Annual Directors' Summit 2024

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Keynote - Emerging global trends in corporate governance

By Christine Chow

Good morning, Chair Dr. Shamshad Akhtar, Mr Memosh Khawaja, Mr. Akif Saeed and the PICG board of directors, distinguished guests, ladies and gentlemen,

As a board member and vice chair of the International Corporate Governance Network (ICGN), I would like to thank the Pakistan Institute of Corporate Governance for giving us an opportunity to deliver a keynote at the Annual Director's Summit. Established, in 1995, ICGN is led by investors responsible for assets under management of $77 trillion. Our mission is to advance the highest standards of corporate governance and investor stewardship worldwide for long-term value creation.

Listening to Dr Akhtar's keynote, especially her own lived experience during the Asian financial crisis reminds us of the impact of corporate governance scandals on the economy and its people, and therefore, the importance of being forward looking in our actions in preventing them whilst reflecting on the past.

When reflecting on the past, we noted that governance has its roots in many cultures.

The Greek word '*kubernao*', first referenced by the Greek philosopher Plato means the 'art of navigation' which is to steer, in the political art of governance. The Latin word '*gubernare*' expanded the meaning, which covers not only to steer, but to drive, pilot, direct, manage, guide and control with authority.

This does not mean that governance is a product of the west. In Asia and the Near East, the spirit of governance has a long history over thousands of years, embedded in philosophy and religion. Good governance often means putting order into society or an organization, ensuring progress and the well-being of its people. This is achieved through fairness, loyalty, harmony and unity.

So, how do we put this into context of the 21st century governance best practices? How can we make it relevant to each market?

This Summit gives us the perfect opportunity to reflect on what good corporate governance means in the context of economic growth, capital markets development in Pakistan through the lens of global investors.

To begin with, I want to highlight **five key global trends** in corporate governance:

1. First, investors are increasingly embracing of what good governance looks like in different shareholder structures including controlled companies. Modern governance standards are established based on widely institutional investors held shareholding structures. But one size does not fit all.
2. In June 2024, ICGN published a Paper on the Governance of Controlled Companies. Some relevant highlights are:

a. First, investors acknowledge that there are many different corporate structures. Some companies are state controlled, others family and founder controlled. There are company groups arising from corporate consolidation, through mergers and acquisitions, which created firms with subsidiaries.
b. In Pakistan, there are 133 SOEs, 88 of them are commercial entities across sectors such as energy, telecommunications, transportation, finance and trade. The Government established the Central Monitoring Unit (CMU) in 2023 to ensure better governance and performance of SOEs by monitoring their financial and operational performance. I personally find the CMU 2023[1] report very useful. For example, the report highlighted the major risks for each sector, and corporate governance issues, such as the need to speed up the transition to more independent boards; to establish a pipeline of qualified board directors; and to strength the monitoring of board skills matrix and board evaluation.
c. Global investors do understand that **State-owned enterprises (SOEs)** have broader mandates than financial return. SOEs may receive subsidies and grants for activities that promote wider economic benefits. They are likely to have systemic and strategic objectives, such as promoting public welfare, national security, employment and economic development.
d. Depending on the type of controlled company, additional disclosures may be necessary. For example, global investors would expect SOEs to have a publicly disclosed ownership policy, explaining the rationales for state ownership, as recommended in the OECD Guidelines on Corporate Governance of State-Owned Enterprises. SOEs should have a high degree of transparency, including equal and simultaneous disclosure of information to all shareholders, regardless of the ownership stake.
e. Besides SOEs, there are other types of controlled companies. In Pakistan, 58% of registered companies are privately held, 39% are single member held, which means that they could be family or founder controlled. That makes up 97% of the economy.
f. In **family-owned businesses**, global investors expect a shareholder agreement to be in place, outlining how family members and other shareholders will interact with the company, covering aspects such as the acquisition and disposal of shares, major decisions, dividends, voting rights, conflicts of interests, and other related party transactions.
g. In **company groups**, investors expect comprehensive disclosure of group structures, controlling interests, cross-shareholdings, and transparency about the role of a company within the Group. Investors also want to know if the boards have authorised a 'delegation of authority' legal document that reflects which board within the Group makes certain decisions and what information needs to be reported to whom and how often.
h. In general, controlled companies need to adopt robust corporate governance practices, which support the achievement of **two** objectives: (1) the ability of all shareholders to express their views on the future of a company; and (2) the ability of management to deliver on the long term corporate objectives, using the

