حوكمة

THE HAWKAMAH JOURNAL

Governance of sustainability
Articles by Mak Yuen Teen and Maria Luiza de Oliveira Pinto e Paiva

Recent developments in ESG
Articles by Stephen Davis, Mike Lubrano and Fianna Jurdant

Stakeholder perspectives on ESG
Articles by Cathrine de Coninck-Lopez, Shameela Soobramoney and Chris Hodge

A JOURNAL ON CORPORATE GOVERNANCE & LEADERSHIP

ISSUE 21

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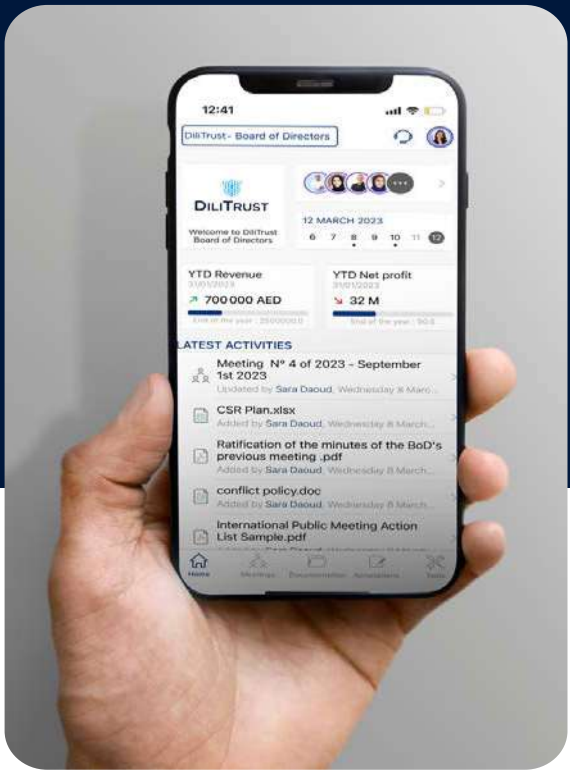

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FOREWORD

Dear Reader,

This 21st issue of the Hawkamah Journal focuses on ESG. This is no longer a “nice to have”, but rather a “must have” for corporates.

The global ESG landscape is evolving at a rapid pace. Investors, customers, regulators, and other key stakeholders are expected to continue to demand corporate responsiveness on ESG issues.

The Middle East and North Africa region has also witnessed significant ESG momentum, as highlighted by hosting of COP27 in Egypt and COP28 in the United Arab Emirates, and Boards of region’s companies increasingly recognize the need to address critical ESG issues. Regional regulators have also been requesting for more ESG reporting from listed companies and financial institutions.

This Journal examines ESG from the perspective of companies and their boards on how to tackle ESG with a particular focus on the governance arrangements around sustainability.

We are delighted to feature prominent international experts discussing various aspects of these developments, such as the role of the board in sustainability, the role of the chief sustainability officer, what reporting framework to follow, understanding institutional investor expectations, etc.

I wish you a stimulating read.

Dr Ahmad Bin Hassan Al Shaikh
Chairman
Hawkamah Institute for Governance

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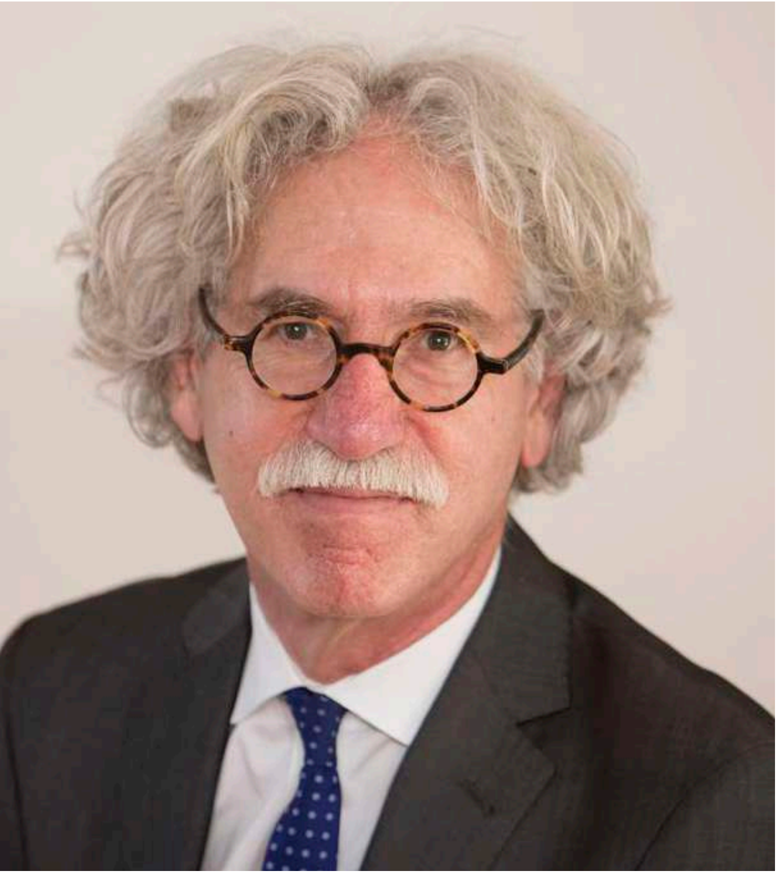
BEYOND ESG[1]



***Stephen Davis**, Ph.D. is a senior fellow at the Harvard Law School Program on Corporate Governance and was founding chair of the independent Oversight Committee monitoring 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 and Chair of Hawkamah's Advisory Board.

In the 1600s, when modern accounting was invented, doctors in Europe still applied leeches on patients' bodies to cure all manner of disease. But just as health care has transformed since then thanks to technology and expanding knowledge, the worlds of business and finance have constantly updated tools they use to gauge risk and opportunity.

Accounting measures applied four hundred years ago are not the same as those deployed today. Equally, factors understood to contribute to success or failure of companies have altered radically over time.

That is why, over the past two decades, corporate executives and investment professionals alike, from markets as diverse as the US, EU, and the GCC, have increasingly embedded environmental, social, and governance risks into corporate assessments.

These so-called ESG metrics seek to capture critical modern threats and opportunities such as climate change, human capital management, and board effectiveness, and put them on information dashboards for corporate directors and asset managers to consider.

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1 *This article is based on a piece the author posted in June 2022 on LinkedIn, drawing 39,000 views, 118 comments, and 21 reshares. Accessible at www.linkedin.com/posts/stephen-davis-6282424_360investing-activity-6931001273143934976-ho5w?utm_source=share&utm_medium=member_desktop.*

Studies have long shown that when directors and asset managers integrate these factors smartly in decision-making, they can make material contributions to value creation and sustainability. Not surprisingly, therefore, the latest data show that business and finance perceive ESG not as a political tool but as an important, pragmatic lens for handling risk.

At the same moment, however, there is rising recognition in markets that the time may be right to move beyond the use of ESG as a financial term of art in order to best reflect deeper insights business leaders have earned following two decades of applying that lens.

First, a word of context. ESG was conjured in 2005 as shorthand for three factors tagged then as “intangibles”, that is, those lying outside the conventional scope of quantifiable risks companies faced. But back then few had any idea how to measure, let alone manage, how a corporation or an investment institution might deploy ESG in everyday work. Worse, research was scant and divided on how ESG factors might relate to long-term success. If investors or companies opted for an ESG lens two decades ago, it was largely out of conviction born of ethics or guesswork.

Today what was once intangible is now the subject of a web of technical disclosure rules and standards, matched by a vast and growing industry devoted to calculating the precise effects of ESG on business and fund success. Want to see how a company is faring compared to peers on water usage, energy efficiency, employee turnover, accident rates, or community trust? There are troves of big data on that. Want to see the level of a mutual fund’s exposure to greenhouse gases? Somebody is computing it.

Moreover, more research—while it is hardly unanimous — has shown that attention to ESG factors can reduce costs and risks, bolster resilience, improve long-term performance, and even produce better outcomes while navigating crises such as the pandemic. No wonder, then, that some 80% of large global corporations now apply ESG reporting standards, while ESG investing strategies draw more than USD 20 trillion in assets under management. Indeed, the financial payoffs of ESG now mean that it is embedded in nearly every nook and cranny of the capital market. Just one telling example: Insurers increasingly give corporate boards discounts on premiums if directors better manage ESG risks.

Regulators worldwide are not far behind. The US Securities and Exchange Commission (SEC) is finalizing new rules that would give shareholders fresh corporate data on ESG factors. Even if these proposals were somehow derailed by courts or legislation, large US companies doing business in Europe will have to comply with the EU's Corporate Sustainability Reporting Directive (CSRD), which came into force in January 2023 and which requires similar information.

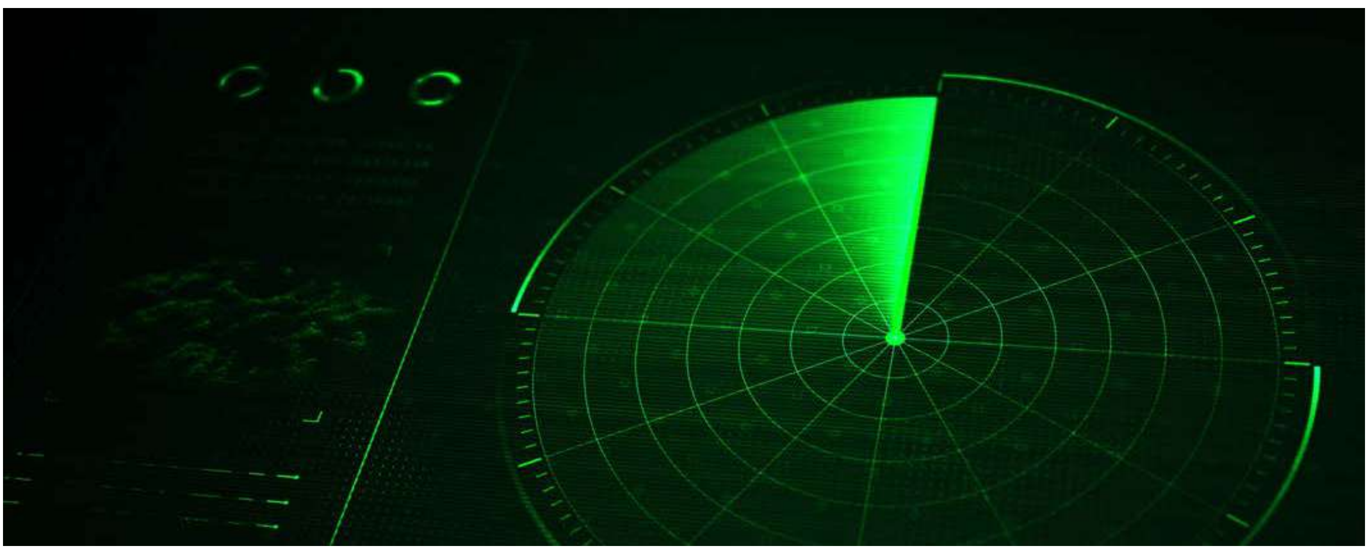
The bottom line: the link between good stewardship of ESG factors and market success is so conclusive, and is now underpinned by so much hard data, so much infrastructure, and so many rules, that there is an almost inescapable fiduciary duty on corporate directors and financial agents worldwide to keep it on radar screens. There is no going back.

