Russell Reynolds Associates

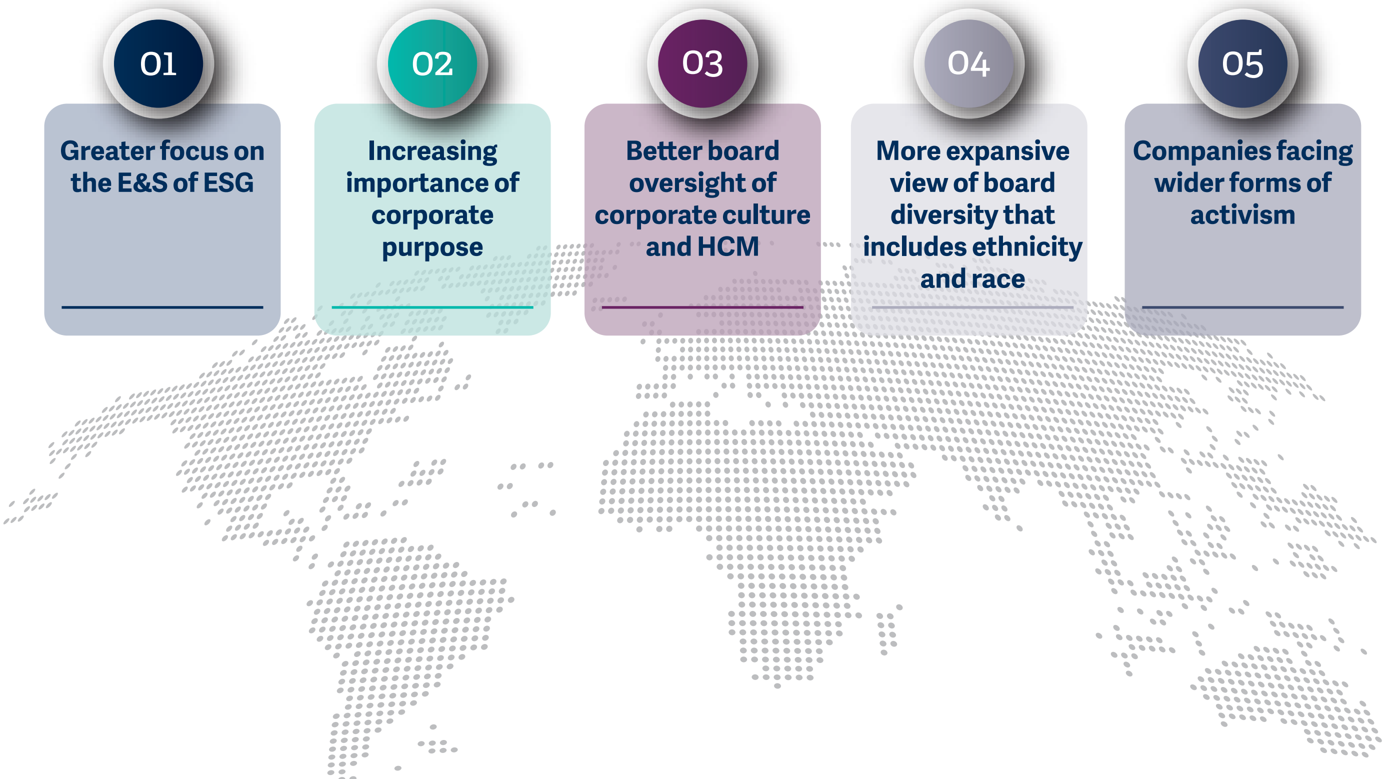
2020 Global & Regional Corporate Governance Trends

Introduction and Background

For the first time, in 2020, we see the focus on the "E" and the "S" of environment, social and governance (ESG) as the leading trend globally, including in the United States, where it traditionally has not received as much attention by boards. Indeed, many of the key global trends for 2020, such as board oversight of human capital management (HCM), can be seen as subsets of ESG.

This year, as in the previous four years, Russell Reynolds Associates interviewed over 40 global institutional and activist investors, pension fund managers, proxy advisors and other corporate governance professionals to identify the corporate governance trends that will impact boards and directors in 2020. This year we have recognized that the UK is expected to leave the EU on January 31, 2020 and we have also added Australia to our global survey.

OVERVIEW OF GLOBAL TRENDS



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01 **Greater focus on the E&S of ESG.** Beyond the global emphasis on good governance, environmental and social issues appear to be taking the greatest precedence for investors, moving from being a national or regional focus to being a truly global phenomenon. Boards and management alike are mostly playing catch-up on how best to define, integrate and oversee the E&S issues that are material to their business. In 2020, boards will be expected to strengthen their oversight and knowledge of material E&S matters and disclose their connection to the business in the form of risks and opportunities. We expect to see a consensus emerge around reporting frameworks such as the Task Force on Climate-related Financial Disclosures (TCFD) and Sustainability Accounting Standards Board (SASB) to help guide companies when reporting on E&S criteria.

