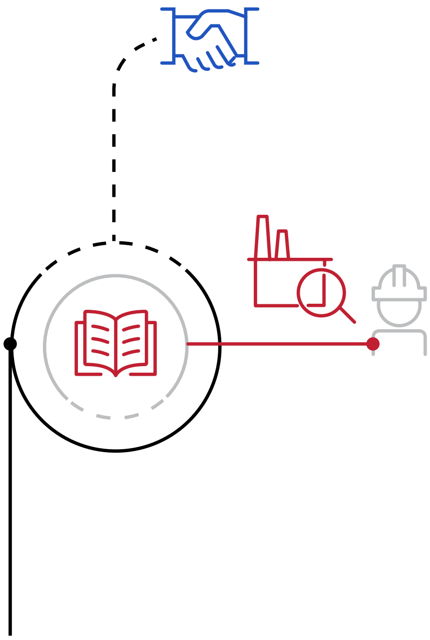


Principles for Developing Company Supplier Codes of Conduct

RETAIL INDUSTRY LEADERS ASSOCIATION

UL

Executive summary

Supplier Codes of Conduct (Codes or CoCs) serve as the cornerstone of any corporate compliance program. A robust Supplier CoC is an essential tool for ensuring that the company's mission, values, compliance obligations and responsible sourcing commitments are embedded into supplier relationships.

Increasingly, Codes fulfill many purposes such as meeting legal requirements, acting as a company's policy statement, aligning with multistakeholder initiatives, implementing international leading practices and fulfilling expectations from customers, company employees and external stakeholders such as investors and civil society organizations. Additionally, a changing global context requires companies to continuously adapt to new responsible sourcing challenges.

These developments mean that businesses increasingly face complex requirements when developing or updating their CoCs and must strike an important balance between adequately addressing relevant concerns and ensuring that Codes are implementable.

While there is no single template for designing a company's Supplier Code, this white paper will introduce some leading practices and address principles that retailers and brands should consider when developing, reviewing or updating their Supplier Codes. This paper will consider the purpose and objectives of Supplier CoCs, how risk assessments can help determine a Code's scope and applicability and discuss practical steps for effective Code implementation. To see an introduction to each of these topics see UL's Blog Series with the Retail Industry Leaders Association (RILA).

The Purpose and Objectives of Supplier CoCs

Beyond translating a company's mission and vision into specific, actionable requirements for suppliers, Supplier CoCs provide an important function as the de-facto umbrella document within a company's compliance ecosystem and may need to speak to very specific statutory, regulatory, voluntary or other requirements and expectations. Some examples are included here.

- **Applicable legal requirements** may be rooted in human rights due diligence legislation (e.g., the California Supply Chain Transparency Act, the U.K. Modern Slavery Act, the Australia Modern Slavery Act, the French Duty of Vigilance Law, the Netherlands Due Diligence Law and the newly adopted German Supply Chain Due Diligence Act). This type of legislation typically requires companies to adopt specific policy statements concerning issues that include human trafficking, modern slavery, child labor or other relevant human rights risks. This legislation often reflects and gives effect to the UN Guiding Principles on Business and Human Rights (UNGP) which will be discussed in more detail below.
- **Industry or multistakeholder associations** may develop specific requirements concerning responsible sourcing and supply chains. Companies should check with associations of which they are a member to see if their Code requirements align with the association's requirements in relation to scope and stringency.

  For example, companies should ensure that Code requirements and suppliers' obligations around wages (e.g., legal requirement to pay minimum wage verses a potential Code provision implementing a multistakeholder commitment requiring the payment of living wage) or working hours limits are clearly stated and communicated to suppliers to avoid supplier confusion. These are two areas that may show up in association requirements.
- **Benchmarks** such as the Corporate Human Rights Benchmark, Know the Chain or the Fashion Transparency Index may measure a Code's content as well as specific indicators related to a company's CoC. Companies may find such benchmarks useful to determine whether they are meeting stakeholder demands.
- **Civil society** frequently publishes subject matter or industry-specific reports investigating companies' supply chain practices and can provide specific recommendations for companies' CoCs.
- **Investors and environmental, social and governance (ESG) rating agencies** are doing more due diligence on organizations' social performance. These actors often first look to a company's CoC and rely on existing benchmarks and reports to inform their decisions. Companies wishing to attract financial investments must ensure that their Supplier Code meets ESG investors' expectations.
- **Customers** increasingly demand that products be made in an ethically and responsible way. For example, one study published by Deloitte[1] shows that ethical and sustainability concerns continue to impact many consumers' behaviors in which they favor companies with clear commitments.
- **Company employees and internal partners** may have specific expectations for a company's Supplier Code to align with company values and purpose.

