

THE HAWKAMAH JOURNAL



Governance innovation to navigate crises

Keynote speech by Stephen Davis

Boards and sustainability

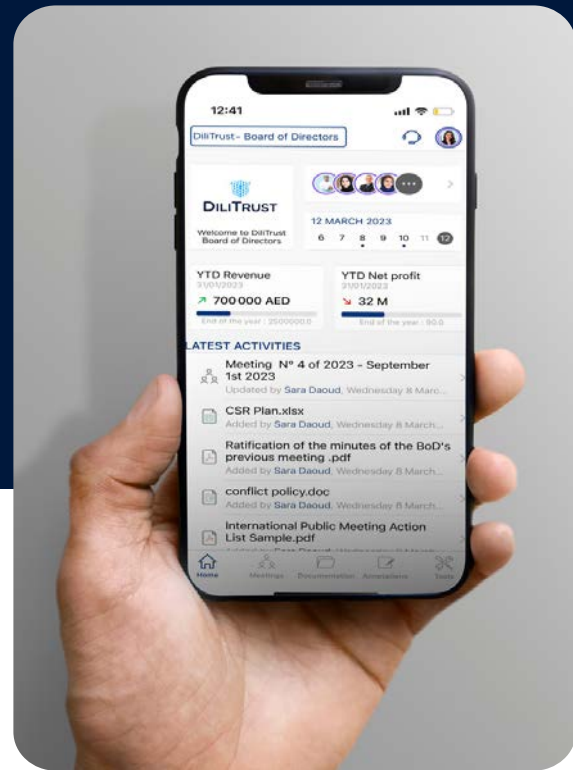
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FOREWORD

Dear Reader,

This 20th issue of the Hawkamah Journal provides an overview of the discussions held at the 15th Hawkamah Annual Conference.

The theme of the conference was “Building Investor Confidence Through Governance”.

The conference gathered prominent corporate governance experts and practitioners from all around the world to share their insights on topics such as ESG standards in the post-COVID world, how investors assess boards as a governance risk, how boards can drive ESG and what priorities investors are placing on companies around issues related to ESG.

I wish you a stimulating read.

Dr Ahmad Bin Hassan Al Shaikh
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GOVERNANCE INNOVATION TO NAVIGATE CRISES



Stephen Davis, Ph.D. is a senior fellow at the Harvard Law School Programs on Corporate Governance and Institutional Investors and chair of the Independent Oversight Committee overseeing the global proxy voting industry's Best Practices Principles for Shareholder Voting Research.

Dr Davis pioneered the field of international corporate governance in 1989 when he founded the Global Shareholder Services unit at the IRRC, in Washington, DC. His Shareholder Rights Abroad: A Handbook for the Global Investor (1989) was the first study comparing corporate governance practices in top markets. Davis has been a nonresident senior fellow in governance at the Brookings Institution, where he co-directed the World Forum on Governance. He is a member of the World Economic Forum's Expert Group on Active Investor Stewardship.

Dr Stephen is the Chair of Hawkamah's Advisory Board and he delivered this keynote speech at the 2022 Hawkamah Annual Conference.

Thank you to Chair His Excellency Dr. Ahmad Bin Hassan Al Shaikh, to the DIFC, Dr. Ashraf and his crack team at Hawkamah, our panelists from around the world, and to you participants here and online, who represent the vanguard of professional governance in the capital market.

Hawkamah, as you know, is the prime resource in the region for addressing cutting-edge governance challenges and solutions. So it is only fitting that we gather here today in something of a whirlwind of change to uncover underlying trends and share ways to handle them.

There has, of course, been an onslaught of crises that have upended assumptions about business and investment in only the past few years. The pandemic. War in Ukraine. Sharply elevated political risk in once-stable jurisdictions. Inflation. Tensions over energy markets. Climate shifts. Supply chain disruption. Growing nationalism amid a populist backlash against globalization.

In my brief address, I plan to touch on how the big three estates of corporate governance—regulators, investors, and corporate boards—are each innovating to navigate these crises, sometimes in ways largely hidden from view.

Let me start with regulators, which will be the topic of the first panel today.

Before the pandemic, the prevailing public policy model in North America, the EU, and Japan was that governments should largely stay clear of prescriptive regulation on environmental, social, and governance (or ESG) factors. Instead, governments sought to empower investors to police markets on corporate behavior.

Now, however, grassroots public pressure has grown around the world for business to act responsibly on social interests, whether on drug prices in the pandemic, or gas prices in the wake of Russia's invasion of Ukraine. Exhibit A in just today's headlines: public fury over record oil company profits as energy prices rise and supplies constrict. Policymakers, not surprisingly, are quickly scrapping laissez-faire for intervention. In the case of oil companies, they may go for punitive windfall profits taxes.

But rule-making is moving well beyond that into the whole ESG space. The EU has developed its taxonomy on environmental and other issues. The Biden administration in the United States has taken a U-turn from the Trump era, with forthcoming requirements on boards to disclose against fresh standards. Corporate boards face a whole new set of reporting and

behavior expectations rooted in the conviction that companies have social obligations to fulfill. Of course, the pendulum rocks the other way too. We are now seeing in the US a powerful backlash against ESG. For instance, in a 10 May speech former Vice President Mike Pence called on states to "rein in" the rights of funds to engage in ESG investing, blasting the practice as elevating "left-wing" objectives. Other Republican lawmakers have since taken up the call, branding companies and investors who address ESG as showing "wokeism". Texas has even passed legislation banning fund companies such as BlackRock from managing state money because it is said to be anti-fossil fuels. Now, with Republicans more powerful in Congress, the anti-ESG movement has a strong platform from which to fight.

Here's where innovation arises. A few years ago, ESMA, the European Securities Market Authority, introduced a new concept, which it called "monitored self-regulation". The target was the proxy advisory industry—that is, firms that advise institutional investors on how to vote at shareholder meetings around the world. It is, as you know, a highly controversial industry. Companies react strongly when such advisors recommend against board members, or when CEOs accuse proxy advisors of getting their facts wrong about the company. So they have clamored for regulation of the industry.



ESMA heard that call, but also understood that black-letter regulation can be rigid and suppress innovation. Instead, it pressed the proxy advisory industry for principles of best practice.