02 **Increasing importance of corporate purpose.** Corporate purpose and stakeholder considerations have been business norms in various parts of the world for decades. In August 2019, 181 out of 188 member CEOs of the US Business Roundtable signed on to an amended Statement on the Purpose of a Corporation, putting aside the traditional view that maximizing shareholder returns is priority one. This was followed by a December announcement from the World Economic Forum updating their 2020 Davos Manifesto (last published in 1973) to center on principles that guide companies into the Fourth Industrial Revolution. The manifesto—like the Business Roundtable's statement—challenges companies to put stakeholders at the heart of a company's purpose. There remains a great deal of skepticism concerning the practical application of these documents, but public opinion in many countries appears to be shifting against shareholder primacy.

03 **Better board oversight of corporate culture and HCM.** Investors are asking what the board is doing to ensure the culture is robust and can withstand transformation and change. Investors would like more transparency on board involvement in culture and HCM to determine whether boards are providing adequate oversight. Data and analysis on corporate culture will play a key part in this oversight by boards. Directors in 2020 should appreciate the impact of culture on hiring, retention and productivity. Management will need to satisfy the board that the company has the culture and talent needed to successfully execute on strategy. (For more information, see our white paper on this topic here.)

04 **More expansive view of board diversity that includes ethnicity and race.** Considerable strides have been made globally around board gender diversity. As institutional investor voting power grew dramatically, so did demands for gender diversity. In 2020, boards will begin to experience additional pressure to consider ethnic and racial diversity. This phenomenon will vary by country. In the United States, it will be driven by investors such as Vanguard. In the UK, it will be as a consequence of the Parker Review. In Japan, the push to add more international directors will also broaden board diversity. In Canada, it will be the Business Corporations Act legislation that will require federally incorporated companies to disclose detailed information on the diversity of board directors and senior management. There will continue to be jurisdictions around the world where it will be harder for this trend to gain traction because the collection of data on ethnicity and race is illegal or highly regulated.

05 **Companies facing wider forms of activism.** Globally, investor activism continues to evolve and grow, creating a kaleidoscope of styles and approaches that change year to year. What remains constant is that directors must maintain a degree of vigilance, ready to respond to activists or assuage the concerns of investors. In 2020, we expect to see increased activism success rates and greater influence from both the traditional "activist" investors in this space as well as larger non-governmental organizations (NGOs). In some countries, employee shareholder activism around "#metoo" or climate risk has been successful at garnering public attention and impacting management decision-making. To prepare for these situations, boards are improving their effectiveness through more robust board evaluation processes. Boards are also engaged with management in scenario planning to ensure role clarity in crisis situations.

United States and Canada

Overview. A number of regulatory changes are underway in the United States and Canada heading into 2020. The US Securities and Exchange Commission (SEC) has announced new proxy solicitation standards and proposed new rules around the timing and delivery of proxy advice, the legality of which Institutional Shareholder Services (ISS) is challenging in a lawsuit as of the writing of this paper. The SEC has also proposed new HCM disclosure requirements and significant changes to the shareholder proposal no-action letter process (paving the way for verbal response or even no definitive response by SEC staff). In Canada, the Business Corporations Act is set to go into effect, codifying mandatory say-on-pay, legal majority voting and board/management diversity disclosure.

E&S focus and demand for transparency. Boards will be expected to continue their focus on governance and to strengthen their oversight and knowledge of environmental and social topics, explicitly linking those risks and opportunities to the business. Large institutional investors from BlackRock to the California State Teachers' Retirement System to the Ontario Teachers' Pension Plan are demanding better oversight and disclosure around E&S matters such as climate change, political expenditures, corporate culture and HCM, as well as human rights concerns around supply chains. Boards should ensure they have insights into the priorities of their shareholder base and benchmark themselves to good E&S oversight practices among peers. Governance issues such as board quality, composition and director overboarding will continue to be of significant concern to institutional investors. Investors expect more rigorous board assessments to be conducted, with an independent assessment every two or three years.

