ICSA Talk - Charting a Path Beyond Zoom – International Regulatory Governance Evolution and its Potential Impact on the Bailiwick – 23rd September 2021

Thank you for inviting me today. You do a lot of good work in helping people think about how to do this properly. Today I am going to talk a little bit about evolution of Governance through the Covid period and the increased impact of sustainability going forward.

The World of Zoom

The means through which governance is conducted has changed considerably as a result of the Covid restrictions and I thought I might start this morning with a few observations on what that may mean. Although over the last 18 months Zoom, Webex and Teams have become part of our everyday lives, the implications of our use of them rather than face to face meetings for discussions and decision making are only likely to emerge gradually.

In terms of practical observations I'm sure mine are similar to those which many of you would offer, namely that video conferenced meetings require, inter alia:-

a) Rigorous and inclusive chairing as you can't read body language very well;
b) Great patience;
c) Constant thought about whether to try to intervene verbally or use the chat function to make your point; and
d) An ability to cope with the exhaustion probably caused by seeing your own face for an unnaturally long period of time (at least for those of us who aren't complete narcissists).

One of the problems which arise is that it is very difficult to be spontaneous and actually engage in a pro-active discussion. After a while you learn to accept this and simply refrain from saying things which probably should be said. My suspicion is that future academic studies will demonstrate that the replacement of physical meetings with virtual meetings led to the suppression of discussion about difficult things which probably needed to be discussed. I can't offer your strong empirical evidence of this at present but I have been in a lot of high level board and committee meetings over the last 18 months – some of which have been physical although mostly virtual or hybrid. When I compare and contrast my experience of them with those of the equivalent physical meetings which took place in 2019 and before, a certain richness is lacking and, to the degree a compromise has been hashed together around a topic, one gets the impression that the collective buy in to the compromise is considerably less than would have been the case had it been the result of a physical discussion at a physical board meeting.

Another hypothesis I'll throw up is that he who speaks last may have become more influential than was the case heretofore. I'll also offer the opinion that speaking has become more important than it was previously. I attend a fair number of international regulatory meetings. They often involve much larger numbers of people than would attend an average private sector board for reasons of international inclusivity. They are correspondingly harder to chair and at a physical meeting a chair would normally be able to glance around a room and read facial expressions and body language before concluding on a matter. This is very very difficult to do on line, especially when 80% of the screen is normally taken up with a slide show of some description rather than the far more useful thumbnails of people's live faces. This means that the numerous non-verbal means we habitually use to convey our feelings are almost entirely devalued leading to a situation where a very small number of committed vocal activists can sway a board or committee towards a decision perhaps markedly different from that which would have been arrived at had people been physically present. I'd also observe that the power of the presenter of a paper has increased relative to what would be likely to be the case in a physical setting where non-rude interruption and challenge is much more easily achieved.

I think it is possible to chair a high quality virtual meeting but the skills of a physical chair do not necessarily fit with the skills required of a virtual chair. In the same way that platform orators – politicians who were amazing at working a physical crowd often found translating to radio or television in the middle part of the last century difficult, I suggest that there are similar challenges when translating from physical to virtual meetings.

One of the first lessons you learn as a regulator or police officer is to be extremely sceptical about what you are told because things are frequently not what they seem on an often too polished surface. What I'd implore you to do, when doubtless superintending numerous video boards and committees is to think not just about what you are seeing but about what you are not seeing and experiencing because you are not in the room with someone. During the second lockdown in Guernsey we did actually try some virtual firm inspections and the firms involved co-operated wonderfully. We found, however, that whilst an electronic file might be shared appropriately it was profoundly difficult to gain a reliable picture of how a firm was actually doing – the quality of our insights were markedly worse than would have been the case from a physical visit – despite the fact that more hours were probably burnt on our virtual visits than would normally be spent on a physical visit as colleagues tried to work harder to compensate for the lack of physical interaction.

I'm certainly not saying that all this new technology and the lack of a need to jump on an plane every five minutes are bad. What I am saying, however, is that you, as individuals keenly interested in the quality of governance at the institutions you serve, should perhaps be as sceptical as me about claims that new modes of working and holding meetings will lead to better outcomes than those associated with the physical meetings to which we humans have had several thousand years of evolutionary time to adapt to.

