MOORE

ESG IN SHIPPING

BUILDING AN EFFECTIVE ESG MONITORING AND REPORTING PROCESS IN 10 PRACTICAL STEPS

Environmental, Social & Governance (ESG) considerations are here to stay. Whether they are imposed by regulators, lenders or other stakeholders along the supply chain - whether they are clearly defined in (a) comprehensive framework/s or remain vague - ESG criteria have become an integral part of decision making for shipping companies' counterparties.

Still, many shipping companies are wondering where to start with ESG and ESG reporting. This practical guide has been designed to help companies remove the noise around ESG and devise a plan of specific steps that will help them on their journey towards raising their ESG profile and reporting, which –in turn – will have a tangible (although not yet measurable) impact on their business success.

WHY IS ESG PARTICULARLY RELEVANT TO SHIPPING?

Although ESG will probably affect every organization, the maritime industry will be particularly affected due to the following reasons:

- Even the smallest shipping companies have a significant environmental footprint due to their operations, for example greenhouse gas emissions from the consumption of fuels by their vessels.
- In 2018, the IMO adopted a strategy for the reduction of Green House Gas emissions, which requires a reduction of the vessels' carbon intensity by 40% by 2030, and by 50% by 2050.
- There are other environmental impacts related to ballast water exchange and treatment as well as potential spills or other releases that also increase shipping's environmental footprint greatly.
- There are highly regulated areas having to do with employee health and safety as well as strict accident and safety management protocols imposed by the ISM Code and other parties.
- Anti-corruption and anti-bribery rules form only part of the business ethics requirements that have been added in the risk registers of companies operating in the maritime sector.
- Capital markets, fund managers, financiers or other stakeholders may impose further requirements relating to ESG. Currently, 27 of the world's leading banks, who jointly represent around USD185 billion in shipping finance, have committed to the Poseidon Principles, thus committing to incorporate, among other, environmental considerations in their lending decisions towards maritime companies. So, inevitably, ESG will have a (soon to be) measurable impact in the cost of capital.

ESG has always been integral in shipping. Leaving the technicalities aside, being consistent, responsible and ethical about your business practices has been what your business partners have always been after.

Building a sustainable ESG profile for your stakeholders to place value on is more about your ability to consistently demonstrate a robust internal control environment that supports responsible and ethical business practices and less about the metrics.

WHAT SHOULD SHIPPING COMPANIES DO?

1. RAISE AWARENESS AND ENSURE TOP MANAGEMENT COMMITMENT

It is crucial for shipping companies to start their ESG project by raising awareness among top management on what ESG stands for and what the key considerations for their particular organisation are. Engaging the right people at the top management level is necessary to ensure that the organisation commits the necessary time and resources and develops a culture that respects and promotes the environmental, social and governance profile of the company. The basis of an ESG system should be based on a corporate long-term strategy that will aim in reducing the company's impact in the ESG related sectors.

2. ASSEMBLE A PROJECT TEAM WITH SUITABLE SKILLS

With the full support of management, shipping companies need to assemble a multi-disciplinary team to implement the long-term ESG strategy ensuring that people from all departments (i.e. technical, crew, HSQE and IT) are included. The appointment of an ESG coordinator who will have a good understanding of the firm's operation in all levels, as well as specialized expertise in environmental, social and governance matters is needed, in which case companies need to consider who that person might be. Trusted external advisors can bring technical expertise, perspective and help save time and resources.

3. SELECT AN APPROPRIATE ESG FRAMEWORK AND CRITERIA (that will cover the needs of their stakeholders)

This is one of the most important steps. While there may be ESG criteria that stem from specific regulatory requirements (such as capital markets, or the IMO), it may be the case where a company needs to select the framework that they feel is most suitable, given their activities, stakeholders and overall strategy. Having said that, even if a specific framework is selected, there is nothing stopping shipping companies from enhancing the informational value of their reporting, by adding KPIs or other criteria and information from other sustainability frameworks.

