

Overview

ESG Issues for Aerospace & Defense Companies

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The category of aerospace and defense companies include (i) aerospace & defense enterprises (supplying primarily to governments); (ii) commercial aircraft manufacturers (supplying to both the commercial aviation industry and to governments); and (iii) defense products, including military aircraft, space vehicles, missile systems, ammunition, naval ships, and military vehicles. One of the key challenges for the industry is that aerospace and defense manufacturers operate globally and serve a world-wide customer base.

Companies in this industry face increasing ESG pressure—especially in the governance component—due to increased aerospace- and defense-related spending by their customers, supply chain disruptions, corruption, import and export controls on defense related technology and an increasing complexity in sanctions rules as geopolitical tensions intensify.

SASB & ISSB Standards

The [Sustainability Accounting Standards Board](#) (SASB) Standards for the aerospace & defense industry are designed to reveal sustainability factors most likely to impact materially the financial condition or operating performance of companies in the industry.

Whilst use of the SASB Standards is voluntary, many aerospace and defense companies have started including disclosures outlined by the SASB Standards in their communications with their investors to provide transparency and accountability on corporate performance, enhancing shareholder value, while also acting as a prophylactic action for regulatory enquiries.

On Nov. 3, 2021, at the 26th meeting of the Conference of the Parties (COP 26), the International Financial Reporting Standards (IFRS) Foundation Trustees announced the creation of the [International Sustainability Standards Board](#) (ISSB) which would be based on the SASB. At the date of writing, the ISSB standards for aerospace and defense industries is still in exposure draft form.

Several regulators in various countries have either recommended or are in the process of recommending the use of SASB or ISSB Standards for disclosing financially material ESG information.

The SASB Standards cover seven disclosure topics. The following paragraphs consider these seven and offer additional topics for further consideration. It is important to note that while SASB cannot address all financially material sustainability risks for the aerospace and defense industry, it nevertheless provides a helpful starting point for determining what disclosures to make.

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For more general information on ESG frameworks and standards, see [Practical Guidance: ESG Stakeholders, Frameworks & Regulation](#).

Energy Management

The SASB Standards recommend that companies disclose the total energy consumed, including the percentage of energy supplied from grid electricity and the percentage of renewable energy.

The SASB Standards specifically define the scope of renewable energy. Under the SASB Standards:

Renewable energy includes renewable energy the company consumed, directly produced, purchased (provided the energy was purchased through one of the list agreements). If grid electricity contains a component of renewable energy that is outside the control or influence of the company, then the renewable portion is excluded from the scope of renewable energy under the SASB Standards.

The scope of renewable energy from hydro and biomass is limited. For example, energy from hydro sources is limited to those certified by the [Low Impact Hydropower Institute](#) or that are eligible for a state [Renewable Portfolio Standard](#), and energy from biomass sources is limited to materials certified to certain specified third-party standards—e.g. [Forest Stewardship Council](#), [Sustainable Forest Initiative](#), [Programme for the Endorsement of Forest Certification](#) or [American Tree Farm System](#)—material considered eligible sources of supply according to the [Green-e Framework for Renewable Energy Certification](#), or Green-e regional standards and/or materials that are eligible for an applicable state renewable portfolio standard.

If energy meet this definition of renewable energy, certain provisions must be included in applicable agreements and document retention requirements apply.

- For renewable energy generated on-site, any renewable energy certificates (RECs) or Guarantees of Origin (GOs) must be retained—i.e., not sold—and retired or cancelled on behalf of the generating company in order for the company to claim them as renewable energy.
- For renewable PPAs and green power products, the agreement must explicitly include that RECs and GOs be retained or replaced and retired or cancelled on behalf of the entity in order for the company to claim them as renewable energy.

Hazardous Waste Management

Companies face operational and regulatory challenges managing waste, including its treatment, transport, storage, and disposal.

Amount of Hazardous Waste Generated and Percentage Recycled

The SASB Standards recommend that companies disclose the total amount of “hazardous waste” generated. Companies should look to the legal frameworks of the jurisdiction in which the waste was created to define hazardous waste. If the jurisdiction in which the waste is generated lacks applicable frameworks, then the company may use the [US Resource Conservation and Recovery Act](#) or the [EU Waste Framework Directive](#).

The SASB Standards also recommend disclosure of the percentage of hazardous waste recycled, calculated by the total weight of hazardous waste generated that was recycled, as a proportion of the total weight of hazardous waste generated. Note, however, that within the category “recycled waste,” the SASB Standards do not include any waste that was incinerated for energy recovery, although the company may separately disclose the percentage of hazardous waste generated that was incinerated.