And yet, factions have arisen recently on the fringes of the political arena, largely in the US but increasingly elsewhere too, that see partisan advantage in branding ESG as "woke capitalism." They call for a return to conventional measurements of risk and opportunity free of ESG analytics. Texas Comptroller Glenn Hegar, to cite one example, declared that the "(ESG) movement has produced an opaque and perverse system in which some financial companies no longer make decisions in the best interest of their shareholders or their clients, but instead use their financial clout to push a social and political agenda shrouded in secrecy." The Heritage Foundation's Patrick Tyrrell wrote that "Environmental, social, and governance responsibility…is an example of the left overstepping its bounds and expanding the political realm into the farthest reaches of society while simultaneously demonizing and mischaracterizing people who disagree with its bossy, woke explanations of how things are." In some cases, decriers have been able to engineer state laws aimed at restricting ESG investing.

These critics' remedy, which is to revert to pre-ESG analytics, would be the financial equivalent of medicine returning to leeches.

As noted earlier, tools developed to meet ESG demands have handed corporate managers and investors detailed fresh insights into ways to create long-term value and curb costs and risks. That's a critical advantage for blockholders, customers, employees, and millions of savers who rely on stock returns for their retirement. What's more, what companies and shareholders can now see through ESG metrics can't magically be unseen.

Indeed, shifting to analysis that actively blinkers executives and fund managers from taking into account certain material factors risks consigning companies and savers into



a slow lane of growth compared to peers, if not failure. That's not what the capital market is about.

To be clear, the debate over ESG is, again, taking place almost wholly in the field of partisan politics. In business and finance, by contrast, the debate is largely settled: ESG factors are material. Of course, companies and investment funds worldwide must always keep an eye on stakeholder critics. But many have come to realize that they must remain laser-focused on strategies vital to value creation over time. And they are doing just that, notwithstanding detractors. Management consultancy Teneo, for instance, found in a 2023 survey of 250 large US public corporations that "By any metric that we tracked, companies remained resolute on their ESG priorities despite the political rhetoric. Almost 80% of companies disclosed that all their ESG goals were on-track. CEOs still signed or co-signed 95% of report cover letters. Average length of 2023 sustainability reports increased by 6%. Even the use of the 'ESG' acronym increased by about 20% from last year – with more companies including ESG in the report title (eight) than removing it (five)."

On the investor side, efforts by critics to attract capital to anti-ESG funds have fallen flat. Some 26 such funds count just USD 2.1 billion in assets—a small fraction of the amount credited to ESG funds, according to a 2023 Morningstar report. Critics' efforts to draw votes to anti-ESG shareholder proposals filed at companies in the US show equally dismal outcomes. One mid-year tracking report found support dropping from "last year's already meager 3.5 percent" to 2.8 percent as of 31 May 2023.

All that said, however, ESG-deniers are not the only ones with concerns over ESG, at least as an expression. Even many institutional investors have become uncomfortable with the term. With the universe of funds and companies claiming ESG credentials proliferating, the phrase could mean just about anything—or nothing deeper than a marketing gimmick. Plus, more risk factors have claimed attention that don't fit readily into typical ESG silos. Former Delaware Chief Justice Leo Strine has suggested amending the term to EESG, adding Employees. But is the solution to add another letter whenever an additional factor draws the spotlight? Finally, as co-authors Jim Hawley and Jon Lukomnik have argued in their seminal Moving Beyond Portfolio Theory, investors are more exposed than ever to market-wide risks well beyond the balance sheets of specific companies. ESG fails to capture that broader context.

The bottom line is that ESG as a term has become a lightning rod for ideologues while losing meaning for many others—even as the substance of what it stands for is more vital than ever. How about shifting to a new phrase that returns to the original concept, which is ensuring that both investors and companies take account of risks and opportunities that lie outside conventional accounting? Call it, for corporate executives, "**360° management**" or, for financial bodies, "**360° investing**". That expression would signal a style that looks at the full range of insights—including ESG, but also others—rather than the old approach of wearing blinkers against ESG factors for fear that they were outside the scope of business. Further, the phrase would avoid narrow definitions under an acronym with a lengthening parade of letters.

For companies and investors, the point of ESG has always been to look at all insights relevant to a market in order to underpin a company's future or to fulfill fiduciary duties. When the meaning of the "ESG" moniker deteriorates so that it threatens that goal, it is time to consider switching names while preserving practice. Boards and funds may wish to try "360° investing" or "360° management". The change might not satisfy political detractors. But it is what was meant all along.

THE BOARD'S KEY PRIORITIES FOR SUSTAINABILITY

*Professor **Yuen Teen Mak**, PhD, FCPA (Aus.), is Professor (Practice) at the NUS Business School, National University of Singapore, where he specialises in corporate governance. He has served on three of the four corporate governance committees set up by the Singaporean authorities since 2000 to develop and revise the Singapore Code of Corporate Governance for listed companies, and currently serves as a member of the Corporate Governance Advisory Committee under the Monetary Authority of Singapore.*

His recent research in the area of sustainability covers issues such as the integration of ESG factors into executive remuneration, sustainability governance structures and practices, board oversight of climate risks and opportunities, and materiality assessment of sustainability-related factors. He teaches a masters course on corporate governance and sustainability at the university and a program on remaking corporate governance for an ESG world for company directors in Malaysia. He is a member of Hawkamah's Advisory Board.

Following the global financial crisis 15 years ago, many countries around the world began paying greater attention to sustainability and the interests of a broader group of stakeholders. By around the mid 2010s, sustainability reporting requirements for listed companies had been introduced in many countries. Nevertheless, these developments have occurred largely separately from reforms of corporate governance rules, although some principles and guidelines on sustainability started appearing in corporate governance codes.

Although the first edition of the OECD Principles of Corporate Governance issued in 1999 has a principle on "The Role of Stakeholders in Corporate Governance", the main stakeholders that were considered then were investors, employees, creditors and suppliers. Today, businesses have to consider a larger group of stakeholders, including the environment and community, and how these stakeholders affect their operations and vice versa.

It is arguably overdue that the latest G20/OECD Principles of Corporate Governance released in October 2023 has now replaced the earlier principle on the role of stakeholders with a new principle which addresses the rights and interests of a larger group of stakeholders that affects an organisation's sustainability and resilience.

Malaysia was one of the first countries in the world to integrate sustainability considerations into its corporate governance rules in a substantive manner, which it did so in the Malaysian Code on Corporate Governance issued in April 2021 (MCCG 2021). One of the three key objectives of this latest revision was to "strengthen board oversight and the integration of sustainability considerations in the strategy and operations of companies".

Boards have a key role to play in guiding companies on their sustainability journey and should ensure that existing policies and practices at the board level and throughout the company are aligned with the focus on sustainability and the wider interests of stakeholders.

Taking responsibility and putting sustainability in the board's agenda

A poll of more than 140 directors of Malaysian companies conducted by the author in October 2023 found that 75% said that their boards have discussed the impact of climate risk on their business more than once in the last 12 months, with another 14% having discussed it once. 64% said that they are already seeing the impact of climate risk on their business, with another 32% expecting to see it in less than 10 years. One third of the directors said that integrating climate considerations into their company's strategy helps manage business and reputational risk; 32% said that it is the right thing to do; 23% said it is important for shareholders, customers and employees; and 12% said it is a regulatory obligation.

The sustainability reporting standard IFRS S1 issued by the International Sustainability Standards Board (ISSB) states that companies should disclose "how responsibilities for sustainability-related risks and opportunities are

reflected in the terms of reference, mandates, role descriptions and other related policies applicable to that body(s) or individual(s).

It is important for boards to recognise that overseeing the impact of climate change and other aspects of sustainability relating to their business is part of their responsibilities. These issues should be an important part of the board agenda.

Ensuring appropriate competencies for the board and senior management

Boards should review the board skills and diversity matrix (BSDM) used for their search and nomination process for directors. It is not just a matter of adding “sustainability” into the matrix but ensuring that the sustainability competencies are aligned to the most material sustainability-related risks and opportunities relevant to the company. A 2019 report by the NYU Stern Center for Sustainable Business, based on a study of 1188 Fortune 100 board directors, found that while 29% had relevant ESG credentials, most were under the “social” or “S” category and few had climate-related expertise.

Many companies now disclose a BSDM in their annual report and “sustainability” is a box that is often ticked for most directors. But how many of these directors are truly equipped to guide their companies on their sustainability journey?

Directors should also attend high-quality professional development programs relating to sustainability, as this area is constantly evolving. Boards also need to ensure that management and employees are adequately equipped with relevant sustainability-related experience and knowledge. IFRS S1 states the companies should disclose “how the body(s) or individual(s) determines whether appropriate skills and competencies are available or will be developed to oversee strategies designed to respond to sustainability-related risks and opportunities.”

To provide a dedicated focus on sustainability, more companies are appointing a Chief Sustainability Officer (CSO). Consulting firm Strategy& found that 30% of the 1,640 companies around the world in their 2022 study had a formalised CSO role and another 50% had a CSO with a limited remit.

Some issues that boards should consider regarding the appointment of a CSO include:

- Should the company appoint one?
- Who should the CSO report to?
- Should the CSO be a dedicated role?
- Should the company appoint an internal or external candidate?
- What are the desired qualifications and experience for the CSO?

Some companies are also supplementing the competencies of the board and management by co-opting external advisors, including forming external advisory panels.

Bringing in new skill sets at different levels of the company, starting from the board, can help overcome legacy issues, change mindset and improve effectiveness in addressing sustainability-related risks and opportunities.