Further, ESMA insisted that stakeholders be empowered to scrutinize industry member compliance with those principles. I chair the Independent Oversight Committee that monitors the proxy voting advisory and research industry, and we are delivering results without the need for harsh regulation. ESMA is now considering “monitored self-regulation” for other controversial areas in the capital market, opening the prospect of solutions in a middle ground between doing nothing and doing too much. Regulators elsewhere may well think about similar innovation as conflicting pressures arise for action.

Let me move next to investor stewardship, which we will tackle in our second panel today.

First, there is no doubt that investors are moving rapidly to active stewardship. I raised this at our last conference, but it might bear repeating that stewardship, by definition, is “the exercise of responsible care by an agent

acting on behalf of an ultimate owner”. That’s what the dictionary says. But what does stewardship really mean?

Well, we know that the investor world has long been about buying and selling shares. What has arisen parallel to the trading discipline is the discipline of stewardship. Stewardship is what you do with shares once you own them in order to optimize value over time. That means not just voting shares as an investor, but also engaging with companies and other players as well. Big institutional investors have doubled or tripled the number of people who work on stewardship in just the last five years. Moreover, while these stewardship professionals used to be marginal players within funds, now they are very much at the heart of the investment process. And as they engage with portfolio companies, they are raising questions of ESG risk and opportunity in board composition, climate, employee health and safety, and a host of other issues.

The question today is whether stewardship thrives or withers in a bear market. So far, there is no evidence that it is a fair-market fad. Indeed, lawmakers and regulators continue to press for muscular stewardship by institutional



investors. Moreover, if we think about innovation, one advance comes in the form of a fresh effort to build global infrastructure around the stewardship profession through an initiative called StePs, short for Stewardship Professionals. Some of our participants today are involved in that project, as am I.

But where innovation is really being introduced may be understood in the context of the new anti-ESG movement I mentioned earlier. Critics of ESG argue that stewardship is grounded in left-wing political and social biases and should therefore be scrapped in favor of evidence-based, value-growing support for business.

But the truth is that stewardship is grounded, more so each day, on a vast new industry of analytics providers. Where ESG might once have been general and aspirational—“we investors want companies to assert their attention to ESG”—it is today all about stewardship professionals conducting detailed, granular testing of those commitments against both company information and externally-sourced big data and AI. Investors are measuring factors such as water use, emissions, employee turnover, brand trust, you name it. So investor stewardship is very much grounded now in evidence. Whether it is the right evidence, is another debate.

Institutions are also drawing on innovation to demonstrate that their stewardship programs are aligned not with leftist ideology, but with the interests and preferences of their beneficiary clients. BlackRock last year introduced a service whereby its large investor clients can cast share votes themselves. Vanguard announced only this month that it expects to do something similar in 2023. Other institutions—Schwab being the latest—are now incorporating new polling tools to anchor their stewardship priorities to those of clients. LGIM, Aviva, and Fidelity International in Britain are doing this using a start-up fintech firm called Tumelo, while big EU asset managers such as PGGM

and APG are long practiced in using classic opinion-gathering techniques. As so-called “expressions of wish” services spread, it may be harder for critics to attack funds on ESG stewardship if their strategies are anchored both in hard data and in client opinion.

Still, in my view a further innovation could be to replace ESG as a term. I suggested this in a post on LinkedIn in June—and it drew a remarkable 39,000 views. There is clearly an appetite for discussing this idea.

So how about pivoting to a phrase that returns us to the original concept of ensuring that both investors and companies take account of risks and opportunities that lie outside conventional accounting? Call it “360° investing” or, for companies, “360° management”. That expression would signal that one is looking at the full range of insights—including ESG, of course, but also others.

Finally, let me turn to corporate boards.

Crises have come like serial cyclones to companies, and we will doubtless hear insights from our extraordinary panelists later today on how they can best navigate them. But one thing crises have done, as I’ve mentioned earlier, is to turbocharge investor stewardship. Are corporate boards ready for that? Innovation here would involve stress testing a board against the new challenges to make sure it has directors with skills in two-way communication, and an ESG balance sheet that can pass muster against current investor opinion. Does the board have the information it needs? Is it well structured to act on that information?

Crises have brought another consequence: a tide of pressure on companies to address political and social issues, whether it be on public health, the war in Ukraine, climate, political stability, or employee rights. Staying clear of such issues and suffering no effects is no longer a realistic option. For example, in



the US, a group of CEOs joined in a statement following the January 6 2020 insurrection at the US Capitol. They asserted support for democratic institutions, which made sense because US political stability is an essential component of business growth. But many others chose not to get involved. Either way, there were effects—criticism from some that companies should be silent, and from others that more should speak out. Disney got entangled in such a case regarding gender issues in Florida. Adidas only three weeks ago had to disengage with Kanye West over racism and antisemitism charges. Coca Cola and more than 1,000 other multinationals had to exit Russia under public pressure following Putin's invasion of Ukraine.

Innovation here involves investment by big companies, and their boards, in better intelligence information on geopolitical risks facing their businesses as well as risks arising from investor, NGO, and public pressure. It may also involve updating the job description for chairs and CEOs to include the kind of communication and public policy judgement skills we normally associate with politics more than business.

I'll stop there. There's a lot more innovation to discuss, so I'm delighted that following these remarks we will have terrific panelists who will be able to lend insights far greater than mine. For now, thank you for listening. And again, thank you to Hawkamah and to all the distinguished participants joining us in this conference.

WHAT INVESTORS ARE LOOKING FOR ON BOARDS

Paul Lee is Head of Stewardship and Sustainable Investment Strategy at Redington.

Paul is responsible for the substantive delivery of Redington's stewardship and sustainability services to clients, having spent more than two decades delivering ESG and stewardship services, helping shape the market as a whole. More than a dozen of those years were at Hermes, helping to create and build the world-leading Equity Ownership Services (EOS) business. After a brief time as head of investment affairs at the National Association of Pension Funds (NAPF, now the PLSA), he was Aberdeen Asset Management's first global head of corporate governance and stewardship.

In this article, Paul sets out how investors assess company boards and what are their expectations in areas such director independence, skillset diversity, expertise and board behaviors.

What does good look like on a company board, at least as far as investors are concerned?

It's a ongoing question, and one that's made more of a challenge because investors in public companies are always on the outside of the boardroom door. We have to use proxies to help understand whether we should have confidence that a board has a chance of doing its job well.