To take one example from the Spring, I'd love to know what sort of digitally enabled governance process led the NHS to decide that it was actually a good outcome to instruct GPs to force older patients to use computers and smart phones not just to make appointments but for attending those appointments by video link. As my mother, a nurse, observed, "A good doctor can tell what is wrong with a patient much of the time by the way in which he walks into the consulting room." The fact that it took an expose by a national newspaper followed by commonsensical public outrage at their parents or grandparents being treated in this way for that decision to be reversed concerns me. It is one example of poor decision making which suggests to me that the Covid crisis and excessive zooming may have dulled the critical faculties which boards need to exhibit if they are to take good decisions.

I may be wrong in all my deductions based on what can only be called slight and partial evidence but I think I owe it to you to sound a note of caution. It is, after all, the regulator's role to question the wisdom of drinking from punch bowls as a party gets going. I'd love to see electric and hydrogen powered aircraft to reduce the environmental impact of travel but I simultaneously think that we should not lightly give up the evidence of history that coming together for communal discussions is often a good way of resolving differences and taking decisions.

Work Away from the Office

Another issue which perhaps deserves a little consideration by those of us interested in the quality of firms' output is that of home working. Covid restrictions forced knowledge workers out of the office. Speaking as someone who endured four hour commutes on heaving tube trains and hideous railway carriages with seats designed to suit only slight females rather than well built men for too many years, I think home working is very appealing, especially if you were habitually based in London or another major conurbation. If you are doing a certain sort of analytical spreadsheet based knowledge work I can see the merits. Indeed if you are writing quasi academic texts (otherwise known as financial services consultation papers) I can see how, provided you have a nice home with a nice home office and a nice cat who is not dedicated to sitting on your computer at the smallest provocation, productivity could be higher than sat at a hot desk in a crowded office without decent sound insulation to protect you from your colleagues endlessly distracting conversations.

What I observed, however, was the impact on many of us as inherently social animals, of being divorced from our work colleagues for extended periods. Innovation was difficult: misdirected effort which would have habitually been corrected through the most casual of mid-morning conversations over a shoulder, went unchecked for many days. The distractions of the house meant many felt they had been robbed of their professional identity. For them housework, cooking and kids proved far worse interrupters than gibbering office colleagues. Then for many at a more formative stage of life, there was the reality of not having a home office and a quiet house in the country but of being confined in an urban pad realistically designed only to be occupied for the most occasional meal and about seven hours sleep a night. I hope that it may be possible to maintain some of the undoubted benefits of being able to avoid horrible tubes and overcrowded commuter trains in the future BUT I have observed the marked increase in morale, innovation and all round effectiveness which, at the Commission, accompanied the end of each of the Guernsey lockdowns. We are thankfully circumstanced so that the longest commute into the office is unlikely to take much more than 25 minutes so the time gains from homeworking are not that marked here thus reducing the potential upside for most workers relative to their London commuter belt peers.

In essence, I think the story of the impact of home working on organisational success has yet to be written. Certainly it has helped organisations survive (but had it not been possible would governments have dared to lock down – I somewhat doubt it) but whether it will help firms thrive in a post lock down environment remains to be seen. In five years time I'm sure business school lecturers will produce case studies of comparable consumer goods companies or similar and argue that one thrived or died because it did a lot of home working relative to its competitors. Our concern, at the regulator, will remain on ensuring that companies are well controlled and profitable regardless of the mode of working their staff employ. I couldn't accurately predict which side will be up and which down at present. As with so many things, we remain somewhat more sceptical about the benefits of homeworking and more attuned to the downside risks than the average organisation and are likely to maintain that position until we have strong proofs that profitability, governance and controls are not materially adversely affected.

Sustainable Governance and Reporting

Having consciously digressed during the first half of this talk to cover two topical subjects which I believe are having and will continue to have a great impact on international regulatory governance, I shall turn to my third (and I'm sure you'll be glad to hear, final) topic of the day, the likely impact of the revolution in sustainability on firms' governance.