Company Aspirations

Besides establishing clear minimum expectations, Supplier Codes can also express a company's aspirations. This is especially true where the content of a Supplier Code directly links to furthering a company's vision and where a company wants to drive far-reaching improvements in their supply chain or implement exceptionally strict standards. Companies should strive to find a good balance between establishing clear minimum requirements in their Codes and setting aspirational goals. The language they use should make clear whether a Code provision is mandatory or provisional.

Aspirational language is also a useful way to roll out requirements that a company anticipates may become mandatory in the future and to begin to socialize these concepts with their supplier base. For example, requirements around carbon reporting may be stated in the Code in terms of recommended leading practices for a period of time, to ensure that suppliers clearly understand the concept and implementation, before such requirements become mandatory.

Accompany Guidance Documents

It is important to remember that although a CoC should address these fundamental expectations, accompanying detailed Code guidance documents can elaborate on individual supplier requirements. Guidance documents can spend more time explaining the Code requirements to suppliers and provide practical examples, FAQs and applications to aid implementation.

Using Risk Assessments to Determine Code Scope and Applicability

Before crafting or updating a CoC, companies should undertake an internal risk assessment to ensure that the Supplier Code is adequately informed and addresses applicable risks in a company's supply chain. Supplier CoCs drive social and environmental practices throughout the supply chain and are rooted in actual company practices for effective implementation. A solid understanding of company's goods and services suppliers, their geographic location, and type of business is key.

Example Guiding Questions:

- Do we understand our business and our full supply chain down to the raw material level, and do we know what risks exist in relation to respective supply chain actors?
  - Do we know who these actors are?
  - Are there specific industry or geographic risks that require special attention?
  - Are there service suppliers engaged in our wider business who present specific risks, e.g., logistics providers, customer care or labor suppliers?
- How do our business practices impact what we can reasonably expect from our suppliers? For example, what is the length and strength of our supplier relationships and how will that impact our ability to realistically drive certain requirements?
- Taking into consideration corporate commitments, regulatory requirements or stakeholder expectations, what supplier requirements are essential?

Who to Engage in the Risk Assessment

The risk assessment should be developed in consultation with knowledgeable internal partners accountable for these areas, and it is also advisable to draw on external subject-matter expertise. A September 2021 Supplier Code of Conduct survey of RILA member companies indicated that a majority of the 31 respondents engage with external consultants and suppliers to obtain feedback during their Code development process. Internal and external stakeholders that might be included in developing the risk assessment are:

- Members of corporate social responsibility (CSR), Sourcing, Procurement, Legal and Compliance Teams
- Staff with direct supplier interaction or tasked with implementing the Code
- Suppliers
- Multistakeholder initiative representatives
- Local and international nongovernmental organizations (NGOs)
- External subject matter experts

Mandatory vs. Aspirational Code Components Risk Assessment

At this point in the risk assessment, it is also wise to ask what actions the company would take if a supplier were to fail to meet proposed expectations. The U.S. Department of Justice's (DoJ's) *Guidance on Evaluation of Corporate Compliance Programs* highlights that key points for evaluating compliance programs are: 1) whether a compliance program is well designed; 2) is the company applying the program earnestly and in good faith; and 3) whether it works in practice.[2] By determining early in the process what Code requirements can realistically "work in practice" – i.e. be acted on and enforced – in contrast with which aspects are merely encouraged, companies can determine what should be communicated as mandatory versus aspirational components of their Code.

Risk Assessment Frequency

As business practices and the global business landscape constantly change, companies should conduct risk assessments regularly to assess impacts and identify new and emerging risks. While this may not always result in updates and changes to the Supplier Code, companies should regularly evaluate whether there is a need to revisit and update requirements. For example, it may be necessary to eventually make aspirational provisions mandatory as stakeholder expectations and legal landscape change.