In essence there are three elements that investors look for within any board:

- skills
- independence
- behaviours



If any one of these three is lacking, a board will fail to be fully effective. So it is worth unpicking what investors mean by each.

Necessary board skills

Non-executive directors are on a board to work, and to add value to the business. That means that they collectively need to have relevant skills and experience to bring into the board meeting. Each individual isn't expected to know everything about the company, its stakeholders and its strategic opportunity, but each should have some relevant skill that can provide useful insights. That might be deep experience of a key area of business, or of an adjacent business; it might be expertise on key



risk areas for the company; it might be working knowledge of a significant geography that the organisation is operating in or where it wishes to expand; it may be skill in navigating relevant regulation; or it might be awareness of the interests of particular stakeholders, such as the workforce, suppliers or customers.

There are also particular professional skills that add value to board discussions. Accounting and reporting experience is vital, particularly to making audit committee discussions as effective as possible. Some boards seek to have individuals with legal expertise among their non-executive directors – though many find it better and easier to access this expertise through arm's length advisers instead. Increasingly the value of human resources expertise is recognised, which makes particular sense as we move towards more knowledge-intensive business operations. And some boards even believe that there is value in having non-executive directors with some experience in the investment world.

A further thing that investors hope for from non-executive directors: curiosity and excitement about the business. If directors have this, they will look to understand and engage with it, and build deep knowledge and insight into

the business model, the operations and the opportunity that the company has to generate value and to prosper for the long-term. Their skill and expertise about the company will increase and they will be able to add further value in the boardroom. Directors who aren't curious and excited, in contrast, are less likely to engage and much less likely to add value.

Sincere board independence

In order to add value, non-executive directors need to feel free to question and challenge management. They do not do so out of disrespect, nor to undermine management's position – at least they shouldn't. Rather, they do it because supportive questioning and challenge will lead to better decision-making and more robustly considered plans. That better planning and decision-making should help ensure that the company prospers for the long term.

Independence is a frame of mind more than something that can be measured clearly. However, there are some measures that investors apply, which they believe strongly indicate a lack of independence on the part of a non-executive director. These are that the individual:

- is a former executive of the company (or a subsidiary), or an adviser to it or to a major shareholder, and there was not a considerable gap before joining the board as a non-executive
- receives, or has received, incentive pay from the company, or receives fees in addition to director's fees
- has close family ties with any of the company's (or a major shareholder's) executives, advisers or directors
- is a nominee or official representative of a major shareholder or of the state, or has been appointed by some mechanism other than the usual director recruitment process

There are also certain broader indicators of a possible lack of independence, which are more debated by investors but which raise issues, particularly if there is not a sufficient weight of clearly independent non-executive directors on the board. These are that the individual:

- holds cross-directorships with another director, or otherwise has significant links with others on the board, through involvement together on other companies or bodies
- has been a director of the company for more than a decade

That last indicator of a possible lack of independence can often be the most controversial, but investors tend to believe that 10 years is a long time to be on a board and any director who has carried out the role for that length of time will have been involved with every major decision for a long time. It will be harder and harder to separate themselves from those decisions and the state of the company as it stands – meaning that their ability to give an independent, dispassionate view is significantly reduced.

Effective board behaviours

Even if a board has a full range of necessary skills and members with sincere independence of spirit, it counts for nothing if the information that flows to the directors doesn't give them enough of a basis for raising views and discussing concerns, or the boardroom dynamics don't allow voices to be heard when they need to be. That's why boardroom behaviours matter so much.

The role of the chair is crucial to delivering effective board behaviours. That's a major reason why investors mostly believe it's important to have an independent chair of the board, and certainly an individual who is not also CEO of the company. That independence helps deliver a more effective dynamic in the boardroom.



The chair needs to set the agenda for the board meeting, allowing appropriate time allocations for the most difficult conversations, and approve the board papers that will help inform those conversations. Papers need to be informative without being excessively burdensome – a difficult balance to strike. The chair needs to ensure that every director contributes as appropriate, helping the board as a whole to benefit from the mix of skills within the boardroom. If there are areas of concern or discomfort the chair should bring those out. It is also down to the chair to decide whether to postpone any decision-making on a particular issue, or if a decision does indeed need to be taken at that board meeting.

It is in the area of behaviours that diversity in the boardroom matters too. The evidence is that diverse boards, bringing together a range of experience and perspectives to enable a richer discussion of issues, make better decisions. Investors therefore increasingly look to see that boards are fully diverse across the range of different dimensions of human variation, but including as a minimum gender and ethnicity. Boards are collaborative human endeavours.

The chair needs to give permission for individuals to contribute, but also individual board members need to assert their right to speak and to share their views, expressing issues and concerns where they have them. Individual non-executive directors who do not share their views are not contributing appropriately to the board. Investors take interest in attendance records at board meetings, but attendance without contributing to the full of an individual's knowledge and capacity is just as pernicious.

The investor perspective

Because investors are on the outside of the boardroom (except in the most unusual circumstances) they cannot see these elements of good boards delivered in practice. Inevitably in particular, the nature of board behaviours is invisible, as is the independence of mind that directors in practice bring to bear in board discussions.

Without direct sight of these things, investors have to seek reassurance in other ways. Companies can assist by making clear the skills that each individual brings to the board;



a good way of doing this can be to provide a skills matrix of the areas expected to be covered within the boardroom and how they are delivered by the board members collectively.

Investors do not insist that every single non-executive director is independent – though it is better that non-independents do not sit on key board committees, particularly the remuneration and audit committees. It is much better that the company accepts that an individual is clearly not independent, or that there may be question-marks as to their independence, as that gives reassurance that the board is considering these issues with full awareness of the investor mindset. Investors look to see that at least a majority of the non-executive directors, and preferably a majority of the board, are clearly independent, and that independent directors populate the key board committees.

Behaviours are still less visible than independence of mind. They can only be tested by investors having an active dialogue with board directors, discussing key issues of importance and exploring the board's approach to them. Investors aren't seeking inside information through these conversations but they are seeking reassurance about the quality of thought and debate within the boardroom. These questions will often be particularly about the most difficult long-term challenges that a business faces (sometimes some of these issues are abbreviated with the ESG acronym) because those are areas where the highest openness to debate and discussion is needed. These discussions also enable investors to understand the director's excitement and interest in the company, and so the likelihood that they will support the long-term prosperity of the business – which is the collective aim of both investors and boards.