Putting in place an appropriate Sustainability Governance Structure

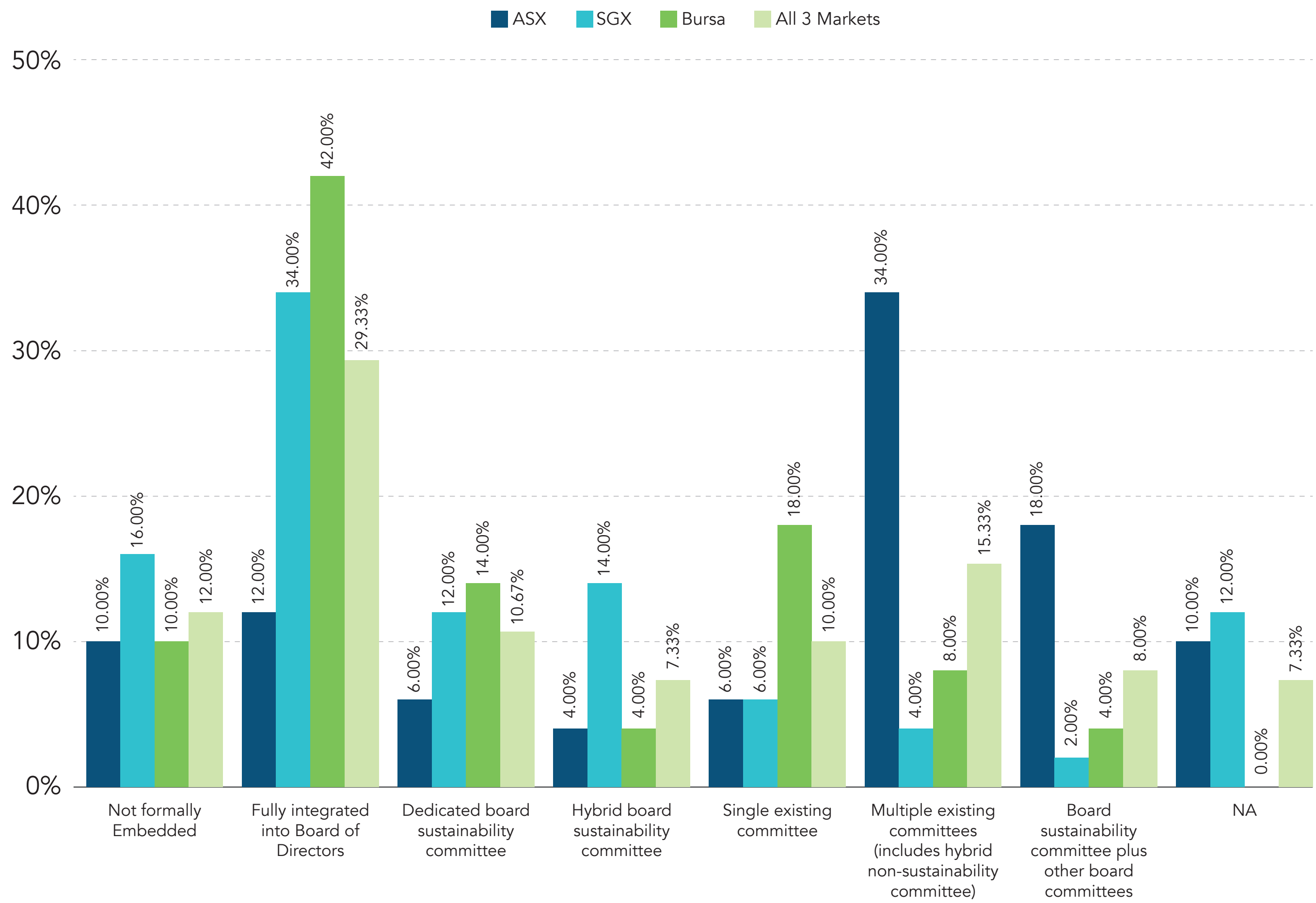
IFRS S1 requires companies to disclose "the governance body(s) (which can include a board, committee or equivalent body charged with governance) or individual(s) responsible for oversight of sustainability-related risks and opportunities."

A report by this author, published by Sustainable Finance Institute Asia and Governance for Stakeholders in February 2023, found a variety of sustainability governance structures that large listed companies in Australia, Singapore and Malaysia have put in place, as shown in the chart below.

There is no "one size fits all" as to what sustainability governance structure works best for a company. It is important that the company does not take a "silo" approach but instead ensures that sustainability considerations are fully integrated into the work of the board and board committees.

Materiality assessment of sustainability-related factors

One of the most critical activities that companies need to get right in effectively managing sustainability-related risks and opportunities is



the assessment of what sustainability-related factors are most material for the company.

The board should ensure that management is undertaking in-depth analysis, and review and challenge the materiality assessment.

There could be good reasons why the materiality assessment for a company is different from its peers in the same business as companies may have different business models and strategies. Nevertheless, it is useful for boards to ask for comparisons with peers and ensure that the company is not missing out blind spots.

Take the case of the four largest glove manufacturers in Malaysia. In 2022, many companies in this sector faced “forced labour” accusations from international NGOs and government authorities, with some facing export bans. The latest materiality assessments of these four companies were substantially different. While human rights, labour management and health and safety were rated as among the most material sustainability-related factors by two companies, environmental issues were almost totally absent from the most material factors. In contrast, another company had four climate-related factors listed among the most material, together with labour practices, workplace safety and product quality and safety. The fourth company included a mix of business performance, data security and social issues among the more material, with only one factor which is directly climate-related rated very low in the materiality assessment.

Some key questions that boards can ask about the materiality assessment process include:

- What is the process used in identifying material ESG factors?
- Which internal and external stakeholders are involved, how are they identified and prioritised, and how they did the company engage with the most important stakeholders?
- Have we benchmarked our materiality assessment against our peers, standards and other external sources? What are the reasons for the differences?

Integrating sustainability into the business

Boards should ensure that sustainability is integrated into the business, and a robust materiality assessment of sustainability-related factors is crucial for ensuring that this is done for those factors most critical to the company’s long-term survival and success.

In the Novartis Lecture in November 2021, Dr. Lutz Hegemann, Group Head Corporate Affairs and Global Health of Swiss-based global healthcare company Novartis, explained how Novartis’s materiality assessment underpins the integration of ESG into the company’s strategy. In its case, the social element is inherent to why it exists and is reflected in its purpose and mission statement.

For Novartis, the most important ESG factors are innovation and access to its medicines. Other elements such as safe and effective

medicines and running the business ethically are also very important. The environmental factor is important and Novartis recognises that it needs to consider how it can reduce any potential harm that its operations can do to the environment, but the company believes that this does not define the contribution it makes to society.

The most material ESG factors – innovation and access to its medicines - are then integrated into Novartis' business. Dr Hegemann shared how Novartis changed its business approach in Sub-Saharan Africa, home to the largest number of underserved patients. The company looked at how to make the biggest impact and measured that through patient reach, and included this metric into its decision framework, above all the traditional financial metrics. This approach also helped the company perform better financially, demonstrating that purpose and profit need not be a paradox.

Another example of integrating ESG into the business is the case of AET Tankers, an energy logistics solution company in Malaysia that provides ship leasing, management, and operation of petroleum tankers for transporting petroleum and crude oil to energy majors, refineries, and trading houses. For a company like AET Tankers, climate change is a key risk but also provides opportunities.

Among its business priorities are the energy transition and a sustainability plan for net zero by 2050. Colin Low, an independent director of the company, shared the plan that the board and management has developed to change its business model for the mid to long term through a number of developed climate change and sustainability initiatives, such as dual-fuel ships on new builds, progressive fleet renewal to decarbonised fuel, low-carbon or zero-emission vessels that are ammonia-powered, and investment in a digital venture company in Singapore for efficient fleet, spares management and ship operations.

Its strategic thinking for the long term recognizes that petroleum reserves are finite and therefore the company has to find a new business, whilst managing its energy transition and meeting the UN SDG goals. New areas of business may include renewable energy sectors that involve skill sets that can be transferred from the current petroleum logistics and ship leasing and management business, carbon capture and storage, zero-emission logistics, and logistics and transport of greenhouse gases.

Effective integration of ESG into the business also requires the board to ensure that material ESG factors are considered in the business plans; risk management framework and policies; setting of goals, metrics and targets; and other company policies and practices. Boards also need to ensure that there are adequate resources to support this integration.

Other issues

Other important issues and developments in this area that boards need to pay attention to include whether and how to link sustainability-related factors to executive remuneration, the use of third party assurance for sustainability reports, and greenwashing risks.

In summary, boards need to ensure that corporate governance and company policies and practices are fit for purpose in supporting their company's sustainability journey.

THE ROLE OF A SUSTAINABILITY OFFICER IN NAVIGATING CHANGE

***Maria Luiza de Oliveira Pinto e Paiva** is Vale's Executive Vice President of Sustainability. She began her career 36 years ago in Human Resources, and for the last 21 years she has been working in the area of sustainability.*

Before joining Vale, she was Sustainability Executive at Suzano and the Executive Director for Sustainability, Communication and Corporate Relations at Fibria Celulose. She previously worked as an executive at Banco ABN AMRO Real/Santander, she led the creation and implementation of the sustainability strategy, which has become a national and international benchmark. She led multicultural teams and projects during the periods in which she directed the HR area for Latin America, the Caribbean and Europe, always focusing on cultural transformation and leadership development.

In this article, she shares her insights on the role of the Chief Sustainability Officer (CSO).

I hold a degree in psychology and have spent twenty years in leadership roles in sustainability and human resources at large companies, both in Brazil and abroad, across various sectors, including finance, pulp and paper, and now mining. Throughout my career, I have realized that a sustainability executive's goal should be to become "biodegradable".

Let me explain: as sustainability awareness grows amongst various roles, and company departments mature, the sustainability executive's role gradually diminishes until it disappears. Our ultimate contribution should be to guide the integration of social, environmental and governance agendas into daily operations, business strategy and operation models - until our role is obsolete.

But this is no easy feat. It can take quite a while to achieve, especially considering that we are working with a moving baseline. As our collective conscience, standards, and best practices continuously evolve, or become more rigorous over time, what was considered "good" performance yesterday won't necessarily meet today's criteria. Catching up, or even keeping up, to these standards will require more work, more innovation, more integration, more collaboration, and new solutions and novel ways of doing business to ensure business competitiveness, resilience, and relevance over time. We need to be vigilant to identify and interpret stakeholder signals and to anticipate trends further embedding these into the business.

The role of the sustainability executive is key to driving relationships of trust on behalf of the company and balancing the interests of different stakeholders, which can include shareholders, customers, employees, investors, suppliers, communities, and regulators, amongst others. It's a job that requires active listening, open dialogue, understanding different perspectives, meaningfully engaging with stakeholders, and influencing in situations where perfect agreements and consensus are rare, and where the interests involved are often divergent.

Regardless, truly understanding the context within which we do business, how it affects stakeholders, and how it can impact and generate new demands, provides the foundation upon which companies should work to tackle challenges, resolve disputes, and even co-create win-win business opportunities with our stakeholders.

Whilst having these conversations, two essential elements are needed, even when they don't seamlessly align. The first is a deep understanding of the business strategy, its underlying model and its connection to the broader societal issues. The second is the clarity that sustainability isn't necessarily the primary focus of these discussions. Instead, it should be seen as a means to interpret and analyze various perspectives and stakeholder demands, all while considering the company's competitive position and the inherent risks and opportunities for its operations and overall value chain.

Environmental, social and governance pillars

Sustainability integration must embed social and environmental dimensions into the decision-making, from the Board of Directors cascading down to the operations themselves. This requires strategic governance oversight and implementation. Therefore, effectiveness will be measured by our ability to directly mobilize the different hierarchical levels in favor

> ***"A sustainability executive's goal should be to become 'biodegradable'"***

of the social and environmental objectives, as well as the mitigation of ESG business risks. Furthermore, companies should use clear metrics and Board supervision to monitor these topics over time. These metrics should affect executive compensation, encouraging progress.

