A maturing corporate governance landscape

Two and a half years have passed since the introduction of the Central Bank of the UAE (CBUAE) Corporate Governance Regulations. Maryam Zaman reflects on what we have learned since then.

As banks evaluate their performance for the last year and make plans for 2022, it is increasingly evident that resilience will continue to be the great differentiator of the pandemic era. This includes the strength of the strategy, organizational model, operations, and corporate governance. In fact, the unprecedented events of the past two years have put banks' corporate governance structures and practices to the test.

We also anticipate increased stakeholder expectations of a more equitable and sustainable future will compel UAE banks to further focus on their environmental, social, and governance (ESG) strategies. In fact, investor scrutiny of companies' ESG performance is even higher in the UAE than globally. According to KPMG's 2021 CEO Outlook - UAE, 84% of UAE CEOs are seeing greater demand from stakeholders — such as investors, regulators, and customers — for increased focus on ESG issues (compared with 58% globally). Strengthening corporate governance practices as part of an overall ESG commitment will continue to be on the agenda of boards. This focus is partially driven by the regulatory obligations introduced by the UAE Securities and Commodities Authority (SCA) and the UAE Central Bank (CBUAE) in the last two years.

Since the issuance of the CBUAE's Corporate Governance Regulation and Standards in July 2019, banks have been instituting sweeping changes to their corporate governance practices, including the following key initiatives:

— Assessing/revising the mandates of the board and board committees

— Updating the bank's delegation of authority to provide further clarity on the delegated powers of the board, senior management, and management committees

— Conducting independent performance assessments of their boards, board committees, and individual board members

— Developing/updating key policies and processes relating to the management of conflicts of interest, related party transactions, insider trading, and whistleblowing as part of the effort to build a strong governance and compliance culture

Disclosure of board and senior management remuneration

The CBUAE Corporate Governance Regulation requires banks to disclose their compensation and incentive policy, and aggregate quantitative information on compensation. Moreover, banks are required to disclose the individual remuneration of board members and key senior management personnel.

Competition between banks to attract and retain top talent will increase as compensation practices become transparent. In such a market, other factors—such as values, organizational culture, trust in leadership, market perception, and brand value—become increasingly important when competing for talent to drive growth ambitions and transformation initiatives.

Remuneration policies

Another area of focus for the banking sector in 2022 will be enhancing the existing compensation frameworks of the board, senior management, material risk takers and key

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control functions to ensure they account for a bank's risk profile. Risk-based compensation frameworks, designed to link incentive payouts to realized risks in the short and long term (for example, ensuring that a substantial portion of the senior management and material risk takers' variable compensation is deferred over at least three years), are yet to be widely adopted by UAE banks.

Conflict of interest management

Focus on effective conflict of interest management and oversight at all levels within a bank, including the board level, will continue in 2022. While most banks have a conflict-of-interest policy requiring timely disclosure of perceived, potential, or actual conflicts, managing conflict of interest and identifying related party transactions is primarily manual and reactive. As a result, in some instances, conflicts of interest and related party transactions are not disclosed on a timely basis. Automated tracking and reporting systems can help manage conflict of interest across the bank. Further, digitization will also help build relationship trees across the bank and automate the conflict disclosure, review, and reporting processes.

Structure and dynamics of board meetings

The structure of board meetings may also require revisiting. In addition to allocating time to reviewing historical performance, sufficient time must be allocated for meaningful two-way discussions between management and the board about forward-looking issues, such as the board's engagement in strategy.

To complement traditional quarterly meetings, boards are now holding additional sessions dedicated to discussions on strategic initiatives. In these sessions, senior management provides context and meaningful information to facilitate discussion, allowing the board to challenge key assumptions and provide valuable feedback. Only through a collaborative mindset – rather than a top-down or a bottom-up approach – can alignment between the strategy, values, and culture be achieved.

Diversity within the board

Board diversity across gender and talent is a critical focus area in 2022. The CBUAE Corporate Governance Regulation and Standards require 20% of the candidates for the membership to be female. Further, the SCA Governance Guide requires the board to have at least one female board member.[19] Several banks continue to struggle to meet these minimum requirements. To tackle this challenge, it is imperative for banks to instill a robust assessment and selection process of board candidates.

In addition, appropriate talent diversity at the board level may also require scrutiny to ensure the board is ready for a changing business and risk landscape. Indeed, new trends, including open banking, digital banking, business model disruptions, technological innovations, ESG focus, and cyber risk, amongst others, may require a more proactive approach to building the right mix of talent in the board.

In 2022, the banking industry must continue to navigate a macroeconomic environment greatly affected by the Covid-19 pandemic, accelerated technological disruption, and significant regulatory changes. Given these challenges, governance maturity is critical to a bank's future as a going concern and to its long-term success.

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