Applying the standards

These are general investor perspectives. Most will apply flexibility and discretion that recognises the specific circumstances of individual companies, and their geographical and cultural context. So for example smaller and younger companies should enjoy more scope for governance that doesn't (yet) measure up fully to these expectations without investors raising significant concerns. And companies from the GCC may also benefit from flexibility on the part of institutional investors, recognising the regional context and their ownership structures. That doesn't mean that the principles of the standards do not apply – and companies are likely to win greater support by responding directly and openly to the issues that underly the concerns covered here – but the investors will typically tailor their specific expectations to reflect local realities.

THE ROLE OF THE BOARD IN SUSTAINABILITY INITIATIVES



Colin Low is currently the Chair of the Audit and Risk Management Committee, and the global independent director of AET Tankers Pte Ltd, a maritime petroleum tanker leasing and energy logistics group. He is also Board Director of private equity firm BLG Capital Advisors Asia, an independent non-executive director at the SGX-listed Jason Marine Group and the Senior Advisory Board Member of the Diligent Institute NY, USA.

He is a Lifetime Fellow of the Singapore Institute of Directors, Fellow of the Hong Kong Institute of Directors and a Certified International Board Director of INSEAD University.

In this article, Colin explores what Boards can do to engage with management, and the outlook for ESG and Sustainability initiatives.

During the period when the Hawkamah Institute Conference was held (Nov 15, 2022) in Dubai, the event coincided with the Conference of the Parties COP 27th held (Nov 6-20) in Sharm El-Sheik, Egypt. Both these events generated significant interests on ESG and Sustainability, regarding boards and management across the Middle East and the Asia Pacific regions.

During this time, there is also increasing regulations throughout the region and boards are getting their attention focused on governance and oversight of climate and ESG issues.

Take the example of sustainability reporting for Climate Change & ESG disclosures.

Since June 2016, the Singapore Exchange (SGX) introduced compulsory sustainability reporting on “a comply or explain basis” – entities listed on SGX were then required to issue a sustainability report annually by 2018.

SGX then introduced a phased approach to mandatory climate reporting beginning in Dec 2021: based on the framework of TCFD (Task Force for Climate related Financial Disclosures). From 1 Jan 2022, all listed companies are to provide climate related disclosures useful to stakeholders on a comply or explain basis.

Effective 1 January 2023, it became compulsory for TCFD modeled Sustainability Reporting for the financial, banking and insurance, agriculture, food, and energy sectors. The agriculture, food, and forest products industry



along with the energy industry are required to report on a “comply or explain basis”. The transportation, building and materials sectors will follow such mode of mandatory reporting in 2024. All the SGX listed entities will progressively on an industry sector basis, move to a full mandatory climate disclosure basis.

Sustainability reporting has been ongoing for several years already, but many companies do not report on climate specifically. These latest changes by SGX effective in Jan 2023, will do away with such reporting inconsistencies on climate related matters. There are also new legislated requirements In Thailand: a climate change bill becomes law in 2023 and sets new carbon neutrality and net zero timeline requirements.

Boards are certainly gearing up to meet all these new legislated sustainability reporting requirements. Such new legislations mandate companies to set climate targets and move progressively towards net zero. This will enable countries to live up to its respective climate change and emission commitments of COP26 held in Glasgow, UK. Legislations

and mandatory reporting requirements lend a credible framework and support, in providing a positive environment and opportunities for businesses to take prompt actions toward low carbon emissions and net zero. These are certainly positive steps and developments in the region!

How Boards organize itself for Sustainability initiatives

1. Board Structure, Composition & Agenda prioritization

I am a firm believer of how Boards and its various committees are structured, organized and orchestrated by the board Chair for maximum effect. Agendas and detailed sustainability plans are closely coordinated with the respective Chair of committees to ensure progress and appropriate deep dive reviews for the company. The Chair acts like the role of the music conductor of an orchestra, in achieving sustainability goals and action plans in close coordination and review with the various Chairs of Committees and members of the board. Along with the practices of DEI (Diversity, Equity, and Inclusiveness), Talent

Management, Board Succession planning, the board must be a role model to the Management by adopting such principles and practices at the board level. Such actions at the board sets the appropriate tone and behavioral expectations at the apex of the corporation, and in turn, expecting and requiring management to take on similar actions on a day-to-day basis.

As ESG becomes much more important in 2023 and beyond, companies are developing more formal approaches to ESG oversight. In a [study](#) by the Diligent Institute and one of the world's largest Executive Search firm, Spencer Stuart in May 2022, it was found that out of 590 corporate director respondents (72% US, and the rest globally), it was found as follows:

- 43% of ESG oversight is conducted at the full board level.
- 30% of ESG oversight is done at the Nominating and Governance Committee.
- 15% respondents manage such oversight at dedicated committees known as ESG/ Sustainability Committee.
- 2% of the respondents do not even oversee ESG at the board level.

The Diligent Institute & Spencer Stuart study also highlighted that the dedicated ESG/ Sustainability Committee is becoming a more common committee in the future. The latter ESG/Sustainability Committee structure is above and beyond the typical Audit, Nomination and Remuneration committees that you normally find in a public board.

2. Recruiting the best fitting Director for your board.

There is no question in my mind that the Board seat is one of the most highly prized real estate on the board. The Nomination Committee Chair and committee have the most important task of finding the most fitting and engaging individual to contribute, not only in the areas of sustainability initiatives, but on how the incoming board member can fit in and guide the company with the rest of the board members (think chemistry and incitements for challenging ideas). Diversity in functional backgrounds, gender, industry relevance is important. Even more so, what are the factors and criterions used by the Nomination Committee in selecting board candidates? This is the key to ensuring a clear and comprehensive process for the entire selection process, to realize the result of selecting the best candidate befitting the board.



3. Training and Upskilling Board Directors on ESG & Sustainability

Knowledge in ESG and Sustainability topics including compliance requirements are multi-faceted and varied. Such wisdom and knowledge must be carefully engineered, implemented, and guarded. The lack of detailed ESG knowledge can stall and create delays and inefficiencies for the board in being the best stewards for its sustainability and governance pathways.