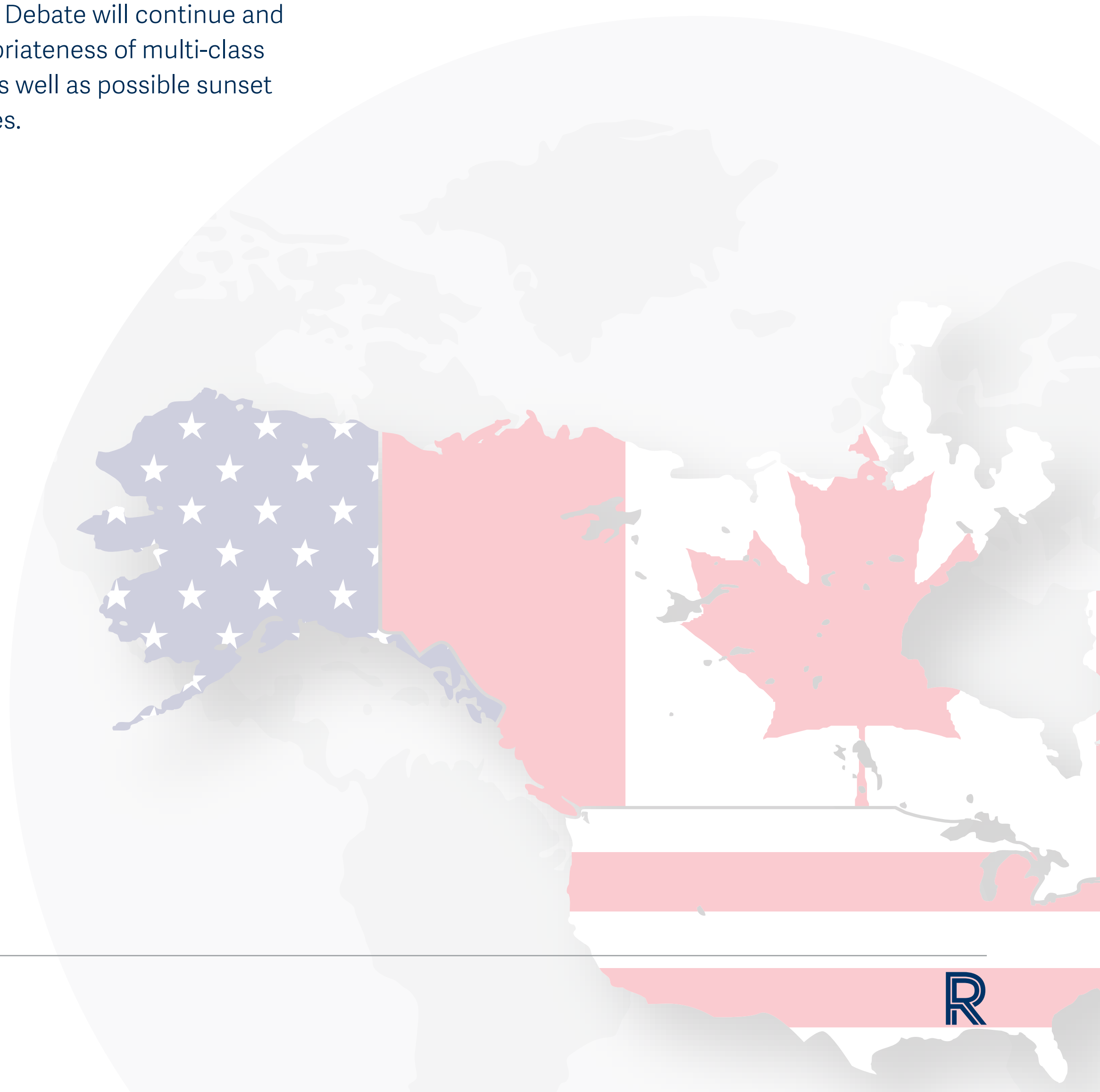
CEO engagement in social and political topics. A shift in corporate purpose from shareholder primacy to stakeholder capitalism is underway, reinforced by the US Business Roundtable's Statement on the Purpose of a Corporation. This focus, combined with public pressure for CEOs to engage on social and political topics (e.g., immigration, gun control, gender pay equity), will require boards and CEOs to ensure public positions align with business strategy before public pronouncements are made by a CEO. In an election year, heightened scrutiny of political spending and employee shareholder activism will be areas where boards and CEOs need to think carefully and scenario planning may be a valuable exercise.

Board ethnic and racial diversity. Boards have been focused on gender equality but have made far less progress improving ethnic and racial diversity. ISS estimates that 10 percent of Russell 3000 directors belong to an ethnic minority group and only 15 percent of new directors are ethnically diverse. For 2020, Vanguard has announced it expects companies to publish their efforts to improve boardroom diversity and will begin asking about the race and ethnicity of directors. The NYC Comptroller's Office (custodian of the $195 billion NYC Employees' Retirement System) is asking companies to implement a modified version of the National Football League's "Rooney Rule" and adopt policies to ensure women and people of color are on the initial list for every open board seat, as well as for CEO appointments. Canada, in a significant shift, will be the first jurisdiction to require regulatory-mandated disclosure on the topic. Beginning in 2020, companies under the Canada Business Corporations Act will be required to disclose the number and percentage of directors and senior management that are women, visible minorities, indigenous peoples and people with disabilities, as well as board and company diversity policies.