By way of preamble I'll note that Guernsey generally has to follow international standards once they have been set as its principle industry is international finance and it is difficult to have an international financial centre without international clients. Reputable international clients are only likely to use you if you follow the international good practises embedded in international standards, even more so as the countries in which those international clients are domiciled are likely to take increasingly active measures in the wake of Covid to dissuade their residents from using IFCs which are not perceived to comply with international good practise.

I hope that makes sense. Demonstrable compliance is required if we are to prosper. In 2023/4 we can look forward to an inspection by the anti-money laundering inspectorate of the Council of Europe – otherwise known as Moneyval. Failure in that inspection is likely to be incompatible with future growth in trade and financial services employment hence compliance with international standards is practically important. I don't want to focus on financial crime standards today, however, as I'm aware many of you will have heard me speak on such matters before. I rather note in short form these demonstrable truths to emphasise how seriously we are likely to wish to take the emerging international consensus on sustainability.

Environmentalism was, historically, something of an optional extra for many corporates. Larger corporates possibly had a small separate department dedicated to it which did things such as encouraging recycling at work whilst providing corporate sponsorship to a couple of sufficiently attractive environmental endeavours. When Covid hit I did wonder if environmentalism would become less trendy as people focused on personal and economic survival. In actual fact, thankfully for the planet, that hasn't been the case. I think this has been the case because Covid made more people realise how little they can take a benign environment for granted and made them more determined to safeguard the natural environment which they enjoy for the future.

In Guernsey I like to think that we had not previously been environmental slakers. We had, after all, invented the Guernsey Green Fund in 2018, designed to give environmentally conscious investors an assured structure through which to invest. We also developed last year what we believe to be the first set of prudential capital rules for the insurance sector designed to counter the naturally conservative investment instincts of life insurance companies and make clear to them that holding green assets against long term liabilities will not attract a de facto capital penalty.

Those two initiatives were very much voluntary – designed to appeal to those in asset or insurance management already looking to do activities closely associated with alleviating climate change.

This voluntary approach has its merits but the international consensus is shifting firmly towards compulsion in the wake of Covid and this will have implications for how firms ensure that there is appropriately environmentally aware governance in the future. Conscious of this, the Commission changed its Code of Corporate Governance which applies to all financial services firms in the Bailiwick in June. Going forwards we have asked all boards to, "consider the impact of climate change on the firm's business strategy and risk profile and, where appropriate in the judgement of the board, make timely climate change related disclosures."

As you will see, this is not designed to be particularly onerous. Rather is it designed to encourage timely thought at board level about how and when businesses will need to adapt, to the extent that they have not adapted already to the major world economies committing themselves to net zero emission targets by 2050 or 2060. Feedback from a similar request made by the Bank of England to UK regulated firms suggests that asking corporate boards to talk about environmental matters rather than have them delegated to the middle manager charged with maximising paper recycling is a powerful way of driving change.

Various international organisations have been formed to consider how best to help corporates become more environmentally aware. The chief one which I'd highlight is the Task Force on Climate-related Financial Disclosures (and CFD) created by the global Financial Stability Board. This has produced a number of interesting reports setting out ways in which different sorts of companies could consider assessing and disclosing their environmental impact. Politicians and, to some degree, regulators have been encouraging firms to take note of the TCFD recommendations issued from 2017 onwards which are structured around governance, strategy, risk management, metrics and targets.

It is probably fair to say that a number of companies, particularly smaller companies not able to employ quantitatively skilled environmental scientists, have struggled with the difficulty of environmental reporting, especially given the lack of consistent disclosure by their suppliers. It had been something of a chicken and egg situation. If the supplier cannot supply his customers with details of his environmental effects it becomes very difficult for them to work out the environment impact of their own products or services.