This is hard work, take years to develop and execute, and it requires the commitment of all the board directors and the senior leadership team. Contingent upon the company's listing/registration in the country of incorporation and its extended geographical sphere of operations, Directors need specific knowledge to ask the right questions and guide management and the company.

The relevant point to note for board directors is "if Board Directors have no skills or knowledge in the ESG arena, how can directors guide/steer management and the company" to a net zero carbon emission target.

Training and upskilling for ESG is certainly a priority for all boards and individual directors. In the same Diligent Institute & Spencer Stuart study, it was pointed out that Boards are upskilling themselves on ESG knowledge by the following practices:

- Bringing in outside consultants – 42%
- Getting training for the board/sending directors to training programs – 38%
- Conducting an ESG-specific board-effectiveness review to identify current gaps -29%
- Conducting scenario-planning around various ESG risks – 27%

There are tremendous opportunities for directors globally, who have knowledge and expertise on sustainability initiatives and ESG. These are significant new areas of need in boards for directors with ESG wisdom and experiences, just like cybersecurity knowledge. Personally, I took a certification program in Diligent's Climate Change Leadership program.

4. Working closely with the CEO and Key Management closely on ESG

ESG and Sustainability initiatives are still relatively new and everchanging across different regions and has varying levels of legislative compliances and reporting requirements which can be extremely confusing and hard to track. My view is for boards to work closely with management and define a common path forward for companies in meeting their ESG goals and milestones for the immediate, mid to long term, on an ongoing collaborative basis. At the same time, Board Directors can use these meeting and collaboration opportunities to learn about the respective external and internal ESG reporting requirements along with the management team.

ESG requirements globally are evolving and changing very quickly. Boards will need to frequently review, refine, and reinvent the business model, capabilities, and culture of the company for relevance and effectiveness in each new context. It is in very much the interests of both the Board and the Management team, to work closely together, so that they are in the best position to adapt and promptly incorporate any ESG issues and concerns into their stewardship and oversight responsibilities. I encourage board directors to be proactive in such an important engagement with the management team and seek the support of the Chair and each respective board member in this sustainability journey.

The Outlook for ESG & Sustainability Initiatives for Boards

Recently, the media has reported that board members and corporations have been put off by the many issues of the day arising from talent shortage, inflation, supply chain shortages, ranging from food to production material inputs, energy security issues for nations and corporations. In fact, there are recent reports citing that the priority for boards and corporations should simply be on managing and mitigating the risks from such “Polycrisis” (new term for the myriads of issues and crisis happening all at the same time) urgently and now, rather than focus on ESG and Sustainability issues. It was in such a context that COP27 in Egypt had not been cited as successful or progressive, due to many nations including the G20 countries having to take on so many challenging fronts ranging from financial, social, economic to geopolitical issues.

Before you even start thinking about letting up in the implementation and drive for ESG and Sustainability issues, please let me bring your attention to this fact: there is continued ongoing pressure from investors and proxy advisors with regards to ESG oversight in 2023. Investment giant Blackrock indicated in Dec 2022 that it will continue to ask companies to disclose their climate-related factors in its investment, engagement and voting processes. Institutional investors like Blackrock are simply not letting up!

According to the Institutional Shareholder Services (ISS) Global Benchmark Policy Survey in Oct 2022, 42% of investors believe that it is not a good reason to re-elect Audit Committee members to boards for companies that exclude climate risk considerations from Critical Audit Matters.

The survey also asked whether individual directors should be held accountable for climate change disclosures and risk management. Only 17% of investors said no.

Finally, 50% of investors consider it a material governance failure if the company and board has not set out realistic targets for Scope 1 and Scope 2 emissions through 2035, with opinions trailing not far behind for relevant Scope 3 emissions. This indicates the heightened legal risks and liability exposures for board directors who do not continue to work on climate risks and sustainability issues.

Facing affronted stakeholders for not bringing companies to ESG compliance and standards is not an open legal liability and exposure that you as a Board Director would want to take on for such inactions and poor stewardships. There is substantial legal, individual and company reputational risks that you as the Board Director must conscientiously mitigate, navigate and steer away from!

Finally, I like to quote my colleague, Mr. Brian Stafford, CEO of Diligent Corporation:

“Rather than continuing a debate about ESG that will neither be satisfying to anyone nor solve any problems by itself, the time for concrete action is upon us”. As Board Directors, nothing is more urgent and poignant for us to make a difference: not only for the companies we serve on the board on, but for the legacy of the next generation living on planet earth. By taking ESG & Sustainability actions now, we get moving on that platform to make real progress toward meeting Net Zero carbon emission goal and to save planet earth! That’s our legacy!

I wish you and your respective boards great success on these ESG and sustainability initiatives.



The challenge of governance often relates to translating the principle into practice

CORPORATE GOVERNANCE ASSESSMENT

Hawkamah has designed a highly confidential corporate governance assessment service for regional organizations and government institutions. Our governance assessments are tailor-made according to the client need, the size and structure of their organization, as well as their sector of activity.

The assessment enables organizations to benchmark their governance practice against the local regulations, as well as regional and international practices. Our approach is based on the recognition that corporate governance is not a compliance exercise, but a platform for enhancing corporate success.

The ultimate purpose of the assessment is to:

- Create insights on effective governance implementation within organization
- Drive further governance reform by identifying the organization's strengths and weaknesses; opportunities and challenges
- Build stakeholder trust in the organization

BOARDS AND SUSTAINABILITY IN THE MENA REGION



Zeina Sammakieh is Assistant Vice President at Hawkamah Institute for Corporate Governance.

She has over 15 years of experience in the field of governance having started as an advocate promoting corporate governance in the region as part of the OECD Governance working Group.

In her most recent roles, she has worked closely with boards of directors and shareholders in multiple capacities including Governance Officer, Board Secretary, and Head of Investor Relations in a listed National Bank in the UAE and a listed multinational company operating in 65 countries.

In this article, Zeina explores the sustainability journey of companies listed in the Middle East and North Africa.

The concepts of ESG and Sustainability have started to gain momentum in the Middle East and North Africa (MENA) region, particularly with Egypt hosting COP27 and the United Arab Emirates hosting COP28 in 2023.

This momentum is evidenced by the growth in sustainability reporting by the region's companies in recent years.