4. IDENTIFY AND RECORD PROCESSES AND CONTROLS RELEVANT TO THE PROCESSING OF SUFFICIENT APPROPRIATE ESG DATA

It is then time to identify and record how the data relevant to the monitoring of ESG KPIs can be/is sourced and processed. This would normally cover identifying the appropriate definitions of the selected KPIs, the sources of the data inputs, departments and people involved, establishment of the relevant processes, as well as ownership and maintenance of the relevant files and calculations. Controls that safeguard the integrity of the data, data processing and reporting are also identified at this stage along with their locations, whether on board or ashore.

5. IDENTIFY AND ASSESS RELEVANT RISKS AND THEIR IMPACT ON ESG REPORTING

While capturing the data flows, shipping companies should look for the weaknesses in their processes and controls. If, for example, a data source is unreliable, there is a risk that the company may not measure an ESG KPI appropriately, with obvious negative implications in their decision making. It is therefore important to identify and evaluate the risks that may lead to errors in the ESG monitoring and reporting process and respond to those risks with a specific remedial action plan, so that each of the risks can be mitigated to an acceptable low level. While performing this risk assessment, companies will need to consider their risk overall profile, the internal control environment, the current compliance framework (for example ISM, MLP etc) as well as IT.

6. IMPLEMENT IMPROVEMENTS REQUIRED TO SAFEGUARD ESG DATA RELEVANCE AND INTEGRITY

Once the specific remedial action plan is complete, companies can then proceed to its implementation. This would normally include making changes in internal reporting templates so that they include additional information needed to estimate the ESG KPIs. It could also include changes in manual or automated procedures. External advisors can again help carry out various aspects of the implementation but also project manage the effort.

7. REPORT ON ESG PERFORMANCE

Once the processes of sourcing and processing the data relevant to ESG, together with their controls are set up and running, companies can start working on designing the contents of the ESG report. Except for the obvious fact that the report should present a fair depiction of the company's ESG status and profile and contain reliable and representative information, it is important to mention that shipping companies should remain cautious of their publicized commitments to improve on their ESG KPIs. With increasing public scrutiny in this area, prudence and consistence with announced plans is highly advisable.