The CSO, as the entire C-suite, needs to be aware of their role in driving financial results and creating value in the broadest and intangible of senses. This involves advancing social and environmental performance, believing that it is crucial to the business' competitiveness and longevity. The sustainability executive should ensure that these two concerns coexist.

A commitment to transparency will be conducive to mature environmental and social governance. Understanding the importance of accountability, aligning with the standards and certifications required by markets and society, and having a strategic communication strategy that shares both highlights and challenges with humility, will prevent greenwashing. These are actions that the CSO can help to influence and implement to enhance the company's reputation and overall image with its stakeholders.

Management of risks, impacts and opportunities

Sustainability is intrinsically related to business' risks, impacts, opportunities, and ultimate legacy. The CSO contributes to building corporate resilience by developing strategies that identify and consider long-term social and environmental risks and opportunities. This involves fostering relationships and managing these issues along the value chain, considering suppliers' and customers' operations, as well as in process, product and service innovation to meet future needs. The CSO must invest time in tailoring the sustainability agenda to investors and customers, since they are influential within the business and are interested in its overall success.

One of the great misunderstandings that exists is the idea that sustainability necessarily implies increased costs or philanthropic initiatives. Instead, I have implemented strategies in my career that have not only reduced costs but have also driven innovation directly tied to the business. The CSO should explore these opportunities in a changing world, helping the company to differentiate itself in the market, bringing in long-term investors, and attracting both conscientious customers and talents who are committed to the same purpose. A company engaged with sustainability should become more attractive to customers, suppliers, employees, communities, shareholders and investors, which, in turn, increases its competitiveness and business resilience.

Beyond business as usual

The way we present sustainability-related risks and opportunities internally can make a significant difference. It can either lead to active, committed, and strategic incorporation by different departments or result in a perception of more work, extra efforts and increasing reporting requirements. Sustainability teams must fight the temptation to centralize actions, and instead insert agendas into other existing forums and efforts, thus creating an enabling environment for different departments to work towards sustainability targets, fostering collaboration and accountability. For example, procurement teams must effectively address sustainability issues in the supply chain to ensure resilience against future supply chains disruptions and mitigation of risks such as potential human rights violations.

For the CSO's function to really be "biodegradable", the executive needs to both exercise and encourage adoption of systemic thinking within and throughout the organization. After all, this is the only way to ensure sustainable development, and produce in a way that meets our present needs without compromising the ability of future generations to meet their own needs.

The CSO plays a pivotal role in driving change processes to embed sustainability into business by increasing awareness and changing attitudes. However, until this transformation becomes a reality and the CSO role truly becomes obsolete, there will be years of work, construction, interpretation, innovation, education, communication, collaboration, transparency and continued improvement to ensure diverse, comprehensive, systemic, accessible and competitive business.

WHAT BOARDS NEED TO KNOW ABOUT SUSTAINABILITY REPORTING

***Mike Lubrano** is Managing Director of Valoris Stewardship Catalysts, a firm that helps investors and portfolio companies improve corporate governance, investor stewardship and sustainability performance.*

From 2007 to 2019, Mike was Co-Founder and Managing Director, Corporate Governance and Sustainability, at Cartica Management, an Emerging Markets active-ownership fund manager. Prior to that, he worked at International Finance Corporation (IFC), where he established and led IFC's Corporate Governance Unit, which developed the methodology for analyzing and improving the governance of portfolio companies that has since been adopted by virtually all development finance institutions.

In this article, Mike discusses recent global developments in sustainability reporting frameworks, standards and guidelines and what they mean for Boards and investors.

Corporate managers and Boards of Directors have for too long lamented the convoluted and confusing landscape of sustainability reporting frameworks, standards and guidelines. "A hundred flowers bloomed" in the field of sustainability reporting over the past decade and a half, leaving potential users uncertain about which to pick.

Executives and Directors still frequently cite the overlapping and sometimes contradictory schemes for disclosing environmental, social and governance (ESG) information to explain why their companies' reporting isn't more comprehensive when investors complain about gaps in disclosure and incomparability between companies.

The field remains complex. We can expect that sustainability reporting will always involve a certain amount of art with its science - with no one single universally accepted way to do it. What we at Valoris see as the end goal is a topography through which each company can navigate - to convey an accurate and complete view of its material sustainability challenges and opportunities, its approach to addressing them, and its performance against meaningful indicators. In our view, developments in the past two years mark the beginning of the end to corporate (and investor) confusion and skepticism around reporting schemes. The acknowledgment by key players that harmonization of sustainability reporting is urgently needed is really more than

lip service, and the consolidation of important standard setters will accelerate the process. To paraphrase one thoughtful commentator, what used to look like confetti on the floor after a party, now is more like pieces of a jigsaw puzzle.[1]

While it is still a ways off, we are beginning to approach a point where the puzzle is one that can be solved for the vast majority of Boards and management. Today, Valoris advises our institutional investor clients to up their expectations of portfolio company sustainability reporting.

Before elaborating on why we believe the pieces are there for companies to move ahead more rapidly on quality sustainability reporting, here is a brief explanation of the definitional landscape of sustainability reporting mandates, frameworks, standards and guidance.

1 Comments at the OECD-Asia Roundtable on Corporate Governance, October 11, 2023. Chatham house rules in force.

Mandates

Some jurisdictions impose legal and regulatory requirements that oblige certain companies (usually listed and sometimes also large unlisted firms) to report general or specific information on their environmental or social practices and impacts. Some mandates are imposed principally for the purpose of increasing financial market transparency around sustainability issues. Others are designed with the interests of non-financial stakeholders in mind, but with the side effect of giving investors insights into companies' risks, performance and impact.

The European Union's Corporate Sustainability Reporting Directive (CSRD), which came into force at the beginning of 2023, mandates that a broad range of listed companies, and large privately-held firms, disclose information on sustainability for the benefit of investors and non-financial stakeholders. Under CSRD, companies will report in accordance with European Sustainability Reporting Standards (ESRS) developed by an independent multi-stakeholder body, the European Financial Reporting Advisory Group (EFRAG).

Importantly, the EU and EFRAG have committed to reducing sustainability disclosure-related costs for companies by harmonizing the information to be provided with other global frameworks and standards, for example those of the Task Force on Climate-Related Financial Disclosures (TCFD, see below).

Frameworks

These are principles-based norms for how companies should organize and present information related to their sustainability risks, performance and impact. Frameworks are intended to provide issuers leeway to select for themselves the specific standards they should rely on to determine what topics to cover and what indicators and metrics to include in their disclosures.

Some frameworks, like the <IR> framework of the International Integrated Reporting Council (IIRC), are intended to be comprehensive, while others, for example TCFD and the Taskforce on Nature-related Financial Disclosures (TNFD), focus on how to present topic-specific information.[2]

Some companies organize their sustainability disclosures in whole or in part along the lines of statements of aspirational objectives, such as the UN Sustainable Development Goals (SDGs) or more targeted guidelines such as those issued by the Organisation for Economic Cooperation and Development (OECD).[3]

We have always been skeptical of sustainability reporting organized around the SDGs. To us, comparing a company's practices with reference to a statement of such broad objectives lends itself to cherry-picking, with companies focusing on those areas where they look good, and ignoring those where their activities are less aligned.

Standards

Standards are norms, or sets of norms, that lay out which sustainability topics are material for particular sectors and industries and what metrics should be used to indicate a company's exposure to sustainability risks, performance and impact.

As already noted, the ESRS are the standards to be applied by companies subject to the EU's CSRD. Particularly in the United States, the Sustainability Accounting Standards Board (SASB) was perhaps the best-known provider of a comprehensive set of standards for ESG disclosure, until the issuance by its successor, the International Sustainability Accounting Standard Board (ISSB) of IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2 Climate-related Disclosures this past July.

Guidance

Influential organizations sometimes issue recommendations, generally principles-based, for how companies should go about the selection and application of reporting frameworks and standards. Stock exchanges in particular have been active in the development of practice guides to assist listed companies in their efforts to provide more actionable disclosure around sustainability issues. Examples include NASDAQ's ESG Reporting Guide and the Japan Exchange Group and Tokyo Stock Exchange's Practical Handbook for ESG Disclosure.

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2 As noted below, the IIRC merged in 2021 with the Sustainability Accounting Standards Board to form the Value Reporting Foundation, which subsequently combined with the International Sustainability Standards Board.

3 See OECD Guidelines for Multinational Enterprises.

Putting the Pieces Together

To our minds, the establishment of the ISSB, and its expeditious issuance of IFRS S1 and S2 are landmark events in the harmonization of ESG reporting.

ISSB's mandate is to become the global standard setter for sustainability disclosures for financial markets in the same way that its International Financial Reporting Standards Foundation sister institution, the International Accounting Standards Board (IASB), has established itself as the standard setter for financial accounting disclosure.

Like IASB-issued financial reporting standards, IFRS S1 and S2 are directed first and foremost to the needs of investors and financial markets, applying a market-centric definition of materiality, as SASB's standards did. But ISSB's multi-stakeholder consultative process, and its goal to be the undisputed standard setter will, in our view, ultimately result in standards that also respond to the information needs of stakeholders besides investors.

The endorsements and positive responses from financial markets regulators and others to its General Requirements for Disclosure of Sustainability-related Financial Information (IFRS S1) and its Climate-related Disclosures (IFRS S2) sound to us less like lip service and more like broad recognition that the time has come for a globally-accepted framework and standard.[4]

The assurance industry is a complementary force for global harmonization. On August 2, 2023, the International Auditing and Assurance Standards Board (IAASB), issued for public consultation its proposed International Standard on Sustainability Assurance (ISSA 5000). The consultation draft of ISSA 5000 recognizes that sustainability assurance is still in a nascent phase. Accordingly, it provides guidance around provision of both limited and reasonable assurance of sustainability disclosures, and its intention is to apply to assurance provided by both audit and non-audit firms (and the involvement in the sustainability assurance process of specialized environmental and technical expertise). We believe the dynamics of greater demand for assurance (driven in part by regulators and market demand) and the quality of IFRS S1 and S2 create a virtuous cycle of practical solutions to the sustainability reporting challenges facing companies and investors.