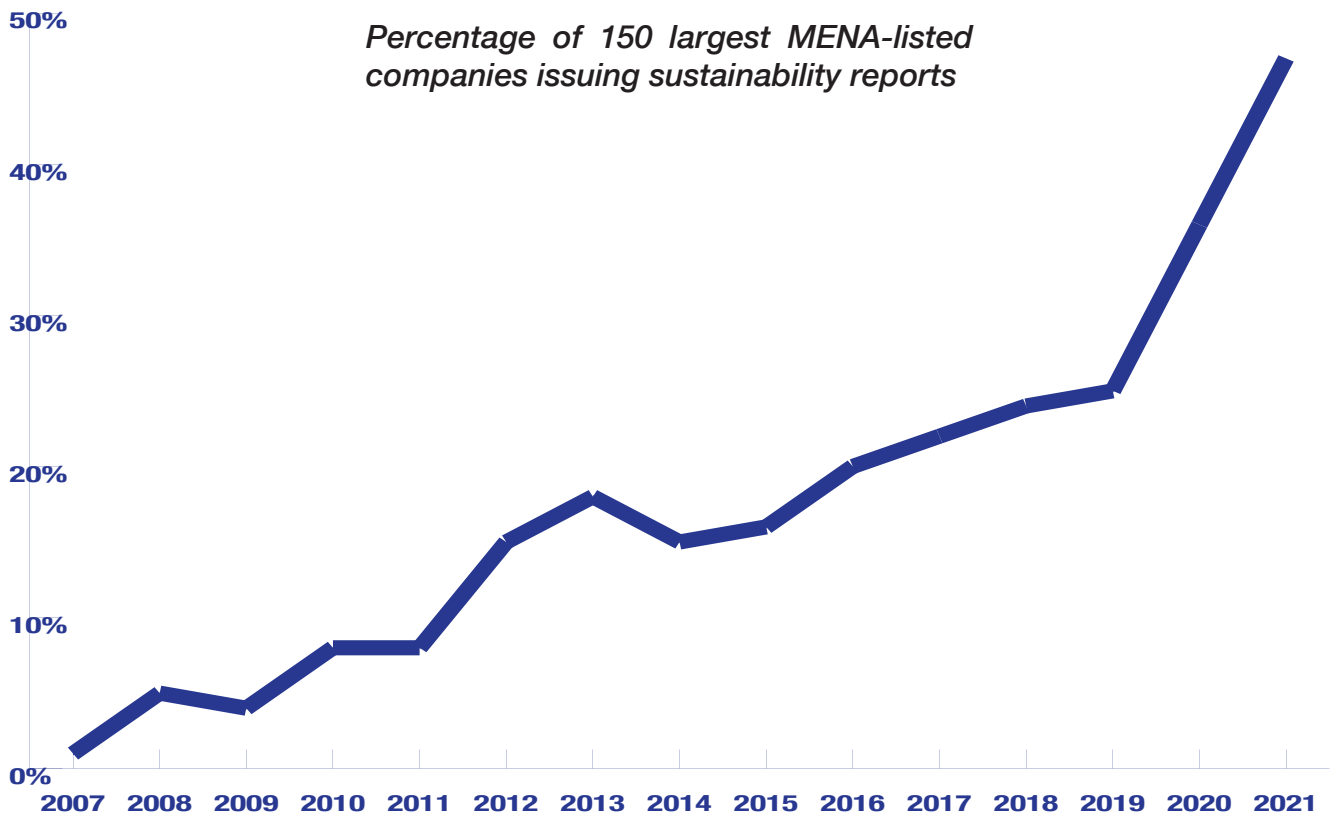
A decade ago, sustainability reports were only issued by a handful of companies, but the latest data by Hawkamah indicate that approximately 50 percent of the largest listed companies across the region are now producing meaningful sustainability reporting, whether as stand-alone reports or as part of their annual reports (see graph below).

These reports are increasingly based on the GRI standards covering areas such as health and safety, greenhouse emissions, water consumption, and community initiatives.

However, in order for sustainability to move beyond reporting and to be embedded into the operations of companies, the boards of regional companies should dedicate more time to discuss sustainability and what it means for their business in terms of opportunities and risks.

Sustainability trends in the Middle East and North Africa region

Until recently, ESG issues have been viewed by many companies in the MENA as a communication and compliance exercise.



This has often resulted in stand-alone ESG initiatives and projects which have been mainly driven by management, with the communication department taking the lead and collaborating with different functions within the company to collect and report on information. Unfortunately, this has meant that boards in the MENA region have spent too little time on sustainability issues.

The lack of engagement of the boards in the MENA region in relation to sustainability in the past could be attributed to a number of challenges. In addition to being a fairly new topic in the region’s boardrooms, the broad and complex nature of sustainability as a concept and the multitude of topics and standards it encompasses have made it less obvious for boards on where to start and how best to address ESG issues.

The biggest challenges, however, are likely related to data and talent. Sustainability reporting requires a significant amount of data

and information, and while this can be difficult to gather to start with, it is even more difficult to present and have directors interpret the data in a meaningful way outside the context of a sustainability strategy. The limited availability of specialized talent in the ESG area in the region has not helped either. In other words, there has been much room for improvement in terms of building governance around sustainability practices.

There are reasons, however, to be optimistic that this has started to change. Here is how matters are changing and why the pace of change is expected to accelerate.

The business case for sustainability is increasingly recognized. Businesses are beginning to acknowledge that incorporating sustainable practices enhances a company’s reputation, reduces costs, increases efficiency, and minimizes risks, ultimately leading to the business long-term growth. Sustainable practices also have the potential to boost a

company's brand, attracting and retaining loyal customers. In addition, sustainable practices enable companies to comply with regulatory requirements, anticipate market demands, and mitigate social and environmental risks.

The region is witnessing a noticeable increase in awareness regarding sustainability's significance for companies and more importantly shift in directors' mindset. There has been a tendency to view sustainability as contradicting or competing with shareholders' interest in short-term returns. The rise in stewardship has brought sustainability to the forefront of board's agenda. Regional board members are increasingly expressing the need for greater focus on ESG at the board's level. As evidenced by board evaluations conducted by Hawkamah, an increasing number of directors are also acknowledging the benefits of incorporating sustainability as part of their ongoing professional development.