Corporate culture and human capital management oversight. As we noted last year, corporate culture and HCM will continue to be a key focus of major institutional investors. Intangible assets, by some estimates, now account on average for more than half of most companies' market value. In today's war for top talent, appropriate HCM oversight is not only prudent risk management, it is strategic asset management. Boards will increasingly be asked by investors to disclose the company's HCM approach and how it links to business strategy and impacts tangible results. Pressures for board oversight of corporate culture and HCM have been reinforced in the United States by the SEC's proposal for new HCM disclosure requirements.

Executive compensation. Executive compensation remains an important topic for board oversight in 2020. Investors are increasing their demands for companies to improve and clarify alignment of compensation with company performance. Investors are increasingly willing to hold the compensation committee chair accountable by voting against them if pay versus performance is not aligned. Committee chairs must also consider the increased public focus on executive compensation, taking into account quantum payout and the reputational risks that now follow.

Multi-class share structure scrutiny. Scrutiny of multi-class share structures in the United States will continue in 2020. The fallout from recent Silicon Valley IPOs (and failed IPOs) with these structures has triggered a backlash from numerous stakeholders concerned about corporate governance. Debate will continue and will center around the appropriateness of multi-class share structures in general, as well as possible sunset provisions for these structures.



Brazil

Overview. Brazil continues to be in a state of flux following the 2018 elections. Reforms around pensions have been slower than hoped, but privatization of state-owned enterprises has had greater success. This has also meant that domestic and international pension funds and other investors are pouring more money into the Brazilian equities market.

Government reform and capital flows. Last year, our trends paper referenced the political uncertainty as a continued disrupter of investment in the Brazilian market. The government's privatization program, which reduces its role in the economy, has had some success, but there is continued opportunity. In 2020, as implementation plans of this program become clearer, expect to see an increase in local pension fund and outside investor capital. With lower interest rates and a rise in company expectations and market infrastructure stability, Brazil is poised for increased investment flows. Moreover, there should be an increase in the number of independent directors, as Brazil is trying to follow the Organization for Economic Co-operation and Development (OECD) framework.

Investor engagement and governance expectations. The increase in Brazilian equities held by institutional investors will help drive an improvement in governance, transparency and board oversight of ESG issues. Investors will also focus on board composition and alignment of director skills with corporate strategy. The top 20 pension funds in Brazil represent around 70 percent of assets under management and will continue to increase their ownership of Brazilian equities. Hermes' stewardship arm, on behalf of approximately 50 asset owners and asset managers, also engages with Brazilian companies, pressing for a direct dialogue with boards on ESG issues. By combining their collective voices, they want to increase the level of engagement and influence with Brazilian companies. In 2020, companies should prepare by training key members of management and the board and providing communication about the engagements back to boards.

Board assessments. 2020 will be the year that more companies undergo outside board assessments. The Brazilian Corporate Governance Code states that companies must either comply or explain why they failed to include certain board assessment processes. The 140 or so companies listed on the Novo Mercado must structure and disclose a process of assessment of the board of directors, its committees and their executive officers. Although these rules are not new, the rigor of these assessments and disclosures is new. In 2020, expect to find investors calling for board assessment best practices for companies in their portfolio. This is likely to include calls for a more regular cadence of independent board evaluations (with a particular focus on culture, engagement and time commitment). As one major Brazilian investor noted, "Board assessment of composition, skills, age and tenure is the tip of the iceberg; more importantly, we want insights into the board culture, level of engagement and how much time directors commit to meetings and are spending on certain topics."

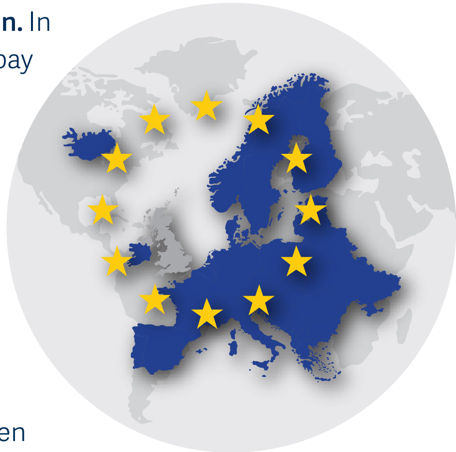
Increased expectations of boards. 2020 will see a greater focus on improving governance practices at state-owned enterprises, as well as family-controlled listed companies with a corresponding increase in responsibilities beyond the traditional Brazilian approach. In 2020, directors should anticipate continued professionalization with investors pressing boards to: (1) maintain their focus on improving independence (Brazil's average independence hovers at roughly 40 percent today given the large number of family-controlled listed companies); (2) increase focus on composition criteria vis-à-vis skill and gender diversity (only 10 percent of directors in Brazil are women); (3) push management on CEO succession (both long-term and emergency succession strategies); (4) push management on technology, from both the infrastructure and development standpoints; and (5) oversee and disclose ESG risk and opportunity (given that Previ, Brazil's largest pension fund, has recently pushed the market to focus on sustainability). Directors should be aware that, within ESG, the focus in Brazil is on the environment (and impacts of climate change) with social issues next in importance.