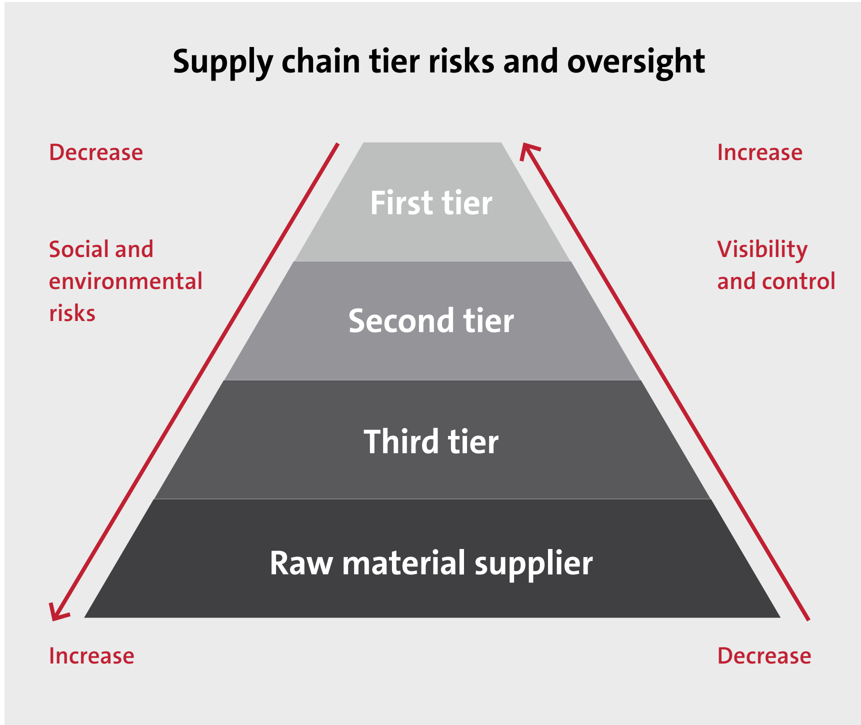
Code Scope

Overview

An important part of a risk assessment is determining who falls under the Supplier Code's purview. Traditionally, Supplier Codes have applied to companies' direct private-label product suppliers (Tier 1) and take effect through purchase contract terms. While focusing only on direct private-label suppliers in Tier 1 makes sense from a direct influence perspective, retailers rely on a much broader ecosystem of suppliers. Suppliers who manufacture the products retailers sell as well as service providers who support a retailer's day-to-day operations may factor into many stakeholder assessments of company risk and reputation.

Entities that are deeper into a company's supply chain (i.e., beyond the Tier 1 supplier) are beginning to attract more attention. This includes their part in producing the products sold by retailers and their impacts on companies' social and environmental risks. For example, the sourcing conditions related to products' raw materials and component parts are facing closer scrutiny, and brands and retailers are being held responsible for those conditions.

Non-product supplier groups, such as service providers for logistics, distribution or customer care, are also getting more recognition for their critical role in many brand and retailer operations. As these non-traditional suppliers attract more attention from stakeholders, a company's CoC may need to be expanded include them in the scope of the Code.



Tier 2 Suppliers and Beyond

One way a company might expand the scope of its CoC is by including supplier tiers beyond direct private label suppliers (Tier 1). The International Labour Organization (ILO) has noted that the risk levels within a supply chain are inverse to the levels of control and oversight,[3] highlighting the need to increase companies' awareness and control throughout their supply chains.

Government regulators and enforcement officials as well as voluntary programs for effective due diligence are increasingly focused on raw material suppliers at the supply chain source. For example, in recent years, the U.S. Customs and Border Protection agency has increased enforcement actions related to forced labor in cotton, silica, seafood, gloves, and tomatoes coming from China, Malaysia and other countries. The Lacey Act protects endangered species and requires importers of certain products to provide declaration of specific raw materials. The Dodd-Frank Act seeks to prevent tantalum, tin, tungsten and gold mined in conflict zones (conflict minerals) from entering supply chains. Emerging legislation in other regions, as well as voluntary programs and investor expectations, mirror these requirements and are making it imperative for companies to have visibility into and control over the supply chain to the raw material level.