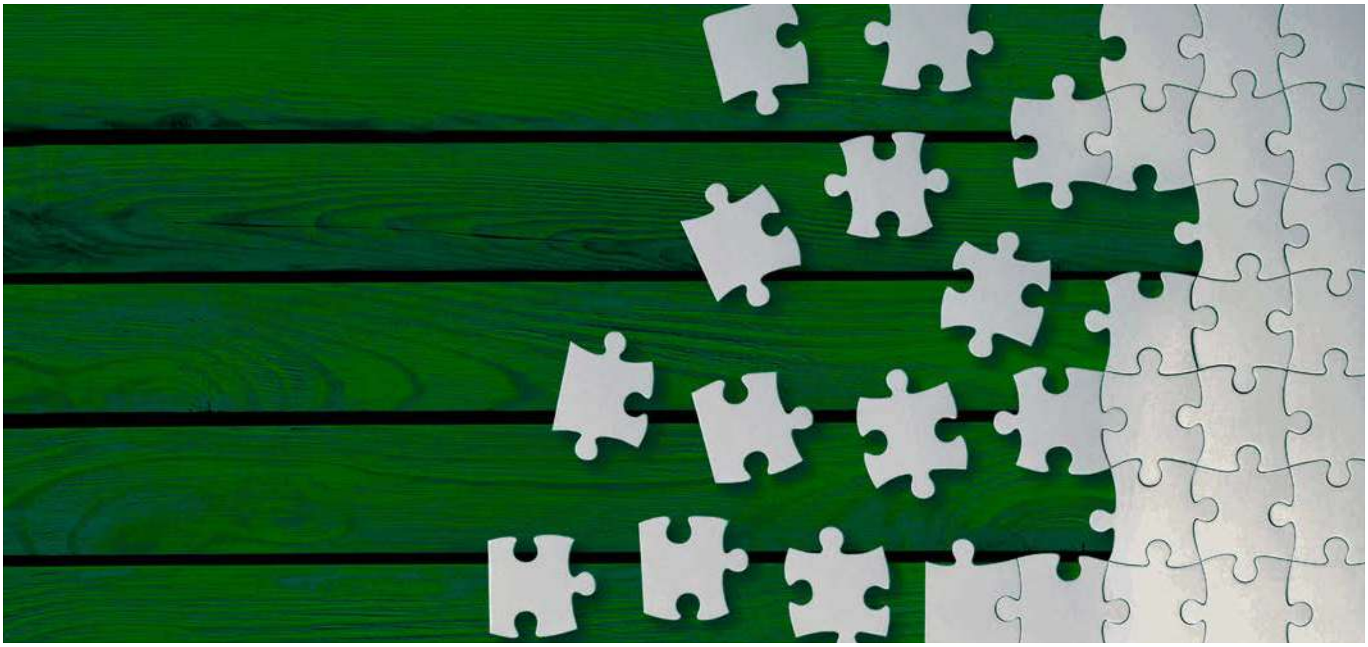
> *"The establishment of the ISSB, and its expeditious issuance of IFRS S1 and S2 are landmark events in the harmonization of ESG reporting."*

Rapid consolidation among standard setters themselves is another reason for optimism. This process accelerated with the merger of SASB and IRRC into the Value Reporting Foundation (VRF) in June 2021. Later that same year, VRF and the Climate Disclosure Standards Board (CDSB) announced their intention to consolidate their staff and activities into the ISSB. This process was completed in 2022. The innovators and activists (the hundred flowers) are now part of the International Financial Reporting Standards establishment. This has entailed a period of continuing compromise (and probably no small amount of adjustment by activists).

While there will remain certain differences between IFRS sustainability standards and ESRS, we believe these will narrow over time under pressure from regulators, multinational companies, international investors and the audit and assurance industry.

4 *IOSCO endorses the ISSB's Sustainability-related Financial Disclosures Standards*

Mandates	Organization	Focus area
The European Union's Corporate Sustainability Reporting Directive (CSRD)	European Union	A broader set of large companies, as well as listed SMEs, are required to report on sustainability in accordance with ESRS (see below)
Frameworks		
<IR> framework	Previously the International Integrated Reporting Council which merged in 2021 with the SASB to form the Value Reporting Foundation, which subsequently combined with the International Sustainability Standards Board	Integrated reporting - encourages organizations to communicate their value creation story by integrating financial and non-financial information in a cohesive manner
Task Force on Climate-Related Financial Disclosures (TCFD)	TCFD	Climate-related financial risks
Taskforce on Nature-related Financial Disclosures (TNFD)	TNFD	Nature-related financial risks
UN Sustainable Development Goals (SDGs)	United Nations	A set of 17 goals addressing various global sustainability challenges
Standards		
European Sustainability Reporting Standards (ESRS)	European Financial Reporting Advisory Group (EFRAG)	Currently 12 ESRS made up of two cross-cutting standards, which apply to all sustainability matters, and 10 topical standards covering a wide range of ESG matters
SASB Standards	Previously the Sustainability Accounting Standards Board. The Standards are maintained and enhanced by the International Sustainability Standards Board (ISSB); this follows the SASB's merger with the International Integrated Reporting Council (IIRC) into the Value Reporting Foundation (VRF) and subsequent consolidation into the ISSB	Industry-specific ESG issues
IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information	International Sustainability Standards Board - established by the IFRS Foundation	General requirements for a complete set of sustainability-related financial disclosures
IFRS S2 Climate-related Disclosures	ISSB	Topic-based standard that specifies disclosures relating to climate. Designed to applied in conjunction with IFRS S1



All this said, we don't want to come across as Pollyannas or excessively positive. This is not the end of history for sustainability disclosure. Significant tensions still exist around the purpose and content of sustainability disclosures. ISSB's point of departure is the demands of financial markets, while ESRS and mandates in other jurisdictions are frequently multi-stakeholder in origin. We find the CSRD's approach to governance very confusing. Our European investor clients are left between a rock and a hard place - obliged to report based on EU standards but with portfolio companies that would be better supported by focusing on IFRS standards only. Similarly, ISSB did not precisely follow TCFD's formulation on governance, without any real explanation.

There is still much to do. But we believe consolidation of standards and standard-setters, and growing expectations around assurance are gravitational forces pulling towards a workable convergence, and sooner rather than later.

Just two years ago, companies arguably lacked visibility around the direction of sustainability reporting. No longer. In most cases, management and Boards should begin their sustainability journey with reference to IFRS S1 and S2 (or ESRS if subject to the European regime), linked together with relevant national and industry-specific frameworks, standards and guidelines.[5]

Investors can now reasonably expect portfolio companies to clearly explain how they are building up their internal controls and related capacities to eventually support third party assurance of disclosure prepared along these lines. Ambiguities certainly remain. We are not there yet. But the jigsaw pieces are there, we can see the picture on the box, and with some trial and error, management and Boards can put them together.

5 *National sustainability standards boards have been established in important markets to support the adoption of ISSB standards, provide additional guidance for issues of particular importance in that market and reduce frictions between ISSB standards and local mandates and standards. See Canadian Sustainability Standards Board,* https://www.frascanada.ca/en/cssb

WHAT'S NEW IN THE G20/OECD PRINCIPLES OF CORPORATE GOVERNANCE

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Fianna has over 20 years' experience advocating sound corporate governance policies and practices globally. She has developed coalitions for reform, policy analysis and advice to support implementation of the G20/OECD Principles of Corporate Governance in Eastern Europe, Asia and the Middle East and Africa.

In this article, Fianna discusses the revised G20/OECD Principles which include a new chapter on "Sustainability and resilience" which provides recommendations to support companies in managing the risks and opportunities of the climate transition and other sustainability challenges.

For nearly 25 years, the G20/OECD Principle of Corporate Governance have served as a benchmark for good corporate governance in advanced and emerging economies. They have recently been revised to ensure that they reflect recent corporate governance and capital market evolution, to continue to guide countries in the years to come.

The most significant revision in the Principles is a new focus on sustainability and resilience to help companies manage climate-related and other sustainability risks and opportunities. Revisions also address new and updated guidance on, among others, shareholder rights, the role of institutional investors, corporate disclosure and transparency, and the responsibilities of boards.

"The revised Principles mark a significant, renewed international consensus and a strong desire from all OECD and G20 Members to strengthen guidance on companies' sustainability and resilience, to help them support the green transition and adapt to climate risks," OECD Secretary-General Mathias Cormann said, presenting the revised Principles on 11 September 2023. "They are the result of an intensive, collaborative process to ensure this important instrument remains the

This article does not necessarily reflect the official views of OECD member countries. The opinions and arguments expressed are those of the author.

global standard for corporate governance, and relevant to advanced and emerging economies alike, by reflecting different capital market trends in different regions."

"The Principles aim to help companies access financing from capital markets, protect investors, and make companies, and hence our economies, more resilient," said Japan's Vice-Minister of Finance for International Affairs Masato Kanda, who chaired the revision. "It was therefore important and timely that we substantially revised them to reflect the many recent evolutions in corporate governance and capital markets."

What are the key changes?

To start with, it is important to understand that the Principles aim to help policymakers evaluate and improve the legal, regulatory, and institutional framework for corporate governance. In turn, this will support market confidence and integrity, economic efficiency, and financial stability. In recent years, the consequences of climate change, rapid digitalisation, and geopolitical conflicts, have grown increasingly pressing. These developments have had enormous impacts on the private sector, testing corporations' adaptability and resilience, and raising the question of whether current corporate governance frameworks are fit for purpose. In this context, the Principles were revised to take into account a growing number of material financial risks, including climate change.

To promote sound corporate governance and well-functioning capital markets, key changes include:

- Promoting disclosure of sustainability-related information, clarifying the responsibilities of boards on sustainability matters, and recommending dialogue between companies and their shareholders and stakeholders on sustainability matters;
- Addressing the complex range of issues that boards are now expected to manage as part of its oversight of the company and its management, including diversity, risk management and the interests of shareholders and stakeholders;
- Encouraging the use of digital technologies in corporate governance practices and supervision and highlighting boards' management of digital risks;
- Considering the rise in the role of institutional investors through recommendations on stewardship codes and ESG rating and index providers as well as proxy advisors;
- Reflecting recent developments in ownership concentration, including through recommendations on company groups;
- Providing new recommendations on bondholder rights and debt contracts to address the increase in corporate debt.

To support and track implementation of the Principles, the 2023 edition of the OECD Corporate Governance Factbook was also published in September. Updated every two years and covering 49 major economies, this edition of the Factbook contains new sections that reflect the revised Principles, highlighting recent developments related to sustainability, digitalisation and company groups.

The Factbook shows that most jurisdictions have taken significant steps to promote disclosure of sustainability-related information using different approaches. For instance, 66% of listed companies in China disclosed sustainability-related information based only on a recommendation only whereas in Europe where this information is mandatory to disclose, 95% of listed companies complied.

This is motivated in part by government-led sustainability-related provisions but also the growing importance that investors are devoting to sustainability-related information.

What are the trends that defined the revised G20/OECD Principles?

First, the revised Principles reflect the role of corporate governance policies in **addressing climate-related opportunities and risks.** Already, companies representing 84% of global market capitalisation disclose some sustainability-related information. However, these companies represent only 19% of all companies listed globally, indicating that there remains substantial scope for further progress. The Principles' new chapter on "sustainability and resilience" provides a comprehensive set of recommendations on sustainability disclosure, recognising that the effects of climate change can represent a material risk for future performance. This includes recommendations for disclosure according to internationally recognised standards, such as sustainability metrics to accompany announced targets and subject to external assurance.

The Principles recognise sustainability-related disclosure as necessary for ensuring the efficiency of capital markets and in facilitating the exercise of shareholders' rights on an informed basis. All 49 jurisdictions surveyed for the Factbook reported having established specific requirements or recommendations for sustainability-related disclosure through law, regulation, codes, principles or listing rules. In 2021, almost 8 000 companies (out of 44,000) listed in 73 markets disclosed sustainability information.