European Union

Overview. Like directors in other parts of the world, board directors in Europe are facing greater investor pressure (including from activists) and more regulatory oversight obligations and expectations. Expectations for improvements in ESG reporting continue to increase. Implementation of the EU's Shareholder Rights Directive II (SRD II) is taking place in each member state, with varying degrees of disruption to existing practices around shareholder rights.

Impact of SRD II. SRD II strengthens shareholder rights in an effort to reduce short termism and improve risk management. Each member state is in the process of transposing and implementing the key requirements, such as giving companies the right to identify shareholders, a proxy advisor code of conduct and shareholder rights to vote on remuneration reports and policies. For some countries, not much change to existing practices will be required. For others, more significant changes to existing practices are required, for example, in Germany around shareholder voting on remuneration. Investors are becoming more willing to vote against binding resolutions and to pressure companies on matters of executive pay, governance standards and corporate scandals.

Director accountability. A corollary to the increase in shareholder dissent is an increase in board accountability. Investors are progressively more willing to vote against individual directors (e.g., the non-executive director chairing the nominating committee for a lack of board gender diversity). A push for annual director elections (declassified boards) is underway, as multiyear director terms are still a popular practice in several countries. In Germany, board service terms of five years are common. Recent efforts to curtail this practice have failed (e.g., a proposed but omitted revision to the 2019 German Corporate Governance Code), but investor pressure for companies to move toward best practices will continue in 2020. ISS, for example, will recommend voting against the election or reelection of any director whose term is not disclosed or when it exceeds four years (without adequate explanation). Germany and Austria are exempted from this policy until 2021.



Executive remuneration. In an effort to better link pay to performance, SRD II requires European companies to submit their remuneration policies and their remuneration report to periodic shareholder votes and disclose how the voting results were taken into account by the board. Each country is implementing these requirements in different ways. The Netherlands will allow for a binding shareholder vote on the remuneration policy and an advisory vote on the remuneration report. In Germany, the votes on both the remuneration policy and the report will be advisory, except that small- to medium-sized companies will not be required to comply. Several European countries already had say-on-pay practices in place and did not require much change in policy. Regardless, scrutiny around remuneration will continue to intensify.

Purpose and ESG. Defining corporate purpose has been a key trend in Europe over the last several years and will continue to spread in 2020. In France, expect more companies to adopt a "raison d'être" (corporate purpose), an expectation which may become a legal requirement. The raison d'être gives a sense of meaning to stakeholders and puts ESG at the core of corporate strategy. Climate change and transitioning to a lower-carbon economy are also top priorities for European stakeholders. Boards will need to be able to understand and discuss ESG data—and its impact on key matters such as executive remuneration—with investors. In France, the number of CAC 40 board committees focused on ESG has doubled in the last two years. This is an important development, as ESG is the focus of a quarter of the questions raised at general assemblies and half the resolutions submitted by shareholders. In Spain, investors will begin to exercise their vote on non-financial reporting. Spain also is extending its corporate governance principles, which promote key components of ESG, to private companies in 2020.

Board composition. Pressure on companies to proactively manage and justify board composition and its link to business strategy will continue in 2020. Disclosure of board skills matrices is on the rise. Many institutional investors are also raising their standards on director overboarding. Board gender diversity will continue to be an ongoing area of scrutiny in some countries. Spain will miss its gender diversity targets for 2020. In December 2019, the Dutch parliament passed a law requiring that at least 30 percent of supervisory board seats of companies listed on the Amsterdam Stock Exchange be held by women. Companies that do not meet the 30 percent rule will have to replace any man leaving the board with a woman or leave the board seat vacant.

Board leadership. Separation of the board chair and CEO roles is generally considered good governance practice in most European countries. Independence of the chair, however, remains an ongoing debate. In Germany, for example, the chair is sometimes a former CEO of the company. In France, where many companies have significant government or family ownership represented on the board, the lead director role continues to grow in popularity. This topic will receive additional focus in many boardrooms next year as institutional investors start to push harder for chair independence.