As countries in the MENA region, and particularly in the Gulf, are ramping up efforts to attract global investors and to diversify their economies, there is a growing recognition of the importance of ESG practices in differentiating businesses as responsible and attractive to investors. Several global rating agencies are assessing listed companies, including the region's companies, based on

their ESG practices. S&P/Hawkamah ESG Index has been assessing the largest 150 listed companies across the region based on their public disclosure since 2007. The results have shown that companies with stronger ESG practices have consistently outperformed their counterparts implying a positive correlation between companies adopting high ESG practices and their share price valuations.

ESG practices have gradually gained traction due to the influence of regulations. Significant progress has been made in the realm of governance, as governments across various countries have introduced and updated codes of conduct for the private sector, state-owned companies, and governmental entities. Notably, many of these codes now place ESG responsibilities within the purview of the boards.

There are early indications of a move towards standardization in the region, as exemplified by the GCC Exchange Committee's publication of a unified set of ESG [disclosure metrics](#). The 29 standards include 10 environmental, 10 social, and 9 governance metrics aligned with the World Federation of Exchanges and Sustainable Stock Exchanges Initiative, covering areas such as GHG emissions, energy and water usage, gender pay, employee turnover, gender diversity, data privacy, and ethics.





Two primary catalysts have ignited the ESG momentum in the region. Firstly, the pandemic and the related supply chain disruptions have had a global impact, including on companies in the MENA region. A recent survey by Masdar indicated that 85% of 525 global executives considered the Covid-19 pandemic a wake-up call on sustainability, with many seeing it as a tipping point for investments in sustainability projects.

However, it is the governments' recent impactful approach to ESG issues that is expected to accelerate the adoption of sustainability practices in the region and maintain its momentum. With net-zero commitments and national visions that prioritize sustainability, different countries have committed to ambitious targets and are working towards achieving them. Some countries have taken more significant steps than others, such as the United Arab Emirates and the Kingdom of Saudi Arabia, which are among the most visible on the world stage. The hosting of COP27 in Egypt in November 2022 and the upcoming COP28

in the United Arab Emirates in November 2023 will further increase the region's prominence in the sustainability dialogue. Other countries are also participating in this change.

The UAE, for example, has launched a series of initiatives in an indication of its commitment to develop sustainable projects tackling environmental and social issues and foster a sustainable economy. These include the UAE environmental goals by 2050, UAE energy strategy 2050, circular economy policy, wiser consumption initiatives, UAE Net Zero 2050, national climate change plan of the UAE 2017 to 2050, UAE green agenda 2015 – 2030. The UAE has also named 2023 to be “the year of sustainability”. It is anticipated that it will be a turnaround year.

The shift towards sustainability will have an impact on companies at all levels, with the boards of directors playing a crucial role in driving this change. Companies owned by the government or sovereign funds are expected to lead the way, with others following suit.

Some companies have already declared they are working towards supporting their countries' national visions and ambitious targets. Concrete actions and plans will have to follow as companies will naturally start taking a more deliberate approach in their oversight of sustainability, with the goal of making a difference and future proofing their businesses.

Board oversight of sustainability

Initially, boards are likely to engage more closely with stakeholders on the sustainability issue. This will include connecting with and listening to governments, investors, customers, and communities, to better understand their concerns, expectations, and perspectives on ESG issues and ensuring that the company's ESG strategy aligns with their needs and interests.

Directors will also be focusing on the formulation of ESG strategies that align with the companies' values, goals, and purpose. This will be carried at the board level or through a Sustainability or another designated committee. The fact that several companies have instituted the function of chief sustainability is a step in the right direction.

Sustainability risks can have a significant impact on a company's operations, reputation, and financial performance, boards will consider identifying, managing, and integrating ESG related risks, including climate change, human rights, data privacy, and supply chain issues into their companies' overall risk management frameworks. More importantly, boards should consider ESG issues as part of their decision-making process.

Sustainability oversight will also be part of the board's monitoring of the business performance and corporate culture. Performance monitoring means measuring and tracking progress towards ESG strategic goals and compliance with regulations. Few companies have taken the lead in including sustainability as part of the CEO and executive management team KPIs.

While many regional companies have made significant progress on sustainability, the region as a whole is still in the early stages of the sustainability journey. Governments and regulators are increasingly addressing this issue and regional boards are increasingly acknowledging the important role they play in driving their organizations for a more sustainable future.



CLOSING REMARKS - 1

Mak Yuen Teen is Professor of Accounting at the National University of Singapore, where he specializes in corporate governance.

Prof Mak has served on key corporate governance committees which developed and revised the code of corporate governance for listed companies in Singapore. He is currently a member of the Corporate Governance Advisory Committee established by the Monetary Authority of Singapore.

He was also the Singapore expert in the development of the ASEAN Corporate Governance Scorecard and Ranking, an initiative of the ASEAN Capital Markets Forum.

He also serves on Hawkamah Advisory Board and he delivered these closing remarks on the topics raised by the conference panelists.



In my part of the closing remarks, I will talk about three main points, certain aspects of which have been covered by today's excellent three panel discussions and by Stephen's opening address.

Integrating sustainability into corporate governance codes

My first point is about the integration of sustainability considerations into corporate governance codes.

The first widely-recognised corporate governance code was released by the Cadbury committee in the UK 30 years ago, in 1992. Since then, many countries have developed their code of corporate governance modelled after the UK code. Many of these codes were developed based on the shareholder model

of corporate governance. I was on the first corporate governance committee set up by the Singapore government in 2000 and the first issue we debated on that committee was whether to follow the shareholder or stakeholder model. We chose the shareholder model, as did a number of other countries in Asia, such as Malaysia.

Whilst there was a recognition of the importance of taking into account the interests of stakeholders, it was in the context of maximising shareholder value. The principles and guidelines in the Code were written with shareholder protection and shareholder value creation in mind. This started to change in Singapore and other countries which revised the codes after the Global Financial Crisis, with more emphasis on stakeholders' interest. In Singapore, a separate section, principles and

guidelines relating to stakeholders' interest were added in the 2018 Code. In the mid-2010s, a number of countries in Asia started introducing sustainability reporting, first on a comply or explain basis and then on a mandatory basis.

It is probably time for stakeholders' interests and sustainability considerations to be more fully integrated into corporate governance codes – UK did it to some extent in the 2018 Code, and well before that in her company law reform, and Malaysia to a significant extent in the Code revision in 2021. The latest revised version of the OECD principles of corporate governance, due to be released in 2023, is expected to integrate sustainability considerations throughout the principles, although there is also a proposed new pillar focusing on sustainability.