The Principles highlight the importance of a dialogue between a company, its shareholders and stakeholders when it comes to sustainability and resilience. General shareholder meetings provide a key forum for a structured decision-making process by facilitating such dialogue. A growing number of jurisdictions have begun providing specific requirements or recommendations on various forms of ownership engagement.

In line with the expectations of both governments and investors, the Principles also clarify the role, rights and interests of shareholders, boards and stakeholders as companies undertake the transition towards climate-related objectives to reach net zero emissions. Notably, they emphasise the responsibilities of boards in ensuring that companies' lobbying activities are coherent with their sustainability goals. The Principles also reflect the important role that environmental, social and governance rating and index providers play in investment and governance decisions, recommending that the methodologies they use should be transparent and publicly available. This is particularly important when they are also used as metrics for regulatory purposes.

The Principles recommend enhancing boards' responsibilities in regard to sustainability considerations when making decisions. This reflects a shift over the past few years to take broader non-financial goals into account. Some jurisdictions (e.g. Brazil, China, Colombia, France, India and the United States) have amended their legislation to highlight the relevance of stakeholder interests (OECD, 2023). Boards are increasingly encouraged to consider the company's impact on sustainability-related and stakeholder considerations when making decisions.

Half of the 49 jurisdictions surveyed for the Factbook require or recommend that boards approve policies on sustainability-related matters, including sustainability plans and targets, internal control policies, and management of sustainability risks. Boards may establish a new committee or expand the responsibilities of an existing one to support these requirements and recommendations. Globally, companies representing half of total market capitalisation have a board committee responsible for sustainability (regardless of its name) (OECD, 2023).

A second trend reflected in the revised Principles reflect the **increasingly important role of institutional investors** in many economies, particularly in the US, UK and other advanced markets. They are the largest investors in stock markets globally – owning 44% of total market capitalisation. In parallel, the ownership of public companies is becoming increasingly concentrated in the hands of company groups and the state, particularly in Asian emerging markets. Thirty-six per cent of listed companies globally have a private corporation as their largest shareholder, an indication of a company group structure. At the same time, state-owned companies listed on stock markets now represent more than 11% of global market capitalisation. Finally, there is an increasing concern that capital markets today are better suited for larger companies. Each of these three trends has implications for corporate governance, and each has been reflected in the revised Principles.

The Principles recommend that governments promote the active engagement of institutional investors in the governance of their portfolio companies, for example through stewardship codes that clearly define how an institutional investor will influence their portfolio companies. With respect to company groups, the Principles call for transparency of company group structures and set out how related party transactions should be managed. This will help investors better understand who controls companies, and ensure their interests are protected when these companies engage in transactions with one another. The Principles apply equally to state-owned companies listed on stock markets, helping ensure a level playing field. The Principles can also help to facilitate access by SMEs to capital markets. For example, they now emphasise the importance of flexibility and proportionality measures that lighten regulatory burdens, where appropriate to support access to public financing for smaller companies.

Third, the revised Principles reflect the impact of the **digital transformation** on corporate governance. They set out how digital technologies can enhance board supervision and facilitate corporate governance, while also supporting regulatory compliance. And the revisions set out expectations for boards to effectively take account of digital risks, for example ensuring data security and providing oversight to prevent biases from being incorporated into algorithmic models supporting decision-making.

Fourth, the Principles better reflect **community expectations about diversity on boards and in executive positions.** They recognise the value of diversity, including gender, in board discussions to enrich discussions and avoid groupthink. Further progress in gender diversity is needed - women currently hold less than 30% of board positions across OECD and G20 countries. Governments can encourage further progress on diversity, including by requiring disclosures of gender composition of boards and senior management, and supporting initiatives such as mentoring networks.

How is this relevant to the MENA region?

Considering recent developments both at global and regional level such as the COVID-19 pandemic, concerns related to climate change, geopolitical tensions and supply chain disruptions, economic resilience is a top priority, which may help to address risks related to sudden capital outflows, job losses and high financial volatility. In this regard, a sound corporate governance framework and good practices are essential to promote transparent, well-functioning markets and build trust, which in turn would contribute to economic resilience, facilitate corporations' access to capital and foster innovation as well as sustainability.

Indeed, to develop deep and efficient capital markets, it is essential to establish a sound corporate governance framework which requires transparent disclosure practices, protection of shareholders' rights and effective risk management. This in turn can boost market confidence and reduce the risk premia requested by investors, facilitating corporations' access to capital markets. In this regard, a key consideration is capital market characteristics in MENA, which based on OECD analysis indicates relatively less-liquid markets compared to the world average, with the turnover ratio of domestic shares in the MENA region on average 23.3% in 2020 compared to 104% globally. Also, concentrated ownership is prevalent in the MENA region, as the public sector is by far the most dominant shareholder, holding 66% of the equity by market capitalization in 2022 higher than 11% globally. To ensure stable demand and market liquidity, a large and diversified investor base is crucial, which in turn contributes to the development of capital markets.

Therefore, the revised G20/OECD Principles are as relevant as ever also for the MENA region. Following long-standing cooperation with the MENA region, the OECD remains committed to further support countries as they update and adapt their corporate governance frameworks to closer align with the G20/OECD Principles and recent global trends and developments.

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NAVIGATING THE RESPONSIBLE INVESTMENT LANDSCAPE

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Cathrine joined HSBC Asset Management from Invesco, where she was Global Head of ESG. She started her career as a responsible investment analyst at Columbia Threadneedle Investments in 2008. Cathrine was a non-executive board member of the UK Sustainable Investment and Finance Association between 2018-2022.

The responsible investment landscape is changing. We have seen growth in assets managed against environmental, social and governance (ESG) criteria, significant regulatory interest as well as growth in data, technology and people dedicated to ESG investing. The United Nations (UN)-backed Principles for Responsible Investment (PRI) was launched in 2006 and has since grown to more than 5000 signatories representing $121 trillion in assets.[1]

In the MENA region we have seen local initiatives to establish capacity building and bring the industry together. The One Planet sovereign wealth coalition launched in 2017 following COP15, and the Abu Dhabi Sustainable Finance Declaration launched in 2019.[2] There are more than 100 signatories to this initiative and the principles include to:

1. Collaborate to create a framework for fostering and integrating green and sustainable investments in the Emirate of Abu Dhabi, the UAE and the wider region
2. Facilitate a constructive dialogue on sustainable finance between all stakeholders
3. Identify new and innovative measures, products and services
4. Encourage education
5. Raise awareness
6. Meet regularly

1 https://www.unpri.org/download?ac=18057#:~:text=The%20PRI%20now%20has%205%2C319,US%24121trn%20of%20AUM

2 https://www.adgm.com/initiatives/sustainable-finance/declaration

There are many areas of development and as boards and companies are trying to respond to fund manager questions, it is useful to reflect on what fund managers do to assess ESG developments by companies.

The three key principles to consider are:

1. What type of fund manager am I talking to?
2. What type of research are they trying to deliver?
3. What type of product are they managing?

There are many types of fund managers and their interests are not always the same. There are short and longer term investment horizons, different asset classes as well as different investment vehicle structures such as active or passive. This broad range of solutions means that there is a lot of choice for the end investor, but it also makes for a more complex investment landscape. A group of industry organisations including the CFA and the PRI and the GSIA (Global Sustainable Investing Alliance) have recently come together to clarify the type of responsible investment approaches that exist.[3] These range from lighter touch to higher impact on investment process.

The various approaches can be categorised in two broad buckets. The first is focused more on the investment process whereas the second focuses on the strategy construction.

- ESG integration
- Stewardship

- Screening
- Thematic investing
- Impact investing

3 GSIA, PRI, CFA definitions - https://www.unpri.org/investment-tools/definitions-for-responsible-investment-approaches/11874.article

As companies are speaking to fund managers, understanding which bucket their shares are held in is important to understand where the questions and the perspective of the fund manager is coming from. We often hear why fund managers are suddenly asking about issues that may seem to have limited impact on the core business strategy. This may be because a fund manager is running a thematic fund, such as alignment to the sustainable development goals, and needs to assess whether a company is eligible for such a strategy. This is distinct from the first bucket where the core questions will be focused typically on financially material topics. Stewardship refers to the dialogue between fund managers and companies and voting in their general meetings. This practice of company interaction is becoming an increasingly common way to express and fulfil fund manager obligations.

The research that the fund manager is trying to deliver may also vary. Similar to credit rating agencies, fund managers are increasingly using tools to help assess companies' ESG practices. These ESG rating providers will tend to provide a score or assessment of a company's ESG practices. Certain strategies are built so that companies below a certain score or assessment cannot be invested in. This drives many conversations between companies and fund managers, as active fund managers in particular look to develop their analysis based on third party information. For passive funds, managers must follow a rules based approach which makes it hard to deviate from a third party opinion. This means that the topics raised by the third party can drive the line of discussion and questions a fund manager or analyst are trying to understand.

ESG ratings tend to be used for the purposes of understanding a company's operations or risk. The types of topics that are generally relevant in this scenario include those that the company finds important but also the issues that fund managers have determined as important, typically in any given sector or industry. Where company and fund manager views of materiality are not completely aligned, this may give rise to misunderstandings. Examples of the types of issues that may be considered by an asset manager under E, S and G include climate change, waste management, biodiversity, health and safety, labour relations, gender diversity, board structure, corruption and bribery, and corporate culture.

The guidance that is often used as a minimum standard is the UN Global Compact. This global standard is one of the most common screens across the investment industry. The principles are centred on four themes including environment, labour relations, corruption and human rights. Data providers will assess compliance against these themes and score companies. Companies will tend to be scored regardless of whether the company has officially committed to the UN Global Compact principles. When issues have been identified by these providers, these will be highlighted to fund managers. As such, it is important for companies to manage these controversies and related assessments.