Activism. Shareholder activism will generally continue to increase in European markets next year. In France, activists are getting better at pressuring companies to make governance changes in order to improve performance. In Germany, a growing number of corporate stakeholders have acknowledged the valuable role activists can play in improving company performance.

United Kingdom

Overview. The story of corporate governance in the UK over the past few years of political turmoil has revolved around the need to demonstrate the value of responsible capitalism and the ways that companies are delivering a social return as well as a shareholder return. For boards, this is manifesting as an increased focus on corporate purpose and culture, a drive toward integrated ESG reporting, a concern over audit quality to guard against corporate failures and a new responsibility to demonstrate and report on the way in which the perspective of the workforce influences board decision-making. Additionally, the issue of chairs ceasing to be independent after nine years on the board, even if only a few years as chair, is beginning to become a challenge. Some investors are putting pressure on boards and may cause higher than normal chair turnover in the next couple of years.

Regulatory reform. After three years of political uncertainty, the UK now has a stable government that will be in a position to enact the changes recommended by the Kingman Review and form the new Audit, Reporting and Governance Authority (ARGA). Pressure for auditor reform and heightened expectations for audit committees will be an important area for boards to monitor. Boards should also monitor the outcome of the Chartered Governance Institute (ICSA) consultation underway to explore evolving standards for conducting independent board evaluations. More broadly, ongoing Brexit-related business scenario planning, implementation complexity and brain drain risk will require focus. After Brexit, Prime Minister Boris Johnson's government will likely bring forward a new industrial strategy and perhaps adopt a more interventionist approach to business.

Revised Stewardship Code. The Financial Reporting Council (FRC) has released a new UK Stewardship Code to take effect in 2020 containing substantial revisions from the last edition. Key changes include a requirement to report annually on stewardship activity; a requirement to report on company purpose, values and culture (aligning to the 2018 Governance Code); extension of scope to asset classes beyond listed equity (e.g., bonds, fixed income, infrastructure and private equity); expectations for different entities in the investment chain (asset owners, asset managers, service providers); and integration of ESG issues (including climate change). The increased pressure on investors to show how their investment and stewardship activities are linked is leading in turn to pressure on companies to ensure their reporting has ESG integrated into every aspect of the business.

ESG data. A variety of stakeholders are increasing pressure on companies to improve the quantity, quality and transparency of various kinds of data that can be assessed as ESG indicators. Compared to other markets globally, the UK has been at the forefront of tackling sustainability issues using regulatory methods and endorsing frameworks such as the TCFD. However, the picture is now becoming more complex given the wide variety of investor preferences concerning ESG reporting frameworks, combined with the competing pressure to produce company-tailored analysis and disclosure. Boards will need to ensure they are engaging with their management teams on this topic at an adequate frequency. Directors will want to focus on the information their company submits to the leading research providers and to remain cognizant of their ESG scores relative to peers.

Remuneration. Executive pay will continue to be a hot-button issue for shareholders and the general public next year. Populist influences continue to drive efforts to establish limits on executive pay. Those investors focused on income inequality will be continuing to pressure companies to provide executive directors with the same proportion of salary to pension as workers and on some meaningful comparison between the CEO pay and general worker salary. For national implementation of the EU's Shareholder Rights Directive (SRD II), the UK maintained requirements for a binding shareholder vote on the remuneration policy and an advisory shareholder vote on the remuneration report. Some institutional investors will begin voting against remuneration committee chairs when executive pay packages fail to meet expectations multiple years in a row.

Broadening board diversity. Board gender diversity has been an area of focus in the UK for the past ten years and has achieved significant success as evidenced by the November 2019 Hampton-Alexander Review, which reported that women comprise 32.4 percent of directors in the FTSE 100 and 29.6 percent of directors in the FTSE 250. The FTSE 350 as a whole stands at 30.6 percent, close to the voluntary target of 33 percent in 2020. There is now equal focus, if slower progress, on increasing the proportion of female executive directors and board chairs. The other area of focus around diversity in the UK in 2020 will be ethnic diversity. Companies in the UK continue to work toward achieving the board ethnic minority targets established by the 2016 Sir John Parker Review, but progress is slow and much work remains.

Activism. Shareholder activism in 2020 will continue to be an area of UK board attention. According to Lazard, the UK was the country with the largest number of activist campaigns in the first three quarters of 2019. UK boards that have experienced activist engagement in past years have learned that a variety of activist styles exist—from hostile and short-term oriented to constructive and long-term oriented. It will continue to be important for boards under activist pressure to identify these styles and engage accordingly. Some activists report significant private quiet support for the spotlight they bring to underperforming public companies and boards in the UK. Activists continue to apply a critical lens to board composition and to target individual directors for removal; routine objective evaluations of individual director capability and performance therefore form an important part of preparedness for activist defense.