[1] https://www.finance.gov.pk/publications/Aggregate_Annual_Report_SOEs_FY2023.pdf

best resources available, in full accordance with the principles of accountability, transparency and appropriate checks-and-balances.

i. Investors believe that this could be done in a way that respects harmony amongst stakeholder groups if one on one and small group consultations take place in a constructive and open manner, and that mutual respect is observed under all circumstances. It might be easier said than done, but candid conversations are better dealt with head-on and issues addressed early before their impact spirals.

3. On the point of having a candid conversation, it brings me to the second global trend - **the role of board directors**.
   a. The demand on board directors have been increasing over time and their duties more complex. Board members are not only responsible for steering the execution of corporate strategy under the leadership of the Chief Executive Officer (CEO); ensuring a smooth CEO succession; they are also responsible for overseeing how a company takes into consideration the material sustainability risks and opportunities.
   b. In June, the Securities and Exchange Commission of Pakistan (SECP) updated the Pakistan Code of Corporate Governance Regulation 10 to reflect this. For example, the board should ensure policies promoting diversity, equity and inclusion (DE&I) are in place to encourage gender mainstreaming, gender equality and the participation of women on the board, management and workforce of the company. Also, the board should take appropriate measures to proactively understand and address the principal and emerging climate related risks and opportunities, assess their potential financial and operational impacts, and implement strategies for management and mitigation.
   a. Board directors are expected to dedicate sufficient time and expertise to specific committees they sit on. In general, the workload of a board chair is expected to be around 4 times that of a board director role; and the workload of a committee chair is around 2 times that of a board director role. Many asset managers voting policies measure the time commitment of board directors that way and set over-boarding thresholds through such an assessment mechanism. Some go the opposite and decide to discard the artificially constructed time commitment based on roles and evaluate directors' performance based on assessment at engagement meetings. This means making sure your board directors are accessible by investors is key, especially if companies do not wish to be bound by rules-based investor assessment.
   b. Aside from time commitment, investors evaluate how board directors are remunerated. The additional chair and committee responsibilities should be reflected in a transparent and fair manner in the directors' remuneration, disclosed in the annual report corporate governance section.
   c. When engaging with board directors, especially non-executive directors, investors pay particular attention to how well they demonstrate their understanding of the business; how they interact with the C-suite and executives; their ability to provide examples where executives are adequately challenged, and how a difference in views are resolved. This comes back to the need to have candid conversation not only between investors and the board members, but also

amongst executive and non-executive board members. Investors wish to see that non-executive directors (NEDs) have regular and practical training to keep up with the changing business environment, mastering skills that are needed, and that directors have multiple channels of information beyond the formal board papers.

d. Directors should have opportunities to conduct site visits, and given the importance of information security, a secure board portal or even equipment should be provided to board directors. Some board meetings now forbid directors taking their personal phones into meetings in case of the potential leak of material non-public information (MNPI).

4. The third key trend is on how the **board is overseeing sustainability integration** within a company.
   a. Key drivers that led the IFRS Foundation to establish the ISSB include the need to address the proliferation of voluntary initiatives in the sustainability disclosure landscape; to ensure that investors receive high-quality, comparable information about sustainability-related risks and opportunities; and to enable companies to provide such information to their investors efficiently.
   b. The voluntary adoption of ISSB reporting standards is acknowledged by SECP. With that acknowledgement, companies should be looking into how sustainability is accounted for, and embedded into, different parts of the business; conduct materiality assessments to highlight why some sustainability factors are more relevant than others and be clear about the process of stakeholder consultation that takes it to its conclusion. This goes beyond what is in the SASB framework and indicators by sector and industry as every business is unique with its own strategy, geographical footprint, product suite and client base.

