Sustainability, Boards and Investment: What's next for Corporate Governance in a post COVID-19 pandemic world

25th European Corporate Governance Conference under the auspices of the Croatian Presidency of the Council of the European Union

18 June 2020

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OPENING REMARKS

> High standards of corporate governance should be the foundation, not only for companies and their stakeholders, but for the market competitiveness of society in general.
>
> **Dražen Bošnjaković**, Minister of Justice of the Republic of Croatia

Corporate governance will play a vital role in helping Europe to achieve a sustainable and successful economic recovery in the wake of COVID-19 pandemic. What exactly will this role entail, however? At the 25th European Corporate Governance Conference, which took place on 18 June 2020, a line-up of expert speakers – including highly respected academics, board members, policymakers and business leaders – shared their perspectives on sustainability, boards and investment. During a series of fascinating speeches and panel discussions, they addressed this important question: what's next for corporate governance in a post COVID-19 pandemic world?

Opening the conference, **Dražen Bošnjaković**, Minister of Justice of the Republic of Croatia, said corporate governance contributes to: "the individual business success of companies as well as general economic growth." He was succeeded by **Ante Žigman**, President of the Board of the Croatian Financial Services Supervisory Agency (HANFA), who noted that good corporate governance: "will take us forward as we restart our economies and develop new business models for the future."

In a keynote speech, **Didier Reynders**, European Commissioner for Justice at the European Commission, said the COVID-19 pandemic: "underscores the importance of a sustainable and resilient economy." He added: "It showed how important it is for the businesses to consider the interests of stakeholders and to have proper processes to identify and address adverse impacts on people, planet and society at large." Sustainable corporate governance is seen as an important catalyst for sustainable recovery in the context of the European Green Deal. As a result, the Commission is planning a public consultation on sustainable corporate governance in addition to its consultation on its **renewed sustainable finance strategy.**[1]

Julie Teigland, EY EMEIA Leader, set the scene for the rest of the conference by explaining that COVID-19 pandemic has made businesses and society more digital, more purposeful and more focused on sustainability. These changes present a huge opportunity for decision-makers and business leaders to reframe the future. She said: "We need a collective effort to build long-term value."

The 25th European Corporate Governance Conference was organized by EY Core Business Services BV, under the auspices of the Croatian Presidency of the Council of the European Union, together with HANFA and EY member firm partners ecoDa, BusinessEurope, EuropeanIssuers, ACCA and Accountancy Europe. It was hosted virtually – a first in the history of European Corporate Governance Conferences – and attended by participants from nearly 60 countries worldwide.

1 **"Consultation on the renewed sustainable finance strategy"**, European Commission, April 2020, (accessed via ec.europe.eu, 24 June 2020)

Ante Žigman
President of the Board of the Croatian Financial Services Supervisory Agency (HANFA)

Didier Reynders
European Commissioner for Justice at the European Commission

Julie Teigland
EY EMEIA Leader

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PANEL 1 The role of corporate governance in shaping the european recovery post COVID-19 pandemic

Panelists:

Pedro Oliveira, Director for Legal Affairs, BusinessEurope (moderator)

Olivier Boutellis-Taft, CEO, Accountancy Europe

Zsofia Kerecsen, Team Leader – Corporate Governance policy, DG JUST, European Commission

Mathilde Mesnard, Deputy Director for Financial and Enterprise Affairs, the Organization for Economic Co-operation and Development (OECD)

Emil Tedeschi, CEO, Atlantic Grupa

Summary of discussion

Boards are currently managing a wide range of issues related to COVID-19 pandemic. They prioritize the wellbeing of their employees, customers and business partners while supervising cash flow and liquidity, and making delicate decisions in areas such as workforce management and dividend payouts.

As a result of the pandemic, boards are also monitoring a broader set of risks – including social and environmental risks, and financial risks – and how they interconnect. Supply chains are a particular focus area since they can seriously undermine business resilience. Mathilde Mesnard from OECD highlighted that, following COVID-19 pandemic, there is "much more awareness about the risks linked to unsustainable or irresponsible business models."

Although COVID-19 pandemic consumes a lot of time, boards must remain mindful of other major systemic threats – in particular, climate change. According to the **United Nations' Emissions Gap Report 2019**[2] the world is heading for a 3.2-degree Celsius global temperature rise over pre-industrial levels, which will have serious environmental consequences.

Research by the European Commission, which has not yet been published, has identified a trend for companies to redistribute profits back to shareholders to the detriment of long-term value creation and business resilience. So, boards should be considering how they can correct this trend toward short-term thinking.