India

Overview. Since the 2013 Companies Act, expectations in corporate governance continue to rise in India. With 2019 having seen increased market participation and regulatory enforcement, in 2020 directors should consider evolving their own expectations of board effectiveness, going beyond the mere compliance oversight model, to meet investor and regulatory demands.

Regulatory reform leads to enforcement. In 2020, oversight of compliance matters will be key for companies to maintain the level of governance effectiveness the market will expect. The level of judicial and governmental enforcement is increasing in the wake of the reforms enacted in previous years, including the Companies Act, the Kotak Committee recommendations in 2018 and the subsequent Securities and Exchange Board of India's updated guidelines. Companies and independent directors are beginning to take notice of increased demands for accountability and are responding by better aligning with the spirit of the new rules and regulations. Other market participants are feeling the governmental and regulatory pressures, including the audit profession.

Proxy advisor influence and investor dissidence. The three domestic proxy advisory firms that have gained prominence in India include InGovern, Institutional Investors Advisory Services (IiAS) and Stakeholders Empowerment Services. These proxy advisors will likely play an increased role in the market in 2020. Also on the rise is the level of dissent that can be expected from shareholders. For example, between 2018 and 2019, IiAS found that 155 resolutions filed at Indian companies saw more than 20 percent support from the investor community—far greater than in previous years. This trend will continue in 2020, leading to increased market transparency and claims for influence assigned to proxy advisors.

Investor engagement rising. India's market has seen increased investor engagement from both national and international asset owners. Institutionally held assets have grown by roughly 40 percent in the last decade. This has resulted in greater voting participation, with institutional investor abstention votes having also decreased by 12 percent since 2015. This has led to increased scrutiny of the proxy and will ultimately lead to necessary engagement between investors and management to bridge any disclosure gaps. In 2020, companies can expect requests for investor engagement to continue to rise, and boards would be wise to ensure adequate oversight of communication between management and shareholders.

Director accountability. Directors in India today—particularly independent directors—are being held to a higher standard, with demands for increased independence and diversity on boards. Since 2014, the average tenure of independent directors in the NIFTY 500 Index has dropped from about 10 years to 6.5 years. Also, the percentage of women on boards has increased from about 6 percent in 2014 to over 15 percent in 2019. Moreover, as of 2019, independent directors are now required to take and pass an exam focused on regulatory competencies and independent director responsibilities.

Board effectiveness. In 2020, board effectiveness is likely to rise to the top of boards' priorities as investor expectations grow concerning the right mix of skills and overall composition of the board beyond gender and independence. As a result, boards will find they need to bolster the quality of their board evaluation criteria and disclosures. Boards would also be wise to develop with management proactive approaches to address investor engagement on board effectiveness.

Japan

Overview. Japan continues to evolve, driven by regulatory normalization with companies catching up to Prime Minister Shinzo Abe's ambitions and targets set in the 2010s. Other pressures include investor expectations and the specter of activist demands. 2020 will see an increased focus from the investor community on committee processes, board effectiveness and oversight of issues that extend to the environmental and social outputs of companies.

Director independence. According to the Nikkei, independent directors account for over 30 percent of the seats held on Japanese public company boards (a historic high). The number of independent directors on Japanese boards has doubled in five years due, in part, to government reforms and enhanced investor engagement. However, that still represents an average of only three independent directors per board. As regulatory practice is refined and investor expectations increase, Japanese boards will need to shift to developed market–like percentages of independent directors. For example, AllianceBernstein is pushing for at least 50 percent of the board to be independent.

Board diversity. Many companies have also chosen to increase both gender and international diversity. Companies are becoming more intentional in their efforts to develop prospective C-suite women and create better pipelines of diverse talent for the decade ahead. (Female executives currently make up less than 10 percent of Japan's overall executive pool.)

Investor activism. Lazard puts Japan second only to the UK in the number of activist campaigns and capital deployed per market. In response, the Japanese parliament convened in late 2019 to tighten foreign investor regulations in companies with national security interests, which may adversely impact activist firms. The regulation requires foreign investors to obtain government sign-off for procurement of a stake of 1 percent or more (compared to 10 percent previously). Foreign investors are also required to give prior notice to regulators before seeking a change in management or the sale of a business line. Nevertheless, directors will need to adjust to a world in 2020 where traditionally quiet asset managers begin to air their grievances publicly.

According to IR Japan, dissidence and other forms of activism have increased: the number of shareholder proposals saw a 10 percent uptick, while the number of companies that were targeted grew considerably (35 percent YOY). There was also a marked increase in significant opposition votes (20 percent or more) on executive director and outside auditor proposals.