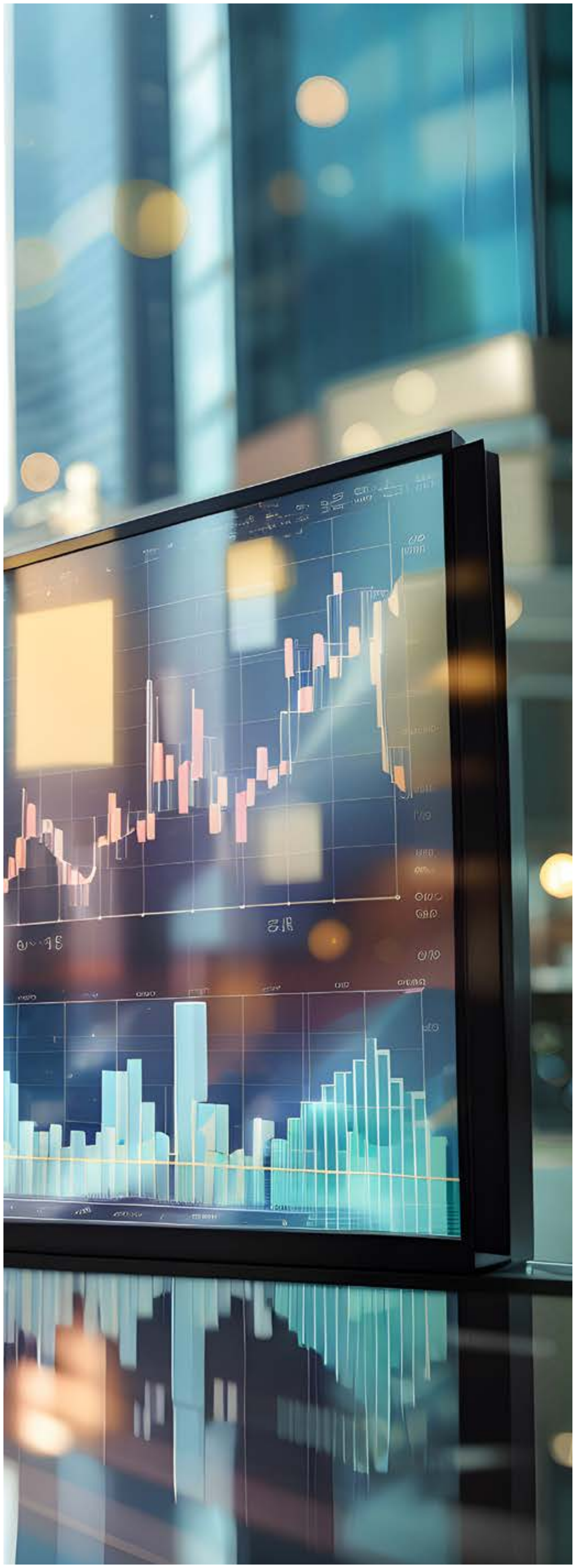
The other side of the equation is the opportunities side where fund managers increasingly assess companies' alignment in terms of revenue with contributing to the sustainable development goals. The sustainable development goals, created by the UN, are 17 goals set by governments to set a common vision for a better future. These goals are typically translated into products and services such as "green revenues". For example, a big consumer goods company would highlight that they have 14 purposeful brands that generated sales of over €1bn in 2022. In the European Union, there is also now a requirement for companies to disclose green taxonomy-aligned revenue. This taxonomy defines what can be considered as 'green activities' and aims to standardise this definition that is otherwise subject to substantial interpretation. Companies are beginning to disclose this, although for many companies this remains a small percentage as the EU taxonomy definitions sets a high standard. To be considered as a green economic activity, it needs to make a substantial contribution to at least one of six environmental objectives, do no significant harm on any of the other

environmental objectives, and comply with minimum safeguards.[4]

This leads on to the different types of investment vehicles and objectives that fund managers have. There are a growing number of funds set up with a climate focus. According to Morningstar, there is around $445bn assets invested across lower carbon, climate transition, green bonds, climate solutions and clean energy/technology. While all of them are under the climate thematic, each of them will have different ways of assessing companies. As such, the landscape can understandably feel complex for companies trying to understand fund manager requirements.

Dialogue and engagement with companies is also part of being a responsible owner. This includes exercising votes at shareholder meetings. Increasingly, environmental and social issues are being brought into the voting approaches of shareholders in light of the heightened risks associated with these issues.

Furthermore, stewardship to promote specific social or environmental goals associated to a given fund or product is increasingly becoming a key part of fund managers toolkit. For example, over 300 global fund managers representing $64trillion have committed to the Net Zero asset manager initiative .[5] This commits asset managers to work towards achieving net zero by 2050, within the context of regulatory and client considerations. The vast majority of portfolio managers' actions will be through the companies in which they invest. As such, we are seeing net zero topics reaching the top of the fund manager conversation. We expect to see increasing fund manager and global government expectations in this area.



4 https://ec.europa.eu/sustainable-finance-taxonomy/
5 https://www.netzeroassetmanagers.org/

THE ROLE OF STOCK EXCHANGES IN SUSTAINABLE DEVELOPMENT

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She is a non-executive director of the WWF (South Africa) and has served as chair of the World Federation of Exchange's Sustainability Working Group, a member of the Strategy Group of the Global Investors for Sustainable Development Alliance, and chair of the Sustainable Finance Working Group of the National Treasury of South Africa.

The rapid pace of change is a reality on all fronts and capital markets have not been immune. Evolution in markets means that the face of marketplaces for raising capital, and even the role of public markets themselves is under constant pressure to maintain relevance. Sustainable development trends favour more transparency, which is the hallmark of public markets.

There is an African proverb which reads: "If you want to go fast, go alone, if you want to go far, go together". In tackling the challenges of transitioning our economic growth models, and the financial markets which underpin these, to re-orientate towards a more sustainable trajectory, the need to go together has never been more clear.

Whether we consider the current state of the considerably inadequate global efforts to mitigate and adapt to climate change or the sad clawing back of progress on the sustainable development goals as we emerged from the grips the COVID-19 pandemic, it is only a unified effort and commitment which will turn the tide.

Stock Exchanges are conduits for trillions of dollars in capital flows and financial transactions which are a key part of the capital markets. Where and how this money flows will have a significant impact on sustainable development. Central to this is the core competency of an exchange as connector. A connector between those who have capital to invest and those who seek such capital to deploy in growing businesses and ultimately the economy.

A connector between various parts of the financial ecosystem and is associated actors. A connector between the might of the markets and the ordinary man in the street.

The value chain of a stock exchange lends itself, depending on its structure, to possibly three main areas in which it can use its unique place in the capital market ecosystem to create impact for sustainable development outcomes. These are: as a regulator; as a marketplace for the trade in financial instruments; and as a corporate citizen itself, with its own governance, social and ecological footprint.

Over time, the business models of exchanges have been evolving, along with the regulatory paradigms in which they operate. From the perspective of regulatory powers, models diverge. As an example, there are exchanges which have a level of regulatory oversight on the market, regulating both listing as well as trading activities across asset classes. This can be under what is know as a self-regulatory model and is as a result of specific provision being made within the overarching financial markets regulation which sets out the role of the various actors and the functioning of the ecosystem in the given market. The part of the exchange with the duty for regulatory oversight could be separately governed and likely functioning as a regulator, and without an inherent profit motive.

As a regulator acting as a listings authority, the exchange can set the context for how listed entities report in the public domain, and the focus of that reporting. Various approaches to sustainability-related disclosures exist and can be voluntary or mandatory. The scope of what is covered can also vary, with some exchanges requiring detailed and quantitative disclosures, and others using a broader and more qualitative approach. Regardless of the scope and disclosure regime, the key here is that the exchange as a regulator can encourage or require from companies varying levels of sustainability-related information. The information should, in theory at least, be useful to stakeholders, including investors, to make better informed decisions on the entity's prospects into the future.

This thread covers other listed instruments too. A case in point is that of listed sustainability-themed bonds. The exchange can require that the issuer produces annual disclosures on the use of proceeds of green- , social- or sustainability bonds and sustainability-linked bonds. This information can serve to reassure investors that the money raised is being deployed and monitored to drive the sustainability-related outcome and intent which was put forward buy the issuer at the time of the original capital raise and listing of the said entity's bond. A failure to do so could require the appropriate remedy to be determined by the relevant actors on the said issuer.

The exchange can also influence the architecture of the ecosystem in which it operates.

Considering the role of the exchange as a marketplace to trade in financial instruments, it has the opportunity to create the types of products (which the market will be keen to consider) which are aimed at meeting a special need (latent or explicit) within the target market. The suite of offerings should, over time, orientate to explicitly support the SDG's or other sustainability metrics as needed. These offerings could even include the co-creation of fit for purpose capital raising platforms outside of the traditional public listings context, such as private placement platforms, which meet a market need.

These platforms could encourage those seeking capital, to include the explicit sustainability needs and use the capital for activities and assets which advance the aims of sustainable development. The opportunity for innovation in sustainable finance, is an important one, especially at the current moment when we are, daily, encountering numbers on how inadequate the committed climate finance is, and how critical private sector participation and finance is. Of course, climate finance is but one example in the broader ambit of needs for sustainable finance, and so the opportunity for innovation is significant. Other instruments and products include, inter alia, sustainability/ESG indices, ESG data hubs, sustainability themed ETF's and derivatives and the like.

Linked to platforms is the area of the exchange as a corporate entity/citizen in its own right. Here, it's opportunity lies in setting the example via: its own sustainability disclosures, its measurement and targets to reduce environmental and social impact, and the integration of sustainability thinking into the various governance structures which oversee it's functioning. Here it could also collaborate with other market infrastructure providers to collectively improve the enabling environment for sustainability practices, products and service to grow.

The third area under which the exchange can arrange itself to support the aims of sustainability is advocacy and engagement. The engagement should seek to answer questions such as "who needs to know my stance on sustainability issues" and "what is the lever we can pull on to drive more attention to a given issue." The targets of such efforts will likely be regulators, other players in the financial market who benefit from the success on a given issue, possibly the board and shareholders of the company, and potentially the global ecosystem of exchanges. The industry platforms which represent the collective view that the exchange and its peers support, such as the Sustainable Stock Exchanges Initiative, are good conduits.

While what is set out above represents a few thoughts on the subject of how exchanges can contribute to the achievement of sustainable development, it is also of value to understand the barriers to this action. One of the key issues is that of level playing fields. Whist one exchange may find it imperative to for example, mandate certain disclosures, it will also seek to understand the possible de-listing impact from what can be perceived as overly onerous disclosure obligations. For each exchange, there are a set of context-appropriate actions which it can take and then, those further along the spectrum which it can aspire towards. Maintaining an on-going and open line of communication with such a regional/issue-specific regulator will be beneficialt.

At the heart of any chosen pathway, is the need for bold and courageous leadership which puts the ecosystem change agenda ahead of the interest of the exchange itself. As we contemplate COP28 and the big agenda that it is hoped this COP will achieve, exchanges will continue to play an important role in the evolution of the markets and the imperative to use the power of the markets as source of good for the wellbeing of people and planet.

ESG DISCLOSURES AND DATA – THE IMPACT ON COMPANIES

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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 the European Corporate Governance Codes Network, which shares information and good practice among the bodies responsible for codes in 28 European countries, and also chaired the Global Stewardship Codes Network which brings together bodies from 20 markets.

Discussion of ESG reporting and data tends to be dominated by the views and perceived needs of investors and other stakeholders. In this article I am going to look at the issue from the perspective of companies.

It is sometimes argued that public reporting requirements are beneficial for companies. They can help to persuade reluctant boards to take ESG issues seriously or provide those companies that are already doing so an opportunity to demonstrate their leadership on these issues. In some cases, they can provide a framework for business planning and risk management.

That is all undoubtedly true, but conversations with companies in recent months suggest that there are also potential adverse impacts on companies that may be underappreciated.

*This article was originally published in the September 2023 edition of The Governance Compass, Morrow Sodali's monthly newsletter

It should be emphasised that none of these companies argued against the importance of addressing and reporting on material ESG issues, but they had concerns about the volume and content of the data being demanded and how it is used.