However, even proponents of sustainability and ESG generally recognise that governance is the foundation – whether a company follows a shareholder or stakeholder model and the priorities it places on “E” and “S” factors, good governance is critical.

Regulatory initiatives

My second point relates to regulatory initiatives globally to encourage sustainability being focused on disclosures and reporting, rather than more prescriptive requirements to mandate specific governance processes and structures.

I am currently working on a report looking at the sustainability governance and management practices adopted by large companies in Australia, Singapore and Malaysia. Not surprisingly, we see a variety of governing and management bodies being formed, a variety of background of chief sustainability officers, reporting relationships, etc.

Boards and management need to be consider what structures and practices are likely to work best for them. For example, should the responsibility for overseeing sustainability be vested with the board, or integrated into existing committees, or a combination of a separate board sustainability committee with existing committees. There are many options.



But regardless of structures, it always comes back to having the right people – in the board and management – who have the necessary independence and competencies to oversee and management of sustainability risks and opportunities. Going from brown to green involves change management, and this may mean having to make changes in members of the board and management.

And from there, the materiality assessment of ESG factors for the company is important, because that drives integration of ESG considerations into strategies, policies, controls, etc.; what ESG factors to link to executive remuneration if appropriate; and what to focus on in the sustainability report. The SASB industry-based standards are a good starting point for identifying what stakeholders believe are the most important for the sector and sub-sector, but each company may have its own critical ESG factors (which may be country-dependent too).

Greenwashing

My third point is about greenwashing. I believe this is going to be a big risk, and we are already seeing cases of asset managers and companies being accused of it.

Recently, we had a Malaysian glove manufacturer which was listed in both Malaysia and Singapore, accused by an NGO of mis-reporting its GHG scope 3 emissions. These emissions have been subject to limited independent assurance.

Just this past week, one of Singapore's government-linked companies has been accused of greenwashing, essentially using financial engineering (or perhaps more aptly called "emission engineering"). It sold 2 coal-fired plants in India, with deferred payment for 15 years and up to 24 years, which can be waived after 24 years. The plants will continue to be run by the same employees, and a

subsidiary of the GLC will provide supporting and advisory services to the buyer under a technical services agreement. The transaction allows the GLC to report a 38% reduction in GHG intensity rate, and avoid a higher interest rate on its sustainability-linked bonds. It has become very embarrassing as it has been reported in all the major international media. I am sure every transaction of this GLC that claims to be part of going from brown to green will be closely scrutinised.

With that, I would now like to hand over to Chris Hodge, my fellow advisory board member.

CLOSING REMARKS - 2



Chris Hodge is an independent advisor on governance and regulation working with organisations including the Institute of Directors in the UK and the International Corporate Governance Network. He is a member of Hawkamah's Advisory Board.

For ten years, Chris was Director of Corporate Governance at the Financial Reporting Council in the UK. In that capacity he was responsible for developing and promoting the UK Corporate Governance Code, and for introducing the first national stewardship code for investors.

Chris established, and chaired until 2015, the European Corporate Governance Codes Network which shares information and good practice among the bodies responsible for codes in 28 European countries. He also chaired the Global Stewardship Codes Network, which brings together bodies from 18 markets.

In his closing remarks, Chris focused on the implications of ESG for boards.

There are two recurring themes in the panel discussions today that I want to highlight.

The first is that the greater focus on sustainability and the environmental and social aspects of ESG represents a significant increase in the board's responsibilities, and is substantially different from thinking only about governance.

Governance can help to support the company's strategy, but it does not determine what that strategy should be. But for many companies ESG and sustainability are becoming one of the main drivers of the strategy and business model, as we have heard today.

Another difference between governance and ESG is the scope and complexity. Good governance is by no means easy to achieve, but there are a finite number of factors that boards need to think about. The list of environmental and social issues that boards might need to grapple with is much, much longer.

It is not feasible for boards to address all those issues so it is important to prioritise and identify the aspects of ESG that are most material to the company's future performance. But you should bear in mind that others may not share the board's views on what is and what is not material.



That is certainly the case with investors. I recently spoke to the company secretary of one of the largest listed companies in the UK and they said that, apart from climate which is a universal concern, all of their major shareholders had different ESG priorities.

These can be influenced by the risks they are exposed to across their portfolio and by the views of their clients. If the move to pass voting rights back down the investment chain to clients that Stephen Davis referred to in his opening remarks becomes more widespread then that is likely to exacerbate the issue.

Similarly, regulators' priorities will include ESG issues that are material to the national or regional economy as a whole or that have the biggest social impacts, which may not be the same as those that are most material for your company.

It is important that boards keep themselves informed of external developments that impact on the company – including how new

and existing competitors are adapting their business models in response to ESG issues – and engage with regulators and investors to explain the company's approach.

The second recurring theme is that there is a lot of uncertainty on all sides, which adds to the challenge for boards.

As we heard in the first session today there are a multitude of different ESG rules and standards, making them currently a source of confusion not clarity.

The first steps have been taken towards agreeing a global approach but that is still a long way off, and may perhaps never be achieved.

Many investors are still trying to work out how to integrate ESG into their investment and stewardship policies. In my experience the members of the investor panel, who all had a clear idea of how to do so, are the exception rather than the rule.

As we have also heard today, one of the most significant uncertainties is the quality of data that all parties – boards, investors and regulators – are relying on when they make decisions. This is a developing industry but the methodology used by many of the ESG ratings agencies and research providers is still unclear.

I wish I could tell you all that all of these uncertainties are on the verge of being solved, and that at next year's conference we will talking about them in the past tense. But that is far from being the case. There is a lot to do, and collaboration will be key.

All the groups we have heard from today – regulators, investors and boards – are facing a shared challenge. From the board's perspective, that challenge is how to ensure the company will adapt in order to prosper as part of a sustainable economy and planet.

So I will finish by repeating my message about engagement. Over the next few years regulators and investors will be taking many more decisions on different aspects of ESG that will directly affect companies. As a former regulator, I know from experience that those decisions will be better targeted and more effective if business gets involved in the process. Give the scale of the shared challenge, that is to everyone's benefit.