Number & Aggregate Quantity of Reportable Spills, Quantity Recovered

The SASB Standards recommend the company disclose the total number and quantity of reportable spills. “Reportable spills” are defined as any release of hazardous substance in an amount equal to or greater than those listed in [Table 302.4](#) in 40 C.F.R. § 302.4 promulgated under the US [Comprehensive Environmental Response, Compensation, and Liability Act \(CERCLA\)](#), even where such spills occurred in jurisdictions not subject to CERCLA.

The SASB Standards also recommend calculation of the quantity of spills recovered as the quantity of spilled hazardous substances (in kilograms) removed from the environment through short-term release response activities—i.e., activities that are less than one year from the time of the spill.

Data Security

Companies in aerospace and defense that develop sensitive military and advanced aviation products are at high risk from cyberattacks. Security breaches may adversely impact revenues and reputation in this industry, from which it may be difficult to recover. For more general information on data security, see our [Privacy & Data Security Practice Center](#).

Number of Breaches, Percentage Involving Confidential Information

The SASB Standards recommend that companies disclose (1) the total number of breaches identified during the reporting period and (2) the percentage of data breaches in which confidential business information (CBI) was the subject of the data breach.

Under the SASB Standards CBI includes:

- Trade secrets, operations, processes, customer IDs, and other information of commercial value, which if disclosed, would cause substantial harm to the company.
- Classified national security information (defined as information that has been determined pursuant to) or an applicable equivalent, and is marked to indicate its classified status.
- Personally identifiable information.

Note that disclosure can be delayed if a law enforcement agency has determined that notification impedes a criminal investigation. The SASB Standards also recommend that the company describe any corrective actions taken in response to data breaches, although the disclosure need not be so specific as to compromise the company's ability to maintain data privacy and security.

For more general information on data breaches, see [Practical Guidance: Data Breach](#).

Description of Approach to Identifying and Addressing Data Security Risks in Company Operations and Products

The SASB Standards recommend the company describe its approach to identifying vulnerabilities in the information systems, separately for (1) within company operations, and (2) its products that pose a data security risk.

- For disclosures pertaining to the company and operations, the disclosure should describe operational processes, management processes, selection of business partners, employee training and use of technology.
- For disclosures pertaining to products, the discussion should include all stages of the product lifecycle, including weaknesses in supplier information systems, "backdoors" being inserted into products, and security measures implemented, including supply chain controls, "ethical hacking" stress testing and others.

The SASB Standards outline that companies should describe the degree to which the company's approach is aligned with external standard or frameworks for managing data security, and proposes additional disclosures that may be relevant based on [US SEC's Commission Statement and Guidance on Public Company Cybersecurity Disclosures](#).

Product Safety

Product safety incidents could directly impact financial performance, including increased costs, regulatory penalties, litigation claims, and reputational loss that could impact market share.

Number of Recalls Issued & Total Units Recalled

The SASB Standards recommend that companies disclose the total number of product-safety-related recalls, including those that are voluntary and involuntary, where:

- A recall is defined under US Consumer Product Safety Commission's (CPSC) Recall Handbook as any repair, replacement, refund, or notice/warning program intended to protect consumers from products that present a safety risk.
- Involuntary recalls required by regulatory agencies and issued when a product does not meet regulatory safety standards or when there is a safety-related defect in a product.
- Voluntary calls initiated by the entity in order to take products off the market.

Number of Counterfeit Parts Detected & Percentage Avoided

The SASB Standards recommend that the company disclose the total number of counterfeit parts or suspected counterfeit parts that were detected in its operations:

- Where counterfeit parts and suspected counterfeit parts are defined according to definitions contained in [48 C.F.R. § 252.246-7007](#), Contractor Counterfeit Electronic Part Detection and Avoidance System; and
- Notably, the scope of disclosure extends beyond those detected during manufacturing, assembly, and testing, but also to those parts detected before procurement, and those detected after sale to the company's customers.

Number of Airworthiness Directives Received & Total Units Affected

Under the SASB Standards, the company is also required to disclose the number of unique [Airworthiness Directives](#) (ADs) it has received from aviation authorities and the total number of units affected, where an AD is any legally enforceable rule issued by the Federal Aviation Administration, the Department of Defense or non-US equivalent applicable to aircraft, aircraft engines, propellers and appliances.

Total Amount of Monetary Losses as a Result of Legal Proceedings Associated With Product Safety

The SASB Standards recommend that the company disclose the total amount of monetary losses incurred due to legal proceedings, adjudicative proceedings whether before a court, regulator, arbitrator or otherwise, that was associated with product safety, and include a brief description of the nature of the claim, context, and result of the legal proceedings.

Fuel Economy & Emissions in Use-Phase

Within the aerospace and defense industry, many products continue to be powered by fossil fuels which release greenhouse gases. Products with higher fuel efficiency and lower use-phase emissions will help a company increase market share, improve financial performance, and develop reputational benefits.