> "Corporate governance is also the instrument that enhances the quality of leadership and decision-making.
>
> Olivier Boutellis-Taft, Accountancy Europe

Today there is a lack of awareness in Europe about what corporate governance actually entails and the benefits it brings. Corporate governance is not just about compliance with rules – it adds strategic value to companies.

Recommendations for boards

1. Boards often lack a sufficiently broad view of their company's risks. By bringing scientists – including neuroscientists and psychologists – into the boardroom, they will have a better understanding of the challenges facing their organization today and tomorrow.
2. To support long-term value creation, boards should reconsider how they allocate the profits of their companies, cater to the interests of their different stakeholders and balance the short and long-term requirements.
3. The sustainability of supply chains will improve if boards adopt and embed a responsible approach to business conduct – first and foremost, by carrying out proper due diligence.
4. To make robust decisions and manage social and environmental risks effectively, boards should request integrated information that connects financial and non-financial business data.

2 **Emissions Gap Report 2019**, United Nations, 2019 (accessed via **www.un.org**, 23 June 2020)

PANEL 2 Board governance in a time of crisis: key considerations to build resilience

Panelists:

Andrew Hobbs, EY EMEIA Public Policy Leader (moderator)

Prof. Dr. Abigail Levrau, Research Director, GUBERNA

Leena Linnainmaa, Secretary General, Directors' Institute Finland

Guylaine Saucier, Board Member and Audit Committee Chair, Wendel

Dr. Ante Žigman, President of the Board of the Croatian Financial Services Supervisory Agency (HANFA).

Summary of discussion

A resilient company is sustainable in the long term. It is agile and financially prudent while having a strong corporate culture that is respectful toward people and the planet. It also plans for worst-case scenarios and resists the temptation to spend excess capital on share buybacks and questionable acquisitions.

Values underpin resilience since they help to guide decision-making in areas such as pay cuts for executives and staff, dividend payouts and decisions around whether a company should claim state aid.

> "The values of the company have become more and more the moral compass on decisions that need to be taken on sometimes delicate or difficult topics.
>
> Prof. Dr. Abigail Levrau, GUBERNA

To build resilience, boards must help their management teams resist market pressure to deliver short-term financial results at the expense of long-term value. Guylaine Saucier, Board Member and Audit Committee Chair for Wendel, said: "It's our role to make sure we are maintaining this long-term view and our corporate culture." In a dual-board system, the actions of the management board should be aligned with the strategic interests and long-term view of the supervisory board.

The pandemic has further accelerated digital transformation. As a result, boards should have a digital vision for their company's future. This will require them to educate themselves in technology, rethink their business models and working practices, and adjust their strategies. They should understand how disruptive technologies, such as artificial intelligence, can build their companies' resilience and how new tools can enhance their effectiveness as board members.

A more diverse board composition can boost the resilience of businesses in the new risk environment. Board members should also commit to life-long learning, consistently updating their skills and knowledge.

Recommendations for boards

1. To thrive post COVID-19 pandemic, boards will need to retain the loyalty of their workforce. Boards should put people at the top of their agenda and challenge management teams to handle the crisis in a way that ensures the company retains the commitment of its people in the future.
2. Boards should review their composition to ensure that they are sufficiently diverse in terms of age, ethnicity, gender, geographical location and professional background. At least one member of the board should have digital expertise.
3. Working practices have changed as a result of the pandemic. Boards should consider the implications of remote working for both the company's structure and its leadership style. This might be an opportunity to shift to less hierarchical approaches.
4. Technology is the future. So boards should develop a digital vision for their company that reflects the potential of new technologies to transform their strategy and business model.

PANEL 3 Corporate governance in the EU: reconciling financial, social and environmental performance for a sustainable future

Panelists:

Maija Laurila, Head of Company Law Unit, DG JUST, European Commission (moderator)

Richard Gardiner, Senior Campaigner, Corporate Accountability, Global Witness

Jimmy Greer, Head of Sustainability, ACCA

Paul Tang, Member of the European Parliament

Damir Vandelić, President of the Supervisory Board, INA d.d.

Summary of discussion

The corporate governance debate in Europe is increasingly focused on how companies can reconcile their business interests with climate and social imperatives. Furthermore, sustainability is core to the European Commission's **Recovery Plan**[3] to rebuild Europe following the COVID-19 pandemic.

At present, the trend toward short-term thinking is a major obstacle to companies transitioning to more sustainable practices. "What I want is to reverse the trend," said Paul Tang, a Member of the European Parliament. "Go back to European tradition where the company is not just there to make money, but to serve people and planet."

Companies can transition to sustainability by transforming their business models to create brilliant new products and services while providing great employment opportunities for people. Digital technologies enable innovation. Companies can also move into the circular economy by extracting the maximum value from materials and products while they are in use and regenerating them at the end of their service life.

