, it is questionable whether their economic activity can even be considered environmentally sustainable. This is especially important since companies sometimes outsource key parts of their activity to suppliers and, although that activity does no longer fall within the company's scope, it is still a crucial part of their economic activity.

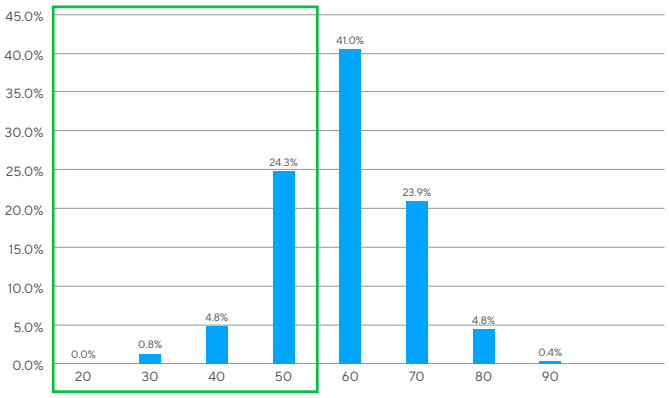
It is key that the sectors relying on complex supply chains consider supply chain impacts along with impacts from their direct operations when assessing the "Do No Significant Harm" criteria. We therefore recommend introducing specific technical screening criteria on supply chain issues for activities involved in manufacturing and construction. "Construction of new buildings" activities for instance rely heavily on building components and materials, ranging from timber to concrete, that could have been manufactured based on practices harmful to the six environmental objectives of the Taxonomy.

The "Do No Significant Harm" technical screening criteria for these activities should, at minimum, require companies to screen environmental risks beyond their Tier 1 suppliers.

10. Recommendation: Require concrete due diligence actions, including in the supply chain, to demonstrate compliance with the minimum social safeguards.

Data from the EcoVadis database shows that companies with advanced environmental practices do not necessarily have advanced labor and human rights practices: In 2019 about 30% of the most environmentally advanced companies (Environment theme score above or equal to 60/100) achieved a Labor & Human Rights theme score of 50 or less, showing they still had significant improvement areas in their management of social issues.

Performance on Labor and Human Rights theme of companies with solid environmental performance (Environment theme score at least 60)



EcoVadis rated companies who achieved at least 60/100 on the Environment theme (January-December 2019, covers over 6,000 companies)

This data confirms that environmental performance does not always go hand in hand with the protection of employees and communities' interests, which is why the minimum social safeguards the taxonomy has introduced are so important. The safeguards reference key human rights frameworks such as the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, but we think the regulation should go further by aligning these minimum social safeguards with the requirements of the upcoming EU mandatory due diligence legislation (see recommendations #1 to #6).

These social safeguards should also be maintained on the supply chain: Some of the activities included in the taxonomy including sectors that have been flagged in the past for social issues in the upper tiers of their supply chain. Solar photovoltaic panels for instance rely on minerals such as copper, nickel and zinc that are often mined in conditions linked to alleged human rights abuses, showing that activities in the manufacture of renewable energy technologies need to have a specific focus on social safeguards in the supply chain.

Only by setting up tangible due diligence systems, aligned with the requirements of the mandatory due diligence initiative, will companies be able to confirm that the environmental sustainability of their activities is not achieved at the detriment of its other stakeholders.

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