5. The fourth key trend is the importance of **climate governance.**
   a. Pakistan is ranked eighth internationally for countries most impacted by Climate Change. It is expected to encounter a 1.4-3.7 degree Celsius temperature increase by 2060. How does the Board oversee the risks and opportunities brought about by climate change, and increasingly the connected issues of planetary constraints in natural resources that could impact the business? The Taskforce for Climate-related Financial Disclosure (TCFD) is focused solely on disclosure of climate-related risks and opportunities. Meanwhile, the Taskforce for Nature-related Financial Disclosure (TNFD) recommendations encourage companies to produce integrated climate-nature disclosures, rather than just nature disclosures, and to develop appropriate risk management processes. Investors expect that TCFD will merge into TNFD disclosure overtime, and companies should be aware of the direction of travel and start identifying nature-related climate issues when conducting businesses.
   b. Increasingly, we are seeing more integrated reports where sustainability and financial metrics presented alongside each other with a clear narrative of how they influence or are co-dependent on each other. More sustainability reports, if they are still separated, and certainly for integrated reports, are approved by Audit committees. Investors and companies often discuss the challenges of putting in place data and workflows to enable a reasonable assurance process

(rather than just limited assurance). Standards setters such as the International Auditing and Assurance Standards Board (the IAASB) is working on enhancing consistency and quality of audit assurance worldwide.

6. Finally, the fifth key trend, and probably the most important and rapidly evolving trend lies in **cybersecurity and AI**. In many markets, cybersecurity is already embedded into companies' risk management framework as regulators have formalized expected disclosure.
    a. For example, the US Securities and Exchange Commission (SEC) implemented a disclosure rule asking public companies to disclose material cybersecurity incidents on Form 8-K within four business days. The rules also require U.S. listed companies to disclose information about their board's proficiency and oversight of cybersecurity risks in their annual Form 10-K and Form 20-F filings.
    b. In Pakistan, the SECP issued Guidelines on Cybersecurity Framework for the Insurance sector in 2020. The Guidelines expected cybersecurity to be integrated into a company's overall risk management framework. SECP is also working with the Pakistan Telecoms Authority (PTA) and other sector authorities on this. All companies in all sectors are encouraged to put in place appropriate measures to address cyber risks.
    c. Cyber becomes even more relevant in the age of AI transformation because access to this powerful technology is very much democratised – which means that risks and opportunities could be everywhere, in every market, every sector, every company, depending on how companies decide to use them. It is very accessible.
    d. According to the Stanford University AI Index report 2024, a total of 149 foundational models were released in 2023, more than doubled from 2022. These foundational models have wide range of applications where coders and vendors build AI products for a variety of applications. The AI value chain is long.
    e. A recent survey[2] on Fortune 500 companies found that 56% companies have flagged AI as a risk in their annual reports reporting a 474% jump compared to last year. Lots of products in cyber and AI, whether rules based or generative, are provided by third parties with some degree of customisation, hosted on private or hybrid cloud. Processing could be onshore or offshore. With that comes intellectual property rights disputes, risk management, information security and data privacy issues. Investor would like to see proper board oversight, strong AI governance, comprehensive business continuity plans and incident response programmes.
    f. The combination of AI and cyber both on the offense and defence is powerful. What do I mean by that? AI can monitor information flow and hence create knowledge graphs that can connect users to malware pathways through domain and uniform resource locator (URLs). AI can identify anomalies and vulnerabilities real time and accelerate both the defence against the dark arts as well as empowering hackers, who can automate vulnerability discovery and

[2] https://fortune.com/2024/08/18/ai-risks-fortune-500-companies-generative-artificial-intelligence-annual-reports/

overcome security measures more easily through continuous learning and adapting.

g. How should a company step up their efforts on having cybersecurity by design in their data infrastructure, workflow, processes, audits and security protocol? This is a huge topic.

As I conclude this keynote on the five major trends in corporate governance, it's clear that the landscape is rapidly evolving, driven by a complex mix of regulatory changes, technological advancements, and shifting stakeholder expectations. We have touched upon the critical areas where companies must focus their efforts to remain resilient and accountable.

I look forward to the discussion on these exciting topics later during the Summit.

Thank you.