Conscious of this the CDP (previously called the Carbon Disclosure Project), the Climate Disclosure Standards Board, the Global Reporting Initiative, the International Integrated Reporting Council and the Sustainability Accounting Standards Board all sought to develop standards to help companies accurately disclose their impact. Unfortunately having five different bodies beneath the higher level TCFD trying to set standards was likely to be a recipe for confusion and a lack of interoperable disclosure standards. Fortunately various actors realised this and in September 2020 these bodies came together and issued a "Statement of Intent to Work Together Towards Comprehensive Corporate Reporting". This statement was followed in December 2020 by the same group publishing, "Reporting on Enterprise Value." This set out how parts of their frameworks and standards along with recommendations set out by the TCFD could form the basis for the development of a climate related financial disclosure standard. They also commend the International Accounting

Standards Board's Conceptual Framework for Financial Reporting as being, "well-suited to sustainability related financial disclosure to providers of financial capital.[1]"

It is apparent that progress is being made. This year the IFRS Foundation trustees (i.e. those people in charge of the International Financial Reporting Standards), following positive feedback to a September 2020 sustainability consultation, have stated an intent to create a new international sustainability standards board, including a roadmap with a timeline, by COP26 in November 2021 – very shortly in other words. It followed this commitment with the launch of a consultation in April on "Targeted Amendments to the IFRS Foundation Constitution to Accommodate an International Sustainability Standards Board to Set IFRS Sustainability Standards." This consultation closed at the end of July with the IFRS's Technical Readiness Working Group publishing a high level prototype setting out the components of disclosure standards earlier this month[2]. This protype envisages:-

- General requirements (the Presentation Standard) to disclose all material sustainability information based around the four pillars of governance; strategy; risk management; and metrics and targets;
- Thematic standards which will set requirements for narrative based disclosures and cross industry metrics; and
- Industry specific standards which will cover all other industry specific disclosure topics not covered by thematic standards.

The IFRS is, of course the body which under the leadership of Sir David Tweedie, accomplished a task many thought impossible, namely coming up with global standards for corporate financial reporting. Almost everyone I have spoken to backs it to become the uniform standard setter for rigorous environmental reporting. We will have to see what the COP 26 Summit in Glasgow in November will agree but my expectation is that, at a minimum, a powerful coalition of the willing will be established who commit themselves to implementing the international standards which the new International Sustainability Standards Board (ISSB) will write.

What happens thereafter perhaps enters somewhat into the realm of speculation but I will hazard something more than a guess, given all the groundwork completed by predecessor organisations, that the new International Sustainability Standards Board will write climate change disclosure standards quite fast, maybe even within one to two years of formation[3]. As I outlined above the high level prototype has already been published just this month. The new standards, when fleshed out, are then likely to be swiftly commended by the global Financial Stability Board and sectoral regulatory standard setters such as IOSCO and IAIS who have already expressed support for the ISSB. At this point there will be something which looks remarkably like a binding new international standard with which firms in Guernsey will be expected to conform within a reasonable period of time - if we are to collectively maintain our reputation as a good place from which to do financial services business. This could happen within as little as two years as though it may take as long as four.

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[1] P. 4 *Reporting on enterprise value – Illustrated with a prototype climate related financial disclosure standard.*
[2] AP3A: Update on the work of the Technical Readiness Working Group (TRWG) (ifrs.org)
[3] Ecological standards may also be written but that is likely to happen on a slower timescale.

At the Commission we intend to remain fully engaged with the regulator led Network for Greening the Financial System and the Sustainable Insurance Forum. As such we will endeavour to exercise what little influence we may have in favour of common sense solutions as we all endeavour to adapt to the climate change reporting and the environmentally conscious changes to business models which will happen, partly as a consequence of that reporting.

What I've endeavoured to sketch out above is not yet entirely reality but what I think we must consider to be a very probable direction of travel. It is in the light of these developments that the Commission has asked all financial services firms in the Bailiwick, through the changes I outlined earlier to its Code of Corporate Governance, to consider their business models and environmental disclosures. Whilst it is heartening to know that we can collectively do last minute improvisation as happened when homeworking was imposed on us in March last year, it is surely better – when one can be pretty confident as to the direction of travel – to be able to prepare in slow time for a transition towards a low carbon economy which should, properly handled, be positive for our future wellbeing.

Summary

In summary, in this video calling home working world, I'd encourage all of you to retain and develop your critical faculties and not be beguiled into thinking that because technology is clever and new, it will automatically deliver better governance outcomes. Similarly, I'd encourage you to critically consider the implications of new working models. Finally I'd encourage you to make sure that your own governance processes engage with the accelerating environmental agenda, keep abreast of what is required and thus prepare to remain competitive in our climate conscious post Covid economy. Thank you for listening so patiently.