A company's Code can serve as a tool to help address these evolving due diligence expectations. In many cases, companies do not have a direct contractual relationship with suppliers beyond Tier 1, so their Code of Conduct does not directly apply to lower-tier suppliers. However, companies have an opportunity to create expectations for their direct suppliers to take ownership over responsible sourcing issues and perform their own due diligence of their suppliers, thereby cascading due diligence expectations down the supply chain. These due diligence requirements can apply to both product suppliers and service providers. For example, due diligence requirements for labor agents are increasingly commonplace.

As companies look to expand the scope of their CoC's application to a broader supplier base, it is helpful to consider whether additional internal partners and external stakeholders should be consulted. This could include internal contact points who regularly engage with suppliers or external experts with knowledge and experience in raw materials, manufacturing and other service areas.

Service Suppliers

Service suppliers provide a wider range of services such as customer care, consultants, IT, logistics, distribution, janitorial and maintenance services that are critical to companies' business operations. Some of these service suppliers may present specific labor, human rights, environment or governance risks and should be included in the Supplier Code.

More recent changes to retail models are creating new challenges and potential social and environmental risks. As many companies continue to grow their online retail presence and expand their global reach, they create possible impacts through the growth of new and different services or inclusion of new geographies.

Where the scope of the Supplier Code includes new service suppliers, companies should assess whether these service suppliers present new risks that have not already been addressed within the Code and that may need to be addressed specifically.

Risks Specific to Different Service Suppliers, For example:

Customer care
- Office safety
- Discrimination and harassment

Logistics
- Precarious employment conditions
- Occupational health and safety concerns related to transport

Janitorial and maintenance
- Health and safety
- Wages and social security
- Benefits

Distribution
- Working hours related to 24/7 models
- Safety on the road
- Casualized labor

The UN Guiding Principles on Business and Human Rights Support Expansion of Code Scope

Retailers and brands that are members of the UN Global Compact follow the UN Guiding Principles on Business and Human Rights, which requires due diligence to assess potential human rights impacts that a business may cause or contribute to through its activities, or which may directly link to its operations, products or services through its business relationship.[4] This is a much wider scope than just private label goods suppliers and is another factor driving retailers to assess their business relationships more broadly to identify potential human rights and environmental impacts from a larger range of suppliers.

Companies' risk profiles vary, and the responses required to address risks need to be tailored accordingly, leading to different Code elements. If the company is considering expanding the scope of its Code, it is important to examine the company's operational context and think about what leverage is available before applying the company's Code to other groups.

Code Implementation

Successful Code of Conduct implementation is critical to ensure that a company's CoC achieves what it sets out to do. Both the U.S. DoJ Compliance Guidance and the UNGP highlight the importance of ensuring that a company's Code translates into meaningful action. The DoJ specifically points to the need for adequate evidence of a compliance program's implementation both within the company and externally.

Some preliminary steps can secure smooth implementation and demonstrate the company's commitment to put its CoC into effect:

- Setting the company's compliance "Tone at the Top" through C-suite level ownership and communication of the Code.
- Translating the company's CoC into all relevant languages for its supply chain.
- Making the Code publicly and easily accessible for suppliers, regardless of region. Leading practice is to post it on the corporate website for easy access.

To ensure that the company's Code can be put into practice, companies should:

- Place ownership and oversight of the Supplier Code at a C-suite senior executive level.
- Ensure that responsibilities for implementing the Code are assigned to the relevant business functions. For example, establish relevant performance indicators where necessary.
- Review internal decision-making processes and ensure that they are conducive to the Code's implementation.
- Review internal procedures and processes for alignment with the Code and make adjustments as needed. For example, update contracts to incorporate requirements for compliance with the CoC.
- Allocate sufficient budget to securing the Supplier Code's effective implementation.
- Develop effective communication and appropriate training for employees and suppliers.
- Introduce regular program implementation monitoring and regularly review the company's systems and progress in implementing the Code.
- Adopt findings and recommendations from internal performance reviews.