Board structure and process. The rapidity of the changes described above has left many Japanese boards struggling to determine appropriate structures and processes, including committee structure and function, investor engagement, and the expanded role of corporate secretaries. Best-in-class boards will begin addressing this in 2020 by leveraging independent resources and expertise. Boards should be prepared for investors seeking increased disclosure as to committee processes as well as director engagement with the investor community.

ESG prominence. Companies in Japan have moved far beyond other developed markets in implementing integrated reporting. For example, close to 400 companies in the First Section of the Tokyo Stock Exchange have implemented integrated reporting compared to fewer than 20 companies in the S&P 500. This is particularly important given the various mandates from Japan's Government Pension Investment Fund. The Financial Services Agency is set to revise the Japanese stewardship code in 2020 and will likely call on institutional investors to state how they will incorporate ESG into investment strategies and engage on the topic with investee companies. In 2020, directors will need to work with management on ESG metrics and ensure adequate board education on the ever-evolving ESG market landscape and the company's own disclosures.

Australia

Overview. 2019 was a turbulent year for governance in Australia, with continuing repercussions from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. Combined with heightened regulatory enforcement and greater engagement from the superannuation funds, directors face greater scrutiny and their appetite for even well-reasoned risk taking has been diminished. Balancing growth, innovation and appropriate risk taking is becoming an increasing challenge for Australian directors and should be addressed in 2020.

The Royal Commission. The impact of the Royal Commission has been felt beyond the banking and financial industries in Australia and impacts virtually every governance trend identified for the country. In late 2017, public outcry over short-term cash bonuses at three of the four largest Australian banks hit fever pitch and the Royal Commission was formally launched. Misconduct was uncovered and its effect has roiled the market ever since. Fallout from the Royal Commission has eroded the public's trust in institutions—particularly financial institutions. To help restore trust, board members will be expected to oversee management with greater focus around: (1) their strategy to put the stakeholder first, bolstering the company's social license to operate; (2) management of E&S risks through KPIs and targets; (3) increased disclosure on corporate purpose; and (4) development of thoughtful investor engagement strategies.

Regulatory enforcement. In 2020, expect to see increased regulatory enforcement in financial services, triggering further dialogue and challenges to the market's corporate governance norms. Following the recommendations from the Royal Commission, the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) took action. In July, APRA announced a draft standard on remuneration arrangements for APRA-regulated entities. This includes compensation standards on deferrals, vesting, clawbacks and additional committee ratification provisions (among others). Additionally, there is a focus on defining the right time horizon for "long-term" compensation as well as trying to determine how to incorporate non-financial measures. ASIC has since intensified regulatory scrutiny across the financial services sector, creating "fear" in the business community and among some board members around balancing appropriate risk taking and encouraging growth.

Director expectations. Directors today are feeling the repercussions from these trends. For example, the accountability standard in the APRA Standards includes language that the board (or the renumeration committee) must "actively oversee" the compensation policies for employees and contractors alike. Beyond the financial services industry, many boards have reacted by heightening their oversight of risk, audit, legal and compliance matters as well as placing greater emphasis on stakeholders rather than just shareholders. This has in turn raised concern from some investors as to whether enough board time is being given to forward-looking topics. In 2020, significant investors will be raising their expectations around overboarding, effective long-term and social license oversight and voluntary adoption of annual director elections.

Investor stewardship and engagement. Boards can expect continued engagement with investors whose equity ownership of Australian companies continues to climb. The Australian Council of Superannuation Investors (ACSI) has close to 40 members and north of $2 trillion in assets managed by their domestic and international members. ACSI hosts engagements with companies and brings with them their collective voice and principles. An unexpected consequence of the Royal Commission has been increased investment flows into "Supers," and it is expected that they will own close to a third of all public equities in Australian companies over the next few years. Australia is moving from a retail market to an institutional investor market, which has shifted the focus from a short-term to a long-term profit time horizon. In 2020, this shift means best-in-class companies will begin to actively initiate direct engagements with individual investors.

ESG data disclosure. In other markets where conservative governments have tended to relax environmental regulation and investment, the private sector has generally sought to fill the regulatory void. As investors push directors to shift their oversight to a focus on the long term, they will increasingly push for disclosure of ESG data to ensure their investments are considering the company's strategy in tandem with the global transition into a low-carbon economy (despite Australia being the world's largest coal exporter). In 2020, investors and NGOs will push Australian companies to disclose material ESG issues—particularly environmental issues—on a consistent basis. Also expect to see increased disclosure concerning the board's role in considering stakeholders beyond shareholders.

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