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By Alissa Kole September 29, 2023

On Sept. 11, the **OECD** officially released newly revised Principles of Corporate Governance, which has, since their last amendment and adoption by the G20 eight years ago, emerged as a key element of global governance architecture. Until then, the principles, accompanied by the Corporate Governance Guidelines for State-Owned Enterprises, were in many ways an aspirational standard influencing national corporate governance rules encapsulated in company laws, listing standards and corporate governance codes that more often than not have followed a "comply-or-explain" approach.

Much has transpired since the OECD issued the first iteration of the principles almost 25 years ago. With the successive revisions of the document, the global standard has expanded both in scope and in depth, reflecting key trends such as greater participation of institutional investors in public markets and increasing shareholder expectations of corporate boards, as well as lessons learned from the financial crisis with respect to risk and audit functions' access to corporate boards. Alongside corporate governance codes, there have flourished stewardship codes and a plethora of other rules.

Until this year's revision, however, the principles primarily concerned themselves with the G of ESG (environmental, social and governance), an acronym which risks receding into obsolescence. Against the background of increasing resistance to ESG for fears of greenwashing and general misrepresentation, this latest revision of the Principles of Corporate Governance has for the first time in its history seen an addition of a new chapter on "Sustainability and Resilience."

In fact, while the principles avoid the term ESG, sustainability is evidently the leitmotif of this last revision, reverberating across the document in other areas such as board responsibilities, where the OECD now recommends both inclusion and disclosure of sustainability-related metrics in board and management remuneration.

In the Institutional Investor chapter of the principles document, additional considerations have been included on minimizing conflicts of interest by ESG data providers and proxy advisors that have adopted Best Practice Principles for Shareholder Voting Research as an industry standard. In 2021, the six main proxy voting firms for the first time published their annual reports against these principles. They continue to annually disclose how they address conflicts of interest arising from a combination of advisory and rating activities, which have required the adoption of Chinese walls.

While Chinese walls are useful, as in the accounting industry, they are far from the holy grail. Mired in controversy, the S&P last month dropped ESG considerations from its debt ratings only two years after they were introduced. This has happened at a time when ESG — and the E specifically — continues to raise its profile with, on one hand, the highly anticipated COP28 meeting in the United Arab Emirates later this year and, on the other, Republican resistance to environmental disclosure in the U.S.

Not only proxy advisors and rating agencies are under pressure — institutional investors are also under scrutiny for their perceived lack of stewardship. According to **Institutional Shareholder Services**, support for S and E proposals has indeed fallen from 32% of 2021 to 15% this year. Data released in late August by **BlackRock** has resulted in sharp criticism, given that it voted in favor of only 7% of such proposals, while **Vanguard** voted for only 2% of E and S resolutions.

Large asset managers are now giving a greater possibility to investors whose funds they are managing, including smaller ones, to vote on critical ESG issues themselves. While this tactic may be perceived as asset managers

washing their hands of ESG, considering that BlackRock, Vanguard and **State Street** are estimated to jointly control 15% to 20% of S&P listed companies, it may in fact be a move in the right direction. At the same time, this delegation may not work in the thorniest cases.

Indeed, with the shifted focus of investors on E and S, the G stewardship responsibilities are getting less attention, while governance crises, such as at India's **Adani Group** earlier this year, continue having enormous repercussions. Not only have billions been wiped out from the value of the group, the downfall has brought political scandal and, according to some observers, "has cast a doubt on whether Modi can ensure India remains the world's fastest-growing major economy."

What do these facts tell us about the direction of global governance standards and their ongoing relevance? Environmental and sustainability issues will remain a focus, both due to a shift of responsibility from governments to large corporations and due to the resistance of right-wing parties to environmental rhetoric. Governance rules are, on the other hand, now seen as less of a focus area, as they have seen an important global standardization over the past decade with respect to key parameters such as board independence.

Where to from here? Indisputably, the broad spectrum of issues which have been amalgamated on the "ESG" bandwagon will clearly require a combination board due diligence, investor stewardship and supervisory oversight. While 20 years ago, when the international governance architecture was being developed, G was the focus, in recent years there has been a clear shift to the S but more importantly to the E. And yet, G often has had a more immediate impact.

It is clear that boards, even if composed of independent directors and supported by committees, cannot monitor all these complex risks. This much is acknowledged in the latest revision of the Principles of Corporate Governance, where a recommendation to introduce "safe harbors" protecting directors from litigation if a decision was taken with due diligence and was made in good faith. Likewise, large institutional investors and proxy advisors are too thinly spread to monitor all ESG risks, as S&P's decision highlights.

These developments point to the fact that ESG will be subject to a "decoupling" of responsibilities not only among the holy trio of boards, investors and regulators. I predict that more specialized actors, such as short sellers that uncovered the Adani and **Luckin Coffee** cases, will pay an increasing monitoring role. Moreover, their assessments will have a more immediate market impact than institutional investor engagement. In the coming years, environmental disclosure monitoring may give rise to similar specialized actors. The good news is that these evolutions point not only to a fragmentation but also to a rising maturity of global governance and sustainability stewards.

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