Finally, companies must ensure that they are taking appropriate action on all aspects of the CoC — in particular, where requirements are mandatory. This includes monitoring and taking corrective action to remediate mandatory Code requirements where needed. Companies should ensure that existing monitoring and assessment solutions such as self-assessment questionnaires and audits adequately cover all Code requirements. Where this is not the case, companies should determine the best option to effectively monitor and act on new Code requirements. Companies can accomplish this by expanding current audit scopes or by undertaking other forms of due diligence.

For example, companies often include animal welfare requirements in their Supplier CoCs. Animal welfare is not usually assessed as part of standard social audits, therefore companies should ensure that these requirements are being effectively managed through other available means such as specific animal welfare assessments.

Internal implementation

Upon adopting a new Supplier CoC, it is important for employees and internal partners to understand the Code and its implications for business operations moving forward. Some steps that companies can take:

- Develop internal communications and trainings to explain the purpose and application of the Supplier Code internally.
- Review business procedures to identify necessary changes under the new Supplier Code. Employees and partners should be instructed accordingly.
- Create new incentive plans that can help drive a new culture which prioritizes adherence to the Supplier Code over other objectives.

Implementation with Suppliers

Before requiring suppliers to comply with a company's CoC, it can be helpful to socialize requirements and take a long-term view of compliance. Understand that suppliers may require some support to implement a Code. This is especially true when companies adopt a completely new CoC or update an existing one with new requirements.

Suppliers should receive clear communication about the Code and its requirements for them. Especially where the CoC includes new or more leading requirements, it can be helpful to provide detailed and practical guidance explaining how suppliers can address such requirements in their own operations. Ideally, this should be in the supplier's preferred language.

Providing key resources and clear instructions for suppliers on how to engage in effective due diligence of their operations can help ensure long-term compliance. Some examples of resources include:

Actions for Implementation

Handbooks and manuals – Handbooks and manuals can address Code provisions and give practical guidance on implementation of requirements. In the aforementioned RILA member survey, over 60% of respondents reported using supplier manuals or handbooks to support suppliers and that these materials are shared either at the beginning of the business relationship or re-shared at regular intervals or at critical points.

Training sessions – Require online and/or in-person trainings on specific aspects of the Code where the CoC includes new expectations or employees are encountering continuous challenges in implementation. Training sessions can also provide good two-way communication to help companies understand specific implementation challenges. Some survey respondents, 33%, also report specifically targeting higher risk suppliers for additional training efforts.

Self-assessment questionnaires (SAQs) and desktop reviews – Allow suppliers to reflect on their own performance against the Code and identify areas for improvement.

Driving ownership of the Code – Support suppliers in their responsible sourcing journey and encourage them to adopt Codes that closely align with a company's CoC. This will encourage ownership over the topics covered by the Code and allows companies to transition to a "trust but verify" relationship.

Conclusion

There is no one way to develop a Supplier CoC, and Codes should reflect a company's own profile and adapt to changing risks and drivers. Nevertheless, basic principles and leading practices can be drawn on to inform and evaluate the Code development and review process.

Three fundamental questions to consider are:

1. Has the company clearly articulated what it hopes to achieve through the Supplier CoC?
2. Does the Code reflect the findings of a company's risk assessment?
3. Do the company's actual due diligence activities reflect and fully cover the requirements of the Supplier Code?

The maturity of a company's corporate compliance program will impact the responses to these questions as more ambitious goals are set, as experience is gained in conducting risk assessments and setting their scope and as due diligence efforts are improved. Nevertheless, companies at all levels of maturity can use these questions to guide their Code development and review processes as they grow their corporate compliance programs.

About the Supplier Code of Conduct Project

RILA, in partnership with UL, launched the Supplier Code of Conduct Project, a multiphase cross functional project designed to provide RILA members an opportunity to review and benchmark on their supplier codes of conduct. This whitepaper is one of the education and thought leadership materials developed under the Project. More information and complementary resources are available here.

Endnotes

1. https://www2.deloitte.com/ch/en/pages/consumer-business/articles/shifting-sands-sustainable-consumer.html
2. https://www.justice.gov/criminal-fraud/page/file/937501/download
3. https://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---ifp_seed/documents/publication/wcms_759213.pdf
4. https://www.ohchr.org/documents/publications/guidingprinciplesbusinesshr_en.pdf

UL.com

CS806941 1221