Revenue From Alternative Energy-Related Products

Under the SASB Standards, the company shall disclose its total revenue from the sale of alternative energy-related products such as vehicles, vehicle components, power generation equipment that rely on alternative fuel, including renewable fuel and energy such as geothermal, wind, solar, hydroelectric and biomass, as well as hydrogen fuel and fuel cells.

Description of Approach & Discussion of Strategy to Address Fuel Economy and Greenhouse Gas Emissions of Products

The SASB Standards recommend that the company describe its approach and strategies for improving fuel economy and reducing use-phase greenhouse gas emissions of its products through introduction of new technologies, improvements to existing products, research and development efforts, and partnerships with peers, academic institutions, and customers. Under the Standards, the company may also provide measurements of any year-on-year fuel efficiency and fuel efficiency improvements.

Materials Sourcing

Many of the technologies adopted by companies in the aerospace and defense industry require the use of critical materials with few or no available substitutes.

Critical materials are materials which are both essential in use and subject to risk of supply restrictions and include—but are not limited to—cobalt, platinum, and rare earths. Critical materials can also include materials open to risk of shortfall in defense-related applications, such as tin, chromium metal, aluminum oxide-fused crude, silicon carbide, bismuth, and others.

Many of these critical materials may be sourced from deposits concentrated only in a few countries which are subject to intense geopolitical uncertainty. Companies that can innovate away from using such critical materials could reduce any financial impact arising from supply disruptions and price volatility.

Description of the Management of Risks Associated With the Use of Critical Materials

Under the SASB Standards, the company should describe its approach and strategy to managing its risks associated with the use of critical materials in its products, including physical limits on availability and access, changes in price, and regulatory and reputational risks.

Business Ethics

Companies within the aerospace and defense industry have been found in violation of [US Foreign Corrupt Practices Act](#) and [UK Bribery Act](#), and are particularly exposed to regulatory scrutiny because of their global supply chains and customer base. For more general information on the FCPA, see [In Focus: Foreign Corrupt Practices Act \(FCPA\)](#).

In addition to monetary loss caused by fines, unethical practices can raise reputational risk and put future growth at risk.

Total Amount of Monetary Losses as a Result of Legal Proceedings Associated With Incidents of Corruption, Bribery, &/or Illicit International Trade

Under the SASB Standards, the company shall disclose the total amount of monetary losses it incurred during the reporting period as a result of legal proceedings associated with incidents of corruption, bribery and/or illicit international trade, including but not limited to legal proceedings associated with the [UK Bribery Act 2010](#), [US Arms Export Control Act](#), [US Export Administration Regulations](#), [US Foreign Corrupt Practices Act of 1977](#), [US International Traffic in Arms Regulations](#), [US Munitions List](#). The SASB Standards recommend that the company describe the nature and context of the legal proceedings, and any corrective actions implemented as a result of the legal proceedings.

Revenue From Countries Ranked in the "E" or "F" Band of Transparency International's Government Defence Anti-Corruption Index

The SASB Standards recommend that the company disclose the amount of revenue from countries scored "E" or "F" band of [Transparency International's Government Defence Anti-Corruption Index](#) and provide discussion around operations in countries which are not scored "E" or "F" but nevertheless present unique or high business ethics risks.

Discussion of Process to Manage Business Ethics Risks Throughout the Value Chain

The SASB Standards further recommend that the company discuss its processes and due diligence procedures for assessing and managing risks relating to business ethics that it faces within the scope of its own operations, as well as those associated with business partners in its value chain, including but not limited to, anti-corruption policies, employee awareness programs, internal mechanisms for reporting and following up on suspected violations and participation in the [International Forum on Business Ethical Conduct](#) and others.

Additional Disclosure Topics

Beyond the SASB Standards, aerospace and defense companies may also want to consider risk management and disclosures in the areas below which can also have an impact on the financial health of the company and impact shareholder value:

- Some subsections of the aircraft manufacturing industry may be vulnerable to labor shortages, such as during the Covid-19 pandemic. Companies in this industry should look to measure and disclose the labor shortages if any, and the progress of employee recruitment, retraining and retention, including disclosures relating to diversity.
- In addition to SASB Standards' scope of disclosures recommended for business ethics, companies should disclose the ways they communicate those business ethics and ensure they are embedded in the company culture.
- In addition to SASB Standards' scope of disclosures on critical materials sourcing, companies should also be aware of, manage and be prepared to disclose policies and procedures for dealing with any human rights violations in the mining, procurement, or transport of such materials.
- Separate to SASB Standards' scope of disclosures on data security, companies should also disclose their data sovereignty policies, particularly because companies in the aerospace and defense industry often collect, process and store sensitive data that a number of jurisdictions will likely be subject to data localization.