Some of these conversations took place in the context of research Morrow Sodali and Durham University Business School undertook on behalf of the UK's Financial Reporting Council into the impact of proxy advisors and ESG rating agencies on UK listed companies. The report on that research was published in June. The activities of the ESG rating agencies are at the root of some of the concerns expressed by companies.

The most common concern is the volume of data that companies are expected to provide and the level of resource associated with doing so. Complying with regulatory reporting requirements can be resource-intensive, but on the whole listed companies understand the need for public reporting and accept it as part of the cost of doing business.

However, many companies we spoke to felt there was less justification for the additional data demanded by ESG rating agencies which could create a lot of extra work, a situation that was exacerbated by the fact that these agencies use different methodologies and data points.

Companies might be more inclined to consider the effort required to measure and report this data to be time well spent if they believed that doing so also helped them in meeting their own ESG objectives and managing the related risk. But many felt that this was not always the case.

The underlying issue is that materiality is defined by regulators and investors, not by the company. Reporting requirements reflect what policymakers consider to be most material in terms of the impact on the environment and society. Data demands from rating agencies reflect what their investor clients consider to be most material in terms of the design and impact on their portfolios.

"It should also be a concern to policymakers if, by deciding to chase ratings, some companies neglect to address other factors that in their cases could have more material impact on the environment and society."

For some companies, such as those that are significant users of natural resources, the ESG factors they see as material might align closely to those on which regulators and investors are focused. For others, some of these factors may not be material at all. For example, we spoke to an insurance company that said it had received a low ESG rating because it had not set out detailed waste management policies in its annual report.

In these circumstances, companies have a choice either to ignore the ratings and hope that investors will base decisions on the company's actual ESG performance, or to devote a lot of time and attention to issues that are not material. This is not a very comfortable position for them to be in.

It should also be a concern to policymakers if, by deciding to chase ratings, some companies neglect to address other factors that in their cases could have more material impact on the environment and society. Similarly, if the regulatory reporting burden leads boards to view ESG as a compliance issue rather than a strategic one, that may have adverse consequences not only for the company but for meeting the longer-term policy objectives.

The final recurring topic in many of our discussions was the techniques used by the ESG rating agencies for gathering data, in particular the use of AI for so-called ‘data scraping’. Most companies said that information and relevant context in the narrative of the annual report was regularly missed by using these techniques. The concern was that by focusing only on detailed data points, the big picture was being missed and no account being taken of the company’s vision and overall ESG performance.

Attempts are being made to address some of these issues. The process of consolidating standards and reporting frameworks that is being led by the ISSB should in time reduce the variety of different metrices and data points being used for specific ESG factors, which in turn should reduce the resource burden on companies. Regulators in several markets, including the European Union and the UK, are considering measures that should at least provide more transparency about methodologies used by ESG rating agencies.

Some of the other problems may be more intractable, though, specifically the materiality mismatch between policymakers, investors, rating agencies and companies. Clearly it is not feasible to have a different regulatory regime or rating for each company or sector. At the same time, if we find ourselves in a position where companies consider it more important to comply with requirements of limited relevance to them rather than address issues that have a material impact on them and their stakeholders, that cannot be to anyone’s benefit.

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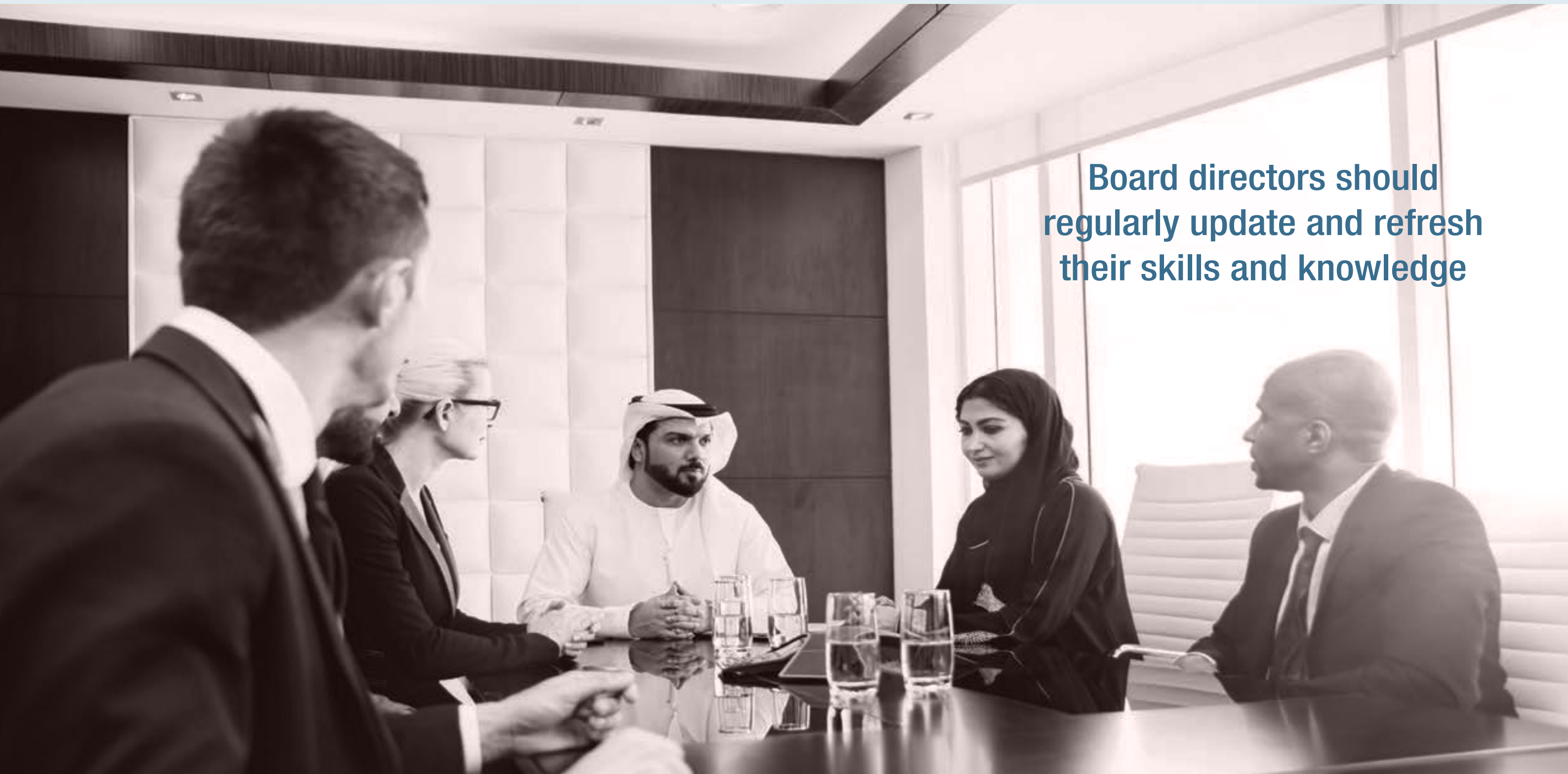

BOARD BRIEFING

Hawkamah briefings, arranged to coincide with board meetings and retreats, enable board members to keep up with the latest developments in corporate governance and refresh their knowledge on corporate governance trends and developments.

Hawkamah provides focused 2-3 hour board briefings to boards across the MENA region. The briefings are conducted by experienced board directors and center on key challenges faced by the regional boardrooms.

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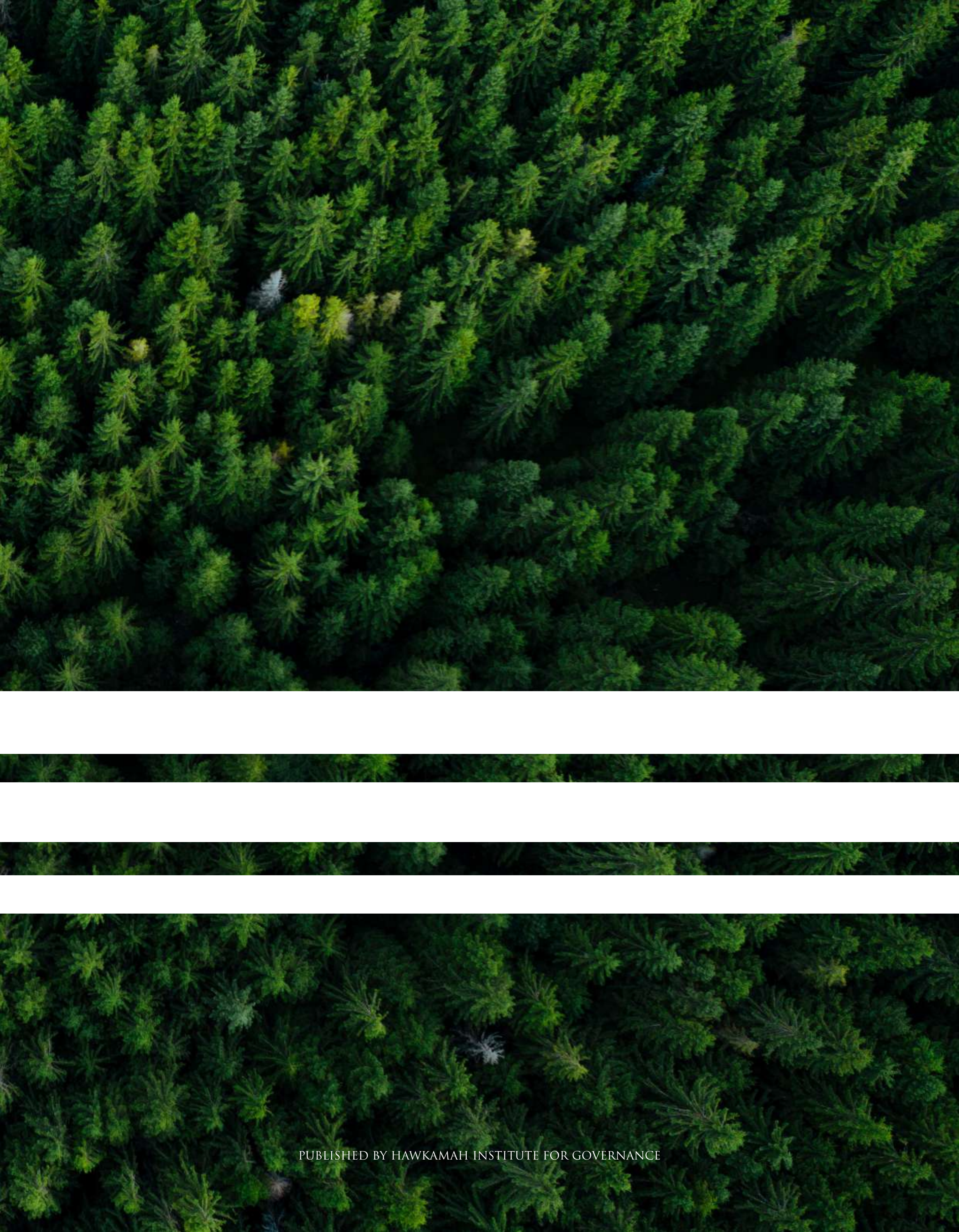

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