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It is of concern to hear some say that we have done "G", and it is now time to focus on "E" and "S". Twenty years after we started the corporate governance journey, we are far from done, and will never be. PHOTO: PEXELS.COM

Governance is the foundation of ESG

The change management necessary to transform from 'brown' to 'green' cannot be achieved without the right board and management team in place overseeing it. BY MAK YUEN TEEN

ON Aug 26, SGX Regco released two consultation papers, one on enhanced rules on climate and diversity, and the other on a common set of core environmental, social and governance (ESG) metrics to be disclosed by companies as a starting point.

On board diversity, SGX Regco is taking up a notch what is currently in the *2018 Code of Corporate Governance*, by making certain disclosures mandatory.

I have long been an advocate for improving diversity on boards, including gender diversity. A report in *The Business Times* on June 21, 2008 titled "*Board Makeup of Singapore Companies Lack Diversity*" quoted me as saying that "It cannot be that there are no women with the required skill sets, just that the board hasn't tried hard enough or has used the usual network to recruit directors".

I added: "I wouldn't start with diversity from the perspective of gender/race... if boards have proper processes for searching for the best candidates, then I don't see why more boards should not have more women and other minorities."

That year, as then chairman of the committee for the Singapore Corporate Governance Awards organised by the Securities Investors Association (Singapore), I recommended the introduction of a new board diversity award.

SGX Regco is now proposing to require all companies to have in place and disclose a board diversity policy, targets, plans and timelines, and disclose "how the combination of skills, talents, experience and diversity of directors on the boards serve their needs and plans".

Without proper processes in place for identifying skills and experience gaps and searching for directors, boards may over time improve demographic diversity but not cognitive diversity. The SGX proposals do not, in my view, directly address the adequacy of these processes.

A bolder step would be to require companies to implement and fully disclose comprehensive board competencies and diversity matrices, explain how competencies and diversity of existing and proposed directors align with these matrices, and disclose the process in searching for directors. If no external searches are done, companies should have to explain why. Otherwise, we may end up like one company which has five female directors who make up more than 40 per cent of directors on the board, but two of the female independent directors succeeded their fathers as independent directors of the company and one is the spouse of the founder.

A PHASED APPROACH

Subjecting the election of all independent directors to two-tier votes, including a separate vote by minority shareholders, would be another step up.

SGX Regco has proposed to move towards mandatory climate-related disclosures, consistent with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). I agree with the phased approach proposed, based on industry classification.

The TCFD recommendations are organised into four pillars which the task force calls governance, strategy, risk management, and metrics and targets.

On governance, TCFD recommends that companies describe "the board's oversight of climate-related risks and opportunities" and "management's role in assessing and managing climate-related risks and opportunities".

On strategy, companies are recommended to describe "the climate-related risks and opportunities the organisation has identified over the short, medium, and long term" and "the impact of climate-related risks and opportunities on the organisation's businesses, strategy, and financial planning".

In the area of risk management, companies should "describe the organisation's processes for identifying and assessing climate-related risks" and "the organisation's processes for managing climate-related risks".

Finally, on metrics and targets, companies should disclose "the metrics used by the organisation to assess climate-related risks and opportunities in line with its strategy and risk management process" and "Scope One, Scope Two, and if appropriate, Scope Three greenhouse gas (GHG) emissions, and the related risks".

The four pillars are all, in my view, very much part of corporate governance.

I agree with SGX Regco that it should not, at this juncture, prescribe specific sustainability reporting frameworks and ESG indicators against which issuers should report. It should wait for further progress on the current effort to harmonise reporting frameworks on sustainability-related disclosures, particularly the work of the International Financial Reporting Standards (IFRS) Foundation and its proposed establishment of an International Sustainability Standards Board.

I have reservations regarding the proposal to make it mandatory for internal auditors, or external auditors or other external service providers, to provide independent assurance on sustainability reports. Internal audits in many companies here currently lack maturity and extending the internal auditor's responsibilities to providing independent assurance on sustainability reports may give investors a false sense of assurance about the sustainability report. My concern also applies to external auditors and other external service providers as lack of relevant competencies and cost may result in little more than superficial assurance. At this point, I would rather leave independent assurance on sustainability reports as voluntary.

Where companies voluntarily subject their sustainability reports to independent assurance, they should provide sufficient information about the qualifications and experience of those providing the independent assurance and the standards used. If a company has poor corporate governance, I would not trust its "independent assurance" of sustainability reports.

On the proposal to make it mandatory for directors to attend training on sustainability, the issue is whether this will have any impact on board and company practices. What is needed is training in areas such as how to incorporate sustainability considerations into strategies, policies and practices; set relevant targets; and monitor implementation and effectiveness.

DO MORE THAN LIP SERVICE

Finally, I am not enthused about the proposal to start with a common set of core ESG metrics. There are 15 categories of metrics proposed under "environmental" (four categories), "social" (five) and "governance" (six), with 27 specific metrics proposed. They come across as ad hoc and selective. For instance, on "social", metrics relating to pay equity, including gender pay gap, are not proposed. Similarly, on "governance", there are many areas that are not included among the proposed metrics, and metrics such as board independence may be poor indicators of actual independence.

It would be wonderful if investors have a simple dashboard to assess the "ESG" of companies. However, an overly simplistic dashboard is more likely to mislead than illuminate. The proposed core set of ESG metrics may also simply add to the already crowded market of conflicting ESG ratings.

While I support the "ESG" thrust of the two consultation papers and do not dispute the importance of "E" and "S", there is a significant risk that "G" becomes an afterthought. As Jamie Allen of the Asian Corporate Governance Association once said, it should be "GES" rather than "ESG". Without good governance, "E" and "S" are likely no more than lip service. It is of concern to hear some say that we have done "G", and it is now time to focus on "E" and "S". Twenty years after we started the corporate governance journey, we are far from done, and will never be.

While many companies here are speaking the "ESG" and "sustainability" language, there is little evidence of any significant changes in "G". We are not seeing many changes in the composition of boards and management of companies here that incorporate the necessary skills and experience related to "E" and "S". We read a lot about companies "pivoting" but see many boards and management teams remaining stationary. The change management necessary to transform from "brown" to "green" cannot be achieved without the right board and management team in place overseeing it.

Regulators, investors and companies should not take their eyes off governance.

The writer is professor (practice) of accounting at the NUS Business School and a corporate governance advocate. The views here are his personal views.