8. TRAIN STAFF ASHORE AND ON BOARD

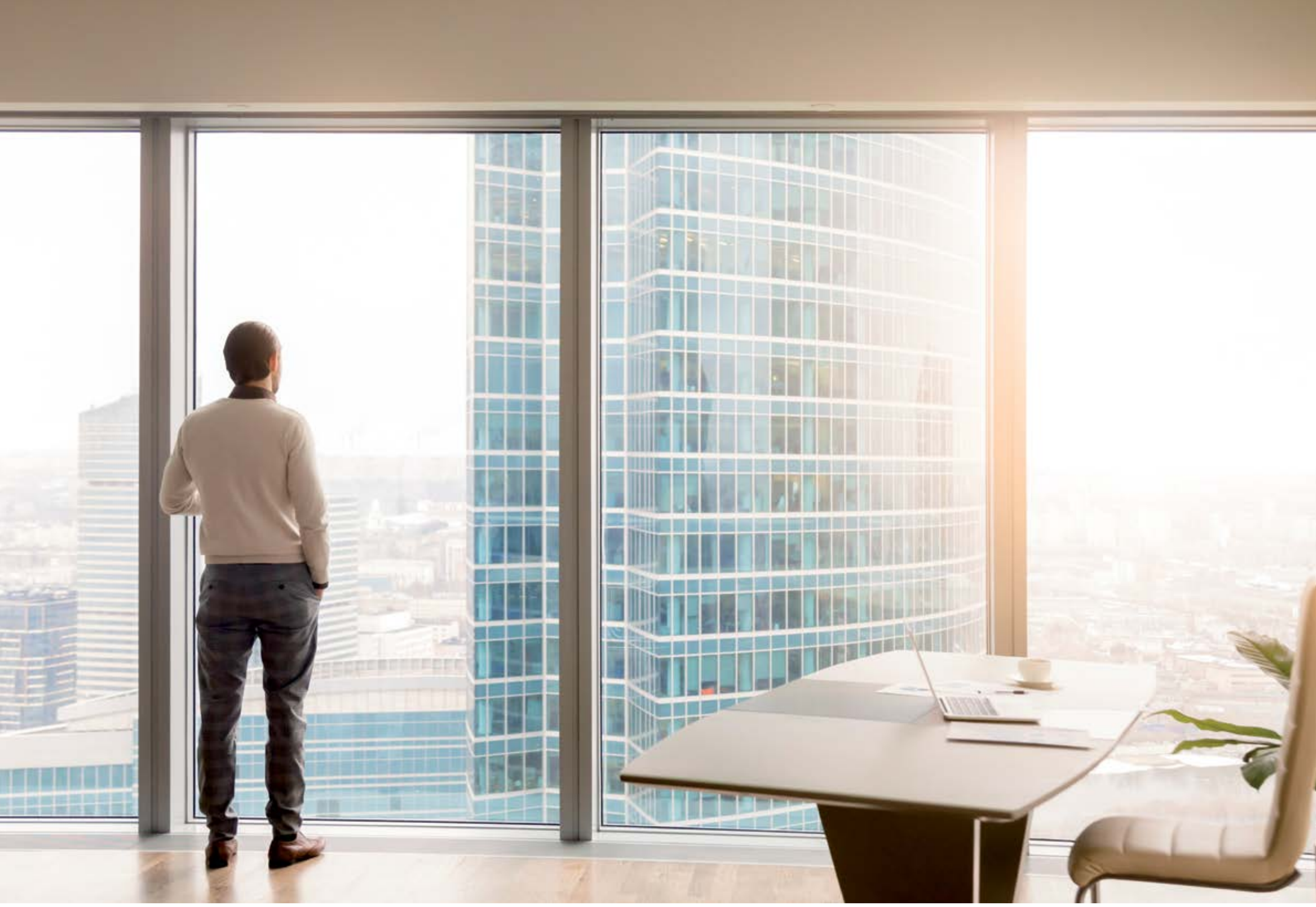
Once the ESG project has been fully implemented, it is highly advisable to roll out ESG training to all crew and staff, highlighting any changes that were implemented due to ESG and the reasons thereto. During training, it is good to emphasize the top management's commitment to ESG.

9. MONITOR ESG AND ESG REPORTING ON A CONTINOUS BASIS

Like all companies, shipping companies need to demonstrate that they monitor their ESG KPIs on a continuous basis (and that they update them as needed), by updating their procedures, training their staff and crew as well as introducing new activities and metrics in their reporting, when these are relevant to ESG. In addition, shipping companies should design (and incorporate in their internal audit) tests of operational effectiveness for controls mitigating significant risks associated with ESG and follow up on the weaknesses identified.

10. FOSTER ESG-DRIVEN CULTURE

No matter how many safeguards are put in place in a company's internal control environment, effective risk mitigation will always eventually come down to how well people understand, appreciate and implement those safeguards. Establishing and maintaining an ESG-driven culture that will empower people to actively contribute to their company's environmental, social and governance status, creates a much more effective shield against errors in ESG monitoring and reporting, compared to a 'compliance-driven' approach that can prove bureaucratic.



HOW CAN SHIPPING COMPANIES BETTER MANAGE ESG MONITORING AND REPORTING?

The bottom line is that ESG drives companies towards the path of creating organizations fostered with an impactful attitude towards society. In other words, companies should behave with responsibility towards all stakeholders linked to their operations and the environment, leading to the creation of value by achieving minimum externalities.

By embedding the principles of governance environmental and social responsibility to their current structures, policies and procedures that were created to respond to various other requirements coming from regulations, authorities or other counterparties, shipping companies can implement ESG in a truly risk-focused, effective and efficient way. Transparency and consistence in reporting, are of the essence, since ESG will be increasingly linked to the reputation of a company and inevitably its ability to remain competitive in a highly competitive market.

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