
# Prepare for Federal Supplier Climate Risks and Resilience Rule

## Lessons from Financial Sector Third-Party Risk Management

Corporate entities that choose to do business with the U.S. federal government take on many regulatory and reporting requirements. This includes requirements related to cost accounting, purchasing, workforce reporting and, most recently, compliance with the Cybersecurity Maturity Model Certification (CMMC). This past year, the Biden-Harris administration signed new laws and initiated new proposed rules to strengthen resilience specific to climate risk, a key priority, and supply chain, which accounts for the U.S.'s position as the largest buyer of goods and services across the world.

Most recently, the administration proposed the Federal Supplier Climate Risks and Resilience Rule. It requires the U.S. government and its federal business partners to disclose greenhouse gas (GHG) emissions, set science-based emissions reduction targets and complete a series of disclosures.[1]

The Rule is a formalized amendment to the Federal Acquisition Regulation (FAR) requiring federal contractor businesses and entities to assess their GHG emissions, set reduction targets that are validated through the Science Based Targets Initiative (SBTi), and report on its federal dollar obligations/revenues and GHG inventory. The rule segments contractors into tiers based on government revenues (Table 1). The cost for federal contractors to comply is estimated to be between $16 and 46 thousand depending on business size and segment.[2]

The proposed rule is open for public comment through January 13, 2023. And there are many questions that remain open including how revenues will be defined (e.g., indirect versus direct), how parent/subsidiaries will be managed, and what, if any, consolidated reporting will be required for them and suppliers and partners.

**Nonetheless, there are several steps federal contractor entities can take now in preparation.**

**Table 1. Former Carbon Disclosure Project (CDP) and Federal Supplier Climate Risks and Resilience Rule**

| Federal Contractors | Proposed Rule Requirements | | | |
|---|---|---|---|---|
| *Segment* | *Annual Federal Obligations* | *GHG Disclosure Scope* | *Climate Risks assessed in alignment with TCFD* recs.* | *Emissions reduction target validated by SBTi* |
| Major Contractors | >$50M | Scope 1, 2 and 3 (through CDP) | Yes (through CDP) | Yes |
| Significant Contractors | >$7.5M-$50M | Scope 1 and 2 | No | No |
| Other Contractors | <$7.5M | None | No | No |

**Task Force on Climate Related Financial Disclosures*

[1] https://www.sustainability.gov/federalsustainabilityplan/fed-supplier-rule.html

[2] https://www.federalregister.gov/documents/2022/11/14/2022-24569/federal-acquisition-regulation-disclosure-of-greenhouse-gas-emissions-and-climate-related-financial

## Rule Parallels to Third-Party Risk Management (3PRM)

Many in the financial services sector might notice similarities between the proposed rule's implications and third-party risk management (3PRM) requirements levied on that sector several years back. 3PRM is a form of risk management that focuses on identifying and mitigating risks (e.g., compliance, concentration, country, customer, financial, legal, reputational resiliency) related to the use of suppliers and their subcontractors by financial institutions.

Like government contractors, financial institutions depend on suppliers to perform and support critical operations. Under 3PRM regulations, financial institutions of all sizes must comply with rules designed to strengthen oversight and control risks associated with suppliers and their subcontractors. Given that, government contractors would be wise to study this sector's experience with 3PRM and its frameworks to prepare for the potential requirements under the Federal Supplier Climate Risk and Resilience Order in 2023.

## Lessons Learned and Steps That Can be Taken Now

Corporate entities and federal government contractors can prepare for the proposed rules by heeding the lessons learned from financial institutions, taking early actions to address future reporting requirements and enhancing supply chain risk management processes.

1. **Understand which legal entities/subsidiaries engage in direct or indirect government business.**
   While many corporate entities structure their business in such a way that only certain lines or subsidiaries are specialized to serve and administer federal contracts, a significant number of others may be unknowingly engaging with Original Equipment Manufacturers (OEMs), suppliers and third-party subcontractors with indirect revenue ties to the federal government. Government contractors and their parent organizations should set a plan to review and assess the full spectrum of their end-customer base prior to rule approval and before completing any FAR representations and certifications.

2. **Review all direct and indirect federal obligations/revenue.**
   Prime and subcontracting relationships are not always as transparent as they seem. In many instances, business entities will have multiple lines of business or subsidiaries registered separately in Sam.gov, all of which may be serving as federal contractors. In other situations, non-governmental lines of business may be delivering services or products to an OEM or government contract organization through a subcontracting or buying arrangement. Firms should seek to understand their full revenue profile – both direct (prime) and indirect (subcontracting).

3. **Stratify suppliers based on risk.**
   Corporate entities and government contractors are responsible for their suppliers' activities and the activities that suppliers may subcontract to other suppliers. Visibility is critical, not only from a quality standpoint, but also as a matter of national security. The world is a global economy and developing countries like Brazil, Russia, India and China (BRIC) serve as the leading suppliers of manufactured goods and services. Companies should account for this in their risk management practices because country risk is one of several factors contemplated in a risk assessment of a supplier and its subcontractors. Once all the risks are assessed, a determination is made whether to contract with a specific supplier or identify a new one where the overall risks are mitigated.

   Additionally, corporate entities and federal government contractors should segment or stratify their supplier base to identify the services performed by suppliers and their subcontractors that require extensive oversight based upon the physical and transition risk posed. Corporate entities should invest in a technology repository that tracks issues and creates reporting that measures the performance of supplier relationships and their subcontractors. This reporting is critical to provide an open and complete path of risk and performance to various stakeholders including regulatory agencies.

4. **Seek opportunities to leverage and maximize tax incentives.**
Lawmakers generally leverage tax incentives to encourage adoption of new regulations and ultimately achieve desired outcomes. For example, this past year President Biden signed a climate change bill into legislation that included an expansion and changes to tax deduction 179D and tax credit 45Q to incent building retrofits to lower carbon emissions. Federal contractors should begin this journey with strong collaboration and coordination between Environmental, Social, Governance (ESG) and tax departments to devise strategies that offset potential costs related to compliance with the Federal Supplier Climate Risks and Resilience Rule.

## Conclusion

If enacted as written, the Federal Supplier Climate Risks and Resilience Rule creates an integration of ESG and supply chain risk management practices with the potential to strengthen federal supply chain resilience and reduce climate risk. While seemingly novel, the activities required to comply with the rule draw significant parallels with those used to implement 3PRM practices in the financial sector, and many of the same frameworks can be applied to accelerate preparation and adoption of the new rule.

**Contact us today to get started.**

## KEY CONTACTS


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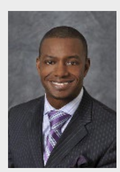

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