The journey to sustainability also requires companies to provide full disclosure around their social and environmental performance. Unfortunately, today, there are insufficient metrics for reporting on social and environmental performance. If boards are to understand the progress their companies are making toward sustainability, they need suitable metrics. Similarly, investors want metrics that allow them to compare different companies over time.

Today there is a narrow interpretation of directors' duties, which tends to favor the short-term maximization of financial value. Board members should take personal responsibility for their company's impact on people and the planet. This may require remuneration packages to reflect social and environmental goals and reduce the amount that directors are paid in shares. Finance teams can play an important role in helping boards understand their companies' exposure to environmental and social risks and opportunities.

In the post-pandemic era, governments should make public investments that support economic recovery and contribute to sustainability. They can also prioritize 'people, planet, profit' companies in public procurement and protect them from aggressive takeovers. To make a successful transition toward sustainability, we need to define it in its broadest possible terms – social and environmental issues must both be considered.

> "The step up with the COVID-19 pandemic is around the social side. The right vision and support will help companies reorganize and rethink their products and services. Finance professionals can support their organizations by using the SDGs as a social and environmental roadmap into the future.
>
> **Jimmy Greer**, Head of Sustainability, ACCA

Recommendations for boards

1. Boards should prepare to pivot. They should look for opportunities to innovate and transform their company's business model to create sustainable products and services.
2. To make effective decisions, boards need access to robust information on environmental and social risks and opportunities. They should ask the company's finance team and other business departments to provide this information.
3. What matters gets measured; hence, disclosures play a vital role in the transition to sustainability. Boards can work with investors and regulators to develop suitable metrics for reporting on social and economic performance.
4. Boards should actively push back against the trend toward short-term thinking. One way to do this is by developing a long-term framework for operational resilience, which they can share with investors. This framework would enable them to plan for pandemics and natural disasters, as well as cybersecurity breaches.

3 **"Europe's moment: Repair and prepare for the next generation"**, European Commission, May 2020 (accessed via ec.europe.eu, 23 June 2020)

PANEL 4 Rethinking corporate governance in the age of digital transformation and COVID-19 pandemic

Panelists:

Berislav Horvat, Country Managing Partner, Ernst & Young d.o.o (moderator)

Dr. Hana Horak, Jean Monnet Chair, Professor of Commercial and Company Law, University of Zagreb

Isabelle Schömann, Confederal Secretary, European Trade Union Confederation (ETUC)

Luc Vansteenkiste, Chairman, EuropeanIssuers

Summary of discussion

This year, European corporate governance has evolved rapidly in response to accelerated digital transformation and the social distancing restrictions that accompanied the COVID-19 pandemic. Board meetings, committee meetings and general meetings have all been held virtually using video conferencing tools.

Technology has also transformed companies' working practices, as large numbers of workers have switched to remote working. Therefore, boards must pay attention to health and safety issues around remote working, including the management of working time, and workers' rights in relation to data protection, privacy and non-discrimination by digital tools.

Another important focus area for boards is cybersecurity. They need sufficient understanding and knowledge of cybersecurity risks to challenge management to address these risks and seek solutions. "The board must engage ... deeply in digital strategy and cybersecurity to provide flexible and secure infrastructure," said Dr. Hana Horak of the University of Zagreb. "It is not only about processes, but also about the company's culture. Protecting and managing cyber risks is protecting the value of organizations."

To meet the expectations of their stakeholders, European companies must invest in upskilling their people and transform ethically.

> "Innovation has to deliver for people in an equal way and in a manner that is socially acceptable.
>
> **Isabelle Schömann**, Confederal Secretary of the European Trade Union Confederation

Trade unions and workers' representatives should be included in the decision-making processes when new technological tools are introduced. This will ensure that tools are safe for workers to use, respectful of their rights and good for their employability while delivering for society as a whole.

Recommendations for boards

1. Boards should review their governance models to ensure they are fit for the current digital context. It may be necessary to establish a specialist cyber-risk committee that can support the board to understand and manage cyber-risks better.
2. It is important to communicate openly with stakeholders around digital transformation. The board can use the annual report to explain how the company is addressing cyber and other technology-related risks.
3. Algorithms should not be allowed to make important decisions on behalf of people — for example, about the hiring and firing of staff. The board should establish the right frameworks and policies to ensure that people remain in control of all technological tools adopted by the organization.
4. Inclusive corporate governance is key to success with digital transformation. The board should work with trade unions and workers' representatives to consider how new technological tools can be adopted in an ethical way that benefits employees.

PANEL 5

Are capital markets delivering a responsible investment that reflects the new challenges of sustainability transition?

Panelists:

Marco Becht, Professor of Finance, Solvay Brussels School for Economics and Management, Université libre de Bruxelles and Executive Director of the European Corporate Governance Institute (ECGI)

Carmine Di Noia, Commissioner CONSOB and Deputy Chair of the Corporate Governance Committee, OECD

Tomislav Ridzak, Member of the Board, Croatian Financial Services Supervisory Agency (HANFA)

Ivana Gažić, President of the Board, Zagreb Stock Exchange

Summary of discussion

Capital markets can play a major role in driving the transition to a more sustainable economy and society. Around the world, there is high demand from investors for sustainable assets and the global sustainable investment market continues to grow. According to the **2018 Global Sustainable Investment Review**[4] there were sustainable investing assets worth $30.7 trillion in the five major markets at the start of 2018. Around half of these were managed in Europe.

Unfortunately, however, there is a lack of clarity around the term 'sustainable asset.' It is not always clear to what extent an asset under management helps to reduce CO^2 emissions, for example, and 'greenwashing' is a growing concern. The **EU Taxonomy**[5] will help in this respect by setting out the performance thresholds for companies concerning specific environmental objectives. Nevertheless, there is a clear need for a single global standard that defines a sustainable business. The EU could play an active role in developing this standard.

Environmental, social and governance (ESG) ratings are material to determining which companies attract investment flows. Scrutiny and supervision of these ratings are currently inadequate, however. There is also a lack of clarity around the methodologies underpinning the analysis. Here, exchanges and regulators could play a role by taking responsibility for the accuracy and methodology of ESG ratings.

Investors can accelerate the transition toward sustainability by putting pressure on companies to act sustainably. A successful transition relies on companies working constructively with investors and regulators because they believe sustainability is in the interests of all their stakeholders, including shareholders. Disclosure around environmental and social performance is critical to enabling effective investor decision-making – therefore, companies must be required to communicate comparable, reliable and standardized information.

> "Consumers believe they will have long-term profits if they invest in sustainable companies.
>
> **Ivana Gažić**, President of the Board of the Zagreb Stock Exchange

Consumers will also help to drive change. There is a notable trend among consumers, especially millennials (those born between 1981 and 1997), toward ethical investing.

Governments can help capital markets deliver responsible investment by supporting companies and investors that are committed to sustainability. One way to do this would be through tax incentives.

Recommendations for boards

1. Participants should collaborate to establish clear and simple rules to define a sustainable company and prevent greenwashing.
2. Investors should prioritize investment in sustainable assets and divestments that do not meet their sustainability criteria. They should also communicate with companies around their expectations concerning sustainability.
3. Regulators should establish a mechanism for supervising the production of ESG ratings to ensure they are reliable and transparent.
4. Governments should explore how they can use the tax system to incentivize capital market participants to pursue sustainability objectives.

4 **2018 Global Sustainable Investment Review**, Global Sustainable Investment Alliance, 2018 (accessed via **www.gsi-alliance.org**, 24 June 2020)

5 "**Taxonomy: Final report of the Technical Expert Group on Sustainable Finance**", European Commission, March 2020 (accessed via ec.europa.eu, 23 June 2020)

CLOSING REFLECTIONS

> "There is an emerging consensus that organizations need to create value for all of their stakeholders, because that is the most important way to create a sustainable business in the long-term."

Ruchi Bhowmik, EY Global Vice Chair

CONFERENCE RECORDING

Closing the conference, **Ruchi Bhowmik**, EY Global Vice Chair (photo) – Public Policy, said she was hopeful that the COVID-19 pandemic would result in a reorientation of companies toward long-term value creation and a focus on stakeholder impact.

She identified three important trends that should help to accelerate this shift. These are policymakers and regulators taking an interest in sustainable development and finance, the market focusing more on non-financial operational risk, and societies and consumers changing their expectations for the public and private sectors.

Participants of the 25th European Corporate Governance Conference shared their views on various themes related to corporate governance. Here are the results.

53%

of respondents believed that **corporate governance could play a great role** in helping companies emerge from the COVID-19 pandemic

45%

said that **their organization was only prepared for some limited systemic risks** when evaluating the resilience and preparedness of their business for coping with the next systemic disruption

29%

said that **embedding clearly defined obligations and duties** on directors should be pursued to better integrate ESG matters and long-term value in corporate governance

27%

thought that **cybersecurity risks would be the greatest challenge** arising from faster digital transformation and the impact of COVID-19 pandemic

26%

believed that companies are motivated by the **desire to build their corporate reputation with customers**, when it comes to reporting on non-financial and ESG activities

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